

political risk insurance newsletter

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How States Can Cope with the Growing Threat of Arbitration

by **Mariano Gomezperalta C.**

During the summer of 2009, Mexican newspapers reported that a large international hemodialysis company operating in Mexico had allegedly been adversely affected by a bidding process managed by the Mexican Government's social security agency. Specifically, it was suggested that the agency, in designing the bidding process so that a larger number of providers would be able to participate in the tender process, failed to follow health and other applicable regulations. The affected company stated that the bidding process had important deficiencies both in its design and in its implementation. The social security agency responded that the procurement process had been carried out properly under Mexican law.

Later reports indicated that the company had challenged the legality of the bidding process in local courts. Interestingly, there was some indication that the company might pursue international investment arbitration against Mexico if it could not obtain relief in local courts.

The scope of arbitration claims keeps widening

The possibility of having an investor file an arbitration claim relating to government procurement measures casts doubt on the traditional view that investor-state arbitration will be used solely to challenge "investment measures" while all other "trade" disputes (e.g., government procurement, market access, intellectual property, services, etc.) will

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Intellectual Property Rights & Insurance Protection in Emerging Markets: An OPIC View

by **Rod Morris**

Rod Morris, Vice President for Insurance at the Overseas Private Investment Corporation (OPIC), has held senior executive positions in the private insurance industry, with responsibility for international property and casualty lines, risk management, captive insurance, and other industry matters. We invited him to discuss the need and prospects for political risk insurance products to protect intellectual property in markets abroad.

In a speech at the Export-Import Bank's annual conference on March 11 of this year, President Obama said, "Our single greatest asset is the innovation and the ingenuity and creativity of the American people... There's nothing wrong with other people using our technologies. We welcome it. We just want to make sure that it's licensed and that American businesses are getting paid appropriately."

The President was referring to a huge and growing problem for American holders of Intellectual Property Rights (IPR) such as patents, copyrights, Trade Marks, etc. The importance of IPR to American interests and the US economy is staggering. Consider some of the following facts:

- American exports equaled \$1.57 trillion in goods and services in 2009.

- More than 50% of US exports depend on some form of Intellectual Property (IP) such as software or complex technology.
- Small and Medium Sized Enterprises (SMEs) are 97% of US exporters and account for 29% of US export value.
- IP equals 20% of the US GDP and 40% of its economic growth.
- According to the US Commerce Department, the value of the theft of US IP is estimated to exceed \$250 billion annually and has cost the US economy 750,000 jobs.
- The International Chamber of Commerce puts the annual loss from theft at \$600 billion.

Clearly, IPR is an essential element to our prosperity and competitive advantage in the world market. Any such advantage, however, is squandered if others can steal an idea, duplicate it with cheaper labor and material, and displace the legitimate holder of

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Underwriting Non-Honoring Risk

by Edward Coppola

Edward Coppola is Senior Vice President, Zurich Surety, Credit & Political Risk. He has over 26 years of experience in the political risk, trade credit and surety business and has held underwriting and managerial positions at U.S. Ex-Im Bank, OPIC, MIGA, and Zurich Financial Services. We invited him to discuss the challenges of underwriting non-honoring coverage.

The credit and financial crisis of 2008 - 2009 exposed some deep fault lines in global financial markets. Unexpectedly for many, those cracks first opened up in highly developed markets rather than emerging markets, which conventional thinking would say are more vulnerable to periods of deep financial and credit market instability. Of course, emerging markets were not immune to the impact of the crisis, but many of them were better positioned to steer through it than they were in earlier years. For those of us who have been around long enough to remember the debt crises of the 1980's, the Great Recession "feels" different. Instead of talking about defaults by Brazil and Mexico, we ponder the creditworthiness of countries like Iceland and Greece. And the exploding United States deficit has for the first time raised questions in some minds about the long-term sustainability of the US as the leading global economic power. Although the focus of concern about sovereign creditworthiness has shifted to countries once thought to be less risky, we are reminded that the specter of sovereign defaults is still a risk to financial institutions.

