Building Bridges

"G20 STOCK-TAKE: BEST PRACTICES OF MDBs AND SPECIALIZED MULTILATERAL INSURERS IN POLITICAL RISK INSURANCE FOR EQUITY INVESTMENTS, MEDIUM AND LONG TERM DEBT INVESTMENTS AND OTHER INSURANCE SOLUTIONS"

A TECHNICAL REPORT

G20 – International Financial Architecture Working Group (IFA-WG)

PREPARED BY IsDB/ICIEC

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List of Acronyms

ABGF	Brazil Guarantees and Fund Managements Agency
ADB	Asian Development Bank
AFD	Agence Française de Développement
AfDB	African Development Bank
AFREXIM	African Export Import Bank
AIIB	Asian Infrastructure Investment Bank
ASEI	PT Asuransi Asei Indonesia
ATI	African Trade Insurance Agency
Atradius DSB	Official ECA of the Netherlands
Bancomext	Banco Nacional de Comercio Exterior
BCBS	Basel Committee on Banking Supervision
BDB	Bilateral Development Bank
BII	Bilateral Investment Insurer
BIO	Belgian Investment Company for Developing Countries
BIS	Bank of International Settlements
BNDES	Brazilian Development Bank
BPI France	National Development Bank and Official ECA of France
BPS	Basis Points
BU	Berne Union
CDC	Commonwealth Development Corporation
CDS	Credit Default Swap
CESCE	The Spanish Export Credit Agency
CF	Contract Frustration
CGIF	Credit Guarantee and Investment Facility
COFACE	Private insurance company
COFIDES	Compañía Española de Financiación del Desarrollo (Spain)
CR	Credit risk
Credendo	Official ECA of Belgium
DAC	Development Assistance Committee
DANIDA	ODA Aid Agency Denmark
DEG	Deutsche Investitions- und Entwicklungsgesellschaf (German DFI)
DFI	Development Finance Institution
Dhaman	Arab Investment & Export Credit Guarantee Corporation
EADB	East African Development Bank
EBRD	European Bank for Reconstruction and Development
ECA	Export Credit Agency
ECGC	Export Credit Guarantee Corporation of India
ECIC	Export Credit Insurance Corporation of South Africa
EDC	Export Development Canada
EDFI	European Development Finance Institutions
EFSI	European Fund for Strategic Investments
EIB	European Investment Bank
EKF	Eksport Kredit Fonden (ECA of Denmark)
EKN	Swedish National Export Credits Guarantee Board
EP	Equator Principles
EPG	Eminent Persons Group
ESG	Environmental Social and Governance
EU AITF	EU Africa Infrastructure Trust Fund
EU	European Union
Euler-Hermes	Private insurance company and official ECA insurer of Germany
EXIAR	Export Insurance Agency of Russia
EXIM Bank	Export-import Bank
Export Finance Australia	EXIM Bank of Australia
FDI	Foreign Direct Investment
FinnFund	Development Finance Institution Finland
Finnvera	Official ECA of Finland
FMO	Entrepreneurial Development Bank (Netherlands)
GEMs	Global Emerging Markets
GNI	Gross National Income
GuarantCo	Multilateral Guarantor
Euler Hermes	Private insurance company and official ECA insurer of Germany
IACPM	International Association of Credit Portfolio Managers
IaDB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
ICC	International Chamber of Commerce
ICD	Islamic Corporation for the Development of the Private Sector
ICIEC	Islamic Corporation for the Insurance of Investment and Export Credit
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Financial Institution
IFTA	International Trade and Forfaiting Association
IMF	International Monetary Fund
IsDB	Islamic Development Bank
ITFC	International Islamic Trade Finance Corporation
IWG	International Working Group on Export Credits
JBIC	EXIM Bank and Bilateral Development Bank of Japan

JEDH	Joint External Debt Hub
JICA	Japan International Cooperation Agency
KEXIM	Export-Import Bank of Korea
KfW	Kreditanstalt für Wiederaufbau (German DFI)
KOICA	ODA Aid Agency of South Korea
KSure	Korea Trade Insurance Corporation
LC	Letter of Credit
LDC	Least Developed Country
LIC	Low Income Country
LMIC	Low Middle-Income Country
LT	Long Term
MCPP	Managed Co-Lending Portfolio Program (IFC)
MDB	Multilateral Development Bank
MFAT	Ministry of Foreign Affairs and Trade
MIGA	Multilateral Investment Guarantee Agency
MLT	Medium-Long Term
MPI	Ministry of Primary Industries
NDB	National Development Bank
NPS	Net Promoter Score
NEXI	Nippon Export Investment Insurance
NHFO	Non-Honoring Financial Obligation
NHSFO	Non-Honoring Sovereign Financial Obligation
NorFund	Bilateral Development Finance Institution Norway
NPI	Non-Payment Insurance
NZ	New Zealand
NZBA	New Zealand Bankers' Association
NZEC	New Zealand Export Credit
NZGCP	New Zealand Growth Capital Partners
NZGIF	New Zealand Green Investment Finance Ltd.
NZTE	New Zealand Trade and Enterprise
NZVIF	New Zealand Venture Investment Fund
OAA	ODA Aid Agency
OCR	Ordinary Capital Resources
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OeEB	Bilateral Development Bank of Austria
OPIC	Overseas Private Sector Investment Corporation (now USDFC)
PBG	Policy Based Guarantee
PCG	Partial Credit Guarantee
PCS	Preferred Creditor Status
PD	Probability of Default
PDM	Private Direct Mobilization
PGF	Provincial Growth Fund
PPP	Public Private Partnership
PRG	Partial Risk Guarantee
PRI	Political Risk Insurance
Proparco	Bilateral Development Bank of France
PwC	PricewaterhouseCoopers
R&D	Research and Development
RBNZ	Reserve Bank of New Zealand
RBP	Regional Business Partners
S&P	Standard & Poor's
SACE	Italian Export Credit Agency
SBI-BMI	Bilateral Development Finance Institution Belgium
SDG	Sustainable Development Goal
SDR	Special Drawing Right
SEK	Swedish Export Corporation
SEP	The Saudi Export Program
SERV	Swiss Export Risk Insurance
SFI	Sustainable Finance and Insurance
SIDA	ODA Aid Agency of Sweden
SIFEM	Bilateral Development Finance Institution Switzerland
SIMEST	Bilateral Development Bank of Italy
Sinosure	Official ECA of PR China
SME	Small-Medium Enterprise
SMI	Specialized Multilateral Institution
SOE	State Owned Enterprise
SOFID	Bilateral DFI of Portugal
SOV	Sovereign
SPC	Special Purpose Company
ST	Short Term
SwedFund	DFI of Sweden
TDB	Trade and Development Bank
TCI	Trade credit insurance
TCS	Trade Commissioner Service
TFAAB	Trade For All Advisory Board
TFP	Trade Finance Programs
TOP	Terms of Payment
TOSSD	Total Official Support for Sustainable Development
UK	United Kingdom
UKEF	United Kingdom Export Finance
UMIC	Upper Middle-Income Country
UN PRI	United Nations Principles of Responsible Investments
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States
USAID	United States Agency for International Development
USD	American Dollar
USDFC	Bilateral Development Finance Institution of the United States of America
US EXIM	United States Export-Import Bank
WB	World Bank
WEF	World Economic Forum
WHO	World Health Organization
WITS	World Integrated Trade Solution
WTO	World Trade Organization

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Executive Summary

Executive Summary

A. OBJECTIVES OF STOCK-TAKE STUDY

This report has a number of key objectives:

- It will identify potential areas for joint (capacity building) efforts by the Multilateral Development Banks MDBs in developing countries, and towards institutional (capital market) investors, to enhance their use of credit and political risk insurance products and to increase equity investments and Medium – and Long Term (MLT) debt investments in developing countries, in particular in Least Developed Countries (LDCs), other Low Income Countries (LICs), fragile states and post-conflict countries.
- It will provide a complete and comprehensive overview of the global market for MLT credit and political risk insurance products that can be used to cover equity investments and MLT debt investments.
- It will describe how credit and political risk insurance products can be effectively used to mobilize additional capital for development, in particular in LDCs and other LICs, fragile states, and conflict affected countries.
- It will identify potential gaps and constraints in the global credit and political risk insurance market.
- It will provide concrete proposals on how the identified gaps in the credit and political risk insurance market could be addressed by a joint initiative of MDBs.

B. CONTEXT

In October 2018, the G20 Eminent Persons Group (EPG) published its report "Making the global financial system work for all"[1]. The report covers the operations of International Finance Institutions among which the International Monetary Fund (IMF), Multilateral Development Banks (MDBs) and Specialized Multilateral Insurers (SMIs) such as ATI, Dhaman, ICIEC and MIGA.

A key strategic recommendation of the report is to "Shift the basic business model of the MDBs from direct lending towards risk mitigation aimed at mobilizing private capital".[2] The report stresses among others the importance of "multiplying private capital by adopting system-wide approaches to risk insurance and securitization".

The report also recommends to "embark on a system-wide insurance and diversification of risk, to create a large-scale asset class and mobilize significantly greater private sector participation" and to mitigate risk "through instruments such as first-loss guarantees, and co-investments to catalyse private investment".

1 The G20 EPG report can be found via the following link: https://www.globalfinancialgovernance.org/assets/pdf/G20EPG-Full Report.pdf
2 See page 17 of the EPG report.

In the context of follow-up discussions on the G20 EPG report, MDBs have been requested by the G20 Saudi Presidency for 2020 to conduct a stock-take study on the use of political risk insurance for equity investment and MLT debt investments and other insurance solutions. At the request of the G20 chair, this study has been coordinated, on behalf of the MDBs, by the IsDB through its political and trade insurance arm ICIEC.

This stock-take study assesses the current state of the insurance market for equity investments and MLT debt investments. It identifies best practices, challenges, and potential market gaps, and provides recommendations on how identified gaps could be filled, particularly for LICs and fragile states. The aim is to offer solutions to crowd-in additional capital to meet the objectives of the UN Sustainable Development Goals (UN SDGs). Mobilization of additional equity investments and MLT debt investments for infrastructure and other industrial projects is a specific goal.

C. METHODOLOGY

This research is based on:

1. Literature search on the operations of Multilateral Development Banks (MDBs), Specialized Multilateral Insurers (SMIs), official Export Credit Agencies (ECAs) and private insurers.
2. Detailed desk research on guarantee/insurance operations of the a.m guarantors/ insurers, and on other relevant key developments.
3. Analysis of data from the Berne Union, the global association of export credit and political risk insurers.
4. Analysis of inward FDI flows and inward FDI stock of a selection of 22 developing countries, including ten Low Income Countries (LICs) , seven Lower Middle Income countries (LMICs), five Upper Middle Income Countries (UMICs) and five Fragile States and Conflict-Affected Countries, to assess the shares of their inward FDI stocks and flows that are insured against political risks.

Countries Selected for the MDB G20 Stock-Take Study (1)

LICs	LMICs	UMICs	Fragile States and Conflict Affected Countries
Afghanistan (7)	Bangladesh (5)	Algeria (5)	Afghanistan (7)
Benin (6)	India (3)	Brazil (5)	Chad (7)
Chad (7)	Indonesia (3)	China PR (2)	Liberia (7)
Ethiopia (7)	Kenya (6)	Mexico (3)	Myanmar (6)
Liberia (7)	Myanmar (6)	South Africa (4)	Rwanda (6)
Nepal (6)	Ukraine (6)		
Niger (7)	Zambia (7)		
Mozambique (7)			
Rwanda (6)			
Tanzania (7)			

(1) OECD ECA country risk rating (as at January 2020) indicated in brackets. All developing countries are rated by OECD ECAs in 7 country risk categories of which 1 is the lowest and 7 the highest risk category.

5. Analysis of the stock of external debt of the selected 22 countries, to assess the share of external debt to creditors with a Preferred Creditor Status (PCS Debt) and other creditors without PCS status.

6. In-depth analysis of the MLT insurance business of Berne Union members with the selected 22 countries to assess the main types of policies that are used to support equity and MLT debt investments and identify potential opportunities for cooperation with MDBs.
7. Analysis of the Basel III regulations that apply to the operations of commercial banks and impact the utilization of guarantees and credit and political risk insurance products.
8. An ICIEC on-line survey of the demand and supply sides of the credit and political risk insurance market for equity investments and MLT debt investments. The questionnaire was submitted to all key stakeholders in the market.

This report includes 15 annexes which covers a broad range of research topics that are relevant for this stock take study. From the research, a series of Key Findings are derived, which lead to the main recommendations, listed below.

D. KEY FINDINGS

The key findings from this research have been grouped by the structure of the Study:

I. Main players, concepts and instruments of political and credit risk insurance

Today, there are seven main categories of guarantee / insurance providers that provide risk mitigation products to support equity and / or MLT debt investments in developing countries. Five of these risk mitigation providers are directly or indirectly supported by one government or multiple governments, which characterizes their operations as "officially supported" (in table below "public") and two as commercial guarantee or insurance providers (in table below "private"). Commercial banks and private (re-) insurers do not benefit from any form of "official support".

Overview of Current Guarantee/Insurance Providers

No.	Organization Category	Public/ Private	Core Business Mandate	Acting as "guarantor" or as "insurer"
		Officially supported Guarantees/Insurance		
1	Multilateral Development Banks (MDBs)	Public	Support developing countries	Guarantor
2	Specialized Multilateral Insurers (SMIs)	Public	Support developing countries	Insurer
3	Bilateral Development Banks (BDBs)	Public	Support developing countries	Guarantor
4	Export Credit Agencies (ECAs) ECAs & Export-Import Banks (EXIM banks)	Public	Support national exporters/ national FDI investors	Insurer, but also some guarantee business
5	ODA Aid Agencies (1)	Public	Support developing countries	Very likely mainly as guarantor
		Commercial Guarantees/Insurance		
6	Private (re-)insurers	Private	Commercial	Insurer
7	Commercial banks (2)	Private	Commercial	Guarantor

(1) ODA Aid Agencies currently mainly provide grants and concessional loans. Given the importance of the mobilization of capital through risk mitigation operations it is likely that OAAs will develop more risk mitigation instruments in the near future. The risk mitigation operations of OAAs have in the context of this study not been further researched.

(2) The focus of the G20 Stock-Take study is on political risk insurance for equity investments and MLT debt investments and other insurance solutions. For this reason, the guarantee operations of commercial banks are not further discussed.

There are important differences between (financial) guarantees and insurance products, which have an impact on the relevant applicable regulations (banking or insurance regulations)[3], the way the risk mitigation operations are conducted, the operational costs of the risk mitigation provider, the terms and conditions of the relevant risk mitigation product, the volume of risk mitigation operations and the amounts of mobilized capital.

In their risk mitigation operations MDBs, BDBs (and likely also OAAs) generally operate as "financial guarantors" while ECAs, private insurers and most SMIs operate as credit and political risk "insurers".

MDBs and BDBs offer limited risk mitigation products for MLT debt investments and the provision of guarantees remains a small portion of their portfolio. From the date of their establishment till today all MDBs have been operating mainly as lenders – both in sovereign and non-sovereign operations. During the period 2010 – 2018 the gross guarantee exposure of nine leading MDBs increased from USD 7.3 billion to USD 17.8 billion. This was, however, mainly attributable to the growth of their ST trade finance (guarantee) programs and the exposure exchange arrangements between various MDBs. Partial Risk Guarantees (PRGs) and Partial Credit Guarantees were only used occasionally. While the growth of (MLT) risk mitigation operations of MDBs was in general modest, most MDBs expanded their lending operations substantially in the period 2010 – 2018, which basically confirms their core business.

MDBs and BDBs are currently not active in PRI for equity investments and shareholder loans. Some MDBs and BDBs make, however, important equity investments in developing countries.

Differences Between Guarantees and Insurance

Topic	Guarantees	Insurance
Unconditional & Irrevocable	Yes	No
Examples	Bank guarantees, capital market "financial guarantees"	Credit insurance, political risk insurance
Who is the client of the guarantor/ insurer?	The borrower (banking approach)	The lender (insurance approach)
Which regulations govern private guarantee/insurance providers?	Central Bank regulations	Insurance regulations
Who makes representations to guarantor/insurer?	The borrower	The lender
Who is the key contracting party for the guarantee/insurance provider?	The borrower	The lender
Do BCBS credit substitution rules apply for guarantee/insurance provider?	Yes, if guarantee is unconditional, irrevocable and comprehensive.	Yes, if insurance is comprehensive and all remaining risks are within scope of control of the insured. Credit substitution does not apply to partial/political risk guarantees. Rules on treatment of credit insurance products and insurers may differ among countries depending on national regulations. In some countries credit substitution does only apply to zero risk weighted MDBs and highly rated official ECAs, but not to private insurers and SMIs without an explicit zero risk weighted recognition of the BCBS.

