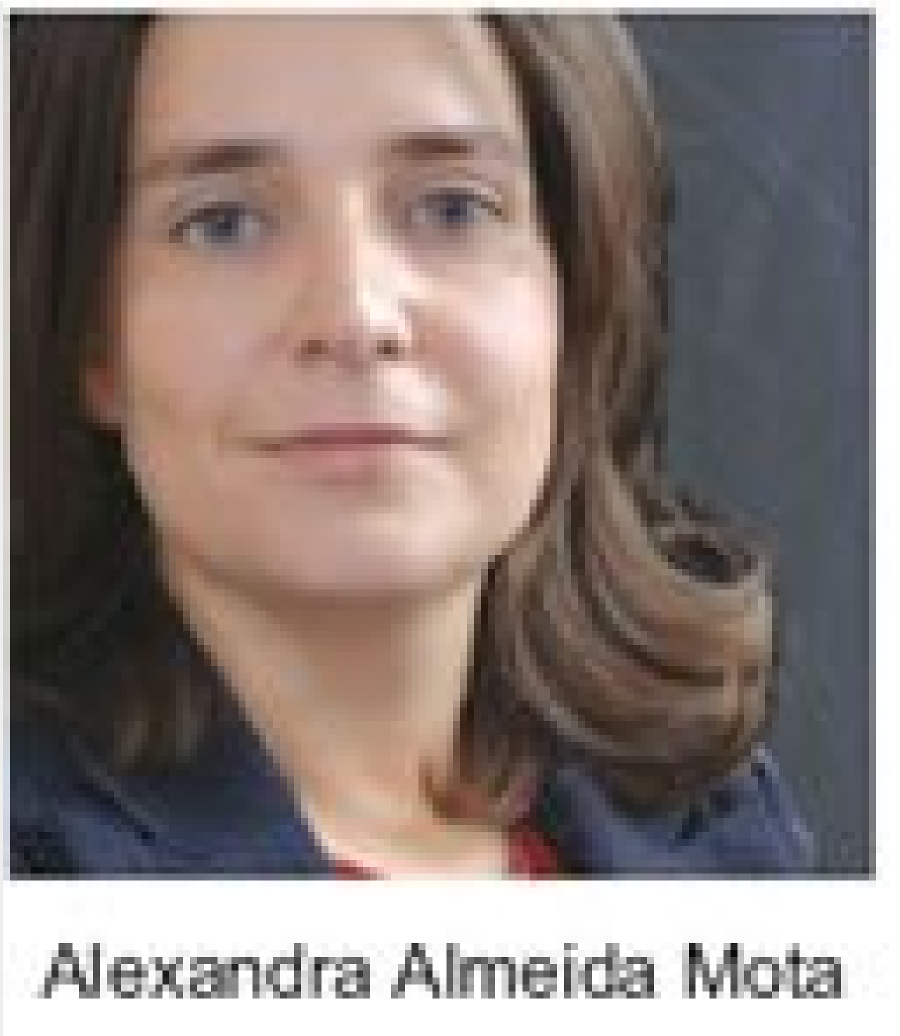
LATIN AMERICA AND POLITICAL RISK INSURANCE - CLIFFORD CHANCE

Posted on 25/02/2010



Category: Corporate

As the financial crisis shows signs of subsiding, companies are again looking to explore investment opportunities in Latin America. However, there is some concern that some political leaders in the region may seek to use the recent crisis to advance protectionist policies that could diminish the value of such investments.

This article considers political risk insurance (PRI), which can be an effective tool in managing such risk. PRI provides direct risk mitigation at a cost. It is available from both private insurers and national export credit agencies and other governmental or quasi-governmental sources.

The main heads of protection offered include:

- • expropriation and nationalisation;
- • non-payment and currency incontrovertibility; and
- • war and civil unrest.

Maximising the benefits

Whilst not all the above are relevant to the region as a whole, even the more stable countries in Latin America have in the past taken measures that directly or indirectly have a significant impact on the value of foreign investments. The drafting of the policy is key in capturing the potential jurisdiction-specific risks. The insured will want the heads of protection to be clearly defined and as wide as possible. Any exclusions should be narrow.

By way of example, expropriation should be defined by reference to the actions of the host government as well as to the consequences of those actions. It should cover not only confiscation/requisition of assets but also arbitrary and capricious intervention that prevents or restricts the operation of the investment or the exercise of the investor's rights in relation to it.

It is a key element of insurance that the insured party has an interest in the subject matter of the insurance and that they have suffered a loss (as defined in the policy). The local subsidiary may suffer a direct loss if there is an expropriation event but a parent insured may suffer an indirect loss as a result of the fall in value of that subsidiary. It is important that the insurance covers such losses and that the definition of insured is carefully considered.

PRI policies should also include calculation methods to ensure that the insured party's loss can be readily valued. Loss may, for example, be quantified by the book value of the investment in the state of origin; the reduction in that book value; or – in the case of a loss to an overseas parent – the equity value of the subsidiary.

Con la crisis internacional financiera eremitiendo, los empresarios están investigando de nuevo las oportunidades para invertir en Latinoamérica. Pero los líderes políticos de la región podrían aprovechar la oportunidad ocasionada por la reciente crisis para introducir sus programas proteccionistas lo que puede reducir el valor de las nuevas inversiones. Tres abogados de Clifford Chance, explican el uso del seguro de riesgo político (PRI en sus siglas inglesas) como herramienta para disminuir la posibilidad de ese peligro en la región.

Making a claim

After the occurrence of a political risk event, an insured party is generally not entitled to make a claim immediately; PRI policies often impose a waiting period of 120 to 180 days. An insured party should therefore act as a prudent uninsured party prior to the payment of any claim, and take steps to mitigate its loss. This could include making an arbitral claim against the state under a bilateral investment treaty (BIT) or against a contractual counterparty. Provided the insurer has no cause to avoid the policy, the claim should be paid before an arbitral award is rendered. The insurer then becomes subrogated to the rights of the insured party and may continue the arbitration(s).

Care must be taken at the outset to ensure the policy wording is properly tailored to the particular project and the insured party can (and then does) comply with the terms of the policy. Otherwise the insurer may avoid paying because: the claim does not fall within the definition of an insured event; an exclusion applies; a warranty has been breached; and/or a condition precedent to payment/liability has not been met.

Notification is often a key condition precedent. In all cases, even though problems seem inevitable with complex projects, it will be prudent to notify all potential insured events as they arise, so as to avoid any future disputes should a claim be made.

With due consideration of PRI at an early stage, political risks are manageable and should not be a bar to an otherwise rewarding investment opportunity.

Philip Hill is a partner in the London Insurance and Reinsurance Group of Clifford Chance. He can be reached via philip.hill@cliffordchance.com.
Caroline Doherty de Novoa is a Senior Associate in the litigation, arbitration and regulatory practice of the firm's London office. She can be reached via caroline.dohertydenovoa@cliffordchance.com.
Louise Hopson is an associate in the litigation, arbitration and regulatory practice, she can be reached via louise.hopson@cliffordchance.com.