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POLITICAL RISK INSURANCE. A TECHNICAL APPROACH.

Riccardo Rolfini and Stefania Paciotti

SACE

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Abstract

This paper analyses the impact of political events and how each specific event, such as expropriation, transfer restrictions, war and civil disturbance and breach of contract, has different impacts in terms of loss, compensation and recovery both from an equity and credit coverage perspective.

This paper also focuses on risk assessment methodology: based on a comprehensive approach, some PRI providers adjust "country political risk" ratings according to project-specific factors. This results in an indication of the likelihood of an event occurring in relation to a single insured project. The main aspects driving the analysis range from economic fundamentals to political instability, as well as institutional and legal framework of the host country. One of the conclusions is that the political risks are not independent dimensions but there is a high correlation among themselves.

Finally, one of the most thorny issues for PRI providers is how to price political risks as statistical and actuarial calculations are of little help with this kind of events. Different approaches have been followed by PRI providers and there is no common playing field as in the case of OECD rules on credit risk. Ultimately it is not even granted that insurers actually charge premia that adequately remunerate risk.

Keywords: political risk, expropriation, transfer restrictions, war and civil disturbance, breach of contract.

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[1] SACE SpA, *Policy Underwriter and Head of Political Risk Insurance*, respectively. The views expressed herein are those of the authors and not necessarily reflect the views of SACE. The authors gratefully acknowledge helpful support from Alessandra Ricci, Alessandro Terzulli and Lorenza Chiampo.
Corresponding address: Piazza Poli, 37/42 – 00187 Rome. E-mails: r.rolfini@sace.it; s.paciotti@sace.it .

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1. Definition of Political Events and Covered Risks

We define in this section the components of political risk from both an equity and a credit perspective. There is a unanimous approach among PRI providers in defining the political events both for equity investments and export credit transactions.

1.1. Expropriation

1.1.a. Covered Risks

Equity coverage. The guarantee against expropriation covers losses due to any legislative, executive or administrative action or omission attributable to the host government which, directly or indirectly: (i) 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 (ii) otherwise deprives the guarantee holder or the project enterprise of a **fundamental right essential to the overall financial viability** of the guaranteed investment and/or the project enterprise provided that:

a. there is a **direct** and **immediate causality** between the event and the losses;

b. the action/event is **discriminatory** and/or **arbitrary** (no measure shall constitute an expropriation if it constitutes a *bona fide*, non-discriminatory measure of general application by governments for the purpose of regulating economic activity, ensuring public safety, raising revenues or protecting the environment, unless the measure is designed by the host government to have a **confiscatory effect**); and

c. such losses continue for the duration of the applicable waiting period.

Credit coverage (including shareholders' loan). The guarantee against expropriation covers the **inability to repay** of the debtor caused **directly** and

immediately by an expropriation, confiscation or nationalization carried against the borrower and/or its assets or the project enterprise (provided that b. and c. above are fulfilled).

As opposed to the equity coverage, the event itself does not necessarily lead to a claim, since the host government (or the expropriating entity) could continue honoring the company's payment obligations.

1.1.b. Compensation

Equity coverage. Compensation payable under expropriation includes: (i) the net book value of the project enterprise (some PRI providers, e.g. SACE, also accept the goodwill value); or (ii) the book value of any confiscated tangible asset (or the portion thereof that has been expropriated).

Compensation is not given if the guarantee holder has received a "fair compensation" from the host government. In order to ascertain "fairness" of the compensation, the local regulatory and judiciary framework is applied. If needed, PRI providers can make recourse to an independent consultant. In the case the guarantee holder has received an unfair compensation, insurers cover the gap between the fair compensation amount and the amount paid by the host government.

Credit coverage. Compensation payable under expropriation includes the due and unpaid principal and interest amounts.