Non-honoring: A different product for changing times

For many years, export credit agencies have been providing protection against the risk of non-payment to their domestic creditors of foreign countries. It is only more recently that the private political risk insurance market began offering non-honoring (NH) coverage to address this risk. This has been the result of a growing demand for comprehensive insurance from the banking sector in the wake of the earlier debt crises in emerging markets, as well as greater reluctance by banks to grant themselves the maximum reserving benefits that had previously been afforded by traditional political risk policies that covered defaults caused by certain specified political risk perils. In addition, the implementation of Basel II (the latest set of recommendations issued by the Basel Committee on Banking Supervision providing a regulatory and governance framework for determining how much capital banks should put aside to deal with financial and operational risks) has the potential to significantly increase the benefits to banks of achieving capital relief by purchasing broader NH coverage, to the extent the bank's management and regulators permit this. Consequently, NH coverage has become an important and growing part of most medium- to long-term political risk insurers' product offerings, and an increasing larger part of their portfolios.

In short, NH political risk insurance policies cover the failure of a sovereign or quasi-sovereign entity to honor its payment obliga-

tions. There are three general situations where an insured may seek coverage specifically against this risk. The first is when an exporter/contractor is selling to, or has signed a contract with, a sovereign or quasi-sovereign buyer to purchase certain goods or services. For this situation, the political risk insurance market can offer a Contract Frustration policy that covers the risks that the sale/contract is frustrated due to specific political risk perils (e.g. political violence) thereby causing the exporter to lose its sunk costs and profit, and the pure payment risk of the sovereign buyer to the extent the supplier has completed its obligations under the contract and the sovereign buyer has acquired a payment obligation to the supplier. Second is when the sovereign (or sub-sovereign) entity has payment obligations under a contract with a domestic entity in which the insured has an ownership interest, and the insured is seeking coverage to protect that investment. In this case the political risk insurance market is most likely to address this non-payment risk not in the form of coverage that would compensate the insured for the amounts that the sovereign defaults, but rather as Arbitration Award Default (AAD) coverage. Under AAD coverage, compensation would cover the failure of the sovereign to pay an arbitration award. Third, and most common, is when a bank is lending directly to a sovereign obligor, or to a quasi-sovereign entity with a Ministry of Finance guaranty. This third type of NH coverage is the focus of this article.

Evaluating sub-sovereign payment risk

For a PRI underwriter, one of the key considerations is whether or not the ultimate obligor whose payment obligations are being insured is the sovereign government (e.g. Ministry of Finance) or a quasi- or sub-sovereign entity such as a state-owned corporation or a state or municipality. This is important because pure sovereign obligations can safely be presumed to carry the full faith and credit of the government. Thus the underwriter's analysis can focus on the ability and willingness of the sovereign to pay, and there is likely

NH coverage has become an important and growing part of most medium- to long-term political risk insurers' product offerings.

to be more public information available from organizations such as rating agencies to help make this evaluation. In contrast, a quasi- or sub-sovereign obligor may not formally carry the full faith and credit of the sovereign government, which means the creditworthiness of the obligor must be looked at on a stand-alone basis as well as in the context of likely sovereign support or intervention in the event of a default. To some extent, evaluating the ability (as opposed to the willingness) of a sub-sovereign to pay is easier than

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Underwriting Non-Honoring Risk (cont'd.)

evaluating the creditworthiness of a pure sovereign because the sub-sovereign that is a corporate entity has its own set of financial statements which can be analyzed objectively.

[The creditworthiness of a quasi- or sub-sovereign obligor] must be looked at on a stand-alone basis as well as in the context of likely sovereign support or intervention in the event of a default.

More difficult to evaluate is the potential impact on the sub-sovereign of changes in the sovereign owner's regulation of or policies towards the sub-sovereign. Many sub-sovereigns do not operate on purely commercial terms and benefit from subsidies and other economic distortions that make it more difficult to assess the true creditworthiness of the obligor. However, those distortions are also an indicator of the willingness of the government to support the sub-sovereign and in the case of financial distress to provide direct financial assistance to ensure the sub-sovereign's ongoing viability. But this is a more subjective determination. One indicator of this is whether the sub-sovereign carries the same rating as the sovereign. In the absence of such a rating or other public information about the explicit or implicit support provided by the government to the sub-sovereign, the underwriter must rely on its own analysis.

