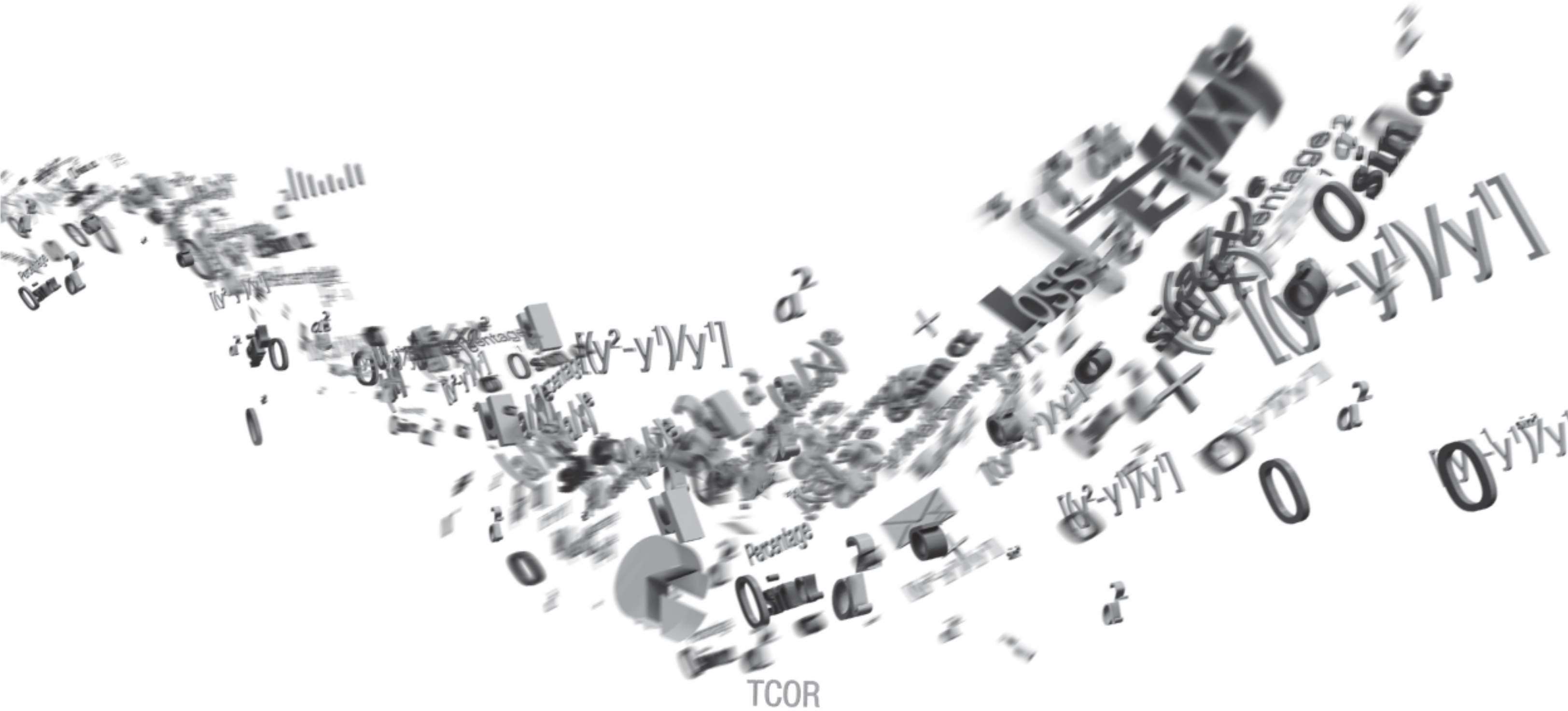

An Introduction to Political Risk Insurance

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Confiscation, Expropriation and Nationalization (CEN) of permanent assets

The risk

Companies who have investments in the form of subsidiaries or joint ventures located overseas are exposed to a potential loss arising from actions taken by the host government(s).

What are the possible losses following acts of CEN?

- Equity held by parent company
- Intercompany loans
- Bank loans to subsidiary/joint venture
- Receivables and stocks
- Parent company guarantees given to local banks in support of subsidiary borrowings

What will the CEN policy cover?