Source: SFI

3 MDBs and SMIs are formally not governed by relevant (inter)national regulations that apply to commercial banking and /or private insurance. However, most of these multilateral institutions apply key standards developed for their peers in the market on a voluntary basis in their operations. That is why many (but not all) Basel regulations that apply to banking are (indirectly) relevant for MDBs and international insurance regulations are (indirectly) relevant for SMIs.

The analysis in the study shows that most MDBs encountered during the past 10 years challenges in developing their MLT risk mitigation operations. Most MDBs provide risk mitigation instruments on the basis of a "guarantee approach" and unlike ECAs, private insurers and SMIs not as an "insurer" and accordingly introduced PCGs and PRGs. Several internal and external factors hinder MDBs in taking full advantage of these risk mitigation instruments. One of them is a consequence of the chosen guarantee approach and concerns "loan equivalent" guarantee pricing.[4] As a result, a MDB loan is cheaper than a commercial bank loan with an MDB Partial Credit Guarantee (PCG), thereby discouraging the use of guarantees / insurance and the mobilization of additional capital from third parties.

The pricing differences in sovereign operations and challenges for insurance of MDB sovereign loans or reinsurance of MDB sovereign guarantees could be solved by introducing blended pricing practices. Given the enormous potential of mobilizing capital for sovereign borrowers and the benefits it can create for developing countries, it is important to investigate the potential of blended pricing practices further.

Comprehensive insurance policies make up the vast majority of business insured by Berne Union members. Of the insurance for equity and MLT debt investments provided by BU members, 83.1% covers comprehensive insurance policies while 16.9% political risk insurance. The vast majority of PRI concerns insurance for equity investments and shareholder loans, with PRI for MLT 3rd party debt investments accounting for a relatively small share (roughly 5% of the overall PRI market). Berne Union data show that comprehensive cover policies are clearly the most commonly used insurance product to mobilize MLT debt capital for development. MLT debt financiers have a strong preference for such comprehensive cover, which was confirmed in on-line survey.

Key players in the credit and political risk insurance market are official ECAs, private insurers and 4 SMIs. ECAs play the leading role in insuring FDI (including shareholder loans) and MLT debt investments, followed by private insurers and SMIs. The top 5 insurers of FDI investments (which includes equity investments) of the BU are: Sinosure (China), PWC (Germany), NEXI (Japan), MIGA (multilateral) and USDFC (USA), but the mandates and operations of these five key players differ substantially.

Insurance holds four main benefits for MLT Debt Financiers. These benefits include:

- Risk mitigation for both commercial and political risks or certain political risks;
- Avoid loss provisioning against bad debts;
- Solution for constraints regarding borrower limits, sector limits and country limits; and
- Solvency benefits for credit risk, when comprehensive cover is used.

The benefits gained by MDBs and Developing Countries from insurance for MLT Debt Investments are numerous. The benefits include:

- Access to finance and new financial markets;
- Better financing terms and conditions than what the (insurance, bank or capital) market would usually offer (e.g. longer tenors and lower pricing);
- Through risk sharing with the beneficiary of the guarantee/insurance, MDBs could mobilize substantial amounts of capital;
- Insurance/guarantees can be used by MDBs for risk transfer purposes and balance sheet optimization, which also contributes to the mobilization of capital;
- Insurance/guarantees assist countries in their transition from dependence on (concessional/non-market based) development finance to market-based finance;
- Insurance can lower substantially the operational costs of development finance; and

4 "Loan equivalent" pricing of guarantees is common in the sovereign operations of most MDBs and also in non-sovereign operations of some MDBs.

- Assist in the development of the financial sector in developing countries.

The benefits of PRI for Equity Investments are manifold. The benefits of PRI for equity investments includes the following:

- Protection against losses that may arise from political risk events;
- Improvement of the risk profile of the FDI investment; and

PRI provided by insurers may assist in the prevention of certain political events.

There is scope for expanding risk transfer operations by MDBs. Public (ECAs and SMIs) and private Insurers that are active in credit and political risk insurance have been successful in mobilizing (private) capital by using reinsurance techniques. This suggests expanding the use of reinsurance by MDBs for their guarantee exposure or insurance for their loan exposure merits further examination.

II. Political risk insurance for equity investments

a. Supply of PRI for Equity Investments

BU net claims were very small for PRI. For 2010-18, investment insurance activities for all BU members were a total of USD 514.7 billion. For the same period, there were USD 1.1 billion claims paid for political risk cover. (ECAs paid 70% of this amount, private insurers 29%, and SMIs 1%). Recoveries were USD 145 million of investment insurance claims paid, so net claims remained under USD 1 billion.

Both Private (re)insurers and Specialized Multilateral Insurers (SMIs) could play a much larger role. ECAs are currently the largest providers. Because they are not restrained by a mandate to only support equity investors from their home country, private (re)insurers and SMIs could, in principle, both play a much larger role as providers of PRI for equity investment.

Cover for South-South equity investment (i.e. equity investments from one developing country into another developing country) has not been a priority. Private insurers could technically support South-South investors; however, most private insurers focus their business on large investors from developed countries, because there are the largest business opportunities. Most of their PRI for equity investments addresses North-South investments (i.e. equity investments from a developed country into a developing country) . SMIs with a mandate to support investments in developing countries have the capability to support South-South investments. Many have also developed a specific strategy to support such South-South investments. In practice, however, the vast majority of the investments supported by SMIs are North-South investments, because this concerns the largest demand for their insurance products. Many countries have an official ECA, but those in developing countries often face constraints to cover equity investments (e.g. too low credit rating, challenges in covering long-term tenors (e.g. 15 years), large amounts and likely also a lack of knowledge about risks and risk mitigation products among potential clients in their markets).

b. Demand for PRI for Equity

Corporates, project sponsors, and commercial banks from developed markets are the most important clients for the insurance of equity investments. Most insurers have limited experience with providing cover to equity investors from developing countries.

Only a small share of FDI into developing countries is insured. Overall, only a relatively small share of the inward FDI into developing countries is insured against political risks. Most FDI investments are uninsured.

Average share inward FDI stock insured of selected countries by IBRD income category during 2010 – 2018.

	Ten LICs	Seven LMICs	Five UMICs	Five Fragile states
Average insured FDI share selected countries	5.4%	3.6%	1.9%	6.2%
Country with highest insured share	Rwanda: 13%	Myanmar: 5.2%	Algeria: 5.9%	Rwanda: 13%
Country with lowest insured share	Liberia: 0.8%	India: 1.8%	Brazil: 0.6%	Liberia: 0.8%

Source: UNCTAD and Berne Union

Substantial differences in insured shares of FDI within the same country income group and among 22 sample countries exist. There are substantial differences in the insured shares of inward FDI stock of individual countries within the same IBRD income group. For example, the average share of insured FDI stock of ten LICs during the period 2010 – 2018 was 5.4%, Within that income category Rwanda had the highest share of insured FDI stock of 13% and Liberia the lowest with 0.8%. This shows that risk perceptions of the market on individual countries differ substantially among countries in the same IBRD income category. The high variability suggests that the nature of foreign investment activity, and risk perception of the various markets, differ significantly. It also indicates that classification of countries based on per capita income is very different than perceived investment risks in each country. Development strategies of MDBs could take these different market risk perceptions into account.

There is a relatively high PRI demand in Fragile States and Conflict-Affected Countries and other high-risk markets. In general, the demand for PRI for equity investment in fragile states and conflict-affected countries is perceived relatively high. Doing more to meet this demand could potentially mobilize some additional capital to strengthen the countries' economies, for which purpose first loss guarantees can be very helpful.

c. Potential Gaps

Awareness of PRI for equity investments needs to be increased with institutional investors. Greater promotion and increasing awareness of the product among institutional investors might encourage additional capital flows.

There is potentially a large gap for South-South PRI investment insurance. The majority of PRI for equity investments is provided by ECAs; however, they will only provide support to equity investors from their home countries. As many developing countries lack an ECA or an ECA that is able to provide adequate investment insurance for equity investments, SMIs could clearly play a complementary role, including through cooperation with local ECAs. Cooperation with local ECAs in developing countries may also be an interesting business opportunity for private insurers.

Domestic equity investments in emerging markets also can face political risks. It may be worthwhile to examine demand from potential domestic equity investors for cover against certain political risks as most insurers only cover foreign direct investments. This could be relevant for cover against insurrection risk and breach of contract risk in PPP projects, in which local investors make an equity investment. This could potentially be an interesting business area for SMIs and private insurers.

There is limited supply of insurance for equity investments from SMEs and small value investments. SMEs and small investment appear to be underserved for political risk cover. This is a potentially interesting area for cooperation between SMIs and ECAs.

d. Potential Solutions

Enhanced cooperation between MDBs and SMIs may address identified market gaps. Survey respondents indicate that MDBs and SMIs could play a more prominent role through co- and re-insurance and other forms of cooperation. They are also seen to tackle the unmet demand for PRI of equity investments in fragile states or other high-risk markets. Another opportunity to address market gaps in developing countries is by providing capacity building to local ECAs.

First loss guarantees can help to unlock additional insurance capacity. The survey results, which varied considerably by group, suggest a first loss guarantee might help to create additional insurance capacity in low income markets, fragile states and conflict-affected countries, and high-risk OECD category 7 countries. First loss guarantees are not new, and there are various examples of concessional (ODA) funds being used on a transaction basis and as a facility. For example, in FY 2018 IDA created a special risk mitigation facility for MIGA to catalyze private sector investment in IDA-only countries, with a focus on fragile and conflict-affected states (FCS). The IDA -MIGA Guarantee Facility (MGF) amounts to a first loss insurance capacity of USD 500 million, which allows MIGA to expand its insurance operations to markets where it has no or very limited insurance capacity / risk appetite. Since 2018, MIGA has used the IDA first loss guarantee regularly. The IDA first loss exposure outstanding at the end of FY 2019 was USD 89 million[5]. Given the success of MIGAs first loss facility it makes sense to explore whether first loss arrangements can be broadened and developed for other official equity insurance providers (e.g. other SMIs and official ECAs).

Greater promotion of the PRI product with new client segments such as investors from developing countries and institutional investors may also mobilize additional private sector funds.

III. Political risk insurance and other insurance solutions for MLT debt investments

a. Supply for Political and Credit Risk Insurance for MLT Debt Investments

Among providers of guarantees and/or insurance, the importance of these instruments varies. However, comprehensive credit insurance is the dominant insurance and its business share has during the past 8 years significantly increased with SMIs and private insurers. Guarantees currently play a very modest role in the operations of MDBs. Lending has traditionally been and is today still their main development finance activity. ECAs in contrast make significant use of insurance and guarantees; comprehensive credit insurance represents 85.5% of ECA exposure in 2018. Political risk cover, generally used for equity investments and shareholder loans, represented only 14.5% of ECA cover. For SMIs, comprehensive cover has grown substantially, from less than 7% of overall SMI exposure in 2011, to 44% in 2018. The supply of political risk-only business by private insurers has been rather stable but the share of political risk business in total business of private insurers fell from 49% in 2010 to 24% in 2018.

There is in general good insurance coverage for debt investment in upper- and middle-income countries. These countries have good to reasonably good access to commercial finance, and there seem to be good opportunities for selective risk-sharing by MDBs with commercial parties through:

- The insurance of MDB sovereign loans (with blended pricing);

5 Source: IDA Financial Statements FY 2019.

- MDB/SMI insurance of sovereign loans provided by commercial debt financiers; and
- Reinsurance for MDB/SMI insurance of sovereign loans provided by commercial debt financiers.

However, cover in selected OECD Category 7 countries varies substantially. Risk cover for MLT debt in selected OECD Category 7 countries from ECAs, Multilateral and private insurers varied significantly, from a high in Ethiopia to a low in Chad.

b. Demand for Political and Credit Risk Insurance for MLT Debt Investments

Commercial banks from developed markets are the most important clients. Commercial banks from developed markets are much more important than commercial banks in developing countries for the MLT insurance operations of SMIs, ECAs and private insurers. At the same time commercial banks in developing countries have little experience with MLT financing. Furthermore, credit and political risk insurance instruments are not well known and/or recognized as adequate risk mitigation instruments by national regulators. As a consequence, local banks in many developing countries do not or hardly make use of credit and political risk insurance. And this negatively affects the mobilization of capital from local banks in developing countries.

Institutional investors from both developed and developing countries – as clients for insurance – play a less important role for ECAs, private insurers and SMIs. This is caused by limitations on the product side (i.e. recognition as risk mitigation tool, lack of unconditional guarantees, portfolio versus transaction investment approach), as well as limited experience of institutional investors in developing countries and lack of knowledge about credit and political risk insurance products. Comfort building regarding the value of credit and political risk insurance/ guarantees is likely very important to create a greater interest among institutional investors to make use of these products for their MLT debt investments in developing countries. The GEMS risk database[6] could play an important role in this area, by collecting data about the claims payment track records of the main insurance and guarantee providers.

Access to commercial credit decreases in line with the country's falling income level and increasing OECD Country risk rating. While potential for risk sharing in private sector transactions might exist in these countries, sovereign borrowers need to increasingly rely on funded MDB support.

c. Potential Gaps

There are many gaps in cover for MLT debt investments. Many potential gaps have been identified in the market for commercial and political risk insurance for MLT debt investments, with a range of views from stakeholders on the size and severity of the various gaps. However, a large percentage of buyers and suppliers of insurance agree on a significant gap for comprehensive insurance of public as well as private sector investments in high-risk markets, as well as for comprehensive insurance in project finance of PPP projects, MLT debt investments in SMEs in developing countries (e.g. working capital) and low value MLT debt investments.

d. Potential Solutions

ECAs, SMIs and MDBs are considered the most important providers of insurance/guarantees for MLT debt investors. Official guarantees from MDBs, ECAs and SMIs have greater value for the market than private insurance, likely due to the fact that private insurance is less favorably treated in Basel II and III regulations than official insurance/guarantees.

6 For more information about the GEMS risk database it is referred to its website http://www.gems-riskdatabase.org/members/index.htm

MDBs could use more risk transfer techniques. The lending activities of MDBs have been dominated by a "buy and hold strategy". Yet insurance of MDB loans can be a very effective risk transfer tool to mobilize capital from 3rd parties and improve an efficient utilization of MDBs' own scarce capital resources.

Insurance can mobilize capital. The insurance model of ECAs, private insurers and SMIs helps to explain their success in cooperating with MLT commercial debt financiers, particularly commercial banks. Especially, comprehensive cover is an effective insurance product for mobilizing capital from 3rd parties. It is effective because it provides adequate cover against all payment risks and leads to important capital relief benefits for commercial banks. Furthermore, IFC and AfDB have executed risk transfer operations (through the insurance of part of their loan portfolios) that led to substantial capital relief and allowed both institutions to expand their lending operations.

Local banks and institutional investors present an untapped opportunity to mobilize additional capital to strengthen the private sector– however challenges exist. Given the demand for local currency financing and strengthening of local financial sectors, local banks constitute an important source to improve access to finance for the developing countries' local economies.

Use of first loss guarantees is of potential interest to mobilize additional MLT debt investments. first loss guarantees are regarded useful to increase insurance capacity for relatively high-risk markets, fragile states and LICs. They may also be helpful for business in middle income countries, but the added value of first loss guarantees is likely much lower than for relatively high-risk markets. Given the strong preference in the market for comprehensive cover it is important that a first loss arrangement for the insurance of MLT debt investments is able to offer comprehensive cover for loans to both public and private borrowers (including project finance loans in PPP projects). First loss guarantees could potentially be funded by concessional windows of MDBs and bilateral ODA Aid Agencies.

Additional insurance capacity could have an impact in higher risk markets. The survey indicates a view that additional insurance capacity for relatively high-risk markets will substantially improve the availability of MLT debt investments for these countries. This also matches the survey results with regard to the potential gaps.

There is no consensus around sharing Preferred Creditor Status. While there could be interesting benefits to mobilize capital from sharing PCS for sovereign operations, this is less valuable for private sector transactions. Given the potential benefits (e.g. lower pricing, longer tenors more general insurance capital and more specific capital for relatively high-risk markets), it worthwhile to examine this topic further. However, the country's overall external debt and the shares of MDB and commercial debt of countries matter. Any potential mobilization impact would be transaction- and country-specific and would also depend on the strength of the relevant MDB's PCS. Some MDBs or SMIs have a stronger PCS than others.

E. RECOMMENDATIONS

This stock-take exercise intends to assess the current state of the MLT guarantee/ insurance market for equity and MLT debt investments. It provides evidence and findings on current and potential practices, challenges, and potential market gaps, for both users and providers of credit and political risk cover for equity and MLT debt. It considers options and potential solutions for how the identified market gaps could be addressed, particularly for low income countries and fragile states.

Based on this paper's analysis, key findings and conclusions, the following broad recommendations have been developed:

RECOMMENDATION #1: FOSTER INCREASED AWARENESS OF CREDIT AND POLITICAL RISK INSURANCE IN ORDER TO MOBILIZE ADDITIONAL PRIVATE CAPITAL FOR DEVELOPMENT FROM LOCAL BANKS AND INSTITUTIONAL INVESTORS (INTERNATIONAL AND DOMESTIC).