1.1.c. Recovery after Compensation

Both for equity and credit risk coverage compensation paid for expropriation is **not eligible to Paris Club** negotiation and it can only be **recovered on a bilateral basis**. PRI providers, failing to recover directly from the host government, can bring the dispute to the International Centre for Settlement of Investment Disputes (**"ICSID"**), an autonomous international institution established under the Washington Convention[2], whose primary purpose is to provide facilities for conciliation and arbitration of international investment disputes. All the signatory countries to the Washington Convention are, therefore, considered less risky since the recovery after compensation is more likely.

1.2. Transfer Restrictions

1.2.a. Covered Risks

Equity coverage. The guarantee against transfer restrictions covers losses due to any action or inaction by the host government (or entities authorized by the host government, under the laws of the host country, to engage in foreign exchange transactions) in either case which prevents, **directly** or **indirectly**, both the guarantee holder and the project enterprise from legally:

i. **converting into the guaranteed currency the local currency** constituting:

   a. dividends, profits or other monetary benefits derived from the guaranteed investment;

   b. proceeds from the disposal of, or other return of, the guaranteed investment; or

   c. any other return on the guaranteed investment;

ii. **transferring outside of the host country the guaranteed currency** constituting a return of, or a return on, the guaranteed investment provided that the guarantee holder or the project enterprise, or both, as required:

   a. has for the duration of the applicable waiting period continuously applied for and failed to convert the local currency or to transfer the guarantee currency through the legal exchange mechanisms sanctioned by the host government

[2] http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ContractingStates&ReqFrom=Main

in accordance with the relevant laws, regulations and procedures of the host country; and

b. had on the effective date the legal right within the host country to convert the local currency and transfer the guaranteed currency,

provided that the amounts have been deposited in the host country.

Credit coverage (including shareholders' loan). The guarantee against transfer restrictions covers the **inability to repay** of the debtor caused **directly** and **immediately** by the **impossibility** to **convert** or **transfer** (subject to the conditions listed under sub-paragraph i. and ii. above) the amounts deposited in the country to repay the loan.

1.2.b. Compensation

For both equity and credit risk coverage, compensation payable in case of transfer restrictions includes: (i) for inconvertibility coverage, the guarantee currency equivalent of the local currency which could not be converted in respect of the guaranteed amount, calculated on the basis of the reference rate of exchange on the date of loss; or (ii) for inability to transfer coverage, the amount of guarantee currency that could not be transferred in respect of the guaranteed investment as of the date of loss.

1.2.c. Recovery after Compensation

For both equity and credit risk coverage, once a compensation is paid due to transfer restrictions, PRI providers can face two different scenarios:

i. **Revocation of the Transfer Restriction measure**:

a. if during the period between the compensation payment date and the revocation of the transfer restriction measure **no devaluation/depreciation** of the local currency has occurred, PRI providers can **recover 100%** of the compensation paid by converting and transferring the amounts deposited in the host country;

b. if during the period between the compensation payment date and the revocation of the transfer restriction measure a **devaluation/depreciation** of the local currency **has occurred**, PRI providers can only **partially recover** the compensation paid by converting and transferring the amounts deposited in the host country.

In case of **credit risk coverage** (including shareholders' loan), PRI providers have the right to recourse against the borrower in respect of the difference between the compensation paid and the recovered amount as long as the loan agreement provides that the obligation of the borrower can be considered fulfilled only if the lender - and PRI providers through subrogation - receives 100% of the due amount in the hard currency.

In case the borrower does not pay and in case of expropriation cover, insurers may recover directly from the host government according to the Paris Club provision.

ii. **No revocation of the Transfer Restriction measure**:

Equity and credit risk coverage. PRI providers may recover the compensation paid directly from the host government according to the Paris Club provision.