Evaluating the ability and willingness of sub-sovereign entities such as cities or municipalities to honor their payment obligations is more difficult than doing so for state-owned entities. The finances of a governmental body are more complicated than those of a corpora-

tion, and they are impacted by a broader set of fiscal and economic policies that are subject to changes in the political fortunes of the officials empowered to run the governmental body. That is not to say that evaluating the creditworthiness of such obligors is impossible. Indeed, many such obligors have a long record of fiscal responsibility throughout the economic cycles, and many are rated by the rating agencies. Thus there is enough reliable information in the public record to make, in conjunction with the underwriter's own analysis, a sound judgment. Risk sharing is an important concept in providing NH coverage, and most PRI insurers will require the insurer to retain a certain pro-rata portion of the risk. Typically PRI underwriters will offer a lower indemnity for quasi- and sub-sovereign obligors (e.g. 90%) than for a pure sovereign payment risk (e.g. 95%) for the reasons stated above.

[M]ost PRI insurers will require the insurer to retain a certain pro-rata portion of the risk.

Other key underwriting considerations

A PRI underwriter can also make judgments about the nature of a country's relationship with the international financial community, both private creditors and bilateral and multilateral organizations upon which the country may be dependent for debt sustainability. A country's refusal to engage these sources of financial assistance, or its record of resisting or refusing their support, can affect the under-

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the IPR. If the US is to continue its leadership in IPR and meet President Obama's goal of substantially increasing both exports and investments, investors and exporters will need more protection and assurances than presently available. To make US investors comfortable they will expect to see evidence of the Rule of Law, enforcement of the laws, and the ability to recoup any financial losses sustained when laws and enforcement don't work. Accordingly, the President went on to say, *"That's why the US Trade Representative is using the full arsenal of tools available to crack down on practices that blatantly harm our businesses, and that includes negotiating proper protections and enforcing our existing agreements, and moving forward on new agreements, including the proposed Anti-Counterfeiting Trade Agreement (ACTA)."*

Without question, enforcement is critical to the protection of Intellectual Property rights and yet enforcement is never a completely adequate mechanism because it usually follows rather than precedes a

loss. Since it rarely prevents a violation or a crime, enforcement should be augmented with mechanisms for making investors whole when a financial loss is actually sustained. This would seem to present a prime opportunity for an insurance program and, in fact, such insurance protection has been available from a few Property & Casualty insurers for a long time. For much of that time, however, the product has not been very profitable—mostly because of very high legal costs and some very large losses. Over the past 15-20 years, this has translated in the US market to fewer companies offering less coverage for more money. In many emerging markets, there isn't sufficient legal protection or enforcement of IPR for insurance companies to feel comfortable offering any coverage at all. That's unfortunate in many ways, not the least of which is that it then inhibits the use of advanced technologies and ideas in the very countries that could benefit the most. This point is not lost on US foreign policy makers and developmental agencies that are actively

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working to develop not only stronger and more broadly accepted international protocols for improvements in the legal and enforcement environments but also for some kinds of risk mitigation or insurance protection. This would include my own agency—the Overseas Private Investment Corporation (OPIC)—that sees a significant opportunity to help investors move forward with the decision to permit their ideas and technologies to be used in emerging markets in the knowledge that the US government will be with them in a meaningful way.

OPIC's mission is to facilitate and mobilize US investment in emerging markets through risk mitigation instruments like Political Risk

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Insurance (PRI). PRI, however, is normally associated with “wrongful” actions by a sovereign government—actions that deny an investor the benefits of those investments; actions that have changed the rules applying to their investment so substantially that the investor cannot continue to operate in that environment. Such actions are usually overt and deliberate. They are, therefore, directly attributable to the foreign government. If, for instance, an investor has a contract or guarantee from the host government, he

could be indemnified by OPIC PRI coverage in the event that the government wrongfully defaulted on or abrogated such contract or guarantee. The same would be true if the government's actions were a clear violation of their own internal licensing or IP laws. Such actions would be wrongful and directly attributable to the host government—again, the subject of PRI.

