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MAKING A PRI CLAIM: READINESS IS ALL

*By: **Robert T. Wray** and **Felton (Mac) Johnston***

A PRI policyholder may make one or more unpleasant discoveries when a political risk loss occurs:

- The policy doesn't address what happened or doesn't clearly do so
- Policy exclusions or limitations bar or diminish compensation
- Recovery under the policy is barred or impaired because the policyholder failed to comply with policy terms or cannot meet its obligations to the insurer in the event of a loss
- The policy was not updated to reflect changes in the investment and its risks

Although the ranks of buyers of PRI that are simply ticking the box to satisfy a credit committee or regulator are probably diminished, it is still common to find executives and risk managers who treat a PRI policy as just another standard insurance product and therefore assume it will provide the coverage they need. PRI coverage, while referred to as insurance because it is provided through the insurance market, is in fact a financial instrument often custom-built for unique investments or to hedge financial risks associated with project or export loans, and should thus benefit from the same expertise and focus that specialized financial instruments require in other circumstances. Buyers often invest significant sums to purchase a PRI policy but make no great effort to assure that it will in fact work for them if the time comes to use it. PRI coverage isn't cheap, and without the investment of time and effort to get it right, premium money may be down the drain, not to mention considerable embarrassment for responsible managers.

We believe that investment and risk managers need to apply simple principles to acquire effective coverage for potential complex claims scenar-

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PRI AND TCI WORDINGS – THE VIEW FROM THE LONDON MARKET

***Tony George** is a partner at Ince & Co., where he currently devotes himself to political and trade credit insurance advice and litigation. We invited him to discuss developments in PRI and TCI policy wordings in the London market.*

After years of contentment with the wordings that have been developed in the commercial political risk insurance market since its start 40 years ago, one has recently noticed a shift from insurers' traditional protection towards contracts which are more favourable to insureds. It has been a soft market for some time with underwriters chasing business which has either not felt threatened by world events or has found alternative balance sheet protection in the capital markets. This competition produces concessions: not just on rates, but on wordings. Although the environment has changed, there remain factors which are likely to keep the wordings developing to the insureds' advantage.

Originally, commercial PRI underwriters saw themselves as a market of last resort: insuring risks which others wouldn't take. Faced with projects which were particularly in the knowledge, experience and control of their insureds, they felt more vulnerable than underwriters insuring other risks. This fear was exacerbated by less certainty of 'repeat' business in this class. To minimise the risk of being selected against, PRI underwriters developed clauses that were more favourable to them than in other insurance sectors. PRI wordings came to contain terms which had been specially-tailored, and perhaps as a result of a lack of competition from overseas markets and within the London Market itself, the scope for amending these terms in favour of prospective insureds was limited.

The starkest example of this (but ironically under English law the most ineffectual) were the provisions dealing with 'Onus of Proof'. The normal position with insurance contracts subject to English Law is that the insured must establish a loss caused by an insured peril, operating on the insured interest during the policy's

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PRI AND TCI WORDINGS – THE VIEW FROM THE LONDON MARKET cont'd

currency. If then the claim is disputed, the burden passes to the insurers to establish that an exclusion applies or a condition has been breached. PRI wordings invariably contained a clause purporting to change this: an insured had to prove not only that the loss was recoverable under the policy, but also that 'no Warranty or Condition' had been breached and that 'no exclusion applies'.

> To minimise the risk of being selected against, PRI underwriters developed clauses that were more favourable to them than in other insurance sectors.

Under English law there are principles of insurance which supported insurers' defensive attitude. For instance, insurers have protection at the placing of the policy under the principle of 'utmost good faith'. Before the contract is concluded a prospective insured must truthfully disclose to the insurers, all 'material circumstances': those matters that an underwriter would have wanted to have in mind in deciding whether to insure a risk, for what price and on what terms. If this duty is not honoured, and if the insurers can show they were induced to write the policy because of the non-disclosure or misrepresentation, they are entitled, in effect, to treat the policy as if it never was, return premium and refuse to pay the claim. They 'avoid' the policy. Nor does there have to be a causal connection between the undisclosed or misrepresented circumstances and the loss giving rise to the claim.

Then English law has 'warranties': terms of the policy which are, broadly speaking, conditions precedent to the insurer's liability – typically, a term in which the insured promises either that a state of affairs existed prior to the inception of the insurance or that it will continue to exist during the policy's currency. If that term is breached then the policy is 'repudiated' and insurers' liability ends. Again there does not have to be a connection between the breach and any subsequent claim.

