

**APPENDIXES**

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## THE MULTILATERAL INVESTMENT GUARANTEE AGENCY

1. The Multilateral Investment Guarantee Agency (MIGA) was established in 1988, as part of the World Bank Group.<sup>1</sup> At that time, several national agencies and private insurers were already providing political risk coverage to international investors. However, the varying eligibility criteria of national agencies excluded certain investors, countries, or projects from consideration. Private insurers were constrained in the terms and extent of coverage that they offered.

### A. Rationale for Establishing MIGA

2. The MIGA Convention designed a guarantee program to complement rather than compete with national and regional investment insurance programs and private insurers of political risk. MIGA was to fill the niches, or gaps, in the market caused by the differing eligibility requirements of the other programs. In particular, MIGA could insure investments in countries that were ineligible for coverage by other programs, or in projects for which ownership, residence, or sources of procurement made the investor ineligible.

3. There was also a broader rationale for the creation of MIGA. Its shareholders comprised both industrial and developing countries, and MIGA would be uniquely placed to serve as an honest broker, guiding all concerned parties toward a common definition of fairness and equitable treatment. This neutrality would help avert disputes from arising altogether, or provide a channel for impartial mediation and amicable settlement when they did arise.

4. This position of honest broker was enhanced by the MIGA Convention requirement that MIGA must obtain the consent of a host government prior to issuing an investment guarantee. Thus, beyond providing financial compensation to investors for actual losses, MIGA's involvement in a proposed project was meant to mitigate the likelihood that such losses would occur.

5. Finally, supported by its own membership of developed and developing countries, and by virtue of its own status as a member of the World Bank Group, MIGA was designed to be particularly effective in recovering the greatest amount possible in a loss situation. Altogether, MIGA was meant to have a deterrent effect, which would be particularly valuable to investors in projects acutely vulnerable to changes in host government policies and commitments.

### B. Structure of Coverage

6. From the beginning, MIGA's guarantee program has provided extended protection (up to 20 years) against losses arising from transfer restrictions, expropriation, war and civil disturbance, and breach of contract.

7. Eligible projects include new investments, and the expansion, modernization, privatization, or financial restructuring of existing investments in a developing member country (DMC). Eligible forms of investments include equity, shareholder loans, loan guarantees issued by equity investors, and loans to unrelated borrowers (under certain circumstances). Technical assistance, management, and franchising and licensing agreements also are eligible, providing they have terms of at least three years and the investor's remuneration is tied to the project's operating results.

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<sup>1</sup> World Bank. 1999 *MIGA – The First Ten Years*, Washington, D.C.

8. Eligible investors should be nationals of a member country other than the country in which the investment is to be made. A corporation is eligible if it is either incorporated in and has its principal place of business in a member country, or if it is majority owned by nationals of member countries. State-owned corporations are eligible if they operate on a commercial basis.

### **C. MIGA's Development**

9. The early years laid the foundations for MIGA's takeoff in the midst of a major surge in global foreign direct investment (FDI) flows. In its first five years, country membership reached 107. Twenty-one guarantee contracts were written in 8 host countries in 1992, with \$313 million of coverage supporting \$600 million in investment. In the following year, 27 guarantee contracts were written in 14 host countries, with \$374 million of coverage supporting \$1.8 billion in investment.

10. During the following two years, MIGA grew to rank among the five largest investment risk insurers in the world, with over \$1.6 billion in outstanding contingent liabilities. In fiscal year 1996,<sup>2</sup> the total number of member countries climbed to 134. Sixty-eight guarantee contracts covering \$862 million of new contingent liabilities were issued, bringing the cumulative number of guarantee contracts issued to 223 and outstanding contingent liabilities to about \$2.2 billion. The amount of FDI facilitated totaled about \$14 billion.

11. In fiscal year 1999, the number of member countries reached 149. MIGA issued 72 new guarantee contracts for \$1,310 million in coverage and had about \$3.7 billion in outstanding contingent liabilities. Between fiscal years 1990 and 1999, MIGA issued 420 guarantee contracts for \$5.5 billion in total coverage, facilitating an estimated \$30 billion in FDI.