RECOMMENDATION #2: CONSIDER EXPANDING INSURANCE AND GUARANTEE OFFERINGS OF MDBs AND SMIs.

RECOMMENDATION #3: EXPAND THE COMPLEMENTARY ROLE FOR MDBs AND SMIs TO COVER EQUITY INVESTMENTS.

RECOMMENDATION #4: ENCOURAGE THE MDBs TO CONTINUE COLLECTING AND SHARING RISK INFORMATION AND DATA SUCH AS GLOBAL EMERGING MARKETS ("GEMs") RISK DATABASE.

01

Introduction

01 Introduction

1.1 BACKGROUND AND OBJECTIVES

In the context of G20 follow-up discussions on the Eminent Persons Group (EPG) report in preparation for the G20 meetings in November 2020 chaired by Saudi Arabia, ICIEC has been requested to conduct a Stock-Take Study on the use of insurance in support of equity investments, and medium and long-term (MLT) debt investments, as well as other insurance solutions.

The Stock-Take Study focuses on the mobilization of additional equity investments and MLT debt investments for infrastructure and other industrial projects. The study also aims to describe potential solutions to crowd-in the additional capital needed to meet the objectives of the UN Sustainable Development Goals (UN SDGs). The developing countries in question for the purpose of this study are in particular Least Developed Countries (LDCs), Low-Income Countries (LICs), fragile states and post-conflict countries.

The objectives of the Stock-Take Study are the following:

- To provide a complete and comprehensive overview of the global market for MLT credit and political risk insurance products that can be used to support equity investments and MLT debt investments, particularly for infrastructure projects in developing countries.
- To describe how credit and political risk insurance products can be effectively used to mobilize additional private capital for development in developing countries.
- To identify potential gaps and constraints in the global credit and political risk insurance market based on an assessment of the main needs and potential constraints of existing and potential new users of credit and political risk insurance for equity investments and MLT debt investments in developing countries.
- To provide concrete proposals on how the identified gaps in the credit and political risk insurance market could be addressed by a joint initiative of MDBs.
- To identify potential areas for cooperation and joint capacity building efforts by MDBs directed towards increasing investment from international banks and international institutional investors and local banks and domestic institutional investors into developing countries.

1.2 METHODOLOGY

In order to achieve the objectives of the study, both primary and secondary research was conducted. As part of the primary research, surveys to both users and suppliers of credit and political risk insurance were designed and distributed, in order to determine the supply and demand sides of the market. The secondary research contained a review and analysis of various publicly available publications and statistics, specifically focussing on the types of institutions in Table 1-1 and the countries listed in Table 1-2.

1.2.1 Primary Research

Primary research was conducted in order to determine the potential market gaps in the credit and political risk insurance market for equity and MLT debt in the countries of interest as well as potential solutions to those gaps. As part of the research, feedback from both the demand and supply side was collected and analyzed. To this end, ICIEC distributed online surveys to the relevant users and suppliers of MLT credit and political risk insurance products. This included the institutions listed in Table 1-1 below.

The relevant questionnaire was submitted to all key stakeholders in the market as of March 2020. The online survey was completed by 64 stakeholders. Of these, the supply perspective was derived from feedback from 42 stakeholders, which included 7 Multilateral Development Banks (MDBs), 4 Specialized Multilateral Insurers (SMIs), 22 official Export Credit Agencies (ECAs) and 9 private insurers/reinsurers. The demand perspective, from users or facilitators of the insurance product, was derived from 22 stakeholders. These included 5 leading credit and political risk insurance brokers as well as 17 commercial debt providers, of which 16 are international banks and one institutional investor.

A complete overview of the survey response analysis can be found in annex I.

Table 1.1 - Stakeholder Categories Surveyed (number of respondents between brackets)

Key Suppliers	Key Users
Multilateral Development Banks (7)	Commercial Banks (16)
Specialized Multilateral Insurers (4)	Institutional Investors (1)
Official Export Credit Agencies (22)	Credit and Political Risk Insurance Brokers (5)
Private Insurance and Reinsurance Companies (9)	

1.2.2 Secondary Research

The secondary research contained a review and analysis of publicly available documents, literature, policy papers and statistics for the institutions and countries analyzed as part of the study.

To assess the guarantee or insurance operations of the relevant MDBs, SMIs, ECAs and private insurers and identify potential market gaps, various publications and sources of data were examined. This included a review of relevant publications such as their annual reports, as well as a review of the information listed on their websites. For ECAs, private insurers and SMIs specifically, this desk review included an in-depth analysis of statistics published by the Berne Union[7].

In order to gain an indication of the share of FDI that is insured against political risks, the inward FDI flows and inward FDI stock of the countries listed in Table 1-2 was analyzed. To assess the amounts and

7 The Berne Union is the global association of leading export credit and political risk insurers, consisting of 50 ECAs, 13 private insurers and 4 SMIs.

shares of external debt to MDBs and to other public and private/commercial creditors (non-MDB debt), the stock of external debt of these same countries was analyzed.

Additionally, an analysis of Basel regulations was conducted (see Annex IV). These regulations apply to the operations of commercial banks and have an important impact on the utilization of guarantees and credit and political risk insurance products. This was done in order to explain one of the key challenges for the mobilization of capital from banks in both developed and developing countries.

Table 1.2 – Countries Selected for the MDB G20 Stock-Take Study[(1)]

LICs	LMICs	UMICs	Fragile States and Conflict Affected Countries
Afghanistan (7)	Bangladesh (5)	Algeria (5)	Afghanistan (7)
Benin (6)	India (3)	Brazil (5)	Chad (7)
Chad (7)	Indonesia (3)	China PR (2)	Liberia (7)
Ethiopia (7)	Kenya (6)	Mexico (3)	Myanmar (6)
Liberia (7)	Myanmar (6)	South Africa (4)	Rwanda (6)
Nepal (6)	Ukraine (6)		
Niger (7)	Zambia (7)		
Mozambique (7)			
Rwanda (6)			
Tanzania (7)			

(1) OECD ECA country risk rating (as at January 2020) indicated in brackets. All developing countries are rated by OECD ECAs in 7 country risk categories of which 1 is the lowest and 7 the highest risk category.

1.3 STRUCTURE OF THE REPORT

Chapter 2 provides an overview of the main providers of credit and political risk insurance, their mandates, main MLT insurance products, key business practices and their roles in the global credit and political risk market. Furthermore, it describes key developments in the credit and political risk insurance market, the main differences between guarantee and insurance products, and the benefits of MLT credit and political risk insurance products for various clients.

Chapter 3 examines the issue of political risk insurance for equity investments. It discusses the supply of PRI cover for equity and examines areas of demand for and use of this cover, by client and by country. PRI cover by IBRD and OECD country category is considered, focusing on the use of PRI for equity investments in 22 selected countries, notably low-income countries and fragile states. It reviews the survey conducted by ICIEC and probes the possible gaps in PRI cover for equity, and the limitations in the current market. Potential solutions and ways to close potential market gaps are outlined, and some conclusions are reached.

Chapter 4 examines the availability and use of political risk insurance and other insurance options for MLT debt, beginning with the supply of insurance for MLT debt financing and then examining demand for and use of this cover, by client and by country. It considers the external debt of 22 selected developing countries, notably low-income countries and fragile states, focusing on the MDB share of each country's debt. It examines the survey and probes the possible gaps in insurance for MLT debt financing, and the limitations or constraints in the current market. Potential solutions and ways to close potential market gaps are outlined, and conclusions are reached.

Chapter 5 provides a number of recommendations.

02

Main Providers and Instruments of Political And Credit Risk Insurance

02 Main Providers and Instruments of Political And Credit Risk Insurance

2.1 MAJOR GUARANTEE AND INSURANCE PROVIDERS

In the global guarantee/insurance market, there are broadly seven main categories of players:

- Multilateral Development Banks (MDBs)
- Specialized Multilateral Insurers (SMIs)
- Bilateral Development Banks (BDBs)
- Official Export Credit Agencies (ECAs), which include ECA-insurers and Export-Import Banks (EXIM banks)[8]. This category includes also specialized official investment insurers[9]
- ODA Aid Agencies (OAAs)[10]
- Private Insurers and Reinsurers (PRIs)
- Commercial banks

Commercial banks, MDBs and BDBs generally operate as "financial guarantors" while ECAs, private insurers and most (but not all) SMIs operate as credit and political risk "insurers".

Table 2.1 - Overview of Current Guarantee/Insurance Providers

No.	Organization Category	Public/ Private	Core Business Mandate	Acting as "guarantor" or as "insurer"
		Officially supported Guarantees/Insurance		
1	MDBs	Public	Support developing countries	Guarantor
2	SMIs	Public	Support developing countries	Insurer
3	BDBs	Public	Support developing countries	Guarantor
4	ECAs & EXIM banks	Public	Support national exporters/ national FDI investors	Insurer, but also some guarantee business
5	ODA Aid Agencies (1)	Public	Support developing countries	Very likely mainly as guarantor
		Commercial Guarantees/Insurance		
6	Private (re-)insurers	Private	Commercial	Insurer
7	Commercial banks (2)	Private	Commercial	Guarantor

(1) ODA Aid Agencies currently mainly provide grants and concessional loans. Given the importance of the mobilization of capital through risk mitigation operations it is likely that OAAs will develop more risk mitigation instruments in the near future. The risk mitigation operations of OAAs have in the context of this study not been further researched.

8 Most EXIM banks are mainly lenders, but many offer also insurance and/or guarantee products.
9 Two well-known official specialized investment insurers are PWC in Germany and USDFC (formerly known as OPIC) of the USA.
10 OAAs have thus far been mainly active in providing grants and concessional loans. In the context of mobilization of capital for the UN SDGs it is expected that they will become more active in providing guarantees in the future. Today, their guarantee activities are limited and therefore not further analysed in this study.

(2) The focus of the MDB G20 Stock-Take study is on political risk insurance for equity investments and MLT debt investments and other insurance solutions. For this reason, the guarantee operations of commercial banks are not further discussed.

2.1.1 Multilateral Development Banks

MDBs are primarily lending institutions, but many are also involved in providing equity investments and guarantee operations. When MDBs provide a risk mitigation instrument it is usually in the form of a guarantee and not in the form of an insurance product.

None of the MDBs are currently providing political risk insurance for equity investments. Their guarantees are only used to support MLT debt investments. For this reason, the guarantee operations of MDBs are further explained in Chapter 4, which covers political risk insurance for MLT debt investments and other insurance solutions. Annex II provides a broad overview of the development guarantee activities of all the individual MDBs during the period spanning from 2010 to 2018.

As outlined in Table 2-2, MDBs today are primarily development lenders. The key MDB products include loans, equity investments and guarantees.

Table 2.2 - Composition of Leading MDBs Outstanding Exposure at Year-End 2018 (million USD)

No.	MDB	Loans	Equity	Guarantees	Total
1	ADB	106.405,00	1.280,00	2.631,00	110.316,00
2	AfDB	26.637,06	1.196,70	1.239,47	29.073,23
3	AIIB	4.709,49	32,86	0	4.742,35
4	EBRD	27.809,30	5.361,85	1.003,44	34.174,59
5	EIB (Only Non-EU) (1)	48.642,70	663,61	2.087,59	51.393,90
6	IaDB	93.377,00	0,00	454,00	93.831,00
7	IBRD	191.983,00	0,00	7.430,00	199.413,00
8	IFC	23.609,00	13.032,00	4.096,00	40.737,00
9	IsDB (2)	19,663.55	1,722.81	0	21,386.37
	Total	**523.172,55**	**21.567,02**	**18.941,50**	**563.681,07**

Source: Annual reports 2018 of relevant MDBs.

(1) Approximately 10% of EIB's operations concerns non-EU countries.
(2) IsDB provides credit and political risk insurance through ICIEC.

2.1.2 Specialized Multilateral Insurers

SMIs are not involved in direct lending operations and do not make equity investments, which distinguishes them from multilateral development banks. Existing SMIs operate under various mandates and in different geographical regions, which makes it difficult to compare the SMIs among each other or with other insurance providers (e.g. official ECAs or private insurers).

Some SMIs are permitted to only cover political risks (or non-commercial risks), while others also cover commercial risks on private sector borrowers. Some SMIs only cover MLT investment risks, while others can cover ST and MLT trade (export and import) transactions, offer bond insurance and MLT investment

insurance for both inward and outward FDI. All SMIs can provide insurance for both equity and debt investments (e.g. ATI, Dhaman, ICIEC and MIGA). Unlike MDBs and BDBs, SMI operate as credit and political risk insurers and not as financial guarantors.

Table 2.3 - Most well-known Specialized Multilateral Insurers

No.	Specialized Multilateral Insurer*	S&P LT foreign currency credit rating
1	African Trade Insurance Agency (ATI)	A
2	Arab Investment & Export Credit Guarantee Corporation (Dhaman)	AA-
3	Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC)	Aa3 (Moody's)
4	Multilateral Investment Guarantee Agency (MIGA)	Not explicitly rated, but explicitly recognised as a zero-risk weighted MDB by the Basel Committee on Banking supervision (BCBS).

Most SMIs have substantially less capital than MDBs. For example, when comparing MIGA's paid-in-capital to that of other World Bank Group members, it shows that IFC's paid-in capital in 2018 was 7 times that of MIGA, while IBRD's paid-in capital was almost 45 times higher than that of MIGA. These capital differences, combined with substantial differences in the mandates of the three WB Group members, have an impact on the operations of these institutions, particularly in high-risk markets. It also explains why for MIGA (and other SMIs) cooperation with the private market (mainly through reinsurance) is far more critical than for most MDBs. Obviously, the dependence of private reinsurance capital also places restrictions on the risk appetite of SMIs and the insurance terms and conditions they can offer.[11] Noteworthy is that total equity in ATI (independent SMI) stood in 2018 at USD 262 million and that of and ICIEC (part of the IsDB Group) at USD 207 million.

Table 2.4 – Shareholder Equity Participation in WB Group Members 2018 (Million USD)

WB Group Member	Subscribed Capital	Paid in Capital	Callable Capital
IBRD	274,730	16,456	258,274
IFC	2,566	2,566	-
MIGA	1,919	366	1,553

Sources: Annual reports and financial statements, IBRD, IFC and MIGA 2018.

The operations of the four specialised insurers – ATI, Dhaman, ICIEC and MIGA – are further explained in Annex II, which provides a broad overview of the MLT insurance activities of these four SMIs during the period 2010 - 2018.

2.1.3 Bilateral Development Banks

Bilateral Development Banks (BDBs) are comparable to MDBs, as they are mainly involved in providing development loans. Some are also active in providing equity investments and guarantees.

BDBs outlined in this study consist of (1) public sector-oriented development banks (e.g. KfW) and (2) private sector-oriented development banks. The main products currently used by public sector

11 The strategic partnership between SMIs and private (re-)insurers implies that SMIs cannot charge – for the insurance they provide and for which they seek reinsurance – premium rates which are below market rates.

development banks are concessional (ODA) and semi-concessional development loans[12] and grants. They are typically not very active in providing MLT guarantees, which is largely linked to the current ODA framework that does not yet adequately account for guarantees. But this is likely going to change in the near future.

Bilateral private sector-oriented development banks' main activities are development loans to private sector borrowers, (quasi) equity investments (either directly or through funds), while only a small portion of their business concerns guarantees. The total portfolio of fifteen European Development Finance Institutions (so-called EDFI members) in 2018 amounted to approximately USD 40 billion. Of this sum, equity and quasi-equity comprised 55% of the portfolio, while 43% consisted of lending products and only 2% of the portfolio took the form of guarantees. EDFI members do not cover political risk for equity investments. Their guarantees usually only support MLT debt investments. Annex II provides a broad overview of the guarantee activities of the members of the European DFI (EDFI) Association along with their equity, quasi equity, and lending activities.

Most BDBs offer like MDBs financial guarantees and not credit and political risk insurance.

Table 2.5 - Composition of the Portfolios of EDFI Members year end 2018 by Product Type (Million Euro)

		Total Portfolio		Proportion			Guarantees
EDFI Member	**Country**	**Mill Euro**	**Mill USD**	**Equity/ Quasi Equity**	**Loans**	**Guarantees**	**Mill USD**
BIO	Belgium	757	855	35%	65%	0%	0
CDC	United Kingdom	7.906	8.934	74%	20%	6%	536
COFIDES	Spain	1.053	1.190	49%	51%	0%	0
DEG	Germany	8.143	9.202	44%	56%	0%	0
FinnFund	Finland	838	947	54%	46%	0%	0
FMO	Netherlands	9.551	10.793	38%	58%	4%	432
IFU	Denmark	779	880	65%	32%	2%	18
Norfund	Norway	2.486	2.809	82%	18%	0%	0
OeEB	Austria	1.193	1.348	29%	65%	6%	81
Proparco	France	5.002	5.652	16%	78%	6%	339
SBI-BMI	Belgium	38	43	100%	0%	0%	0
SIFEM	Switzerland	683	772	80%	20%	0%	0
SIMEST	Italy	1.084	1.225	68%	32%	0%	0
SOFID	Portugal	7	8	32%	68%	0%	0
Swedfund	Sweden	455	514	60%	40%	0%	0
Average				55%	43%	2%	
Total		**39.975**	**45.172**				**1.405**

Source: EDFI annual report 2018 and website.