Not content with relying on these principles, PRI underwriters devised even more favourable provisions in their wordings with regard to disclosure. We had the 'basis clause' when the insured warranted the truth of the information supplied, however insignificant to the placement, and the 'No Prior Knowledge' clause, embodying subtle and important differences from the principle of good faith and increasing the insured's duties and the insurers' rights in the event of the former's shortcomings.

When the policy was in place, there could also be variations from the normal approach. The usual link between a cause of loss and a right to indemnity, 'proximate' or direct cause, might be shifted so that the loss must be caused 'solely and directly' by an insured event. Conversely, the criteria for exclusions were sometimes widened so that insurers were exempted from paying where the loss was 'directly or indirectly caused by' an event.

These principles: utmost good faith, warranties and the insurer-orientated clauses may shortly be made more difficult to impose on insureds by statute. We have our Law Commissions looking at insurance law. It is likely there will be legislation, and it will extend some principles of consumer protection to what the Commissioners call 'business insurance', including PRI.

In the meantime, things are changing anyway. The market is more mature and the products have expanded. 'Confiscation Expropriation and Nationalisation' cover – 'CEN' may now be supplemented with refinements such as 'deprivation', 'selective discrimination', 'forced abandonment' etc., and there has been a move towards merging more attritional contract coverage, with this long-established cover becoming known as 'Full PRI' (or confusingly just 'PRI'), or specifically 'Investment', 'Equity' or 'Loan' insurance. It is now common to find policies providing additional coverage for breach of contract and failure to honour arbitration awards. Other coverages may be added – War and Political Violence/Terrorism. Currency Inconvertibility insurance is available to compensate investors for their inability to convert local currency into hard currency and transfer remittances outside of the host country.

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What was described as 'Contract Frustration' or CF: cover provided to ensure the performance or payment obligations of public buyers or to protect against the impact of government action on private buyers, has changed too. Changes in the private market have allowed Lloyd's to insure pure 'credit' risks, and now you may find the CF protection extends to commercial 'can't pay/won't pay' situations. Known as 'Comprehensive Non-Payment Insurance' or, more generally, Trade Credit Insurance – TCI, this insurance will cover short and medium term trade and its finance. It can also cover the income stream from projects.

There have been other opportunities that have had their effect. There is Basel II: an 'accord' intended to be adopted as law which revises the standards for measuring the adequacy of financial institutions' capital with a system making banks' assessments of their loans and investments more sensitive to credit and market related risks, and taking account of operational risk for the first time. When a bank assesses the credit risk in a deal, it can take into account techniques which banks have traditionally used to mitigate that risk: collateralisation of loans; third party guarantees; credit derivatives – 'credit risk mitigation' or CRM. There is nothing in Basel II about insurance as a CRM instrument, and technically, under English law, an insurance is not a guarantee. Basel II is, however, not a legal document, and commercially a policy can

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MAKING A PRI CLAIM: READINESS IS ALL cont'd

ios, but doing it takes determination and expert focus:

- Assure that the underwriter has been given complete and accurate information upon which to base its underwriting decision and set the premium rate
- Negotiate policy terms that correspond to project vulnerabilities and management's concerns
- Stress-test the policy terms and conditions to determine that they are effective to cover specific project vulnerabilities and management's concerns and needs
- Understand the entire policy (this can be a real challenge)
- Have a process in place to keep in compliance with policy terms and to amend or replace the policy if changed circumstances warrant
- Be prepared to act appropriately if a loss threatens and when a claim is made

Negotiating the Policy.

Investors or lenders run a very high risk that things won't work right if the team familiar with the covered transaction or loan and its risks isn't actively involved in the application process and the negotiation of "manuscripting" changes. But since few investors or lenders – including in-house company lawyers – have multiple opportunities to gain understanding of the specialized world of political risk insurance, outside experts – specialty brokers, lawyers and other advisers, need to work with them. Neither company officials nor outside experts can properly do the job alone. They have to work together – and with the right underwriter.

> Buyers often invest significant sums to purchase a PRI policy but make no great effort to assure that it will in fact work for them if the time comes to use it.