The policy will indemnify the Insured for 100% of their loss following an act of Confiscation, Expropriation or Nationalization by the host government which:

- Permanently deprives the Insured of their shareholding in the foreign enterprise
- Permanently deprives the foreign enterprise of all or part of its fixed or current assets;
- Expressly and selectively prevents or restricts the operation of the foreign enterprise so as to cause the total cessation of its activities
- Unilaterally abrogates or cancels the joint venture agreement, or constituent part thereof, so as to cause the total cessation of the foreign enterprise's activities

Policies respond net of any compensation the Insured might receive from the host government

Availability of CEN insurance

CEN insurance is available from three main insurance markets:

- State-owned Export Credit Agencies (ECA's) such as ECGD or OPIC
- Private insurer's such as Lloyd's and the company market;
- Multilateral agencies such as MIGA

The ECA's are ideal for covering one-off, new projects, but can only cover their own nationals. Lloyd's and the company market, however, are willing to cover existing as well as new investments, for Insured's or any nationality, and can insure worldwide exposures (on a first-loss basis) in addition to single project policies.

There are supplementary covers which may be considered as additions to the basic CEN policy:

Repatriation of Dividends

The risk

The parent company is exposed to a potential loss arising from the host government imposing foreign exchange remittance restrictions, or shortages of foreign exchange, which prevent payment of dividends or repayment of loans by or from the foreign enterprise.

The cover

The policy will indemnify the Insured for up to 100% of the dividend amount due, and where local currency deposit made, as a result of:

- Introduction of a law, order or decree which prevents, restricts or controls transfer of payment to the Insured's country
- Political events or economic difficulties arising or legislative or administrative measures taken which prevents or delays payment to the Insured's country

Cover only responds after a waiting period (normally 180 days)

Loss of Profit / Business Interruption

The risk

Following an act of CEN, the Insured may also be exposed to a loss of profit from the foreign enterprise and/or resulting business interruption.

The cover

The policy will indemnify the Insured for 100% of their net loss of profit following an act of CEN. Cover is usually restricted to a 12-month indemnity period.

War, Civil War, Terrorism, Sabotage, Strikes, Riots and Civil Commotions (SRCC)

The risk

Companies are exposed to the risk of physical loss arising out of damage caused to the foreign enterprise from any of the above perils.

The cover

The policy will indemnify the Insured for up to 100% of their net loss, in excess of a deductible, following:

- Physical loss or damage caused by War/Civil War/Terrorism
- Damage caused in the course of a disturbance of the peace
- A willful act of any striker or locked-out worker
- Damage caused by the authorities in suppressing a riot or disturbance
- Damage cause by sabotage

Confiscation, Expropriation, Nationalization and Deprivation (CEND) of mobile assets & stocks

The risk

Companies who have mobile assets in a foreign country are exposed to a potential loss arising from action taken by the host government. Likewise, the many companies who hold stocks of their products in a foreign country in warehouses or on consignment face similar perils.

What are the possible losses?

- The value of plant, machinery, vehicles and equipment
- The value of stocks in warehouses, on consignment or in transit

How can insurance help?

Insurance is available to protect the company against the financial loss resulting from confiscation of their equipment and/or stocks by the host government.

What will the policy cover?

A policy will indemnify the Insured for 100% of the value of their equipment/stock lost due to:

- Confiscation, Expropriation, Nationalization by the host government
- Seizure, requisition, willful destruction by the host government
- Damage or forced abandonment caused by War, Civil War, Terrorism and Sabotage may be added

Deprivation

The risk

Companies who have mobile equipment and stocks in a foreign country are exposed to the additional risk of losses arising from action taken by the host government which prevents or prohibits the export of re-export of the goods out of that country.

The cover

The policy will indemnify the Insured for 100% of the value of the lost goods, after a waiting period of normally 180 days, as a result of:

- Refusal of the foreign government to permit the export of the insured equipment
- Inability of the Insured to obtain an export license from the appropriate authority

The following additional covers should be considered where appropriate:

Loss of Hire

The Risk

A company is exposed to a potential consequential loss where equipment is prevented from generating income or hire fees as a result of an act by the host government.

The cover

The policy will indemnify the Insured for 100% of the loss of income, generally limited to an indemnity period of 12-24 months, as a result of:

- Confiscation, Expropriation, Nationalization and Deprivation
- War, Civil War, Sabotage, Terrorism & SRCC
- Seizure, requisition or willful destruction by the host government
- Loss or damage from derelict weapons of war

Repossession of leased equipment

The risk

Companies leasing an aircraft, vessel, plant or other equipment to an overseas lessor may be exposed to loss in the event they are unable to repossess the goods subsequent to a default under the lease contract.