12. To assess MIGA's role in stimulating FDI activity around the world, MIGA conducted a confidential and anonymous survey of all current guarantee holders in 1994 and 1996. Seventy-three percent of all MIGA clients responded. A majority of the respondents in both surveys considered MIGA coverage to have been "absolutely critical" in their decision to proceed with their planned investment. Almost all reported a desire to use MIGA insurance again.

13. Some of the indicators of the direct development impact of MIGA-guaranteed projects include the flow of capital, amount of output produced, number of jobs created, and the exports and taxes generated. Between years 1990 and 1998, MIGA-supported projects directly created an estimated 46,800 new jobs.

14. A source of persistent concern has been that FDI tends to flow only to a relatively small number of developing countries. In 1997, for example, 10 developing countries accounted for some 72 percent of all FDI flows (Table A1). The People's Republic of China alone received about \$37 billion or 30 percent of the total.

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<sup>2</sup> MIGA's fiscal year ends on 30 June.

**Table A1: FDI Flows to the Top Ten Recipient Developing Countries**  
(\$ billions)

Country	1991	Country	1994	Country	1997
Mexico	4.7	PRC	33.8	PRC	37.0
PRC	4.3	Mexico	11.0	Brazil	15.8
Malaysia	4.0	Malaysia	4.3	Mexico	8.1
Argentina	2.4	Peru	3.1	Indonesia	5.8
Thailand	2.0	Brazil	3.1	Poland	4.5
Venezuela	1.9	Argentina	3.1	Malaysia	4.1
Indonesia	1.5	Indonesia	2.1	Argentina	3.8
Hungary	1.5	Nigeria	1.9	Chile	3.5
Brazil	1.1	Poland	1.9	India	3.1
Turkey	0.8	Chile	1.9	Venezuela	2.9
Top 10 share in FDI to all developing countries (%)	74.2		76.1		72.3

PRC=People's Republic of China, FDI=foreign direct investment.  
Source: World Bank.

15. However, since its inception, MIGA has deliberately allocated its scarce guarantee resources in a manner that was contrary to the conventional follow-the-herd phenomenon among international investors. In fiscal year 1998, MIGA guarantees outstanding in the 10 largest recipients still amounted to only 27 percent of all guarantees.

16. Overall, MIGA's portfolio is well diversified by country. By the end of fiscal year 1998, MIGA had guarantees outstanding for projects in 52 DMCs. In all, MIGA has facilitated FDI into 62 DMCs. Of particular note, 28 percent of MIGA's portfolio consists of projects in the poorest countries, countries that are eligible for concessional lending by the International Development Association. Since it began operating, MIGA has issued about \$1 billion in coverage for investments in 26 of these countries, and has paid only one claim in 2000 in relation to an expropriation event relating to a power project in Indonesia.<sup>3</sup>

<sup>3</sup> The expropriation claim was received in March 1999 and MIGA paid the claim in the summer of 2000. MIGA's gross liability under the contract is \$15 million, of which \$10.5 million is reinsured.

## PRICING OF POLITICAL RISK INSURANCE

1. This appendix provides a brief overview of indicative premium rates and fees currently seen in the market for political risk insurance (PRI) cover from public and private sector institutions. While the actual fees charged depend on a number of factors, including (i) the risks covered, (ii) complexity of the transaction, and (iii) market conditions at the time the cover is offered, these rates would be used by the Guarantee Committee as reference points when setting partial risk guarantee fees in the current environment.

### A. Multilateral Investment Guarantee Agency (MIGA)

2. MIGA charges an application fee for definitive applications for guarantee. The fee is \$5,000 for guarantees up to \$25 million, and \$10,000 for guarantees over \$25 million in the manufacturing and services sectors, and \$10,000 for guarantees in the infrastructure, oil and gas, and natural resources sectors. There is no charge for filing a preliminary application.

3. The application fee is reimbursed under the following two conditions: (i) if an application is made, and a guarantee is offered and accepted, the fee will be credited against the first year premium; and (ii) if MIGA declines to offer coverage, the fee will be refunded.