It is tempting for investors or lenders to enter negotiations with the insurer who throws out the lowest "non-binding indication". The lowest rate may come from the underwriter whose policies and practices are least favorable and appropriate to buyers' needs, so those issues ought to be explored before entering into detailed negotiations with one particular underwriter. Midway through negotiations is not a good time to discover, for example, that the underwriter fixes the exchange rate for compensating an inconvertibility claim at the end of a long transfer delay waiting period, while other underwriters take a more insured-friendly approach.

Although in theory the policy form is the only basis for determining the validity and outcome of a claim, the policyholder's application for the coverage is typically incorporated by reference, and all communications leading up to (and even after) the policy comes into effect will come into the discussion if there are differences over a claim. The application has to be accurate and thorough, and since the application form is invariably supplemented with email exchanges and conversations, it is essential to keep good and accessible records. Lenders have to rely on sponsors or borrowers for much of the information the underwriter requires – hence the importance of having confidence in that source of information and the desirability of policy wording that puts reasonable limits on the lender's responsibility for accuracy and completeness. Shortly before the policy is finalized, someone needs to do a final review and make sure that the supporting records are there and that the representations are correct. An insurer can deny coverage if information on which it acted to offer insurance proves significantly wrong.

> ...around the time that the buyer thinks it is getting the wording and coverage it wants … reality or stress testing with a claims exercise can have great benefits.

If PRI policy wordings were unambiguous or had settled meanings, and if underwriters were willing to part with cherished and sometimes murky language, life would be much simpler, but it is not often so. Unfortunately, underwriters are reluctant to provide written explanations of what their policy wordings mean. But oral understandings will not do. Some insurers may be able to point to case examples to demonstrate how their wordings work, but not many can. If the buyer can't initially get what is needed in terms of clarity and responsiveness to its concerns, it and its advisers should press firmly for improvement, or even look for a more cooperative underwriter. If those efforts fail, the investor or lender may decide the value of the policy doesn't warrant its cost. That's a hard decision for most people to make once they have entered into negotiations with an insurer, but in some cases it could be the right one.

Somewhere along the line – not at the last minute but around the time that the buyer thinks it is getting the wording and coverage it wants – reality or stress testing with a claims exercise can have great benefits. This isn't just to see if a likely loss scenario would yield coverage, but also to be sure the policyholder will be in a position to meet the policy requirements to perfect a claim. A "mock" claim may reveal discrepancies between what compensation can be achieved, and the value of the policyholder's exposure plus the costs of a claim. Because no PRI policy covers every political risk, this exercise can also raise awareness of the risks that will need to be managed in some other way.

Fix It and Forget It? Definitely Not.

The temptation to put the hard-negotiated policy in the drawer or to consign it to a clerk may be great but it is potentially costly or even disastrous. Why? Because when circumstances change, the insured may need to change the policy to keep abreast of them. For example, suppose that the anticipated remittances from the project are markedly different from those initially contemplated. The insured may need to take a fresh look at its coverage needs or elections. Or suppose that there is a significant change in the

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MAKING A PRI CLAIM: READINESS IS ALL cont'd

ownership structure of the investment project, or the enterprise undertakes a different operation from that contemplated when coverage was initially applied for. If either of these changes is associated with a loss, the insurer might feel justified in denying a claim, because the basis on which he offered coverage has changed. The insured will need to keep the insurer informed and may need to modify the policy to reflect changed circumstances.

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Lenders may have a harder time keeping themselves informed about the project and complying with insurance policy warranties and covenants because they are dependent on the borrower, and on its compliance with loan agreement terms, to do nothing that could trigger a policy exclusion. Lenders also have the burden of getting the insurer's approval for material changes in loan terms and conditions.

A good way to avoid overlooking the policy holder's obligations to keep the policy current and the insurer informed is to require executive-level attention to the policy at least annually, perhaps in connection with premium payment or coverage election cycles. At least one project executive, together with the political risk manager, should be required to review a checklist of items like these:

- Have there been any significant changes to the investment project or its structure, in the host country's economic or political environment, or with respect to information provided to the insurer at the time of application?
- Do coverage elections make sense in light of changed circumstances?
- Is the policyholder doing what it needs to have done if a loss situation arises? (E.g., are financial statements for the project being maintained as required; is the project being monitored to be sure that licenses are maintained and local laws are being observed; are employees aware of policy non-disclosure obligations; and are responsible employees aware of their responsibilities for loss avoidance?)