1.3. War and Civil Disturbance

1.3.a. Covered Risks

Equity coverage. The guarantee against War and Civil Disturbance covers losses due to:

a. the **destruction or disappearance of, or physical damage to**, tangible assets in the host country functional to the investment project;

b. the **total inability** of the project enterprise to conduct operations essential to its overall financial viability as a going concern for the duration of the applicable waiting period;

c. the **business interruption.** Few insurers (e.g. MIGA) offer coverage against the **temporary but complete** suspension or interruption of the construction or operation of the investment project for the duration of the applicable waiting period due to loss of assets or unreasonably hazardous conditions that result in the **temporary abandonment**, evacuation or denial of use of the investment project or its facilities,

provided that the **losses**, due to one of the above mentioned events, **are direct and immediate results** of acts of war, revolution, insurrection, civil war, civil commotion, riots or acts of **terrorism** (terrorism event covered only by some PRI providers, e.g. MIGA and all the private insurers) or sabotage carried out, in each case, by those primarily pursuing political or ideological objectives in the host country (*force majeure* is not covered).

Credit coverage (including shareholders' loan). The guarantee against War and Civil Disturbance covers the **inability to repay** of the debtor caused **immediately** and **directly** by any political violence event (acts of war, revolution, insurrection, civil war, civil commotion, riots or acts of **terrorism** or sabotage) or *force majeure* (not covered under shareholders' loan) damaging the investor's assets or the project enterprise. The event *per se* does not necessarily lead to a claim, since a physical damage to tangible assets does not prevent the borrower from paying back the due amount. A claim is less likely when the damage is partial and the activity is run through more than one facility (e.g. financial sector, several branches in the country).

1.3.b. Compensation

Equity coverage. Compensation payable under War and Civil Disturbance is:

a. in the case of loss of assets coverage: (i) the lesser between the replacement cost of such tangible assets with assets of the same kind and quality and the reasonable cost of repair of such tangible assets, provided that such compensation is actually utilized for replacement or repair of such assets, as applicable; or (ii) if the relevant assets are neither being replaced nor repaired, the book value of the affected tangible assets, determined (if necessary by a third party consultant) as of the day immediately preceding the date of loss;

b. in the case of **permanent loss of use** of the project, the net book value of the project enterprise calculated as of the day immediately preceding the date of loss;

c. in the case of **temporary loss of income**, the sum of the lost business income, continuing expenses and extraordinary expenses of the project enterprise incurred during the indemnification period.

Compensation paid for **business interruption coverage** is based upon the lost business income calculated taking into account business income before the loss occurred, the likely business income if the loss had not occurred, and any other relevant information including financial records, accounting procedures, bills, invoices, other vouchers, deeds, liens and contracts.

Credit coverage. In this case the compensation is equal to the unpaid due amount by the borrower.

1.3.c. Recovery after Compensation

For both Equity and Credit Risk coverage, compensation paid for War and Civil Disturbance is **not eligible to Paris Club** and it can only be **recovered on a bilateral basis**[3].

1.4. Breach of Contract

1.4.a. Covered Risks

Equity coverage. The guarantee against Breach of Contract (BoC) covers losses that are the **direct** and **immediate result** of the inability of the guarantee holder or the project enterprise (on behalf of the guarantee holder) to enforce, following a BoC by the host government, an award rendered in favor of the insured party against the host government (including any agency, ministry, company or other body under the control of the host government) ("**Arbitral Award Default**"), provided that the guarantee holder and/or the project enterprise, as applicable, have made all reasonable efforts to enforce the award against the host government, including initiating and participating in appropriate judicial proceedings, for the duration of the waiting period.

PRI providers with a lot of experience in BoC coverage (e.g. MIGA) have widened the definition of BoC including also **Denial of Justice,** defined as any action by the host government (including any agency, ministry, company or other body under the control of the host government) which makes the **invocation, operation or formal conclusion of the dispute resolution** procedure either:

[3] See comments in Paragraph 1.1.c.

i. **impossible or unable to be proceeded** according to its rules and the terms of the project agreement;

ii. **exceptionally hazardous** to the physical safety of any representative of the guarantee holder or the project enterprise, as applicable, or to any other person who is essential to the dispute resolution procedure; or

iii. **commercially impracticable** to the guarantee holder or the project enterprise, as applicable, under the facts and circumstances of the case, provided that (a) the merits of the guarantee holder’s claim have been determined through an opinion rendered by an independent expert; and (b) the project agreement or related documentation allows PRI providers to join the dispute resolution procedure in the event of payment of compensation.