4. MIGA also imposes a processing fee for the extra costs it incurs when considering projects that are environmentally sensitive (e.g., infrastructure projects) or that have a complex financial structure. The initial processing fee is \$25,000. The unused portion of this fee is reimbursed if actual expenses are less than this amount.

5. A commitment fee is charged if the applicant is not prepared to purchase the coverage when offered. The commitment letter issued by MIGA allows the applicant to reserve capacity. Commitments are valid for three months. Commitment fees range from 0.25 to 0.50 percent of the coverage offered.

6. Guarantee (or premium) fees charged by MIGA are now market-related and reflect a variety of factors including risks taken, complexity of the transaction, and pricing of other similar transactions. In the past, however, MIGA published so-called base rates to establish a benchmark for the pricing of its guarantee fees. These base rates are shown in Table A3.1. While these base rates were merely indicative and could be adjusted for each specific transaction to preserve maximum flexibility in the pricing of its guarantees, MIGA recently stopped publishing these base rates.

7. MIGA also charges a standby fee for the undisbursed amount of the approved guarantee. These standby fees are typically half the guarantee fee.

**Table A3.1: MIGA's Base Guarantee Fees**  
(percent per annum)

Guarantee Cover	Manufacturing	Natural Resources	Infrastructure
Expropriation	0.60	0.90	1.25
FX Transfer & Inconvertibility	0.50	0.50	0.50
Political Violence	0.55	0.55	0.60
Breach of Contract	0.80	1.00	1.25

FX=foreign exchange.

Source: MIGA.

## B. Bilateral PRI Providers

8. The Organization for Economic Cooperation and Development (OECD) recently established minimum premium benchmarks for officially supported export credits, which attempts to group countries with similar sovereign risk into seven categories and assign a minimum premium benchmark to each group. While these minimum premium benchmarks technically do not apply to PRI, increasingly they are being seen as a benchmark for PRI premia by some export credit agencies.

9. Nevertheless, there is no single approach to PRI pricing among export credit agencies. Some strictly follow market-pricing principles, while others apply preapproved premia more or less independently of the risks covered under the PRI. The indicative premium base rates currently used by Overseas Private Investment Corporation (OPIC), one of the largest and oldest providers of PRI, are provided in Table A3.2 below.

**Table A3.2: OPIC's Base Fees**  
(percent per annum)

<b>Guarantee Cover</b>	<b>Guarantee Fee</b>	<b>Standby Fee</b>
Inconvertibility	0.45	0.20
Expropriation	0.40-0.90	0.20
Political Violence	0.40-0.70	0.20
Breach of Contract <sup>1</sup>	n.a.	n.a.

Source: OPIC.

## C. Private Sector PRI

10. In the private sector, PRI premium rates are a function of supply and demand, and rates for a country are dependent on the supply of insurance capacity for that country. Thus, actual premium rates can vary by a factor of two to three, depending on political events and country risk assessment. During times of political crises in a country, PRI may become totally unavailable or be available only at prohibitively high rates.

11. The actual rating process of a transaction is somewhat arbitrary. Few PRI underwriters are inclined to refer to base rates or a rating book when they underwrite a transaction. Thus, it is difficult to predict the actual premia that are to be paid, as the rating process is a highly subjective exercise. Table A3.3 indicates how private sector PRI providers typically price their guarantees. Table A3.4 summarizes fees and charges of major PRI providers.

<sup>1</sup> OPIC provides breach of contract insurance within its expropriation cover. This is achieved by way of guaranteeing the risk of non-enforcement of arbitration awards. For example, OPIC can provide termination payment cover under, say, a power generation build-own-transfer project. In this case, the beneficiary of the guarantee is assured timely payment of the termination payment should arbitration proceedings determine that the government has not complied with its payment obligations under the legal agreement.