<u>When Losses Loom.</u>

Of course it is better to have a plan in place so that parties know what they need to do if a loss threatens, rather than having to scramble to figure out how to respond. The first requirement is to get the attention of senior management, and make sure that timely notice goes out to the insurer (in exactly the manner prescribed in the policy) and to the broker, attorney or other advisers. This is a good time for all concerned to re-read the policy carefully in order to evaluate the prospect of coverage of the potential loss and also to know what the policy requires of the insured at this stage. A claims strategy that can be supported by facts and fits the coverage should be developed early because it may be hard to change later on. Legal advice should be available to confirm or modify the claims strategy. Information will need to be gathered to deal with the situation, to provide prompt and accurate information to the insurer and, if need be, to prepare for a claim. While policyholders may think the obligatory claims "waiting period" before a loss is ripe for a claim is too long, the time can be put to good use in consulting with insurers and preparing for a claim if the loss can't be avoided.

The insurer should be approached in a businesslike manner. This is not the time to argue about coverage but rather to give the insurer the information it requests about the situation and to give it an opportunity to weigh in on decisions, or at least to object to any proposed course of action for loss avoidance or mitigation. Whether lawyers or brokers or the claimant itself should present the matter to the insurer initially or at later stages will have to be determined on a case-by-case basis, but there should be a plan that keeps all of these parties informed and involved.

The insurer, especially if it is an official agency, may have influence that it can bring to bear to help overcome the problems that could give rise to a claim. It will certainly want to if it can. Indeed, some private PRI insurers boast of their claims avoidance or mitigation capabilities. Also, they may have valuable experience in managing political risk loss situations, so it is worth getting their advice.

All this said, interacting with the insurer when a loss threatens can be a tricky business. The insured's and the insurer's interests are not identical. If the insurer is a public agency, it will view the situation, at least in part, in a political rather than a merely commercial context, and while it may have helpful abilities to resolve the problem, it may also have other concerns about its relationship with the sovereign that is causing the trouble. And insurers generally may be focused on loss avoidance and recovery more than they are on paying the claim. The policy usually requires the claimant to take all reasonable steps to avoid or minimize a loss and to obtain the insurer's written consent before entering into any agreement concerning a loss or potential loss. However, the guidance given by the insurer for loss avoidance may be more advantageous for the insurer than for the claimant and might even imperil the claimant's larger interests in the country where the covered investment resides. This may be especially problematic for a lender with multiple exposures and interests in the host country. Once more, the importance of specialist legal and insurance advice can be critical to the insured's interests.

<u>Submitting a Claim.</u>

It is difficult to generalize about the claims process because every claim situation is different. Each type of coverage has its particular requirements for presenting and perfecting a claim and every insurer will have its own expectations. Some insurers will suggest

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a format for claims and some will not. Drawing on experienced professionals to assist in preparing a claim will save time and may help avoid damaging mistakes.

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In general, a well-organized factual narrative and a presentation that addresses every relevant policy requirement, with the associated documents and other evidence attached, is the best beginning. Just as important as providing thorough and accurate information to the insurer is to conform the claim to the requirements of the policy. Here is where the claimant will be reminded that it has the burden of proof. That means going through the policy terms to see how the circumstances surrounding the loss match up against the policy provisions, that exclusions don't apply, and that the claim falls within the policy limitations. This is what the insurer and its lawyers will do, and their requirements should be anticipated by the claimant and its lawyers. The PRI claims process is almost certain not to end with the formal claim application. The claimant can expect more questions and a potentially lengthy interactive process.

The Insurer Agrees to Pay. It's Not Over Yet.

As a condition of compensation, the equity claimant will have to transfer to its insurer the interest corresponding to the compensated loss. For a political violence damage claim, that may be just title to damaged assets, or the assets themselves, if they have any residual value. For an inconvertibility claim, the insurer will insist that the claimant transfer over the blocked currency or perhaps the right to dispose of it, or the note in respect of which a payment was blocked. The claimant must be sure that the legal decks are cleared to have this done. For expropriation, the insurer will want to be subrogated to the claimant's interests, which in the case of an equity investment usually means an unencumbered interest in the shares that correspond to the insured investment. If shares are pledged to a lender, the equity claimant may be unable to perfect the claim unless the insurer has previously agreed to accept pledged shares - which may prove to be very difficult (this problem, though, should have been anticipated at the policy negotiation stage).