Credit coverage. Standard credit risk policies covering against political risks does not include BoC. Therefore, the BoC coverage appears as an add-on in a credit risk transaction widening political events coverage in order to include the risk of a shortfall in the cash flow of the borrowers caused **solely** and **directly** by the lack of performance of a public buyer and/or a public supplier to the borrower. In such a case, taking into account how BoC coverage works, PRI providers would pay the claim as an Arbitration Award Default (see above). It is not market practice to extend political risk coverage to include BoC as it would ultimately result in covering political plus commercial risks. Therefore, any PRI insurer prefer to provide a comprehensive policy on political and commercial risks.

1.4.b. Compensation

Equity coverage. In case of **Arbitral Award Default** coverage, compensation shall computed as the guarantee holder’s share of the award payable in guaranteed currency as of the date of loss. In respect of **Denial of Justice** coverage, compensation is payable prior to the issuance of an Award in an amount not to exceed the lesser of: (i) the amount determined to be due by the host government to the guarantee holder, or the guarantee holder's share of the amount determined to be due by the host government to the project enterprise and (ii) the outstanding amount of the guarantee.

Credit coverage. In this case the compensation is equal to the unpaid due amount by the public borrower according to the rendered award provision (Award Arbitration Default) or to the lesser of (i) and (ii) above (Denial of Justice).

No compensation shall be payable for any loss under BoC suffered by: (i) a State-Owned Enterprise or public authority which, on the date of loss, is no longer under the supervision, control and direction of a governing authority, unless such an authority is otherwise legally liable for the obligations of the State-Owned Enterprise or public authority; (ii) a public or regulatory authority for the obligations of which the governing authority was liable on the effective date, but for whose obligations the governing authority is no longer liable on the date of loss. In other words, if the public entity is privatized the transaction is no longer eligible for BoC risk coverage.

1.4.c. Recovery after Compensation

Compensation paid for Breach of Contract is **not eligible to Paris Club** and it can only be **recovered on a bilateral basis**[4].

2. Risk Assessment

In order to assess political risk some PRI providers (e.g. ONDD and OeKB) simply use the OECD categories by applying a fixed premium rate for each risk category. Few PRI providers (e.g. PwC) consider all the countries that have entered into a Bilateral Investment Treaty (BIT) with their home country equal in ranking,

[4] See comments in Paragraph 1.1.c.

indifferently treating them as eligible without taking into account the actual level of risk faced by the guarantee holder.

Most of PRI providers (e.g. SACE and MIGA) have set up an internal scoring system which ranks countries in terms of political risk, through a **methodology that is based on a combination of qualitative and quantitative analyses** and that is usually conceived by single risk (transfer restrictions, expropriation, war and civil disturbance and breach of contract).

The analysis is conducted on two different levels, **from a country-level political risk basis to a project risk one.** Project-level assessment is carried on in order to highlight potential risks arising from specific features of the investment; its outcome is integrated within the country-level political risk indicators and the final result may significantly differs from the "pure" country political risk score.

2.1. Country-level Political Risk Analysis

Generally speaking, the country-level analysis deals with **three** main dimensions:

i. **economic fundamentals**, specifically the quality of macroeconomic management and the resilience to adverse shocks;
ii. **political system**, in terms of both legitimacy and "interventionism" in the economic activity (culture/intrusiveness);
iii. **legal system**, based on the integrity of the judicial system and the insurance track record in the country, including the claims history.