12 These non-ODA development loans are often called preferential loans or promotional loans. For example, KFW the German development bank offers promotional loans to borrowers in developing countries at "close-to-market rates" to fund and secure projects that are economically viable and have effective development objectives but do not manage to acquire funding from commercial markets. See: https://www.kfw-entwicklungsbank.de/Download-Center/PDF-Dokumente-Finanzprodukte/Merkblatt_Förderkredit_en.pdf

The US Development Finance Corporation (USDFC), formerly known as OPIC, is the U.S.'s bilateral DFI. It provides both investment loans and investment insurance. It recently expanded its mandate to provide equity investments. Unlike EDFI members, USDFC can cover political risks through investment insurance for both equity and MLT debt investments.

In Japan, the Japan Bank for International Cooperation (JBIC) has a dual mandate in terms of providing development and export finance. As such, the bank provides development loans and guarantees, untied investment loans and guarantees, and export credits. JBIC is currently one of the largest bilateral EXIM/ development banks in the world.

2.1.4 Official Export Credit Agencies

Official Export Credit Agencies (ECAs) and specialized bilateral investment insurers (SBIIs) have mandates to support national exporters and investors, grow exports, sustain and grow employment and promote national companies abroad. They are mainly providers of insurance products, although for some ECAs certain products can be characterized as guarantees[13]. Most EXIM banks across the world have also a capability to provide, in addition to their lending and guarantee products, credit and political risk insurance.

Most ECAs in developed markets provide credit and political risk insurance for both equity investments and MLT debt investments. However, they are typically restricted by their mandates to only support national investors and exports/exporters.

The actual investment insurance activities for equity investments of individual ECAs in developed economies differ substantially. Some have little or no investment insurance business. Some offer in addition to PRI for equity and debt investments also comprehensive cover for 3rd party investment loans, whereas others only cover PRI for equity investments, shareholder loans and in some cases also for 3rd party investment loans. It has not been investigated why there are such big differences among ECAs in developed markets. Most ECAs in developing countries with a rating below S&P A, have limited or no experience with the insurance of equity investments. Key challenges are not only their credit rating, but also constraints in covering long tenors and relatively large investment amounts.

In some countries, two different agencies are involved in the provision of export credit and investment insurance. This is the case in the USA, where USEXIM provides official export credits support (through loans, guarantees and insurance products) and USDFC provides investment insurance (in addition to investment loans). In Germany there are also two separate agencies, namely the private insurer Euler Hermes, which conducts part of its export credit insurance operations for the account of the German government, and PricewaterhouseCoopers (PWC) that acts as the official investment insurance agency.

Table 2-7 below shows the list of existing official ECAs, EXIM banks and official investment insurers in G20 member countries. Similar organizations exist in many other developed and developing countries. Of the G20 members 11 members (including the EU) are full member of the OECD Arrangement on officially supported export credits[14]. Brazil is a participant to the OECD sector understanding for officially supported export credits for aircraft. Ten G20 member are currently not a full and permanent member of the Paris Club. Most ECAs of G20 countries are a member of the Berne Union, the global association of credit and political risk insurers.

13 Many ECAs also provide bond cover, which concerns cover for advance payment bonds, maintenance bonds, performance bonds and bid bonds. The cover is in many cases provided in the form of a guarantee. ECA cover for export credits and/or investments, which are the two key areas of ECA operations, is usually provided in the form of insurance.

14 The Arrangement is a «gentlemen›s agreement» amongst its Participants: Australia, Canada, the European Union, Japan, Korea, New Zealand, Norway, Switzerland, Turkey and the United States. The main purpose of the Arrangement is to provide a framework for the orderly use of officially supported export credits by fostering a level playing field in order to encourage competition among exporters based on quality and prices of goods and services exported rather than on the most favourable officially supported export credits. The OECD Arrangement has many common "core standards" to avoid unfair competition and a credit subsidy race among OECD ECAs/ governments.

The business of official ECAs and EXIM banks is further explained in Annex III. This Annex covers among others more detailed information about the history of ECAs, their mandates, main ECA products and pricing practices, international regulations applicable to ECA operations and a brief description of key international challenges in today's ECA world.

Table 2.6 - Official ECA-Insurers, EXIM Banks and Investment Insurers in G20 Countries

No.	Country	S&P Sovereign Credit Rating	Official ECA-Insurer	Official EXIM Bank	Official Investment Insurer (2)	Participant in OECD Arrangement on Officially Supported Export Credits	Full & Permanent Member of The Paris Club
1	Argentina	CCC-	Unknown	Unknown	Unknown	No	No
2	Australia	AAA	Export Finance Australia	Export Finance Australia		Yes	Yes
3	Brazil	BB-	ABGF	BNDES		Only for OECD Aircraft sector understanding	No
4	Canada	AAA	EDC	EDC		Yes	Yes
5	China PR	A+	SINOSURE	China EXIM bank		No	No
6	Germany	AAA	Euler Hermes		PWC	Yes	Yes
7	France	AA	BPI France			Yes	Yes
8	India	BBB-	ECGC	India EXIM bank		No	No
9	Indonesia	BBB	ASEI	Indonesia EXIM bank		No	No
10	Italy	BBB	SACE			Yes	Yes
11	Japan	A+	NEXI	JBIC		Yes	Yes
12	Mexico	BBB+	Bancomext	Bancomext		No	No
13	Russian Federation	BBB-	EXIAR			No	No
14	Saudi Arabia	A-	SEP	Will be established shortly		No	No
15	South Africa	BB	ECIC			No	No
16	South Korea,	AA	Ksure	Korea EXIM bank		Yes	Yes
17	Turkey	B+	Turkish EXIM bank	Turkish EXIM bank		Yes	No
18	United Kingdom	AA- (Fitch)	UKEF	UKEF (direct lending facility)		Yes	Yes
19	United States (2)	AAA (Fitch)	USEXIM Bank	USEXIM Bank	USDFC	Yes	Yes
20	European Union (3)	AA	N.A.	N.A.		Yes, on behalf of EU member states	N.A (3)

Source: Berne Union and research by SFI.

(1) S&P Sovereign credit rating as at January 2020.

(2) In most countries the ECA-insurer provides both export credit insurance and investment insurance. Among the G20 countries, only in the USA and Germany there are two separate government agencies involved in these two lines of official insurance operations.

(3) The European Union does not have an ECA-insurer or EXIM bank and is not a member of the Paris Club. ECA/EXIM activities are undertaken by individual EU member states.

(4) The entities in bold and italics are member of the Berne Union, a global association of leading credit and political risk insurers. Almost all G20 members have insurance agencies that are member of the Berne Union. The only exceptions are Argentina and Russia.

2.1.5 Private Re-Insurers

Private insurers and reinsurers usually only provide insurance products and not financial guarantees. They have the capability to cover both equity investments and MLT debt investments. Most of the business of private insurers for MLT debt investments is trade related and therefore supports export - and/or import transactions. However, during the past 10 years, many insurers have also progressed to non-trade related credit and political risk insurance.

Table 2.7 - Leading Private Insurers Active in MLT Credit and PRI

No.	Private Insurers	S&P Long Term Foreign Currency Credit Rating	No.	Private Insurers	S&P Long Term Foreign Currency Credit Rating
1	AIG	A+	11	FCIA	A+
2	Aspen	A	12	Lancashire	A-
3	Atradius	A (A.M. Best)	13	Liberty Mutual	A
4	AXA XL	AA-	14	Lloyds [1]	A+
5	Chubb	AA	15	SCOR UK	AA-
6	Coface	AA- (Fitch)	16	Sovereign	AA
7	Euler Hermes	AA	17	Starr	A (A.M. Best)
8	Everest insurance	A+	18	Swiss Re	AA-
9	Fidelis	A-	19	Tokio Marine HCC	AA-
10	Hartford Financial services	A+ (A.M. Best)	20	Zurich	AA-

(1) Lloyds is not a corporate insurer but a market of Lloyds syndicates.

The business of private insurers is further explained in Annex V. This Annex covers among others more detailed information about the main products and pricing practices, key developments in the private (re-) insurance markets and the cooperation between the private market and official insurers / guarantors.

2.2 OVERVIEW OF CLIENTS/BUYERS OF INSURANCE / GUARANTEES

2.2.1 Commercial Banks

International commercial banks are the most active users of MLT guarantees and insurance. The financial instruments allow banks to mitigate the various commercial and political risks associated with their lending operations. Important is also that comprehensive insurance policies provide capital relief. They also constitute an important source of collateral.

2.2.2 Corporates/SMEs

Many corporates today are active users of trade credit insurance for their domestic as well as export business. Exporters are often well versed in the various insurance products mitigating potential export-related risks (i.e. performance guarantees, contract bonds and buyer credit insurance). When corporates start investing abroad, they also might require forms of political risk insurance. Typically, SMEs are less

versed with available insurance/guarantee products as larger corporates, given their comparatively limited resources and often smaller margins.

2.2.3 Project Sponsors/Investors

Project Sponsors (often in close cooperation with their nominated arranger banks) are responsible for structuring the project and often provide initial seed funding. Their interest is to protect their investments against political interference. At the same time, they work to achieve financial viability of the project. As such, they are interested in finding solutions to mitigate any identified risks that would prevent commercial financiers entering the transaction.

As investors provide the necessary equity, they are typically similarly interested in mitigating any risks that might threaten the economic and financial viability of the project/investment.

2.2.4 Institutional Investors

Institutional investors are not yet common clients of guarantees/insurance products. However, examples exist where risk mitigation instruments were used to make capital market debt financing more attractive, especially in developing countries. This concerned mainly sovereign bond issues.

2.3 OVERVIEW OF MAIN INSURANCE AND GUARANTEE PRODUCTS

Credit and political risk insurance is by far the most frequently used risk mitigation product in financing international trade and cross border equity and MLT debt investments. The insurance or guarantee products that are globally available can be broadly categorized into three main categories:

i. "Classical" political risk policies, which in general cover transfer risk, inconvertibility risk, expropriation and (civil) war. Such policies are typically used to cover equity investments and to a much lesser extent MLT debt investment (e.g. shareholder loans or 3rd party loans, of which the latter are usually commercial bank loans).

ii. "Extended" political risk policies, which covers the four "classical" political risks and breach of contract. Extended political risk policies are typically used in project finance transactions whereby the borrower – often a Special Purpose Company (SPC) – has various contractual arrangements with the government or government-owned agencies. This may include concession agreements, LT offtake contracts, LT supply contracts or contractual subsidy arrangements. The breach of contract cover can protect the (shareholders of the) SPC and/or the debt financing bank(s) against losses that are caused by an unfair repudiation of contractual obligations by the government (or its agency). Some insurers are also able to provide "breach of contract" cover on a stand-alone basis (i.e. without covering the four "classical" political risk).

iii. Comprehensive cover policies cover all payment risks on either a public sector borrower (sovereign, sub sovereign or SOE) or a private sector borrower. Comprehensive cover policies with private borrowers provide protection against both commercial risks and political risks.

Comprehensive cover is not available for the insurance of equity investments and shareholder loans. Equity investments or shareholder loans can only benefit from PRI cover, because the mother company that makes the investment is able to control the commercial risks on the daughter company in which the equity or debt investment is made. Comprehensive cover for such inter-company financing arrangements would cause potential conflicts of interest. For this reason, such inter-company financing arrangements through equity or shareholder loans are only eligible for political risk cover.

"Classical" political risk policies can also be used to insure MLT debt investments such as 3rd party investment loans (e.g. a bank loan to a private borrower in a developing country) or trade finance loans, but this is less common. Most 3rd party investment loans benefit from comprehensive cover. In project finance, MLT debt investments can also be covered by "extended" political risk insurance policies. Both insurance options for MLT debt investments will be further discussed in Chapter 3.

2.3.1 Main difference between Guarantees and Insurance

In the credit and political risk insurance business the concepts of guarantees and insurance are often used interchangeably. However, from a legal and commercial perspective, there are various important differences, that have an impact on the relevant applicable regulations (banking or insurance regulations)[15] terms and conditions of the cover, the way how the business is conducted, the marketing of the products, the operational costs of the risk mitigation providers, the volume of risk mitigation operations and the amounts of mobilized capital. Guarantees are in principle unconditional and irrevocable payment obligations (such as commercial bank guarantees or guarantees for capital market bonds from so-called "financial guarantors"), while insurance policies are of a conditional nature. The insurer will only indemnify a loss if the policyholder has met all his insurance obligations and insurance policies may include certain exclusions of cover.

Table 2.8 - Differences Between Guarantees and Insurance

Topic	Guarantees	Insurance
Unconditional & Irrevocable	Yes	No
Examples	Bank guarantees, capital market "financial guarantees"	Credit insurance, political risk insurance
Who is the client of the guarantor/insurer?	The borrower (banking approach)	The lender (insurance approach)
Which regulations govern private guarantee/insurance providers?	Central Bank regulations	Insurance regulations
Who makes representations to guarantor/insurer?	The borrower	The lender
Who is the key contracting party for the guarantee/ insurance provider?	The borrower	The lender
Do BCBS credit substitution rules apply for guarantee/ insurance provider?	Yes, if guarantee is unconditional, irrevocable and comprehensive.	Yes, if insurance is comprehensive and all remaining risks are within scope of control of the insured. Credit substitution does not apply to partial/political risk guarantees. Rules on treatment of credit insurance products and insurers may differ among countries depending on national regulations. In some countries credit substitution does only apply to zero risk weighted MDBs and highly rated official ECAs, but not to private insurers and SMIs without an explicit zero risk weighted recognition of the BCBS.

Source: Sustainable Finance & Insurance

15 MDBs and SMIs are formally not governed by relevant (inter)national regulations that apply to commercial banking and /or private insurance. However, most of these multilateral institutions apply key standards developed for their peers in the market on a voluntary basis in their operations. That is why many (but not all) Basel regulations that apply to banking are (indirectly) relevant for MDBs and international insurance regulations are (indirectly) relevant for SMIs.

It is not uncommon practice to speak about credit and political risk guarantees, although the cover is often neither unconditional nor irrevocable. From a legal perspective, these conditional "guarantees" are more akin to insurance. This report uses these terms interchangeably, but in general it should be noted that MDBs and BDBs offer financial guarantees whereas ECAs, private insurers and SMIs offer insurance products.

2.3.2 Main risks and common concepts

In the credit and political risk insurance market, it is quite common to classify the risks into various risk categories, based upon the (1) duration of the risk, (2) the type or nature of the risk, and (3) the period at risk. This section describes the most commonly used definitions and concepts; however, it must be understood that they may differ among individual guarantee/insurance providers.

2.3.2.1 Duration of Risks

Based upon the duration of the risk, credit and political risk insurers distinguish among:

- Short-Term (ST) credit risks: Up to and including 1 year.
- Medium-Term (MT) credit risks: From 1 year up to and including 5 years.
- Long-Term (LT) credit risks: From 6 years up to including 15 to 20 years.

Some insurers define ST as up to and including 2 years, but for most insurers it is defined as insurance with a maximum risk period of 1 year. Transactions that are typically financed and insured on a ST basis are consumer goods, agricultural goods and other commodities. The most common credit terms in ST business range between 30 and 90 days. In some cases, the credit period is extended to 180 days and in exceptional cases the credit period may be up to 1 year.

The main users of ST credit insurance are corporates, in particular exporters, that seek protection against payment risks under their supplier credit[16] operations. Most ST credit insurers offer ST credit insurance only for ST supplier credits, whereby the seller makes use of credit insurance. Some insurers offer ST credit insurance to financing banks as well, although this is less common. Banks make use of ST credit insurance policies primarily for their ST letter of credit operations and ST trade finance loans.

ST supplier credit insurance is usually provided on a whole turnover basis, whereby the insurer covers all, or a substantial share (e.g. only the export business and not the domestic trade), of an organization's sales receivables. Some insurers are also able to insure ST credits on a single transaction basis. In those single risk transactions, insurers are very selective in their underwriting.

Private insurance companies dominate the ST credit insurance business, particularly in Europe. Important global private insurers include Euler Hermes, Coface and Atradius, with each having their head offices in the European Union. In some OECD countries, and in many non-OECD countries, governments still play an important role in ST credit insurance. For example, Sinosure, China's ECA, is very active in insuring ST export credits and ST domestic trade. Furthermore, in Germany, approximately 60% of the export credit insurance offered by the German government is ST export credit insurance covering "non-marketable risks".[17] The remaining 40% is MLT credit insurance. Japan's national ECA, NEXI, is also dominated by ST credit insurance as it covered approximately JPY 5 trillion of ST business out of a total underwriting of JPY 6.3 trillion[18] from 2018 to 2019.