In an equity expropriation case subrogation means not just that the claimant has to hand over the shares but also whatever rights it has in respect of them. The insurer will expect the claimant to pursue reasonable remedies, such as taking the issue to arbitration pursuant to a bilateral investment treaty the claimant's government may have with the sovereign, so that it can secure its share of any award that might issue from that process. (Typically, the insured must bear the reasonable out-of-pocket expenses of loss avoidance or minimization until the claim is paid. Thereafter, the insurer is usually responsible for salvage expenses. PRI policies vary as to how these expenses are to be reimbursed out of loss recoveries.) An insured lender will normally have to rely on the sponsor or borrower to pursue such arbitration on the lender's behalf. Another problem for lenders is that when the insurer succeeds to the note corresponding to a defaulted installment (or beneficial interest in it), the lender has a new co-lender, one who may have differing interests and approaches. This is yet another situation in which carefully negotiated policy and loan documentation might avoid later problems and issues involving voting rights and creditor actions.

> ...when pursuing coverage it is well for the investor to consider how all of its interests could be affected by subrogation and the requirement for continuing cooperation when a claim is paid.

If the claimant has uninsured as well as insured interests in the expropriated project, or other interests in the country, its situation will be rather complicated. The matter of subrogation and cooperation between the insured and the insurer is worthy of extended treatment. Suffice it to say here that when pursuing coverage it is well for the investor to consider how *all* of its interests could be affected by subrogation and the requirement for continuing cooperation when a claim is paid.

What if the Insurer Denies the Claim?

Before becoming indignant about an insurer's claim denial, the claimant should listen carefully to what the insurer has to say. Does the insurer have a complete and correct understanding of the situation? If the claimant disagrees with the insurer's determination (not just that it doesn't like it), it should try making its case again with the insurer's objections in mind.

In a case where there are ambiguities or where neither party seems to have an obviously winning case, there may be room for a settlement. Is the claimant amenable to that? If not, or if the insurer is unwilling to negotiate, it is time to weigh the costs and prospects of recourse to arbitration or the courts. The claimant should consult with legal and other experts experienced with PRI arbitrations again, and if the decision is to resort to a dispute settlement forum, to let those experts, and not just general litigation lawyers, help weigh the costs and prospects of that course and prepare the case.

Arbitration is the mode commonly stipulated for the settlement of disputes between PRI policyholders and insurers. It is thought to be faster and cheaper than the courts, and is likely to be definitive. Still, it can be a long and costly process so it should not be undertaken lightly. The insurer similarly has to consider its costs and the uncertainly of the outcome – especially before an arbitral

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CLAIMS ARBITRATION

*The Overseas Private Investment Corporation (OPIC) has long experience arbitrating PRI claims. We invited **Robert O'Sullivan**, OPIC's Associate General Counsel, Insurance Claims, to discuss that experience and OPIC's views of arbitration as a means of dealing with disputes with policyholders.*

All insurance contracts issued by OPIC (and USAID before it) have provided for resolution of disputes by arbitration under American Arbitration Association (AAA) rules. Coverage and compensation disputes in the context of insurance claims account for all but two of the arbitrations in OPIC's experience, although the arbitration clause extends to "any controversy or claim arising out of or relating to this contract."

The major change that OPIC has made in its arbitration clause has been to shift from the AAA Commercial Rules, which disfavor reasoned awards, to the International Rules, which require them.

OPIC has paid over 90% of the claims that have been presented to it, and so arbitrations have been relatively few (14 in a 35 year period). In eight cases, the insured received nothing and in two cases was awarded considerately less than the amount claimed [*see* chart below]. Notwithstanding an overall favorable win/loss record that confirms OPIC's confidence in its claims procedures, even the smallest of these controversies diverted resources from more productive activities, so winning did not lead to celebration.

Each case did cause OPIC to review its contracts and reconsider the use of arbitration as a means of resolving disputes. The drawbacks to arbitration include the lack of a right to appeal based on error of law and the difficulty of disposing meritless claims through the equivalent of motions to dismiss. On the positive side, two major advantages over litigation are the opportunity to select decision makers who are knowledgeable about the subject matter of the dispute and the autonomy of the parties to work with the arbitrators within the rules to present the case effectively and efficiently. Also, the case will proceed upon a timetable mutually agreed by the arbitrator and the parties, not one disrupted and dictated by a court calendar.