There is a quite wide literature on political risk and the way economic, political and legal dimension interaction impacts on political risk. N. Jensen[5], for example, argues that "**political constraints**"[6] provide stability in policy and protect foreign investors from government policy changes that can harm their operations or threaten their

[5] See N. Jensen, *Measuring Risk: Political Risk Insurance Premiums and Domestic Political Institutions* (2005).
[6] According to Jensen "political constraints" means political institutions.

assets. The impact of **democratic institutions** on political risk is conditional on a country's economic performance: democracy protects property rights by generating audience costs for political leaders that expropriate, renege, or harm foreign investments. During financial crises, politicians with already tarnished reputations face strong demands for redistribution and have small marginal costs to their reputation. This is when the properties of democracy to reduce risks are weaker and the incentives for politicians to exploit foreign investments are strongest.

One of the most significant interactions is between expropriation and transfer restriction risk, in particular they way democracy and political constraints affect both of them. Although **democracy** and **political constraints** both **reduce the risk of expropriation and breach of contract**, they have different impacts on the level of transfer risk: **political constraints are considered to be capable of reducing transfer risk**, while **democratic institutions have no impact** on such a risk.

It is possible to list the main factors underlying political risk assessment by single risk-generating event coverage:

Expropriation/Breach of Contract

- **government/opposition general attitude toward foreign investment**, relationship between the guarantee holder's home country and the host country (record of interventions in foreign investment, including settlements and pending disputes);
- degree of **legal protection of the guaranteed investment** under the domestic law;
- existence of an **investment protection agreement** with the host country;
- **vulnerability to terms of trade shock** (i.e. Venezuela);
- **institutional permanence**, in particular the clear establishment of a relationship among the executive, legislative and judicial branches of the government (system of checks and balances);

- **representativeness,** i.e. how much the population and organized interests can make their voices heard in the political system;
- **political** and **economic instability** (i.e. the effect of succession issues on the economy);
- features of **judicial system**, especially independence, predictability and efficiency.

According to Jensen, political constraints, level of democracy and checks on government reduce the expropriation risk. These factors are well captured by the latter four elements listed above.

SACE's risk assessment methodology adopts a similar framework, focusing on the quality and clearness of the regulatory and legal systems as well as the ability of individuals to own private property secured by clear laws fully enforced by the state.

Transfer Restrictions

- the **exchange control regime**, its evolution over time and perspective changes which are linked to the role of monetary policy;
- the **liquidity position** and its likely development over the period of the guarantee: (i) **balance of payments**; (ii) **foreign exchange reserves**; (iii) general payment record on foreign debt, especially in case of a debt rescheduling;
- **debt service ratio**, the degree to which the country's international reserves can cover the debt service;
- **vulnerability to terms of trade shock** (i.e. Venezuela);
- transfer and convertibility delay experience;
- use of local currency agreement between PRI providers and the host country;
- potential of recovery and salvage risk.

In order to give an effective measure of transfer restriction risk, SACE relies on the OECD categories built, among others, on the first above mentioned three dimensions.

Therefore SACE's political risk assessment methodology is based on quantitative measures strictly linked to the ability of the sovereign to repay its own foreign debt. The rationale of such a choice is based on the high correlation between economic and transfer restriction risks.

Also Standard&Poors (S&P), through its Transfer&Convertibility (T&C) rating, measures the likelihood of a sovereign restricting access to foreign exchange needed to honor non-sovereign's debt service obligations. Historically, sovereign states suffering mounting political and economic pressures often try to protect lacking reserves by restricting the ability of residents to convert local currency. The T&C assessment methodology relies on the dimensions listed above, giving a rating from one to three notches above the sovereign foreign currency rating. The elevation above the sovereign foreign currency rating depends on: (i) degree of openness of the foreign exchange regime; (ii) outward-oriented nature of economic policies; (iii) import dependency; (iv) non-sovereign external debt level; and (v) "interventionism" attitude and recent history of T&C restriction measures. Even in this case the strict link between transfer and sovereign credit risk is clear.