The more likely circumstance, however, is that the investor/exporter does not have a government contract or guarantee and that losses cannot be clearly attributed to a wrongful action by the government or its authorities. In that case, PRI in its current form would not be the proper vehicle to mitigate the risk. It is possible—at least in some countries—that private market insurance might be available. Unfortunately, however, investors in many emerging markets would find the private market to be unavailable, unaffordable or inadequate. Emerging markets falling into this category would see less foreign direct investment and interest in investment. Professor Mike Ryan, Director of the Creative and Innovative Economy Center at The George Washington University Law School, has studied the correlation between IPR protections and FDI. So has the World Bank. Both conclude that there is a direct and substantial benefit to countries that enact protections and enforce IPR. It should also follow that risk mitigation tools like PRI would further stimulate and enhance FDI opportunities for those countries that recognize investor concerns. Countries that have signed onto the *Agreement on Trade Related Aspects of Intellectual Property Rights* (TRIPS) have at least made a start and yet many of these countries remain very

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How States Can Cope with the Growing Threat of Arbitration (cont'd.)

have to be resolved through state-to-state dispute resolution mechanisms, such as those under NAFTA Chapter XX or the World Trade Organization (“WTO”).

The question of which mechanism applies is of great relevance to respondent states since the stakes in investor-state cases are much higher than in state-to-state procedures. In investment cases, respondent states face claims that can be initiated by private claimants for substantial sums of money. In the WTO, the remedy granted by a panel is a recommendation that the WTO-inconsistent measure be either removed or brought into conformity with the respondent state's WTO obligations. As is the case with the WTO, remedies granted under state-to-state dispute resolution mechanisms are prospective remedies with no risk of exposure to pay monetary damages to a successful claimant. In addition, state-to-state mechanisms involve disputes between governments who are repeat users of the dispute settlement system and who frequently have broader agendas with a variety of political and diplomatic ele-

ments influencing their litigation decisions.

Given these differences, states are of the view that the right of access to international arbitration does not extend to all obligations contained in a free trade agreement (“FTA”), but rather is limited to the specific obligations contained in the FTA's investment chapter or the relevant bilateral investment treaty (“BIT”). States tend to maintain that matters falling outside these obligations cannot be resolved through investment arbitration.

In recent years, investors have presented (or threatened to present) as investment claims matters relating to a government's procurement practices. For instance, in August of 2000, *ADF Group Inc.* brought an investor-state claim against the United States under NAFTA Chapter XI (i.e., the NAFTA Chapter dealing with investment arbitration disputes) to challenge the Federal Surface Transportation Assistance Act of 1982 and the Department of Transportation's implementing regulations which required that federally-funded

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How States Can Cope with the Growing Threat of Arbitration (cont'd.)

state highway projects use only domestically produced steel. More recently, the Buy American clause of the U.S. Stimulus Bill of 2009 (which restricted the use of federal funds to the purchase of U.S. origin materials in public projects) was considered by some as inconsistent with the international investment obligations of the United States.

The jurisdictional question of whether foreign investors can use investment arbitration to challenge measures that typically would only be challenged in state-to-state dispute resolution mechanisms has also arisen in the context of foreign trade measures.

For example, in 1998, *S.D. Myers*, an Ohio corporation that processes and disposes of PCB waste, filed a NAFTA Chapter XI arbitration against Canada arising out of Canada's ban on exports of PCB wastes to the United States. *S.D. Myers* claimed that its investment suffered economic harm as a result of Canada's ban on exports (which in and of itself was purely a trade measure). Mexico faced a similar situation in the Chapter XI case brought by *Archer Daniels Midland Co. and Tate & Lyle Ingredients Americas Inc.* These companies submitted that they were entitled to compensation not only for the damages they had suffered in their capacity as investors but also for damages suffered in their capacity as exporters into Mexico when Mexico adopted restrictions on the importation of fructose during its sugar crisis of 2002.

Under this expansive view of investment arbitration, claimants are increasingly attempting to use investment arbitration for a wider variety of measures, and cases are getting more and more complicated.

Arbitration cases are becoming more expensive

These developments have also had an impact on the costs of arbitration (i.e., legal counsel's fees) and the amounts in dispute. A report by the Commission on Arbitration of the International Chamber of Commerce showed that legal fees incurred in connection with arbitration proceedings accounted on average for approximately

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82% of the costs of arbitration. The growing complexity of arbitration cases will no doubt contribute to the continuing increase of legal fees. While a few years ago a "typical" arbitration case could cost between US \$1.5 and US \$3 million in legal fees, it is not uncommon nowadays to see legal fees above US \$5 million. The same goes for the amounts at issue. It is not surprising to hear today of arbitration claims for well-beyond US \$200 million.