**Table A3.3: Illustrative Private Sector PRI Premia**  
(percent per annum, as of May 2000)

<b>Guarantee Cover</b>	<b>Premium Range</b>
Expropriation	From 0.45 upwards
w/ Breach of Contract <sup>2</sup>	from 2.50 upwards
FX Inconvertibility	0.25-2.00
Political Violence	from 0.30 upwards

<sup>2</sup> Breach of contract is sometimes included in expropriation cover. When this cover includes breach of contract associated with a government or semigovernment entity acting, for example, as an input supplier (e.g., raw water or fuel) or as a distributor or user (e.g., power), the premium charged will be significantly higher than for simple expropriation cover, especially if the cover goes beyond politically motivated disputes to commercially motivated disputes.

**Table A3.4: Summary of Fee Structures and Charges of Major PRI Providers**

		Coverage	Fee Structure	PRI Fees	Maximum Cover and Term <sup>a</sup>
<b>A.</b>	<b>Multilateral Institutions<sup>b</sup></b>				
	<b>MIGA</b>	Equity and loans against losses arising from transfer restrictions, expropriation, political violence, and breach of contract	Market-based, comprising an application, processing, commitment, and guarantee fee	Currently, base premium rates set at 0.5-1.25 percent, per single cover	Up to 95% of loan principal, plus 135% of principal to cover interest. Up to \$110 million per project
		Cooperative Underwriting Program (CPU) for private PRI providers	A fee is charged under CPU		Up to 20 years
	<b>IADB</b>	Covers loans against losses arising from transfer restrictions, expropriation, political violence, and breach of contract	Market-based with an appraisal and a guarantee fee, but no front-end fee. Guarantee fees are often set at around half of the lending spread	Appraisal fee of \$50,000-\$300,000, guarantee fee of (currently) 150-250 basis points	Up to 100% of the loan principal and interest; limit set at 50% of project cost, or \$150m, whichever is less
	<b>Proposed ADB PRG without counter-guarantee</b>	Loans only against losses arising from transfer restrictions, expropriation, political violence, and breach of contract	Market-based, comprising a front-end, standby, and guarantee fee	Minimum guarantee fee set at 0.4%	Up to 100% of loan principal and interest; "stand-alone" PRGs not available; total ADB financial assistance to a guaranteed project (including the PRG) not to exceed twice the PSO limit
		Coguarantee Program (CP) for private PRI insurers	A fee is to be charged under CP		Up to 15 years

Note: Information in the table applies only to market-based PRI investment cover (i.e., not related to official trade), as of April/May 2000.

<sup>a</sup> For loans only.

<sup>b</sup> World Bank PRGs are offered only against a counterguarantee by the host government. Accordingly, World Bank's PRG charges are not set in accordance with market principles and are not comparable to those of other PRI providers. While the European Bank for Reconstruction and Development can, in principle, offer political risk guarantees, these are currently not a priority area in its operations. Therefore, no clear pricing policy exists.

**Table A3.4: Summary of Fee Structures and Charges of Major PRI Providers (contd.)**

	<b>Coverage</b>	<b>Fee Structure</b>	<b>PRI Fees</b>	<b>Maximum Cover and Term</b>
<b>B. Bilateral Institutions</b>				
<b>OPIC</b>	Equity and loans against losses arising from transfer restrictions, expropriation, and political violence. Breach of contract may be available under expropriation cover	Market-based, comprising retainer fee, a standby fee, and a guarantee fee	Currently, base premium rates range from 0.4 to 0.9%, per single cover	Up to 100% of loan principal and interest  Up to 20 years
<b>MITI</b>	Offers both debt and equity coverage against losses arising from transfer restrictions, expropriation, and political violence, as well as breach of contract	Fees are based on internally-determined pricing criteria, rather than market rates	Complete coverage against political risks for debt products can be secured for less than 1%	Up to 100% of principal and interest is covered for the agreed maximum liability
<b>ECGD</b>	Offers both debt and equity coverage against losses arising from transfer restrictions, expropriation, and political violence, as well as breach of government undertakings	Fees are based on country and project-specific considerations. Annual guarantee fees are complemented by an annual commitment fee	As an example, premium rates for the PRC are 0.7% for expropriation, political violence and transfer restrictions cover	Up to 90% of the insured amount. Term is up to 15 years

