Understanding Political Risk Coverage

by Mark Garbowski and Joshua Gold

The economic crises and political upheavals occurring around the globe the past few years have highlighted the risk of engaging in international trade and investment. In just the last five years, entire industries and business entities have been nationalized in Argentina, Bolivia, Greece, Ireland, Pakistan and Venezuela, among others. Foreign bank deposits were effectively seized and heavily devalued during the Cypriot bank crisis of 2012-2013. Currency controls are currently in effect in dozens of countries around the world, and are subject to change seemingly at a whim.

These events have created a heightened interest in political risk insurance. Whether you already have a policy, are facing renewal or are considering purchasing a policy for the first time, a careful review of policy terms will be worthwhile. Political risk policies vary greatly from company to company, including those sold by the Overseas Private Investment Corporation (OPIC), a self-financing government-created entity. Beyond the differences among different providers, most policies are specifically tailored from an assortment of possible coverage options, and it is critical to be certain that your company has selected the best and necessary options that it needs for its operations.

Coverage Grants and Types

Most political risk policies offer some combination of the following types of coverage:

- **Expropriation risk** covers the possibility that the host government will seize all or some substantial portion of your assets in-country, or the assets of a borrower or business partner so the borrower or partner is unable to make payments or otherwise fulfill their obligations to you.
- **Moratorium risk** covers the chance that a government does not allow a borrower or business partner to make payments (e.g., a moratorium on debt payments, foreign debt payments, banking in general, etc.).
- **Currency transfer risk and inconvertibility** can cover a host of ills, including when the government does not allow a borrower or counterparty to 1) convert its own currency into dollars; 2) convert to the local currency to make payments; 3) or to transfer funds out of the country to convert or transfer local earnings. Some policies may also include coverage for "risk of unavailability of U.S. dollars in the market," which concerns a regime in which currency exchange or transfers are nominally legal but other government policies made it impossible to do so in a functioning market.
- **Political violence** covers events such as war, insurrection, civil strife, terrorism and sabotage (depending on the definition and terms).

Exclusions, Conditions and Traps

Having carefully selected the proper coverages is barely half the task, however, as political risk policies may contain a variety of definitions, conditions and exclusions that can trap unwary policyholders and render coverage illusory.

First, some policies include a definition of "government" or "government authority." If so, this is typically a key component of coverage. Some definitions are ambiguous, and might be read to refer only to a central bank. Such language should be clarified, but if that is not possible, be prepared to argue for a policyholder-friendly understanding of the terms.

In addition, policies typically limit their coverage to a specified country or countries. Be careful that the definitions and conditions that create this limit do not undermine your company's needs – especially where boundaries and political power might be in a fluid situation, such as we are now seeing in the Ukraine.

Next, various exclusions can purport to limit coverage, sometimes in unexpected ways to the policyholder. It is also important to note that sometimes this exclusionary language is tucked inside the coverage grants or policy definitions. Besides making them harder to find in advance, insurance companies might argue that this means they should not be subject to the rule of construction that exclusions be read narrowly. That argument should not stand unopposed.

Some policies try to exclude acts performed by a government entity in a business capacity, using language such as "in its capacity, or through its powers as, a purchaser, supplier, creditor, shareholder, partner, director or manager of a [designated party]." As governments are capable of doing a lot of mischief in unofficial ways, this exclusion could cause problems for claims that should be covered. In one instance, for example, the government was acting to guarantee the loan that was the purpose of the policy. As such, it had commercial rights that could have interfered with the ability of the borrower to repay.

Another exclusion is for pre-existing conditions at the time the policy is sold. While understandable, be wary of broader language that excludes restrictions that the policyholder "should have known about" or that target "proposed restrictions" or "publicly known to be under consideration. If the insurance company wants such items excluded, they should be specifically identified.

Another example of potential coverage issues involves a policy that covers currency risks but measures damages using a government-approved exchange rate. If you are allowed to convert currency, but only under a government imposed exchange rate that is out of line with the real market, you effectively might have no coverage.

Finally, is your host country a client state, or subject to outside interference? Check for language excluding loss due to a government law, regulation or other action having legal effect but issued by another country.

As with most types of insurance coverage, policy language is key when it comes to political risk coverage, and because each policy is usually adapted to specific risks, there is more opportunity to craft (or fail to craft) the proper coverage in advance. Policyholders should work closely with their brokers and insurance companies to make sure they are buying coverage that actually suits their needs. ■

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