The cover

A policy will indemnify the Insured for 100% of their net loss following:

- Confiscation, Expropriation, Nationalization and Deprivation
- Refusal of the foreign government to allow rights of access or repossession
- Refusal of the foreign government to allow de-resignation (vessel / aircraft)
- Exchange Transfer following forced local sale

Political Violence including War on Land

The risk

Companies who have fixed or mobile projects, investments, stocks or other assets overseas may be exposed to potential losses arising from physical damage due to war related perils.

What are the possible losses?

The loss of insured buildings, plants, machinery, vehicles, stock or other goods or assets.

How can insurance help?

Insurance is available to protect the company against financial loss arising from the loss of their assets due to war related perils.

What will the policy cover?

A policy will indemnify the Insured for 100% of the value of the insured assets in excess of a deductible due to:

- War and Civil War
- Revolution and Rebellion
- Insurrection and Civil Strife

Strikes, Riot, Civil Commotion & Terrorism Insurance (SRCC)

The risk

The company may also be at risk of loss arising from the ‘lesser’ perils of physical damage due to Strikes, Riots, Civil Commotion & Terrorism.

The cover

The policy will indemnify the Insured for 100% of the value of the insured assets in excess of a deductible due to:

- Strike, Riot & Civil Commotion
- Terrorism, Malicious Damage, Sabotage and Vandalism
- Looting and fire damage resulting from the above

Both War and SRCC cover can be bought separately or combined. They may be packaged alongside other asset policies (see Confiscation for Permanent or Mobile Assets) or bought stand-alone. An Insured may select specific countries or cover a multi-market or world-wide spread. Cover can sometimes be arranged to protect domestic as well as overseas assets.

Contractors' Plant and Equipment

The risk

Companies who have contractors plant and equipment overseas in areas of instability or conflict are exposed to potential losses arising from damage caused to that plant and equipment as a consequence of various perils, including war.

What are the possible losses?

The potential loss of use or possession of the insured's plant and equipment

What will the policy cover?

Insurance is available from the Lloyd's and company market to 100% cover against loss of use of possession of contractors' plant and equipment arising from:

- Physical loss or damage following a forced abandonment
- Deprivation resulting from failure of the host government to allow re-export
- Loss or damage resulting from confiscation, expropriation, seizure or willful destruction or damage caused by or at the orders of the host government
- Destruction or damage caused by strike, riot, civil commotion, terrorism, sabotage and malicious damage
- Destruction or damage resulting from war, civil war and revolution

Contract Frustration (CF) for exporters – pre-shipment

The risk

An exporter is exposed to the potential loss resulting from a sales contract being cancelled or frustrated due to political action or events over which he has no control. This is especially important where an exporter is manufacturing goods to the buyer's specific requirements where re-sale or salvage possibilities are minimal.

What are the possible losses?

- Direct costs incurred up to the date of cancellation or frustration
- Additional costs necessary to pay subcontractors and suppliers
- Loss of profit

How can insurance help?

Insurance is available from Lloyd's and company underwriters to protect an exporter against net losses incurred due to political actions or events during the pre-shipment stage of a contract.

What will the policy cover?

This policy will normally indemnify the Insured for up to 90% of costs incurred, additional expenses plus a provision for loss of profit, after a waiting period, following:

- Cancellation of contract by a government owned buyer
- Cancellation of contract by any buyer due to political reasons
- Cancellation or non-renewal of import or export licenses
- Imposition of import or export embargo in Insured's or buyer's country
- Imposition of embargo by a third-party country from which essential goods/services were to have been supplied
- Frustration of the contract due to war, civil war, revolution etc.
- Failure of a government buyer or employer to certify invoices, preventing draw-down under an external financing or loan agreement
- Failure of a government buyer or employer to honor an arbitration award following a contractual dispute

Contract Frustration (CF) for exporters – post-shipment

The risk

A company which has exported goods to a lesser developed country, and where the debt may not have been fully secured by, for example, obtaining a confirmed letter of credit, is exposed to the potential loss arising from non-payment or non-transfer.