ST trade guarantees are also provided by various MDBs, including ADB, AfDB, EBRD, IADB and IFC. The Trade Finance (or Facilitation) Programs (TFPs) of these MDBs generally cover risks extending up

16 A supplier credit concerns a credit provided by the seller to the buyer of goods and services.
17 Source: annual report of Euler Hermes, see: https://www.agaportal.de/en/jahresberichte
18 Source: annual report NEXI 2019, see: https://www.nexi.go.jp/en/publications.html

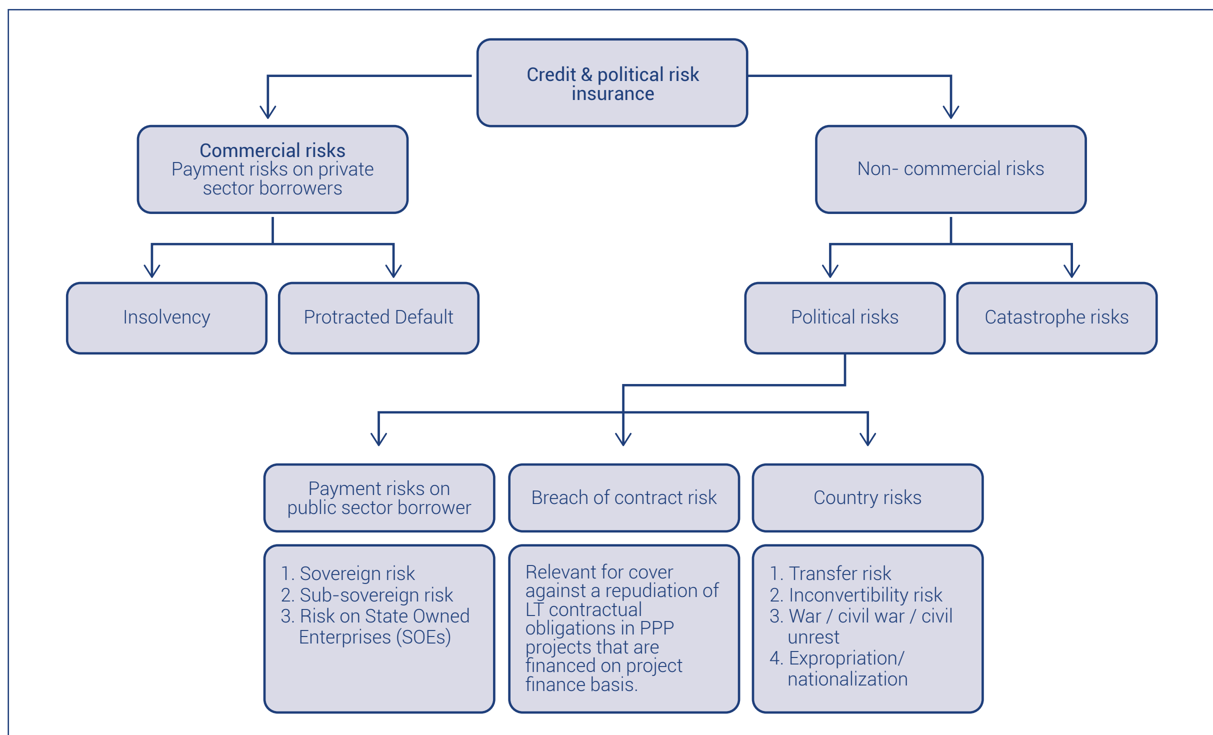
to 3 years, although tenors beyond one year occur only in exceptional circumstances. TFP cover is in most cases provided on a single transaction basis, although some banks may utilize a portfolio cover arrangement with an MDB.

MLT credit and political risk insurance business is usually conducted on a single transaction basis. MLT or political risk insurers provide insurance support for a single loan, equity investment or a project. Given the large investments required for projects, they can be, and often are, co-financed by multiple loans or investors that are backed by different guarantees from various guarantee providers. Various guarantors/ insurers are active in the MLT market.

2.3.2.2 Nature of Risk

With regard to the nature of risk, the credit and political risk insurance industry makes a distinction between commercial risks and non-commercial risks as displayed in the below figure.

Figure 2.1 - Main Insurable Risks in the Global Credit and PRI Market



Non-commercial risks can be subdivided into:

- Political risks; and
- Catastrophe risks or natural disasters.

Political risks can be subdivided into:

- Payment risks on public sector buyers/borrowers;
- Breach of Contract risk; and
- Country risks.

Public sector buyers/borrowers include (1) the monetary authorities of a country (i.e. Ministry of Finance or Central Bank), (2) other ministries of a government, an individual state, province or a municipality and (3) State-Owned Enterprises (SOEs). The risks on monetary authorities of a country are often referred to as sovereign risks, whereas risks on other public-sector entities are defined as non-sovereign public sector risks or sub-sovereign risks. Risks on State-Owned Enterprises (SOEs) are usually categorized in

a third category of public sector borrower risks. (Some insurers perceive risks on SOEs as commercial risks, so here the practices with regards to categorization differ among various insurers.)

Country risks can be subdivided into:

(1) Transfer risk is the risk that one cannot transfer an amount denominated in a foreign currency through regular legal channels from the debtor country to the creditor country. For example, a debtor in country X has to pay to an exporter in country Y an amount of USD 100,000. In this case, the debtor has this USD amount in his own country. However, due to transfer restrictions imposed by the government in country X, the money cannot be transferred to the exporter in country Y.

(2) Inconvertibility risk is the risk that one cannot convert the local currency of the debtor into the foreign currency of the payment obligation as agreed in the export contract. For example, if a buyer in country X has local currency but is not able to convert the local currency into USD (the export contract currency), this would illustrate an inconvertibility risk. As a result, the payment is frustrated and the exporter in country Y suffers a loss.

Transfer and inconvertibility risks can prevent the buyer from making external payments. A payment moratorium imposed by the government covers a period of time in which there is a suspension of payments either until future events warrant a removal of the suspension, or the issues that led to the suspension have been resolved. In some insurance policies, the wording of transfer risk and inconvertibility risk are combined in one risk description.

(3) War and civil disturbance cover protect against losses due to the destruction, disappearance, or physical damage to tangible assets caused by politically motivated acts of war or civil disturbance, including revolution, insurrection, and coup d'état. Non-payments of debt obligations, which are caused by a (civil) war are typically also covered.

(4) Confiscation, expropriation and nationalisation cover offers protection against a loss of the insured as a result of acts by the host government that may reduce or eliminate ownership of, control over, or rights to the insured asset. Some insurers also cover a so-called "creeping expropriation", being a series of acts that over time have an expropriator effect. Non-discriminatory measures taken in good faith by the host government, which fall within its legitimate regulatory authority, are not covered under expropriation.

Breach of contract can be insured to cover certain specific breaches of contractual commitments made to a private sector project by the host government (including, where appropriate, sub-sovereign entities or SOEs). These commitments must be legally enforceable in the host country and relate to the viability of the project. They can include payment guarantees, long-term (LT) concession agreements, obligations under an LT off-take contract, contractual obligations to provide infrastructure in relation to a project and obligations to grant tax holidays and/or to provide certain subsidies.

Breach of contract insurance is often offered to cover certain contractual risks in private sector project finance transactions. In these Public-Private Partnership (PPP) Projects, the private company involved, which is financed by a combination of equity investments provided by project sponsors and loans from MLT debt investors, often has certain important LT contractual arrangements with the central government or an agent of the government that are critical for the future cash flow and overall financial performance of the company. The bankability or financial viability of the project is to a large extent determined by the reliability of these LT contractual obligations.

In the event of an alleged contractual breach or repudiation, an investor that has obtained breach of contract cover first has to invoke a dispute resolution mechanism (such as an arbitration procedure) set

out in the underlying contract. Should the investor be unable to obtain an arbitration award after a specific period of time due to the government's interference with the dispute resolution mechanism (i.e. denial of justice), or has obtained an award but not received payment (non-payment of an award), an insurer will compensate a breach of contract claim. Some insurers may provide provisional claims payments in anticipation of a positive arbitration award, however, should the arbitration not end in favour of the insured, the insured would be required to refund the provisional claims payment.

Catastrophe risks or natural disasters can be defined as the manifestation of a natural force that is beyond the control of the insured, buyer, guarantor (if any) or the government of the buyer's country. Examples of a natural disasters include earthquakes or extreme floods, which may cause non-payment by the buyer/borrower. Some insurers refer to these natural disasters as "Acts of God". Catastrophe risks are usually (implicitly) covered under so-called comprehensive risk insurance policies, but not under ("extended" or "classical") political risk insurance policies (further discussed below). It is likely that the recent COVID-19 crisis will prompt a discussion regarding the insurability of credit insurance losses that are caused by a pandemic.

Commercial risks can be defined as the payment risk on a private sector buyer. It includes:

- Insolvency of the private buyer. This is a juridical or administrative procedure whereby the assets and affairs of the buyer are made subject to control or supervision by the court, or a person or body appointed by the court or by law, for the purpose of the reorganisation or liquidation of the buyer or of the rescheduling, settlement or suspension of payment of its debt. Examples of insolvency are bankruptcy and a moratorium (suspension of payment obligations). An example of the latter is a so-called Chapter 11 treatment in the USA. It suspends all payment obligations of the buyer for a certain period to allow for a (financial) restructuring of the company.
- Protracted default of the private buyer. This is a failure of the buyer to pay the contractual debt, which is not (yet) caused by an insolvency. In this case, the insured suffers from a payment default and the underlying commercial cause of the non-payment remains unclear.

2.3.2.3 Period at Risk

In the trade and investment insurance business, it is quite common to make a distinction between the manufacturing period (or risk) and the credit period (or risk).

Manufacturing risk is often called pre-delivery, pre-completion, or pre-shipment risk, as it refers to the risk that occurs in the period between the date of the export contract coming into force and the date of delivery. In particular, in the capital goods and construction business, the costs incurred by the manufacturer/supplier during the manufacturing/construction period can be quite substantial. For this reason, many insurers offer insurance to suppliers of goods and services for the potential losses that may occur during the manufacturing period or pre-completion period. If an insured event occurs, the costs incurred are the basis for the claim compensation. The insured party for risks during the manufacturing/pre-completion period is usually the exporting manufacturer or construction company that is obliged to deliver the construction services.

In the case where a project is financed by commercial banks (e.g. through a buyer credit or a third-party investment loan), the disbursement phase of the loan often coincides with the manufacturing period of the exporter/construction company. During the manufacturing period, the buyer/borrower approves for disbursements under the buyer credit/third party investment loan and payments by the bank are usually made directly to the exporter/construction company. In this way, the manufacturing costs of the capital goods or construction services are financed through the buyer credit/third party investment loan.

Credit risk is often referred to as post-delivery, post-completion or post-shipment risk, as it is the risk that occurs after delivery of the goods or completion of the project. In such cases, goods have been shipped in accordance with the export contract thus ensuring a payment obligation; however, the payment has been frustrated due to for example an insolvency of the buyer or political events in the buyers' country. The invoice concerning the delivered goods is the basis for a credit risk claim. This includes the manufacturing costs incurred by the exporter and his profit margin.

In case of a bank loan the total (credit) risk period is usually split into a disbursement period and repayment period. In officially supported export finance activities the repayment period is then usually referred to as the credit period[19].

Some insurers and/or financiers in the development finance community make a distinction between the grace period and repayment period. The grace period is the period during which disbursements take place and no repayments must be made. This definition applies to traditional commercial lending as well.

2.3.3 Insurance products covering Equity Investments

For equity investments, the main insurance products that are used are "classical" PRI products, which in essence cover (1) transfer risks, (2) inconvertibility risks, (3) (civil) war/ unrest / terrorism and (4) expropriation/ nationalization risks.

In project finance transactions whereby a special purpose company (SPC) is set up to operate and manage the new project, project sponsors / shareholders of the equity investments in the SPC can obtain "extended" PRI that provides cover against the four classical political risks and various breach of contract risks. The breach of contract cover, which by definition is project / contract specific, can provide protection against non-performance of certain contractual undertakings of a host government, or an agency of the government, that are vital for the operation of a PPP project. For example, in electricity generating PPP projects, breach of contract cover can protect the equity investors against the non-payment by an off taker to pay for the electricity produced by the SPC in long term off take contacts. These long term off take contracts are critical for an electricity producing SPC to generate cash flow, repay MLT loans from debt investors and pay dividends to equity investors. Another example for breach of contract cover concerns a government commitment to build a high voltage transmission line to allow a PPP power plant to distribute and sell electricity to the off taker[20].

In the past, it was a common practice to buy cover against at least the 4 classical political risks because most insurers were not willing to insure just one or two risks separately, but this practice has changed. Today, most insurers are able to cover one or two risks on their own without needing to package the four classical political risks together. Equity investors can today buy specific cover against expropriation risks or war risk or breach of contract risk for projects where these risks are perceived as critical. This may concern hard currency generating projects in mining as well as oil and gas, whereby the receivables can be captured offshore in an escrow account to manage and mitigate not only commercial risks, but also transfer and inconvertibility risks. For these projects cover against transfer and inconvertibility risks is perceived as less essential. This may be different for local currency generating projects.

Both "classical" and "extended" PRI products are also available to cover MLT debt investments, which will be discussed further in Chapter 4.

19 This distinction between pre-credit risk and credit risks is typical for OECD ECAs, because of regulations in the OECD Arrangement on officially supported export credits, which among others include maximum repayments for various types of exports. These maximum credit periods are defined to create a level playing field for OECD ECAs and their exporters. Credits beyond these maximum periods are in principle not allowed.

20 In the lake Turkana windfarm project in Kenya, the government was contractually committed to build in time a transmission line that was critical for the PPP power plant to distribute and sell electricity to the Kenyan off taker. When the windfarm was completed it was unable to distribute its electricity because of substantial delays in the construction of the transmission line. See: https://www.theeastafrican.co.ke/business/Lake-Turkana-Wind-Power-fine-pushed-to-consumers-/2560-4825152-vff05t/index.html

Figure 2.2 - Example: MIGA PRI for an Equity Investment

In 2019 MIGA provided PRI for an equity investment in a waste-to-energy project in Belgrade, Serbia. The project enables the use of municipal waste and landfill gas to generate renewable heat and electricity. The project also received MLT debt financing from various multilateral and bilateral development finance institutions, which include EBRD, IFC and the Austrian development bank OeEB.

MIGA guarantees of Euro 97.3 million were provided for up to 20 years against non-commercial risks, including breach of contract. The guarantees are covering up to 90 percent of the equity investment of the investor.

Source: MIGA press release of 3 October 2019 and EBRD press release of 2 October 2019.

2.3.3.1 Benefits of PRI for Equity Investments

The main benefits of PRI for equity investments are the following:

(1) **Protection against losses that may arise from covered political risk events**

When an equity investor buys PRI against certain political risks it is adequately protected against these risks. Most insurers cover 90% of the risks, which implies that the equity investor will bear 10% of the risk for its own account.

The policies in the market usually can cover transfer risk, inconvertibility risk, expropriation risk and (civil) war risk. For project finance transactions an equity investor can also obtain breach of contract cover.

(2) **I**mprovement of the risk profile of the FDI investment

PRI for equity investments may also be attractive for financing banks that provide MLT loans to new investment projects abroad. If the FDI investor has bought PRI for its equity investments, it improves the risk profile of the project and makes the new business venture likely also more attractive for MLT debt financing.

In project finance transactions it is not uncommon that financing banks ask the equity investor to pledge the shares in the new company as a collateral to the debt financing banks. When the political risks of the equity investment are adequately covered, this improves the collateral of the banks, which may lead to improved financing conditions for the debt financing of the project.

(3) PRI **provided** by official insurers may assist in the prevention of certain political events

PRI provided by public insurers – ECAs and SMIs – is usually fully transparent to the government of the country in which the FDI investment is made. This is normally not the case for private insurance.

For example, MIGA requires prior host country approval of the MIGA insurance for all its investment insurance policies. The knowledge of MIGA involvement in a project may prevent host governments to take discriminatory actions against the insured project. It is also relevant that a government knows that when political problems arise in a MIGA insured project, it may also impact its relationship with other WB group members and other MDBs.

The involvement of some ECAs, in particular those of large countries, may also have a more or less similar loss prevention effect, in particular if the ECA country is also a large investor or bilateral (ODA)

donor of the country where the investment is made. Formally national ECAs don't have a Preferred Creditor Status (PCS) like SMIs and MDBs, but in practice the "political clout" of an individual ECA/ creditor country can be of equal value or even of greater value than a PCS to prevent or minimize (potential) losses.