The complexity of arbitration cases also appears to affect the likelihood of states prevailing over claimants. A number of commentators have stated that five or ten years ago states tended to prevail over claimants roughly 70% of the time but that percentage is rapidly decreasing to the detriment of respondent states.

Closely related to this is the fact that most international claims are brought by claimants represented by large U.S. and European law firms with great depth of experience. Most of these firms have had successful international commercial arbitration practices for decades. Their substantive knowledge of international investment treaty law may not be much different or better than that of respondent states, but their skills and experience on the practical side of the arbitral process may be much greater. Moreover, claimants' law firms, with the prospect of high hourly fees and sometimes contingency fees that enable them to share in an award, have a powerful incentive to recommend a vigorous arbitration effort rather than a negotiated settlement.

Challenges faced by Latin American states

The foregoing circumstances are particularly important for Latin American countries as an ancillary effect of the large number of BITs and FTAs that they have signed over the past 20 years has been a surge of arbitration claims. Mexico has faced 15 arbitration cases since NAFTA came into effect and Chile, Ecuador, Bolivia, Peru, Venezuela and others have also faced substantial claims over the past few years. There is little question that international agreements such as NAFTA (in the case of Mexico), DR-CAFTA (in the case of the Dominican Republic, El Salvador, Guatemala, Honduras and Costa Rica) or the free trade agreements that the United States has negotiated with Chile and Peru (and is still seeking with Panama and Colombia) will continue to increase the exposure of Latin American nations to arbitration claims.

In addition, Latin American countries face further challenges. International arbitration rules typically fuse together features of the civil and the common law systems. They reflect the former's emphasis on documents and written submissions and the latter's preference for "pre-trial" disclosure of documents by disputing parties and oral hearings at which witnesses can be confronted through the process of cross-examination.

Because civil law typically does not rely on oral testimony, most civil law attorneys, often unfamiliar with common law practice, are not trained in the art of witness examination and oral submissions and are, therefore, at a disadvantage when dealing with lawyers who have these skills. Civil law states and the lawyers who are charged with defending their interests must develop expertise in arbitration case management, a process derived from the common law system.

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How States Can Cope with the Growing Threat of Arbitration (cont'd.)

Latin American countries have unfortunately seen that it is in the practical aspects of an arbitration where cases are often won or lost. For example, issues such as the selection of arbitrators and experts, the drafting of pleadings and correspondence to the tribunal, the preparation of oral hearings or the development of case “themes” can have a major impact on the outcome of a case.

Latin American countries have unfortunately seen that it is in the practical aspects of an arbitration where cases are often won or lost.

Most of these items relate to the practice of arbitration law as opposed to substantive knowledge of investment treaty law. This is not to diminish the importance of the latter, but rather to emphasize the fact that where Latin American states have been “out-lawyered” is usually in the imbalance of expertise and experience in conducting actual cases.

For this reason, Latin American countries have a vital interest in enhancing their ability to defend investment claims by (i) establishing and maintaining a well integrated and highly competent defense team at a reasonable cost; (ii) developing internal governmental expertise in procedural and substantive aspects of international arbitration and (iii) creating a regional platform that facilitates the continuous exchange of information.

An advisory mechanism for investment disputes

Latin American countries have explored ways of accomplishing this goal. Perhaps their most important effort in this regard has been the attempt over the last couple of years to create a center that would assist in the defense of claims brought against Latin American states and modeled somewhat on the Advisory Center on WTO Law in Geneva. However, the enormous difficulty of setting up such a center (given that its constitutive text has been conceived as an international treaty requiring legislative and administrative action of member countries), together with the complexity of the center's operation and financing, make it necessary for Latin American states to examine other alternatives that could yield far better results in terms of legal representation and internal capacity building.