What are the possible losses?

- The value of the unpaid invoices, which may include profit and interest

How can insurance help?

Insurance is available from Lloyd's and company underwriters to protect exporters for their net losses in circumstances where amounts due under the contract are not received

What will the policy cover?

The policy will indemnify the Insured for up to 90% of the amounts due, after expiry of a waiting period, as a result of:

- Non-payment by a government buyer, employer or central bank
- Failure of a government obligor to honor a guarantee or back-up guarantee
- Failure or inability of the appropriate foreign exchange authority to remit hard currency to the seller on behalf of a private company, buyer or employer
- Failure of a state bank to honor an International Letter of Credit or payment guarantee
- Failure of a government buyer or employer to certify invoices preventing draw-down under an external financing or loan agreement
- Failure of a government buyer or employer to honor an arbitration award following a contractual dispute

Contract Frustration (CF) for importers – non-delivery

The risk

A significant proportion of commodities purchased from lesser developed countries are paid for in advance of delivery. There may be a government payment guarantee as additional security. A company, having made the advance payment, is then exposed to a potential loss arising from the contract being frustrated or defaulted on, and the goods they contracted to buy not being delivered. Similar events may prevent delivery under barter or countertrade contracts.

What are the possible losses?

- Amounts paid in advance
- Additional consequential costs incurred in purchasing commodities elsewhere to meet a forward supply obligation

How can insurance help?

Insurance is available from Lloyd's and company underwriters to protect an importer against losses suffered as a result of non-delivery of goods paid for in advance.

What will the policy cover?

The policy will indemnify the Insured for up to 90% of:

- The amount advanced by the Insured and "claimable" under a government bank guarantee following non-supply, and
- The amount of additional costs and expenses necessarily incurred to obtain alternative supplies to honor a forward supply contract

after a waiting period, and as a result of:

- Default by a private supplier caused by political events
- Default by a government supplier
- Failure of a government bank to honor a guarantee or repayment
- Cancellation or non-renewal of export license
- Imposition of export embargo
- Frustration of contract due to war, civil war, revolution etc.

Unfair Calling of on-demand bonds and guarantees

The risk

Contracts for the supply of goods or services to overseas buyers often require the exporter to provide 'on-demand' bonds. The unconditional nature of these bonds means that the exporter is exposed to the risk of the bonds being called "unfairly", or "fairly" where the reason for non-performance of the contract is political.

What are the possible losses?

The value of any on-demand bonds, including, but not limited to:

- Tender/bid bonds
- Advance and progress payment bonds
- Performance bonds
- Retention/maintenance bonds
- Standby letters of credit
- Customs or other bonds

How can insurance help?

Insurance is available from Lloyd's and company underwriters to protect a company's bank counter indemnity against a call on the bond. Insurance is available to protect individual bonds, a selection of bonds or the company's worldwide bond portfolio.

What will the policy cover?

The policy will indemnify the Insured for 90-95% of the bond value (or 100% excess of a country or policy deductible) after expiry of a waiting period, as a result of:

- Unfair calling of the bond by a government entity where the Insured is not in contractual default

  or
- Fair calling of a bond where the Insured is directly prevented from performance of a contract as a result of:
  - Cancellation or non-renewal of import/export licenses
  - Imposition of import/export embargo
  - Frustration of contract due to war, civil war, revolution etc.

Non-Repossession for lease contracts

The risk

Companies which lease equipment and goods to a foreign territory, typically aircraft and vessels but any mobile assets, are exposed to the potential loss resulting from their inability to repossess the goods following a default under the lease contract.

What are the possible losses?

The value of the goods, normally on an agreed value basis

How can Non-Repossession insurance help?

Non-Repossession insurance is available from Lloyd's and the company markets to respond in such circumstances.

What will the Non-Repossession policy cover?

The policy will indemnify the Insured for 100% of their loss, after a waiting period of normally 18p days, following:

All goods:

- Confiscation, Expropriation, Nationalization by a foreign government
- Seizure, restraint, detention or requisition for title by a foreign government
- Refusal of foreign government to permit the Insured their rights of repossession or access
- Refusal of the foreign government to permit removal of equipment/goods
- Exchange transfer of funds following compulsory local sale of equipment/goods

Vessels:

- Refusal of the foreign government to de-register vessel from the appropriate maritime register following exercising of Insured's rights or repossession

Aircraft:

- Refusal of the foreign government to de-register aircraft from the appropriate aviation register following exercising of Insured's rights of repossession

Trade Disruption Insurance (TDI) for exporters, importers & contractors

The risk

Exporters, importers or contractors may be exposed to financial losses resulting from interruptions to trade due to a variety of delays or force majeure events which are outside of its control.