2.3.4 Insurance products covering MLT Debt Investments

The three main insurance/guarantee products that can be used to cover MLT debt investments include:

- "Classical political risk insurance policies": This covers transfer risk, inconvertibility risk, expropriation and (civil) war.
- "Extended political risk insurance policies": This concerns insurance policies against "classical political risk and cover against breach of contract risks. This cover is typically used for equity investments in PPP projects financed on a project finance basis. Extended political risk insurance can also be used to cover debt investments in PPP projects.
- "Comprehensive cover policies": This covers all payment risks of an insured loan, which, in the case of a private borrower, implies cover for both commercial and political risks. Through a reduced percentage of cover (e.g. 95%) the insurer shares risks with the insured financier (e.g. 5%).

Similar to PRI for equity investments, many insurers can also cover only one or two risk events (e.g. only (civil) war risk or only breach of contract risk) for MLT debt investments.

2.3.4.1 Benefits Of Insurance to cover MLT Debt for Developing COuntries

1) Access to finance and new financial markets

   For many in particular relatively high-risk developing countries, it would be impossible or very difficult to obtain MLT financing if credit or investment insurance were not available. Guarantees and credit insurance are therefore important tools to mobilize financing from commercial financiers, in particular from commercial banks. Guarantees can also be used for capital market bonds, which allow a borrower to access domestic or international capital markets and broaden its funding base. Today the main users of MLT guarantee and insurance products for MLT finance of infrastructure projects in developing countries are globally operating commercial banks.

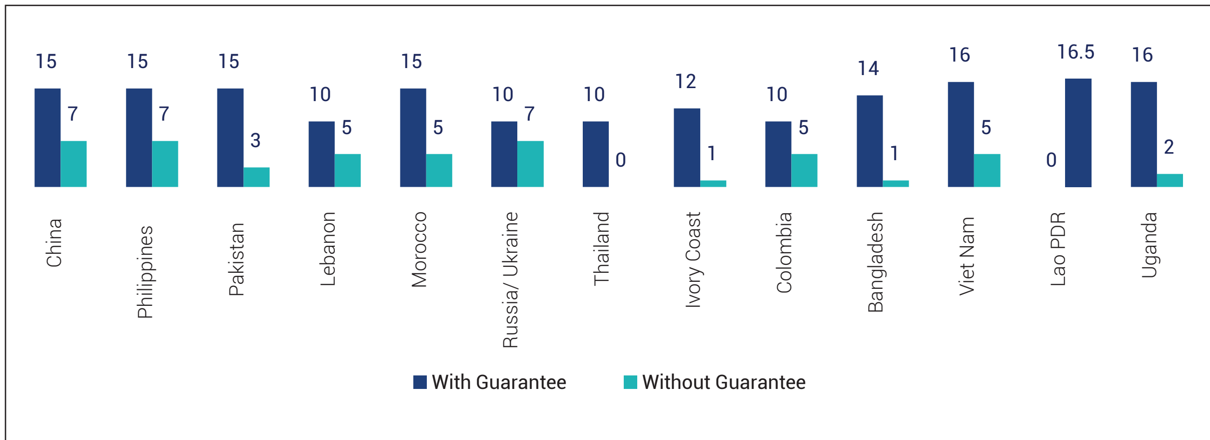
2) Better financing terms and conditions

   Guarantees will give developing countries not only access to other sources of finance, but also at better terms and conditions than those available on the market (e.g. bank market, bond market, official and private (re) insurance markets). This is the second mobilization impact of guarantees and concerns:

   - Longer credit periods (e.g. up to 10-15 years).
   - More favorable interest rates and lending conditions.

   The graph below shows some projects that benefitted from a guarantee from the IBRD and the impact of the guarantee on the tenor of the commercial bank financing. The difference in tenor with and without guarantees was identified at the time when the guarantees were provided. Furthermore, the terms and conditions of the cover provided by IBRD, which also have an impact on pricing and tenor, differed among the various projects. The key message is that guarantees can substantially improve the tenor of financing.

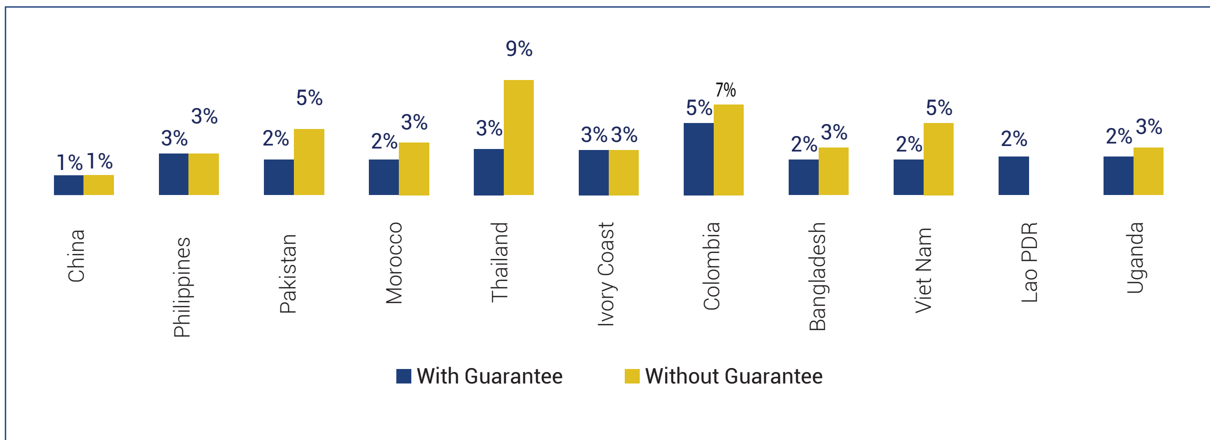
Figure 2.3 - Impact of World Bank Guarantees on Tenors (Years)



Source: IBRD

Guarantees also have an important positive impact on the pricing of MLT bank loans. This is illustrated in the graph below regarding various IBRD guarantees. Here again it should be noted that the pricing difference between with and without a guarantee was assessed at the time of the issuance of the guarantee.

Figure 2.4 - Impact of World Bank Guarantees on Pricing (Interest Margin Over Libor)



Source: IBRD

3) Insurance/guarantees can lower the operational costs of development finance substantially

In general, the operational costs of credit and political risk insurers are lower than those of direct lenders/financial guarantors. This is evidenced in the table below, which shows the efficiency ratios of various insurers and lenders. Efficiency ratio in this context is defined as the ratio of non-interest expense to net operating revenue. The latter is equal to the sum of net interest income and non-interest income:

Efficiency Ratio = Non-Interest Expense / (Net Interest Income + Net Non-Interest Income)

A higher efficiency ratio indicates higher operating costs, or equivalently, lower efficiency. Effectively, this ratio measures the operating cost incurred to earn each dollar of revenue. Efficiency ratios of

large commercial banks vary widely, but typical values range from 50 to 80 percent[21]. The efficiency ratios of ADB and IFC, which both are primarily involved in lending, are structurally substantially higher than those of MIGA, Lloyds and the ECA UK Export Finance.

Table 2.9 - Comparison of Efficiency Ratios of Various Lenders and Guarantors/Insurers

Organization	2013	2014	2015
IFC	57,09%	42,88%	59,39%
ADB	65,98%	55,64%	60,31%
MIGA	47,15%	34,87%	39,86%
Lloyds Insurance Market (private insurer)	38,01%	38,51%	40,76%
UK Export Finance (UK ECA)	18,39%	24,52%	31,48%

Source: Relevant annual reports & SFI calculations.

Insurance operations require substantial less operational costs. This is partially due to the division of labour and responsibilities between insurers and commercial banks. Insurance models can therefore contribute to an improvement of aid efficiency and aid effectiveness. Lower operational costs of insurers also explain why their insurance premiums are usually substantially lower than interest rate margins of lenders or fees of financial guarantors. The treasury departments of insurers are usually also much smaller than within banks.

4) Assist in the development of the financial sector in developing countries

When guarantees are used to support local banks in developing countries, the guarantee business will assist these local banks to improve and expand their business. This in turn can contribute to the development of a more robust financial sector, which is critical for the development of a country. Furthermore, guarantees to local banks can enhance their capabilities to provide financing to local companies (e.g. loans to SMEs, working capital or pre-export financing for corporates). Important is as well that local banks can provide local currency financing, which is in particular of interest for borrowers / projects that mainly generate local currency income.

Today most guarantee/insurance providers mainly cooperate with large international banks. By working with reputable local banks, MDBs and other insurance / guarantee providers could mobilize domestic sources of capital.

2.3.4.2 Benefits for MLT Debt Financiers

1) Risk mitigation for all or certain political risks

Guarantees provide protection against all (comprehensive cover) or certain political risks (classical and extended political risk guarantees) that can cause a payment default. As mentioned, debt financiers, in line with the recommendations of banking regulators, have a strong preference for comprehensive guarantees.

2) Avoid loss provisioning against bad debts

Comprehensive guarantees can avoid that banks have to make provisions for non-payments under bank loans. In this way, the cash flow of the bank can be stabilized. This effect is less relevant for partial/political risk guarantees as defaults can be linked to commercial issues.

21 See the article "Do big banks have lower operational costs?", published in Economic Policy Review of December 2014 and written by of Anna Kovener, James Vickery and Lily Zhou.

3) Solution for constraints regarding borrower limits, sector limits and country limits

Comprehensive guarantees can help in solving constraints that banks may experience in managing borrower limits, sector limits and country limits. For country risk limit constraints, political risk insurance only (i.e. cover for all 4 'classical' country risks) could be sufficient, but this depends on the risk model of a bank and national country risk regulations.

4) Solvency benefits for credit risk

Regulatory capital relief is an important factor that determines the behaviour of banks in using insurance/guarantee products. According to international solvency regulations of the Bank for International Settlements (BIS) irrevocable and unconditional guarantees have substantial capital benefits for commercial banks. For comprehensive credit insurance policies that meet the guarantee criteria of the BIS the solvency required for the covered portion of the loan will in most jurisdictions be determined by the credit rating of the insurer instead of that of the borrower. This is known as credit substitution. In case comprehensive cover is provided by a triple A rated MDB or an ECA in a S&P AAA rated country this will lead to a zero-risk weight for the covered portion of the bank loan. For the uncovered part of the loan the risk weight applicable to the borrower applies.

Table 2-14 below provides the minimum risk weights for credit risk by type of borrower/guarantor according to the so-called "standardised approach" of the BIS. Official ECAs can in most countries be treated as sovereign risk and private insurers fall under the category "corporates". Leading – highly rated – MDBs that meet specific criteria, among which a AAA rating and significant contribution from shareholders with at least an AA- rating, carry a zero-risk weight. Zero risk weighted MDBs include among others IBRD, IFC, MIGA, ADB, AfDB, IaDB, EBRD, EIB and IsDB. For MDBs that do not meet the zero risk weight criteria (e.g. ATI, ICIEC and Dhaman) separate solvency requirements apply (in table: "other MDBs").

Table 2.10 - Risk Weights by type of obligor of Credit Insurers and Commercial Banks Based on Standardized Approach

External Rating	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Sovereign/official ECAs (1)	0%	20%	50%	100%	150%	100%
NBB/PSE	20%	50%	50%	100%	150%	50%
Highly rated MDBs	0%					
Other MDBs	20%	30%	50%	100%	150%	50%
Private Insurers	20%	50%	75%	100%	150%	50%
Commercial banks	20%	30%	50%	100%	150%	No Data

Source: BIS.

(1) In most jurisdictions a 0% risk-weight applies on exposures covered by a national ECA if it can be assumed that the risk on the national ECA is equivalent to the sovereign of the country and the insurance is provided in the national currency of the ECA country.

Political risk only policies (classical or extended) may also lead to some solvency benefits, but they are less significant than those under comprehensive insurance policies. The level of solvency relief is bank/country specific. It depends on the solvency/risk model of a commercial bank and regulations of the national supervisor.

A recent survey of the International Association of Credit Portfolio Managers (IACPM) and International Trade and Forfaiting Association (IFTA)[22] in which 43 commercial banks participated basically confirms the importance of comprehensive insurance policies (in the survey referred to as "Non-Payment Insurance" (NPI)) for banks.

Key conclusions in the survey are the following:

1. NPI ranks as a close second right after secondary loan trading and well ahead of Credit Default Swaps (CDS) and synthetic securitizations. Next to conventional credit protection products, banks are increasingly using NPI solutions across all asset classes: corporate loans, asset-based finance, trade finance, etc.

2. European banks are currently more advanced than non-European banks in usage of insurance-based solutions for credit risk mitigation. They have used the product for much longer on average and show more volume and number of transactions per annum than their American or Asian counterparts, diversifying thereby their sources of credit protection.

3. Banks are using NPI solutions as an additional risk distribution channel to increase lending capacity to borrowers while complying with internal credit limits and avoiding accounting or risk mismatch between the loans and the protection instrument. Unrated and non-investment grade borrowers that do not trade in CDS are the main beneficiaries as banks turn to NPI to release regulatory capital.

4. Releasing regulatory capital is the second most important objective for the use of NPI by participating banks as most obligors do not have a traded or liquid CDS. This is not surprising given that 75% of all insured loans (and 38% of insured corporate loans) are non-investment grade. It is therefore clear that NPI fulfils a unique function as Credit Risk Mitigant (CRM) for banks to support core lending, as well as specialized finance. Bank lending could become more restricted if regulation affects the NPI product in a negative way. In this respect, a careful study of the unintended consequences of the final Basel III framework might be required as banks using Internal Rating Based methods will be asked to increase their equity for loans covered by credit insurers as the standard Loss Given Default rate (or losses after a default) might increase by 10% to 25% up to 45% for the tranche covered by a credit-insurer. This is currently being discussed.

Today, there are various issues regarding the treatment of credit and political risk insurance products in the Basel framework. In the context of the mobilization agenda for the UN SDGs, it is important that these issues are addressed. Against that background the topic is further discussed in Annex IV.

2.3.5 Exposure analysis of MLT Debt Investments

In insuring MLT debt investments it is interesting to see what type of cover is most commonly used by BU members. Table 10 below shows that of all MLT insurance by all BU members, covering both MLT export credits and MLT investment insurance 83.1% concerns comprehensive insurance policies and 16.9% political risk insurance. The vast majority of the political risk insurance business concerns insurance for equity investments and shareholder loans (on average respectively 50% and 20%), which means that political risk insurance for MLT 3rd party debt investments is substantially less than 16.9% in the range of around 5% (30% of 16.9%). In terms of outstanding exposure this was in 2010 equal to an amount of approximately USD 36.5 billion, which increased to approximately USD 51 billion in 2018.

22 The joint IACPM/IFTA survey results were published in 2019 can be found via the following link: http://iacpm.org/wp-content/uploads/2020/01/IACPM-ITFA-Non-Payment-Insurance-Survey-2019-Select-High-Level-Results.pdf

Table 2.11 - MLT Outstanding Exposure of all BU Members by Type of Insurance Policy (Million USD)

Activity	2010	2012	2014	2016	2017	2018	Share 2010	Share 2018
MLT Export credits	**525.371,58**	**628.115,52**	**650.087,42**	**653.383,44**	**697.293,94**	**685.559,23**	**74,0%**	**68,4%**
MLT Investment insurance								
Investment insurance (pol risk only)	121.739,83	135.309,00	141.241,47	145.552,05	157.039,84	169.442,61	17,1%	16,9%
Other cross-border insurance	35.538,60	57.592,87	70.248,45	79.729,12	91.595,54	96.782,30	5,0%	9,7%
State obligation insurance	27.486,97	28.993,22	29.142,42	48.521,32	47.564,20	50.797,13	3,9%	5,1%
Total MLT Investment Insurance	**184.765,40**	**221.895,09**	**240.632,34**	**273.802,50**	**296.199,58**	**317.022,05**	**26,0%**	**31,6%**
Total MLT Exposure	**710.136,98**	**850.010,61**	**890.719,76**	**927.185,94**	**993.493,51**	**1.002.581,28**	**100,0%**	**100,0%**
of which Comprehensive Insurance	588.397,15	714.701,61	749.478,29	781.633,89	836.453,68	833.138,66	82,9%	83,1%
of which Political Risk Insurance	121.739,83	135.309,00	141.241,47	145.552,05	157.039,84	169.442,61	17,1%	16,9%
Total MLT Exposure	**710.136,98**	**850.010,61**	**890.719,76**	**927.185,94**	**993.493,51**	**1.002.581,28**	**100,0%**	**100,0%**

Source: Berne Union.

2.4 RISK SHARING BY MDBs

2.4.1 Risk sharing by MDBs with Private Insurers and ECAs

Risk transfer in the form of insurance of MDB loan exposure or reinsurance of MDB guarantee exposure is currently used by only a few MDBs, in particular for private sector loans. The amounts involved are thus far compared with risk transfer practices of SMIs, private insurers and ECAs relatively modest. Through the insurance of loan exposure, capital within the MDBs could be freed up which can be used to finance other development objectives. It is a very effective tool to mobilize alternative sources of finance and to manage borrower-, country- or sector limits. This explains why many commercial banks make actively use of this technique (see further above under benefits for commercial financiers).