The major change that OPIC has made in its arbitration clause has been to shift from the AAA Commercial Rules, which disfavor reasoned awards, to the International Rules, which require them. One may hope that arbitrators who are required to explain their decisions will be somewhat deterred from imposing settlements in the guise of decisions. More importantly, an award that identifies

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Year Denied	Investor	Country	Amount Claimed	Coverage Type	Amount Paid
1972	Anaconda Co.	Chile	$154,000,000	Expropriation	$95,092,138
1972	International Bank of Washington	Dominican Republic	$318,000	Expropriation	$0
1973	ITT Corp	Chile	$95,066,000	Expropriation	$94,091,531
1977	Revere	Jamaica	$90,475,200	Expropriation	$1,313,979
1982	Beckman Instruments	El Salvador	$1,440,000	War, Revolution, Insurrection	$0
1986	Caribe Crown	Haiti	$67,190	Political Violence	$0
1993	Good Fortune Gold	Yugoslavia	$386,000	Political Violence	$153,644
1994	Green Mining	Guyana	$11,675,300	Contractor Dispute Coverage	$0
1995	African Holding Co.	Zaire	$4,467,164	War, Revolution, Insurrection	$3,950.000
1999	Marine Shipping	Egypt	$3,030,746	Expropriation	$0
2002	Bucheit International	West Bank/Gaza	$639,000	Expropriation/ Political Violence	$0
2002	Bechtel/General Electric	India	$57,500,000	Expropriation	$63,548,698
2004	Bellfinance Haussman	Georgia	$500,000	Expropriation	$0
2006	ROTA International	Guinea-Bissau	$810,000	Expropriation	$0

MAKING A PRI CLAIM: READINESS IS ALL cont'd

panel, which is not bound by precedent, not likely to have its decision subject to review, and often prone to compromise. Hence the threat of dispute resolution may inspire insurers to consider a settlement.

Conclusion.

A political risk insurance claim is unique in most firms' business experience, and PRI policies are unlike their other insurance coverages. Getting the best coverage possible, understanding what it does and doesn't do, and avoiding pitfalls that could vitiate or preclude loss compensation requires senior management attention and the involvement of experts at the early stages and continuing attention to the policy and what it covers. With that preparation and follow-through, the issues and problems that arise when losses loom and claims are to be presented will be much easier to handle, and the prospects for a successful outcome will be much enhanced with the ultimate cost of risk mitigation much lower. ■

robert wray PLLC **provides expert assistance to investors in connection with the negotiation of political risk insurance, evaluation of coverage effectiveness, the pursuit of claims, and arbitration of disputed claims.**

CLAIMS ARBITRATION cont'd

and decides issues openly can provide guidance that may be useful in improving the insurance contract forms, underwriting practices, and contract origination.

… based on a sample of 14 cases in 30+ years, **[OPIC]** has decided to treat occasional unsatisfactory experiences as random incidents, not institutional weaknesses.

Implicit in this discussion is rejection of litigation as an alternative. In court, the parties would lose the autonomy and flexibility that arbitration offers, would be unlikely to have a trier of fact familiar with international investment or political risk management and would be subject to the competing demands of a court calendar. Finally, considering that the most contentious claims tend to be expropriation claims, the court would be asked to pass judgment upon the propriety of acts of a foreign government, a subject that U.S. courts avoid.

From time to time, OPIC has also considered use of other arbitration institutions but, based on a sample of 14 cases in 30+ years, has decided to treat occasional unsatisfactory experiences as random incidents, not institutional weaknesses. Any system of rules that allows party autonomy and encourages efficient handling of the proceedings is acceptable in principle. ■

PRI AND TCI WORDINGS – THE VIEW FROM THE LONDON MARKET cont'd

be seen as a form of guarantee. It is the credit risk aspect of Basel II which the London Market sees as an opportunity to sell new products.

If a TCI policy is to equate to a guarantee for a bank in calculating capital requirements, Basel II requires it be 'direct, explicit, irrevocable and unconditional'. TCI can meet the first three criteria. It is the 'unconditional' where the problem lies. The CRM instrument must contain no obligation outside the control of the bank that could prevent the guarantor from paying in a timely manner if the original counterparty fails to pay.

Traditionally, the TCI policy a bank took out to protect its transactions would contain many general terms and conditions, and if subject to English law it would incorporate the terms and conditions that are peculiar to insurance contracts in general and to PRI and TCI in particular. Foremost would be the concepts of 'utmost good faith' and 'warranties', 'No Prior Knowledge' clauses and reverse burden of proof provisions. Such a policy therefore created 'conditionality' – in contrast with the common perception of a 'guarantee' (a couple of pages containing a promise to pay if someone else doesn't.)