What are the possible losses?

- Value of lost or damaged assets
- Unexpected and unbudgeted expenses
- Additional costs incurred to overcome disruption of trade
- Additional costs necessary to procure alternative supplies
- Additional financing costs incurred
- Write-off costs if project is irretrievably damaged and has to be cancelled
- Liquidated damages
- Loss of profits

How can Trade Disruption Insurance help?

Trade Disruption insurance is available from Lloyd's and company underwriters to protect exporters, importers, contractors or their financiers, against net losses incurred due to local political difficulties or the loss in transit of vital supplies or components.

What will a TDI policy cover?

The policy can be tailored to indemnify the Insured in a variety of ways, e.g., for an agreed value, for replacement costs, for actual cash value, for net asset value, for daily costs incurred, for additional expenses, plus a provision for loss of profit, after a waiting period, following:

- Non-arrival or late arrival of Just-in-Time deliveries
- Shipment delay or non-arrival
- Re-routing of shipments/deliveries
- Disruption of transport logistics
- Political risks including war, civil war, riots and terrorism
- Strikes
- Abandoning country or relocation facilities
- Mobilization expenses
- Trade Embargo, import/export license cancellation
- Delayed production line start-up
- Loss of contract expenses
- Film cancellation

Force Majeure

The risk

All construction and engineering projects are susceptible to the risk of delay in start-up and/or completion. Delays can be caused by a multitude of physical and/or non-physical factors. The economic consequences of delay for an owner involved in a construction project can be considerable. Liquidated damages imposed on the contractor under the contract will only protect the owner against delay caused on the part of the contractor. If the delay is caused for reason of force majeure, the contractor can escape liability leaving the owner with a financial loss.

What are the possible losses?

- Loss of revenue
- Continued debt servicing
- Loss of investment income
- Continued standing charges

How can insurance help?

Force Majeure insurance is designed to protect the owner of a project for its debt servicing obligations to the lending banks in the event of delayed completion or permanent abandonment of a project. The lenders may even make it a pre-requisite.

What will the policy cover?

Force Majeure insurance will provide an indemnity that corresponds to the level of debt service to the lenders, plus related additional costs and expenses incurred, in the event that the project is delayed or permanently abandoned following:

- Fire and allied physical perils on an off site
- Riots, civil commotion and malicious acts intended to cause damage (on or off site)
- Strikes, lock-outs and/or labor disputes, including contractor’s workforce
- A change of law (e.g., revocation of valid building permits, safety codes reviewed)
- Embargo preventing delivery of essential components to the site
- Any other cause beyond the control of the owner, contractor, the operator or sub-contractors and suppliers

The policy will usually include a time deductible before payment of a claim, and underwriters generally request a legal report to be provided in advance of cover being bound.

Non-Ratification of contracts

The risk

A company may be required to begin work before a contract comes into 'full force and effect'. In the event that the contract is prevented from becoming fully ratified, the company is exposed to a potential loss of all the expenditure and costs up to that date (see also section on Contract Frustration – pre-shipment).

What are the possible losses?

The potential loss would include:

- Direct costs incurred up to the date of non-ratification
- Additional costs necessary to pay subcontractors and suppliers
- Loss of profit

How can insurance help?

Insurance is available from the Lloyd's and company market on a highly selective basis to protect companies in such circumstances.

Underwriters need to be convinced that full 'ratification' is achievable and obviously intended, and they will provide cover only in circumstances where it is considered commercially viable and necessary for the Insured to start work before the effective date of contract

The insurance is 'tailored' to fit the specific circumstances and requirements under which full ratification of the contract would be met.

What will the policy cover?

The policy will indemnify the Insured for up to 90% of all costs incurred to date, after a waiting period, as a result of:

- Export Licenses not being granted by government authority
- Letter of credit not issued by government buyer or central bank
- Government approvals not granted
- Government failure to supply other crucial items or carryout crucial preparations
- Down payment not made by government buyer or employer

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