**Table A3.4: Summary of Fee Structures and Charges of Major PRI Providers (contd.)**

	<b>Coverage</b>	<b>Fee Structure</b>	<b>PRI Fees</b>	<b>Maximum Cover and Term</b>
<b>EFIC</b>	Equity and loans against losses arising from transfer restrictions, expropriation, and political violence. Breach of contract may be available under expropriation cover	Market-based pricing, including an “establishment fee” of 0.3-0.5% (de facto an up-front fee), a standby fee, and a market-based guarantee fee. Pricing is based on a classification of all countries into six risk categories	Minimum guarantee fees are 10-40 basis points for each type of coverage; they can reach 1.5% for high-risk countries	100% of loan principal and interest covered for an agreed period
<b>Others (including EDC, COFACE, NCM, SACE)</b>	Equity and loans against losses arising from transfer restrictions, expropriation, and political violence. Breach of contract not always available	No single approach to PRI pricing; some follow market pricing, others apply preapproved premia independently of cover offered	OECD’s minimum premium benchmarks for officially supported export credits increasingly used as benchmark for PRI premia	Maximum coverages set for individual countries or group of countries  Up to 20 years
<b>C. Private PRI Providers</b>				
<b>Lloyd’s of London, AIG</b>	Equity and loans against losses arising from transfer restrictions, expropriation, political violence, and breach of contract	Market-based, comprising an up-front fee, a standby fee, and a guarantee fee	Currently, minimum premium rates are set at 0.25 – 2.5%, per single cover  Fee levels can fluctuate significantly, depending on the level of demand and underwriting capacity	Lloyd’s can “pool” up to \$2 billion of PRI cover, per project  AIG’s single project exposure limit set at \$150 million  Generally, 3-5 years. Up to 15 years possible

## SUMMARY OF PROPOSED PRG FEES

Guarantee Charges	Public Sector PRG	Private Sector PRG without Counter guarantee	Private Sector PRG with Counter guarantee
<b>Front-End Fee</b>	10-90 basis points on the face value of the guaranteed loan depending on the guarantee to associated ADB loan ratio, paid up front.	Market-based rate, currently set at 100 basis points, levied on the face value of the guaranteed loan, paid up front.	Market-based rate, currently set at 100 basis points, levied on the face value of the guaranteed loan, paid up front.
<b>Standby Fee</b>	Built into the guarantee fee.	Market-based rate determined by the Guarantee Committee. Benchmark fee currently set at 50 percent of the guarantee fee, typically, paid on interest payment dates of the underlying debt instrument, in advance.	Built into the guarantee fee.
<b>Guarantee Fee</b>	40 basis points, levied on the face value of the guaranteed loan outstanding plus (i) the interest that will accrue in the succeeding interest period, and (ii) any other interest covered under the PRG which has fallen due and has remained unpaid; payable in arrears or in advance, on the interest payment dates of the underlying debt instrument. A counter guarantee fee, if justified, will be paid directly by the beneficiary of the guarantee to the host government.	Market-based rate determined by the Guarantee Committee. Guarantee fees will be levied on the face value of the guaranteed loan outstanding plus (i) the interest that will accrue in the succeeding interest period, and (ii) any other interest covered under the PRG and has fallen due and remained unpaid; payable in advance, on the interest payment dates of the underlying debt instrument.	40 basis points, levied on the face value of the guaranteed loan outstanding plus (i) the interest that will accrue in the succeeding interest period, and (ii) any other interest covered under the PRG which has fallen due and has remained unpaid; payable in advance, on the interest payment dates of the underlying debt instrument. A counter guarantee fee, if justified, will be paid directly by the borrower to the host government.
<b>Administration Fee (for Coguarantee Program only)</b>		Market-based rate determined by the Guarantee Committee. The administration fee will be charged by retaining a percentage of the guarantee fee the coguarantor is entitled to under the coguarantee facility.	Market-based rate determined by the Guarantee Committee. The administration fee will be charged by retaining a percentage of the guarantee fee the coguarantor is entitled to under the coguarantee facility.