An alternative approach would be for the countries, possibly through a multilateral development institution, to outsource the following core functions:

- creation and maintenance of a roster of qualified external legal counsel experienced in the conduct of investor-state arbitration and who are committed to the following principles:
 - to work collaboratively with government lawyers with a view to contributing to their training and experience in the conduct of investor-state arbitration; and
 - to enter into fee arrangements with states at competitive rates.
- provision of a forum for government lawyers to share information and discuss matters of mutual concern pertaining to, among other things, the content of investment treaties, the institutions administering investment disputes, the selection of arbitrators and experts, the importance of the procedural calendar, domestic law issues and others;
- facilitation of the preparation and filing of agreed notes of interpretation or submissions with respect to the interpretation of treaty provisions (e.g. 1128's under NAFTA, 10.20's under CAFTA, etc.) that improve the defense of respondent states;
- organization of specialized training sessions and seminars for government lawyers in both substantive law applicable to investment treaty claims and practical skills needed for the proper conduct of investor-state arbitration; and
- initial review and recommendations for approaching potential arbitration claims.

By properly structuring long-term relationships between Latin American states and qualified law firms and with the creation of a platform for the exchange of information, Latin American states would not only enhance their ability to defend arbitration claims but would also benefit from a system that would increase transparency with respect to legal fees and promote the development of internal governmental capacity to reduce dependency on external counsel over time. ■

We are pleased to announce that Mariano Gomezperalta has returned to robert wray PLLC after serving as General Counsel of Mexico's Ministry of the Economy (“Economia”) for over two years. In his article “Sovereigns Assess the Risks of Investment Arbitration” in the December 2009 edition of the Newsletter, Mariano wrote about the evolving view of sovereigns on the international arbitration of investment disputes. His experience at Economia litigating matters relating to international trade and investment agreements gave us a unique insight into the ways in which states approach investment disputes and arbitration. We have asked Mariano to once again share his expertise on “How States Can Cope with the Growing Threat of Arbitration” in this issue of the Newsletter. We hope you enjoy the article. ■



Underwriting Non-Honoring Risk (cont'd.)

writer's risk appetite for NH coverage in that country. Also of importance is the underwriter's assessment of the insured's experience in lending to sovereign or sub-sovereign borrowers, and the insured's ability to deal with its sovereign borrowers in an intelligent, transparent and if necessary forceful but prudent way to minimize any potential loss and to maximize recoveries.

Another important factor a PRI underwriter will consider is the use or purpose of the financing that is to be insured. Underwriters prefer that the funds are being used for a dedicated purpose that serves an important domestic need or that will otherwise promote the country's growth and thereby enhance its ability to repay the debt.

All of the above factors become increasingly important as the tenor of the insured debt increases. Uncertainty grows as the risk horizon gets longer, and the general long-term trajectory of a sovereign's economic development becomes more significant in the underwriter's analysis. The period of NH coverage available in the PRI market can vary depending on the underwriter's general risk appetite, capacity, and existing exposure.

The importance of recoveries

Another important consideration for PRI underwriters is the potential for recoveries. The ability to achieve substantial recoveries on claims paid is a critical element in the long-term profitability of PRI in general, and specifically in the underwriter's decision to offer NH coverage. The good news regarding sovereign defaults is that they are usually followed by reschedulings which provide the opportunity for the underwriter to recover any claims paid, albeit under terms less favorable than those applied to the original instrument. What cannot be known is whether or to what extent any rescheduling will

Underwriters prefer that the funds are being used for a dedicated purpose that serves an important domestic need or that will otherwise promote the country's growth and thereby enhance its ability to repay the debt.

involve a haircut on principal and/or interest and thereby diminish the underwriter's net recovery. Forced haircuts or debt forgiveness implies that the insurer's maximum potential recoveries may be less than what was owed to the insured creditor and what is paid by the insurer. This risk must be taken into account when determining whether or not the underwriter will offer coverage and under what terms and conditions. One clue in helping an underwriter evaluate this risk is whether the obligor is a Highly Indebted Poor Country (HIPC) under the IMF and World Bank program. These countries are more likely to benefit from debt relief in the form of debt-

forgiveness. Another factor to consider is the potential for a sovereign buyer to restructure its debt under the auspices of the Paris Club, an informal group of official creditors whose role is to address sovereign payment difficulties by debtor countries. Paris Club reschedulings can result in debt forgiveness and/or very long and concessional repayment terms. This is more of a concern for private PRI underwriters when they are directly reinsuring member creditors of the Paris Club since any Paris Club rescheduling that involves debt forgiveness would directly impact the PRI underwriter's interest in the insured debt.

The ability to achieve substantial recoveries on claims paid is a critical element in ... the underwriter's decision to offer NH coverage.