Conscious of this problem, the London Market is striving to produce policies which meet the requirements of Basel II. Such wordings spell out clearly what is insured, premium terms and that the policies cannot be amended, terminated or cancelled except for non-payment of premium. Usually the 'No Prior Knowledge' clause is gone. There are other clauses dealing with disclosure – sometimes the duty of utmost good faith is explicitly spelt out. Another approach is to make the duties of disclosure a 'warranty'. Sometimes claims resulting from failure to meet the standard of utmost good faith are dealt with by way of exclusion. One also sees attempts to delineate the information provided to the insurers and to confirm its completeness. The bank's department charged with providing the placing information may be identified to the exclusion of others.

Under policies intended to be Basel II compliant, most of the usual warranties remain. They are within 'the direct control' of the bank and permissible. Clauses, however, seeking to reverse the burden of proof have gone, and sometimes the normal insurance rules are expressly set out: the insured has to establish that the loss falls within the policy and its amount, leaving the insurers to

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PRI AND TCI WORDINGS – THE VIEW FROM THE LONDON MARKET cont'd

establish that a term has been breached or an exclusion applies.

Basel II talks of payments under guarantees being 'timely', and the new wordings seek to make the situation clear. What does the insured do to get a claim paid? What has to be provided as support? How far can the insurer ask for further information? What is the waiting period before the claim gets paid? How quickly does the insurer have to decide to pay a claim? These are dealt with.

The greatest problem in making a policy qualify as Basel II CRM lies with the exclusions. Customarily a TCI policy excluded losses caused by 'material default' of the insured – so within the direct control of the bank, but there were exclusions for loss caused by insolvency or financial default, currency fluctuations or devaluations, war involving the five permanent members of the UN Security Council and various forms of the 'Radioactive Contamination Exclusion Clause'. All these excluded factors are outside a bank's control, and so fall foul of the Basel II requirements for guarantees. Company insurers could drop the exclusions, but Lloyd's Underwriters were required by regulation to insert them. This was a problem which could have prevented the use of TCI policies as effective credit risk mitigation. Lloyd's has, however, changed its rules. A Market Bulletin issued last year 'to address the issues raised by the implementation of the Basel II' provided that CF and trade credit insurances are no longer required to include war, insolvency or financial default or currency fluctuation exclusions. With this, the major obstacle preventing financial institutions using TCI as a credit risk mitigant has been overcome.

Some things have emerged from the Market's approach to the opportunities offered by Basel II. Wordings are clearer, shorter and more up-to-date. Uncertainties have been removed and exclusions limited. If there is a claim, the position is clearer sooner. These changes could well affect the converged PRI policies and other credit insurance policies even though compliance with Basel II may not be the intention. A bank insuring its foreign direct investment may wonder why brokers cannot secure similar wording to its trade credit cover. One may even see the new environment extending to the classic CEN perils. Perhaps a definition for 'expropriation' allied to state default under bilateral investment treaties: something which caters for 'regulatory takings'? Maybe we will get a form of prospective arbitration award default coverage for BITs tailored to respond more quickly and more cheaply than the international arbitration process: the sort of thing that would have made the Argentine claims in 2001-2002 so much easier for both insurers and insureds. ■

LOSS & RECOVERY JOURNAL

NEWCO Limited, a joint venture between German and U.S. investors, won a substantial award from a UNCITRAL Arbitration Panel against the Government of Belize relating to a wrongful termination of a concession agreement for the privatization and development of the international airport in Belize. The Government of Belize has affirmed that it is obligated to and will honor the award. The Claimant was represented by Robert T. Wray, Mariano Gomezperalta C. and Tatyana A. Mikhailova of robert wray PLLC.

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.

If you would like to receive future editions of the PRI Newsletter electronically, or if you have friends or colleagues who would be interested in joining our distribution list, please e-mail us at *info@robertwraypllc.com*. This and previous editions of the newsletter are available at *www.robertwraypllc.com*

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about robert wray PLLC

robert wray PLLC is a law firm focused on analyzing complex issues and providing innovative solutions in the areas of investment political risk management, project finance, transportation infrastructure, aircraft finance, and microfinance. The firm's political risk practice, led by Robert T. Wray and Felton (Mac) Johnston, offers comprehensive advice relating to international political risk management for investors, including the negotiation and evaluation of political risk insurance, the presentation of political risk insurance claims, and the arbitration of international investment disputes.

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