Risk transfer in the form of reinsurance of guarantee exposure is a common practice among insurers. Private insurers and ECAs make use of this technique. It is also a common practice among SMIs. MIGA, for example, reinsured 64.44% of its gross exposure in 2019 with ECAs and particularly private insurers. In 2010, this was substantially lower, namely 44.37%. Other SMIs such as ATI and ICIEC have also a strong reinsurance strategy. In 2018 ATI reinsured approximately 79% of its gross exposure and for ICIEC this was around 64%.

Table 2.12 - MIGA Gross and Net Exposure at Year-End (Billion USD)

MIGA	2010	2012	2014	2016	2018	2019
New Guarantees Issued in year	1.464	2.657	3.155	4.258	5.251	5.548
Gross exposure at Year-End	7.723	10.346	12.409	14.187	21.216	23.327
Net exposure at Year-End	4.296	6.262	7.113	6.665	7.878	8.295
Exposure ceded to 3rd parties	3.427	4.084	5.296	7.522	13.338	15.032
MIGA	**2010**	**2012**	**2014**	**2016**	**2018**	**2019**
Gross exposure at Year-End	100,00%	100,00%	100,00%	100,00%	100,00%	100,00%
Net exposure at Year-End	55,63%	60,53%	57,32%	46,98%	37,13%	35,56%
Exposure ceded to 3rd parties	44,37%	39,47%	42,68%	53,02%	62,87%	64,44%

Source: MIGA annual reports

A good example of risk transfer operations in the MDB community concerns a transaction whereby ATI – together with private reinsurers – provided USD 500 million of credit insurance cover (thus comprehensive cover) to the AfDB for a portion of the Bank's portfolio of non-sovereign operations in Africa[23]. While ATI is the direct insurer facing the AfDB, the transaction involves the participation of a number of Lloyd's & corporate private reinsurers to share the risk on African financial institutions. The ATI insurance covers approximately 22% of the Bank's USD 2.3 billion outstanding non-sovereign financial sector portfolio. Specifically, it protects the Bank against the non-payment of loans made to approximately 30 African financial institutions and is expected to release sufficient capital to create almost USD 500 million of headroom for new lending.

This initiative of AfDB and ATI is similar to the Managed Co-Lending Portfolio Program (MCPP), which was launched earlier by the IFC and has been recently renewed. In the Credit Mobilization tranche of the MCCP, IFC lends for its own account with an A Loan and gets a credit insurance cover on a portion of its loan, allowing credit insurers to take risks without mobilizing funding[24].The cooperation with private insurers was recently renewed.

IFC arranged recently an amount of USD 2 billion in credit insurance capacity under the Managed Co-Lending Portfolio Program (MCPP). The IFC initiative is, like the AfDB/ATI transaction, based on comprehensive cover for part of IFC's lending portfolio of loans to financial institutions (mainly banks) in developing countries, According to IFC's press release of 23 June 2020 the new insurance obtained allows IFC to increase its MLT lending to commercial banks and non-bank financial institutions in emerging markets by up to USD 5 billion.[25]

ADB has also increased its risk transfer operations in recent years with significant purchases of credit insurance cover on its non-sovereign loan portfolio. As of 2019, ADB had roughly USD 3.4 billion[26] of risk transfers on its private sector business.

23 For more information see the AfDB press release of 22 October 2018, which can be found via the following link:https://www.afdb.org/en/news-and-events/african-development-bank-launches-landmark-us-500-Million-credit-insurance-deal-with-african-trade-insurance-agency-and-uk-reinsurers-18600.

24 See IFC brochure" Credit Mobilization, a pioneering insurance solution for long-term funding in emerging markets. This brochure can be found via the following link: https://www.ifc.org/wps/wcm/connect/660917da-ad81-412a-b054-e484b0da7678/Credit+Mobilization+Flyer+2018.pdf?MOD=AJPERES&CVID=mcoaAvR

25 Source: IFC press release "IFC Mobilizes 2B in Credit Capacity from Insurers to Expand Lending to Financial Institutions" of 23 June 2020, which can be found via the following link: https://ifcextapps.ifc.org/ifcext/pressroom/ifcpressroom.nsf/vwAllDocumentsByUNID_NL/BCEF554100F72E99852585900045F48C?opendocument=

26 Source: ADB

Thus far, most risk transfer operations done by MDBs concerned the private sector operations of MDBs. Private sector loans of MDBs are usually priced at market-based interest rates, which makes risk transfer to other market players possible. A challenge regarding the risk transfer of sovereign MDB loan exposure is the current pricing practice of MDB sovereign lending. Private (re-)insurers charge commercial rates but are often prepared to slightly reduce their rates if they can benefit from the PCS of the MDB/SMI[27]. Despite such a reduction, the private (re)insurance rates are in general substantially higher than the MDB sovereign lending rates. This explains why thus far, only a very limited number of risk transfer transactions has been done regarding sovereign loans of MDBs. An example of such a risk transfer is a guarantee of the Swedish ODA Aid Agency SIDA to ADB to cover sovereign loan exposure on India. SIDA was apparently prepared to accept a non-market-based fee for its guarantee as its intervention is provided on an ODA basis. The SIDA guarantee created substantial new headroom for ADB but did not mobilize additional private capital[28].

Another example of SIDA's risk sharing practices is the Infrastructure Tranche of the MCCP promoted by IFC[29]. With a 10% guarantee of SIDA, IFC is able to extend an A Loan for 90% of a project and a C Loan for the remaining 10%. The C Loan is junior to the A Loan and then IFC can more easily find investors ready to share the risk of the A Loan. The amount of the SIDA guarantees could reach EUR 57 m and the maximum duration of individual guarantees will be capped at 20 years[30], The SIDA's guarantee enables IFC to make more sustainable investments in low-income countries and to further invest in renewable energy, which are priorities for SIDA.

OECD ECAs charge risk-based minimum premiums in their export credit operations, which are usually also much higher than MDB sovereign lending rates.[31] This sovereign MDB pricing practice is also identified as a risk transfer challenge in Annex 2 of the G20 EPG report.

2.4.2 Risk sharing by MDBs with the Beneficiary / Policyholder

As explained, lending is the current dominant form of MDB development finance. In loans, all risks are borne by the lender, whereas in insurance/guarantees structures the risks can be shared with the beneficiary of the guarantee. In partial credit guarantee (PCG) operations, MDBs could - like ECAs, private insurers and SMIs share the risks with the policyholder through the percentage of cover (e.g. 90% cover implies that 10% of the risk is uncovered). In partial risk guarantees (PRGs) where only certain political risks are covered, the partial cover implies that commercial risks are uncovered. Through risk sharing, MDBs can mobilize substantial amounts of capital for developing countries.

Through use of PRGs, MDBs could mobilize private capital for commercial risks in projects. Yet "classical" political risk cover policies are not very effective in mobilizing MLT private debt financing. Extended political risk policies for project finance transactions can be effective for certain better risk countries, but the market has a strong preference for comprehensive cover. This partially also explains why the shares of comprehensive cover in the total credit and political risk business of private insurers increased from 51% in 2010 to 76% in 2018. For SMIs the share of comprehensive cover in their total insurance portfolio increased from 7% in 2011 to 44% in 2018.

27 This is why insurance or reinsurance rates that MDBs or SMI are offered by private insurers are not comparable with the market rates they offer to commercial lenders or insurers that do not have a de jure or de facto Preferred Creditor Status (PCS).
28 See press release ADB of 3 October 2016, which can be found via the following link: https://www.adb.org/news/adb-sweden-unveil-innovative-risk-transfer-arrangement-expanded-lending
29 https://www.ifc.org/wps/wcm/connect/4c9e0868-1232-4212-b4f2-a5c39d177afa/MCPP+Infrastructure+Flyer+2018.pdf?MOD=AJPERES&CVID=mcoa4bt
30 https://www.sida.se/globalassets/sida/eng/how-we-work/financing/sida_infoblad_ifc_loan_portfolio_guarantee_webb.pdf
31 OECD ECAs apply to their officially supported export credit operations minimum risk-based premiums. In this respect it is referred to the OECD Arrangement of officially supported export credits. This document can be found via the following link: https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?doclanguage=en&cote=tad/pg(2020)1

2.5 KEY FINDINGS/CONCLUSIONS

MDBs and BDBs offer limited risk mitigation products for MLT debt investments and the provision of guarantees remains a small portion of their portfolio. From the date of their establishment till today all MDBs have been operating mainly as lenders – both in sovereign and non-sovereign operations. During the period 2010 – 2018 the gross guarantee exposure of nine leading MDBs increased from USD 7.3 billion to USD 17.8 billion. This was, however, mainly attributable to the growth of their ST trade finance (guarantee) programs and the exposure exchange arrangements between various MDBs. Partial Risk Guarantees (PRGs) and Partial Credit Guarantees (PCGs) were only used occasionally. MDBs and BDBs are currently not active in PRI for equity investments and shareholder loans. Some MDBs and BDBs make, however, important equity investments in developing countries.

The analysis in the study shows that most MDBs encountered during the past 10 years challenges in developing their MLT risk mitigation operations. Most MDBs opted for a "guarantee approach" and accordingly introduced PCGs and PRGs. Several internal and external factors hinder MDBs in taking full advantage of these risk mitigation instruments, which are further explained in annex XV. One of them is a consequence of the chosen guarantee approach and concerns "loan equivalent" guarantee pricing[32]. As a result a MDB loan is cheaper than a commercial loan with an MDB Partial Credit Guarantee (PCG), thereby discouraging the mobilization of additional capital using guarantees or insurance and the mobilization of additional capital from third parties.

The pricing differences in sovereign operations and challenges for insurance of MDB sovereign loans or reinsurance of MDB sovereign guarantees could be solved by introducing blended pricing practices. Given the enormous potential of mobilizing capital for sovereign borrowers and the benefits it can create for developing countries, it is important to investigate the potential of blended pricing practices further.

Comprehensive insurance policies make up the vast majority of business insured by Berne Union members. Of the insurance for equity and debt investments provided by BU members, 83.1% covers comprehensive insurance policies while 16.9% political risk insurance. The vast majority of PRI concerns insurance for equity investments and shareholder loans, with PRI for MLT 3rd party debt investments accounting for a relatively small share (roughly 5% of the overall credit and political risk insurance market).

Key players in the investment insurance market are official ECAs, private insurers and 4 SMIs. ECAs play the leading role in insuring FDI (including shareholder loans), followed by private insurers and SMIs. The top 5 insurers of FDI investments of the BU are: Sinosure (China), PWC / Euler Hermes (Germany), NEXI (Japan), MIGA (multilateral) and USDFC (USA), but the mandates and operations of these five key players differ substantially. For example: PWC's investment insurance program offers mainly classical or extended political risk insurance for private sector projects, whereas the vast majority of NEXI's investment insurance concerns comprehensive cover for "untied investment loans". MIGA's new

32 "Loan equivalent" pricing of guarantees is common in the sovereign operations of most MDBs and also in non-sovereign operations of some MDBs.

investment insurance business in 2019 consisted of USD 3.2 billion of PRI for private sector projects and USD 2.3 billion of comprehensive NH(S)FO cover for public sector borrowers.

Insurance holds four main benefits for MLT Debt Financiers. These benefits include:

- Risk mitigation for all (both commercial and political risks) or certain political risks;
- Avoid loss provisioning against bad debts;
- Solution for constraints regarding borrower limits, sector limits and country limits; and
- Solvency benefits for credit risk, when comprehensive cover is used.

The benefits gained by MDBs and Developing Countries from insurance for MLT Debt Investments are numerous. The benefits include:

- Access to finance and new financial markets;
- Better financing terms and conditions than what the (insurance, bank or capital) market would usually offer (e.g. longer tenors and lower pricing);
- Through risk sharing with the beneficiary of the guarantee/insurance, MDBs could mobilize substantial amounts of capital;
- Insurance/guarantees can be used by MDBs for risk transfer purposes and balance sheet optimization, which also contributes to the mobilization of capital;
- Insurance/guarantees assist countries in their transition from dependence on (concessional/non-market based) development finance to market-based finance;
- Insurance can lower substantially the operational costs of development finance; and
- Assist in the development of the financial sector in developing countries, for example by providing insurance to local banks to increase their domestic (e.g. working capital to local corporates) and international lending operations.

The benefits of PRI for Equity Investments are manifold. The benefits of PRI for equity investments includes the following:

- Protection against losses that may arise from political risk events;
- Improvement of the risk profile of the FDI investment; and
- PRI provided by insurers may assist in the prevention of certain political events.

03

Political Risk Insurance For Equity Investments

03 Political Risk Insurance for Equity Investments

3.1 INTRODUCTION

Chapter 3 examines more in detail the issue of political risk insurance for equity investments. The chapter begins by discussing the supply of PRI cover for equity. It next examines areas of demand for and use of this cover, by client and by country. It considers in detail the availability of PRI cover by IBRD and OECD country risk category, with a focus on the use of PRI for equity investments in 22 selected countries, notably low-income countries and fragile states. It then turns to the survey conducted by ICIEC and probes the possible gaps in PRI cover for equity, and the limitations in the current market. Potential solutions and ways to close potential market gaps are outlined, and some conclusions are reached.

3.2 SUPPLY FOR PRI FOR EQUITY INVESTMENTS

3.2.1 Exposure analysis by PRI provider

Political risk insurance for equity investments is supplied by many different providers. Table 3-1 below gives the annual volume of new business for political risk only insurance for private sector projects of all BU members for 2010-18, or the annual flow of investment insurance activities for all BU members. Together, they insured USD 514.7 billion of new investments in private sector projects against political risks, of which 79.5% was underwritten by official ECAs, 15.2% by private insurers, and 5.3% by specialized multilateral insurers.

In 2010, BU members provided USD 50.7 billion in PRI. Peak BU PRI was in 2016, at USD 66.0 billion. In 2018, total annual new PRI business had decreased to USD 46.6 billion, of which USD 33.2 billion was underwritten by official ECAs, USD 7.7 billion by private insurers, and USD 5.7 billion by SMIs.

Table 3.1 - Annual New Investment (Political Risk Only) Insurance of all BU Members (million USD)[1]

BU Member Type	2010	2012	2014	2016	2018	Total	Share in Total
ECA	37.372,60	49.700,78	49.905,58	55.472,43	33.230,87	409.038,08	79,5%
Private	11.568,73	7.693,25	9.453,86	10.331,00	7.656,71	78.343,69	15,2%
Multilateral	1.786,62	2.722,20	2.090,36	3.220,43	5.731,70	27.269,89	5,3%
Grand Total	**50.727,95**	**60.116,23**	**61.449,80**	**69.023,86**	**46.619,28**	**514.651,67**	**100,0%**

Source: Berne Union

(1) The figures in this table concern investment insurance against "classical" or "extended" political risks for equity investments, shareholder loans, and 3rd party loans.

The ICIEC survey indicated that on average approximately 50% of political risk business of all political risk insurers provided cover for equity investments, 20% for shareholder loans, and 30% for 3rd party investment loans[33]. When these percentages are applied to the BU data, they provide a reasonable indication of annual new PRI for equity investments, which ranged from a high of USD 34.5 billion in 2016 to a low of USD 21.9 billion in 2011. Table 3-2 below provides the data for even years since 2010. More detailed information about the insurance activities of BU members can be found in Annex VI.