The sovereign default by the Dominican Republic in 2005 is a good case study of a well-managed debt crisis and the effectiveness of NH coverage. One PRI underwriter had insured several banks that had made loans to the government to finance specific projects and purchases. The government defaulted on these credits in the face of a short-term liquidity crisis that required interim relief in the form of a debt rescheduling. The government worked with the IMF and World Bank in a cooperative way and successfully restructured a portion of its debt to provide some breathing room while the government sought to address the specific issues that had prompted the default. In the meantime the PRI underwriter paid out approximately \$15m in claims to its customers, and by the second half of 2010 will have recovered 100% of the claims it paid.

Conclusion

Sovereign payment risk has existed for a long time but it has taken on a new dimension in the wake of the 2008-2009 global financial and credit crisis. Emerging markets have made significant progress in economic development and debt sustainability while more developed countries have shown they are not immune to debt problems. These developments and the pressures of Basel II have helped to fuel the demand by banks for NH coverage from PRI underwriters. These banks use NH insurance as a tool to manage their cross-border exposures, expand their ability to lend to their best emerging market sovereign customers, and make the most efficient use of their capital. Concern about the actual risk of default is often not the principal motivation for buying NH coverage. That banks can successfully lend to emerging market sovereigns supports the notion that PRI underwriters can underwrite this risk profitably as well. A number of factors affect an underwriter's willingness and ability to provide NH coverage, the most important of which is the likelihood that in the event of a default there will be significant recoveries. ■

Intellectual Property Rights & Insurance Protection in Emerging Markets: An OPIC View (cont'd.)

difficult environments for effective IPR protections.

TRIPS is an international agreement administered by the World Trade Organization (WTO) that sets down minimum standards for IP regulations as applied to nationals of other WTO Members. Member countries are required to enact protective laws and enforcement procedures. IP laws may not offer any benefits to local citizens which are not available to citizens of other TRIPs signatories. The Agreement also provides for remedies, dispute resolution and disciplinary procedures. When such protocols, laws, regulations, and obligations have been voluntarily adopted by member countries, are not investors entitled to some reliance on them as a condition precedent and inducement to their investment? What, then, if it is discovered that these protocols are useless and not enforced? Investors can be victimized and suffer financial loss not just from overt and deliberate actions by a government but also by those failures of governments to act or protect. Either way, an investor has, in a sense, been duped. Isn't it at least arguable that a lack of enforcement, the absence of protections or any reasonable attempt to protect investors is, in fact, a political risk and, therefore, an appropriate subject for PRI? Providing such protection is fraught with some difficulties for OPIC and the US government, but the mat-

ter is worth considering. It is also worth considering the applicability of some form of investment guarantee—a product not tied to the structure and limitations of PRI.

Investors can be victimized and suffer financial loss not just from overt and deliberate acts by a government but also by those failures of governments to act or protect.

In conclusion, I believe that the protection of IPR is a critical component to the mobilization and facilitation of US investment in emerging markets. It is, therefore, incumbent upon OPIC to come to grips with the problem—what the investor needs in order to be incentivized to invest. The President has recently expressed a strong desire to increase exports, fight cybercrime, and fight for the protection of US IPR. Those are lofty goals that will require international cooperation and agreement at the highest level. But, in the meantime, the need is clear and immediate, and OPIC is dedicated to leading the market into a solution. ■

about this newsletter

Our intention is to provide a forum for the exchange of information and opinions relating to topics that will be of interest to political risk insurers, buyers, brokers, attorneys and others. We invite contributions and suggestions from professionals in the field.

We also encourage readers to submit information about notable transactions, personnel changes and other important developments in the political risk insurance sector.

The Newsletter is a periodic publication of *robert wray* PLLC and should not be construed as legal advice or relied upon as a substitute for legal advice.

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about robert wray PLLC

robert wray PLLC is a specialized law firm focused on analyzing complex issues and providing innovative solutions in the areas of political risk insurance, project finance, transportation infrastructure, privatization, aircraft finance, microfinance and international arbitration. The firm's political risk insurance practice offers comprehensive advice related to the mitigation of risks and selection and acquisition of political risk insurance associated with international investments. Felton (Mac) Johnston is the firm's expert adviser on the mitigation and insurance of political risks.

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