War and Civil Disturbance

- **internal** and **external political consensus**;
- external aggression, i.e. the **likelihood of armed conflict** with another country; existing insurgency, revolution or violent opposition;
- existence of **armed conflict outside** the host country which might affect the investment project's viability;
- **extent of tensions** which might erupt as violent action politically motivated (i.e. by terrorist movements, student or labor unrest);
- **representativeness,** i.e. how well the population and organized interests can make their voices heard in the political system;
- **political** and **economic instability** (i.e. the effect of succession issues on the economy);

- features of **judicial system**, especially independence, predictability and efficiency.

There is a wide consensus in literature as well as among PRI providers on the fact that the above set of variables captures all the main triggers of political violence risk. It is evident how expropriation and war and civil disturbance risks are strongly linked and correlated.

2.2. Project-level Political Risk Analysis

The outcome of the country-level risk analysis is a score that gives a view on the relative **likelihood of a claim** occurring per type of risk over the medium term together with the description of the factors affecting the ability to recover based on the country track record and comparative data from different countries and political risk insurance providers. The country risk score may be upgraded or downgraded on a project level according to the main features of the investment project. For each single risk, there are several features:

Expropriation/Breach of Contract

- type (equity/non equity) and size of the investment project in comparison to the host country's GDP;
- existing investment agreements with the host government, especially dispute resolution mechanisms (international arbitration), fairness to the host country, clarity and flexibility (renegotiation clauses);
- sector (especially oil and gas, mining, public utilities, other natural resources and manufacturing), importance of the sector for the host economy (strategic importance to government) and size of the sector in the host economy;
- degree of competition in the host economy by sector, e.g. monopoly or part of an oligopoly;

- relations with locally or state-owned enterprises;
- contribution to the host economy, especially generation of export revenues and import substitution;
- economic viability of the project and its foreign currency earnings;
- dependence on incentives or trade restrictions (as well as on host government, e.g. monopoly supplier or monopoly purchaser);
- exposure to the host government regulation, in terms of price controls, export and import quotas, performance requirements, tax regime, environmental protection, labor legislation and capital market regulation;
- vulnerability to adverse economic developments;
- importance to labor market in the host country;
- potential for disinvestment, i.e. mobility of assets;
- expected profitability, including volatility of profits;
- ownership and control, especially if in joint-venture and also wholly owned subsidiary or majority/minority participation;
- joint-venture partners, e.g. host government, domestic investors, third country investors/institutions, international institutions;
- reliance on continued participation of sponsors;
- host country's ability to compensate out of project's earnings.

Transfer Restrictions

- type of investor's return on investment, e.g. dividends, share in profits, revenues or production volume, fixed royalties or fees, prepayment of loan;
- amounts of expected transfers and time schedule (e.g. earning forecasts, repayment schedule) and expected transfers relative to host country's foreign exchange position;

- potential for earning export proceeds in freely usable currency, ratio of such export proceeds to projected remittances and agreement with the host country on preferential access to freely usable currency;
- the use of offshore accounts and existing agreements with the host country on accumulation of export proceeds in offshore accounts;
- contribution of the investment project to the balance of payments, especially with reference to import substitution effects;
- importance of the investment project to the host country, especially in case of a preferred investment status;
- financing structure, especially relative amounts of claims to freely usable currency of various creditors and shareholders;
- shareholders and long term creditors, especially participation of local partners, public domestic institutions, e.g. ECAs, international institutions;
- financial rate of return and the foreign exchange earning potential;
- sector and sector priority in the host country policies.

War and Civil Disturbance

- type of investment, especially equity/non equity as well as tangible/intangible assets;
- strategic significance to both the host government and its potential rivals (military and politically importance);
- geographic location with respect to areas of hostilities;
- vulnerability to damage and reliance on critical transportation links or raw material supply or energy sources;
- visibility as foreign-owned project;
- mobility of assets;
- security arrangements in place.

2.3. Political Risk Events Correlation

Although the three political risks (expropriation/BoC, transfer restrictions and war and civil disturbance) examined may seem mostly and separately linked to each one of the three dimensions above (transfer restrictions risk to economic fundamentals; war and civil disturbance risk to political system; and expropriation/BoC risk to legal system), actually the analysis of the main factors driving political risk assessment provides the opposite evidence. The three political risks are not independent but there is a high linear correlation among them. On one hand, there are some common factors affecting more than one risk component (e.g. "vulnerability to terms of trade shock" affects both expropriation and transfer restrictions risk, level of political instability and judicial system have an impact on both expropriation and war and civil disturbance risk). On the other hand, there are quantitative studies proving this correlation.

Expropriation and transfer restrictions risk correlation. Jensen clearly shows a high correlation between expropriation and transfer restrictions risks. These political risk components are correlated at 0.79 mainly because of the role political constraints can play in order to provide political stability so allowing to avoid frequent and dramatic changes in government policies. A major change, for example, in the level of commodity prices can therefore affect the expropriation risk but also influence the likelihood of transfer restriction measures.

Expropriation and war and civil disturbance risk correlation. SACE's political risk assessment methodology, through a cross-section analysis (on almost 200 countries), provides evidence of how expropriation and political violence risks are correlated at 0.86. This result is mainly due to the weight of the political instability level in terms of likelihood of government changes and reliability on government's commitments towards foreign investors as well as local population and minorities able to raise social and political unrest. If the level of political stability and/or representativeness decreases it is likely to see an increase in terms of expropriation as well as political violence risk.

Transfer restrictions and war and civil disturbance risk correlation. The correlation between transfer and political violence risk is probably the weakest one and it is quite hard not to think about these two components as independent. SACE's cross section analysis shows a correlation index equal to 0.7; the likelihood that a transfer restriction measure (leading to a claim) may generate war and civil disturbance events (or the other way round) is significant especially during an economic or financial crisis affecting the overall economic situation. If the liquidity position worsens the likelihood of both transfer restriction measures and civil commotion events increases significantly.

3. Pricing Methodology

The previous chapter highlighted how qualitative the political risk assessment is: with the exception of economic fundamentals - that can be easily measured - all the other factors, from the level of political stability to the integrity of the judicial system, are difficult to be expressed by numbers. Due to the uninsurable nature[7] of political risk, every PRI provider has developed its own pricing model, based on its own risk methodology, in order to apply an insurance premium adequate to remunerate the covered risk. PRI providers that simply use the OECD categories apply a fixed premium rate depending on the risk category. Some other PRI providers have a flat premium rate, relying on the existence of a BIT agreement and not reflecting the actual level of risk faced by the guarantee holder (e.g. PwC charges 50 bppa for every commitment).

[7] See R. Ascari, *Political Risk Insurance: an Industry in Search of a Business?, SACE Working Paper n.12 (March 2010)*

PRI providers that set up an internal scoring system can classify every country in terms of political risk and assign a premium rate to every risk group. The premium rate is calculated by assigning a cap and a floor in terms of basis points for every scoring cluster. Within every premium range the final rate can be increased or decreased according to variables such as:

a. **type** of the investment (equity/non equity; some PRI providers, e.g. SACE, apply a discount for shareholders' loan coverage);
b. **size** of the investment (the bigger the size, the higher the premium);
c. **tenor** of the investment (the longer the commitment, the higher the premium);
d. **exposure** and level of **portfolio concentration** in the host country (the higher the concentration, the higher the premium).

PRI providers can provide coverage for one to four risks (SACE usually covers at least two combined risks) and for most of them the standard coverage is on the first three risks (Expropriation, Transfer Restrictions and War and Civil Disturbance).

According to the evidence which shows a correlation among political risks, almost all PRI providers do not offer single risk coverage. This is mainly due to the fact that a single risk coverage puts the insurer in the position to suffer losses that would be potentially caused also by one of the risks not covered. This also explains why an insurer may often charge a higher price for single risk coverage.

In case of comprehensive coverage, premium level is not affected by the correlation among risks since it is sufficient one single event leading to a claim to make the insured party eligible for compensation.

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