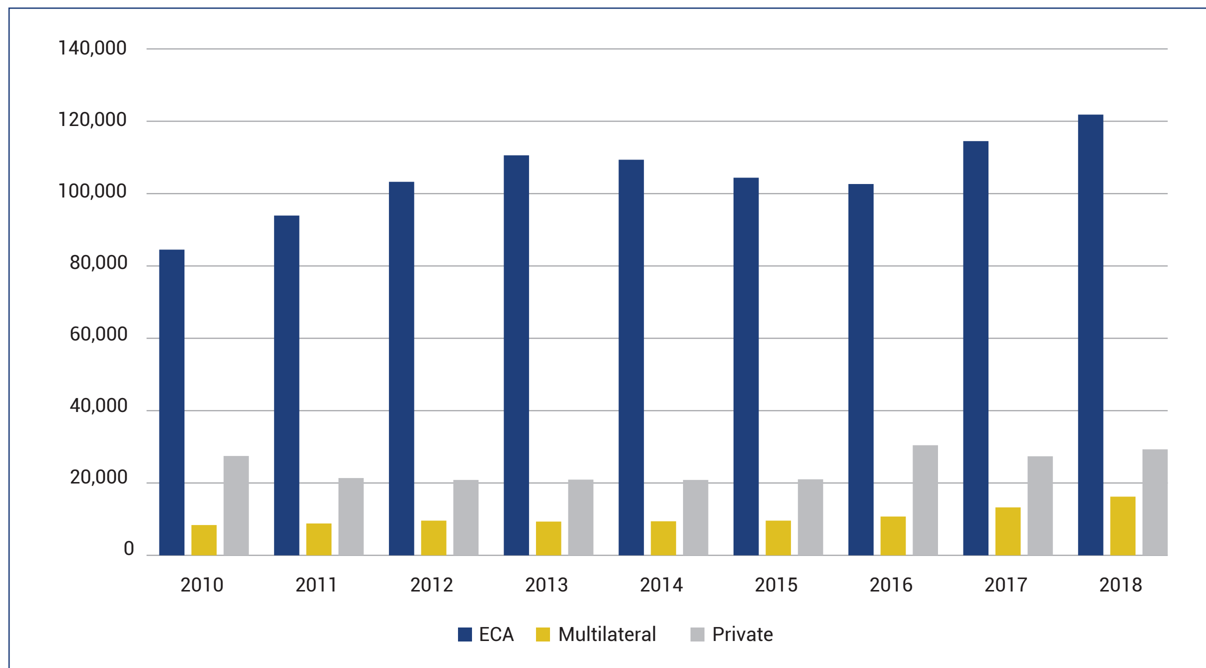
Table 3.2 - Estimated Annual New Political Risk Insurance from BU Members, by Type of Investment (Million USD)

Type of Investment	2010	2012	2014	2016	2018
Equity Investment (50%)	25.363,98	30.058,12	30.724,90	34.511,93	23.309,64
Shareholder Loans (20%)	10.145,59	12.023,25	12.289,96	13.804,77	9.323,86
3rd Party Loans (30%)	15.218,39	18.034,87	18.434,94	20.707,16	13.985,78
Total	**50.727,95**	**60.116,23**	**61.449,80**	**69.023,86**	**46.619,28**

Source: Berne Union

Figure 3-3 below provides the PRI exposure outstanding at year-end, or the stock of PRI exposure, for classical or extended PRI for private sector projects. In 2010, total exposure was USD 121.8 billion, of which USD 85.5 billion was covered by ECAs, USD 27.8 billion by private insurers, and USD 8.4 billion by SMIs. By 2018, total exposure had increased to USD169.4 billion, with ECAs covering USD 123.3 billion (or 73%), private insurers USD 29.7 billion (18%), and SMIs USD 16.4 billion (10%).

Figure 3.1 - Investment Insurance Exposure at Year-End (Political Risk Only) for Investments of all BU Members (million USD)[(1)]



Source: Berne Union

33 These percentages are based on the average percentages of all ECAs, private insurers and SMIs that responded to the questionnaire. Obviously, the % shares of an individual insurer may differ from these averages.

(1) The figures in this graph concern investment insurance against "classical" or "extended" political risks for equity investments, shareholder loans and 3rd party loans.

Based on input from the ICIEC survey, it is reasonable to assume that approximately 50% concerns political risk cover for equity investments, 20% for shareholder loans, and 30% for 3rd party investment loans. Table 3-4 below shows the stock of PRI exposure for these three types of investments. PRI exposure for equity investments ranged from USD 60.8 billion in 2010 to USD 84.7 billion in 2018.

As noted earlier, MDBs are not directly involved in insuring equity investments at present. Some can provide such cover through other members within their group e.g. MIGA and ICIEC, as members of the WBG and IsDBG, respectively.

The MLT political or partial risk guarantees offered by MDBs to cover MLT debt investments are discussed in Chapter 4.

It is important to mention that most MDBs that conduct business with private sector clients are involved in making equity investments by themselves, either directly or indirectly through (joint) equity investment funds. This concerns among others IFC, EBRD and ADB.

Table 3.3 - Do MDBs Provide PRI for Equity Investments?

No.	Name MDB	Involved in PRI for Equity Investments	Does the MDB Make Equity Investments
1	ADB	No	Yes
2	AfDB	No	Yes
3	AIIB	No	Yes
4	EBRD	No	Yes
5	EIB	No	Yes
6	IaDB	No	No
7	IBRD	No	No
8	IFC	No	Yes
9	IsDB	No	Yes

Source: desk research, confirmed by MDB feedback through ICIEC survey among stakeholders for G20 Stock-Take study.

3.2.1.1 Insurers With Experience With Mlt Investment Insurance

The demand for PRI for equity investments differs substantially among individual ECAs. Some are very active (e.g. Sinosure in China, PWC in Germany, NEXI in Japan and USDFC formerly known as OPIC) in the US., while others have little investment insurance activities (e.g. UKEF in UK, BPIfrance in France, Atradius DSB in the Netherlands).

The reasons for the differences in experiences with investment insurance business among ECAs requires further examination. It may be caused by a number of factors: different underlying investment patterns between countries; risk perceptions of investors from different countries; differences in the costs of investment insurance among ECAs; specific eligibility criteria of individual ECA investment insurance schemes; and differences in the perceived value of investment insurance by investors in different ECA countries.

One difficulty in comparing investment insurers is that their mandates, clients and portfolios differ quite substantially. For example, the USD 37.9 billion investment insurance exposure of the German investment insurance scheme in 2018 is not comparable with the USD 47.8 billion of exposure of NEXI. The German program covers only political risks in private sector investments, whereas NEXI's investment insurance program covers political risk only (USD 14.7 billion) and comprehensive cover for "untied" investment loans (USD 33.1 billion).

In comparison, MIGA investment insurance exposure in 2018 includes USD 13.8 billion of PRI for private sector projects (for equity, shareholder loans and 3rd party loans) and USD 7.4 billion of (comprehensive) cover against non-payment by sovereign borrowers (i.e. NHSFO-insurance).

3.2.2 Exposure analysis by country risk category

The Participants of the OECD Arrangement on officially supported export credits developed a common country risk classification system, which covers both political and commercial risks and is used to determine minimum (risk-based) premiums for officially supported export credits. Countries (and sovereign borrowers) are classified into one of eight risk categories. High Income OECD countries that are full members of the OECD Arrangement are not rated and are given a 0 ranking. For other countries, category 1 represents the lowest country risk and category 7 the highest. The OECD Arrangement premium system sets minimum premia by category for both political risk and commercial risk, to avoid unfair competition among ECAs of OECD countries. The OECD minimum premium system is basically a set of common "core standards" for pricing of officially supported export credits.

The OECD country classification system can be used to analyze the developing country profile of the investment insurance activities of BU members.[34] The country risk ratings of non-OECD countries provide a valuable indicator of the MLT risk perception of all OECD ECAs. The system is based upon a collective risk assessment of the economic, financial and political situation of countries, and the MLT payment experiences of OECD ECAs, taking into account their claims payment and recovery experiences. The OECD country risk rating system is recognized by the Basel Committee for Banking Supervision (BCBS) as an adequate external credit rating methodology to determine minimum risk weights for sovereign credit risk for commercial banks.

The OECD country risk classification system can be combined with the data on the investment insurance activities of Berne Union members, to create a picture of where BU PRI exposure is being carried by developing country risk category.

As shown in Table 3-4 below, in 2018, OECD ECA risk category 3 countries represented the largest outstanding exposure, at 24.8% of total PRI exposure of all BU members. Countries in risk category 3 include among others: Costa Rica, India, Indonesia, Mexico, Morocco, Peru, Philippines and Uruguay.

The second largest share of investment insurance exposure was in category 5 countries, with a share of 22.3%. This category includes countries like Algeria, Brazil, Bahrain, Bangladesh, Egypt, Jordan, Kazakhstan and Uzbekistan.

Investment insurance is also bought for investments in relatively high-risk markets (category 6 and 7 countries). The % share of investment insurance exposure in category 6 countries in 2018 is 15.1% and insurance for investments in category 7 countries is 15.3%.

34 The country risk classification by OECD ECAs can be found on the website of the OECD via the following link: https://www.oecd.org/trade/topics/export-credits/arrangement-and-sector-understandings/financing-terms-and-conditions/country-risk-classification/

Approx. 18% of BU investment insurance exposure in 2018 was for investments in OECD countries. Investors perceive there to be political risk for investments in these high-income countries. PRI in these countries mainly covered breach of contract risks in large PPP infrastructure projects.

Table 3.4 - Total Annual Exposure PRI, BU Members, by OECD Risk Category (million USD)(1)

OECD Rating	2010	2012	2014	2016	2018	Share in 2010	Share in 2018
0	16.152	20.299	18.769	22.679	30.457	13,3%	18,0%
1	-	-	-	-	-	0,0%	0,0%
2	19.077	25.634	25.774	29.861	33.054	15,7%	19,5%
3	22.597	32.318	33.375	39.552	42.049	18,6%	24,8%
4	31.847	32.008	30.755	28.152	29.190	26,2%	17,2%
5	38.015	38.660	40.606	39.161	37.851	31,2%	22,3%
6	17.233	19.105	18.461	24.303	25.607	14,2%	15,1%
7	12.953	17.238	15.083	18.927	25.993	10,6%	15,3%
#N/A	- 36.135	- 49.953	- 41.582	- 57.083	- 54.758	-29,7%	-32,3%
Grand Total	**121.740**	**135.309**	**141.241**	**145.552**	**169.443**	**100,0%**	**100,0%**

Source: Berne Union

- The figures in this table concern investment insurance against "classical" or "extended" political risks for equity investments, shareholder loans and 3rd party loans.
- #NA refers to business in countries that are not rated by the OECD.

Overall, as shown below, the global PRI business for equity investments is modest.

Table 3.5 - Annual New Investment (Political Risk Only) Insurance of all BU Members by Type of Investment (Million USD)

Type of Investment	2010	2012	2014	2016	2018
Equity Investment (50%)	25.363,98	30.058,12	30.724,90	34.511,93	23.309,64
Shareholder Loans (20%)	10.145,59	12.023,25	12.289,96	13.804,77	9.323,86
3rd Party Loans (30%)	15.218,39	18.034,87	18.434,94	20.707,16	13.985,78
Total	**50.727,95**	**60.116,23**	**61.449,80**	**69.023,86**	**46.619,28**

Source: Berne Union

At a global level, insurance covers only a small share of inward FDI into developing countries and most FDI investments remain uninsured. The average inward FDI stock insured during 2010-18 for all developing countries was around 1%. Average annual inward FDI flows insured during the nine-year reference period for all developing countries is 5%. There are, however, substantial differences among individual countries, even among countries that are classified in the same IBRD income category.

Table 3.6 - Average Share of Inward FDI Stock Insured 2010 – 2018

Country	IBRD Income Country Category	OECD ECA country risk category (January 2020	Average share of FDI stock insured 2010-2018
Rwanda	LIC + Fragile state	6	13%
Afghanistan	LIC + Fragile state	7	10.8%
Ethiopia	LIC	7	1%
Chad	LIC + Fragile state	7	0.9%
Liberia	LIC + Fragile state	7	0.8%
Myanmar	LMIC + Fragile State	6	5.2%
Ukraine	LMIC	6	4.2%
Kenya	LMIC	6	4.1%
India	LMIC	3	1.8%
Bangladesh	LMIC	5	2.3%
Zambia	LMIC	7	2%
Algeria	UMIC	5	5.9%
PR China	UMIC	2	1.2%
South Africa	UMIC	4	1%
Brazil	UMIC	5	0.6%
Mexico	UMIC	3	0.7%

Source: Unctad, OECD, Berne Union and calculations SFI.

3.2.3 Claims and recovery experience

During 2010-18, BU members paid USD 1.1 billion of claims for political risk cover in private sector projects. ECAs paid 70% of this amount, private insurers 29%, and SMIs 1%.

The relatively low claims payment experience of SMIs could be a reflection of their preferred creditor status and their leverage with host governments, which can prevent or minimize political events that would trigger claims. Their relatively modest share of global investment insurance business may also play a role.

Insurance of political risk only for equity investments or shareholder loans has a much lower risk profile than comprehensive cover for MLT debt investments, which includes cover against commercial risks. This partially explains why there is substantial private insurance capital available for this type of PRI.

The claims experience of the three categories of insurers has an impact on their debt recovery performance. BU members were able to recover USD 145 million of investment insurance claims paid during 2010-18, of which USD 82.9 million was recovered by ECAs, USD 62.7 million by private insurers, and USD 5.0 million by SMIs.

Whether the claims concerned losses in equity investments, shareholder loans or 3rd party investment loans is not known, nor can the nature of the political risk that triggered a loss (e.g. expropriation, transfer risk, inconvertibility risk, breach of contract or civil war) be identified from BU statistics, as such information is not collected by the BU.

3.2.4 Private capital mobilization with re-insurance

Among guarantors and insurers that are active in MLT investment insurance, ATI, ICIEC and MIGA are the most successful in mobilizing private capital by using reinsurance techniques.

The table below shows the percentages of gross and net exposure of the three SMIs at the end of 2018, and the shares of their gross exposure reinsured with third parties. Private (re-)insurance companies are the main reinsurers of the three SMIs. The figures in the table cover the total credit and political risk operations of the three SMIs, and not only traditional investment insurance or PRI for equity investments. Such specific data is not published by the SMIs (and other insurers involved).

Table 3.7 Gross and Net Insurance Exposure of ATI, ICIEC and MIGA in 2018 (Million USD)

SMI	ATI	ICIEC	MIGA
Gross exposure	4.758	4.065	21.216
Net exposure	1.006	1.643	7.878
% ceded to reinsurers	79%	64%	63%

Source: Annual reports of the relevant SMIs.

3.3 DEMAND FOR PRI FOR EQUITY INVESTMENTS

As noted earlier, the percentage of FDI that is actually covered by equity investment insurance is fairly limited. This section analyzes the demand side.

3.3.1 Client-Level demand

There are various types of clients which may seek PRI for their equity investments.

3.3.1.1 Institutional investors

According to a recent World Bank study[35] the current share of institutional investor contributions to total global investments in PPP infrastructure projects, both in terms of debt and equity, is miniscule. Of the total investments in PPP that was researched, with a total value of USD 1.878 billion, only 0.67 % of the total global PPP investment (comprising 0.4% of the total debt and 1.3% of the total equity) was financed by institutional investors. This shows the enormous challenge to attract their capital for projects in developing countries.

There are many insurance companies among the institutional investors, which on the investment side of their operations act as institutional investors and apply strict minimum investment criteria (e.g. only investment grade assets). On the business side, however, some insurers offer credit and political risk insurance services where they demonstrate a much higher risk appetite. In order to attract capital from these insurance companies/ institutional investors it is likely better to approach them through their credit and political risk insurance window than their investment window. This notion could encourage MDBs to make more use of credit and political risk insurance not only to optimize their balance sheets, but also to mobilize substantial amounts of capital from these insurance companies.

35 The World Bank study "Contribution of institutional investors private investments in infrastructure 2011- H1 2017" can be found via the following link: https://ppi.worldbank.org/content/dam/PPI/documents/PPI_InstitutionalInvestors_Update_2017.pdf

Figure 3.2 - Breakdown and Share of Institutional Investor Contributions to Projects by year

	Equity		Debt		Total Investment	
Year	Institutional Investor Contribution (US$ million)	Share of Global Totals	Institutional Investor Contribution (US$ million)	Share of Global Totals	Institutional Investor Contribution (US$ million)	Share of Global Totals
2011	-	0.0%	$76	0.2%	$76	0.2%
2012	$152	1.1%	$73	0.1%	$225	0.3%
2013	$43	0.4%	$22	0.1%	$65	0.2%
2014	$333	3.0%	-	0.0%	$333	0.8%
2015	$172	2.3%	$619	3.1%	$791	2.9%
2016	$249	2.4%	$108	0.4%	$357	1.0%
H1 2017	$31	0.4%	-	0.0%	$31	0.1%
TOTAL	**$980**	**1.3%**	**$898**	**0.4%**	**$1,878**	**0.67%**

Source: World Bank

It is likely that most institutional investors seldom use PRI for their equity investments. This may be due to most institutional investors acting as portfolio investors in stock markets in developing countries, not as strategic investors in key private sector projects.

Institutional investors are for the insurance of equity investments for most ECAs of "no" importance or their relevance is unknown.

Institutional investors from developed countries are of medium to very high importance to 44% of the private insurers (meaning the majority are not). Institutional investors from developing countries are substantially less important.

For three of the four SMIs responding to the ICIEC survey, institutional investors from developed countries are of "medium" or "high" importance. One SMI responded that for equity investment institutional investors from both developed and developing countries are of "very high" importance. The other three SMIs perceive institutional investors from developing countries of "low" or "medium" importance.

3.3.1.2 Corporates/Commercial banks/Project Sponsors

The survey feedback indicates that corporate clients from developed countries are important PRI clients for private (re)insurers. Similar clients from developing countries are substantially less important. Unlike ECAs, private (re)insurers are not restrained by a mandate to only support equity investors from their home country. For ECAs corporates, banks and project sponsors that are based in their home country are the key clients for PRI for equity investments. The experience of ECAs in developed countries with PRI for equity investments varies substantially. ECAs in developing countries have in general limited experience with such cover.

Commercial banks in developed markets are far more important as clients for PRI for equity investments for private (re)insurers, than commercial banks from developing countries.

Corporate clients from developing countries and corporates of developed countries generally received the highest ratings from SMIs, although one SMI considered corporates from developing countries of "low" importance. Project sponsors from developed and developing countries also received high ratings.

Commercial banks from developed countries are of "very high" importance for the equity insurance business of all four SMIs, while banks in developing countries had mixed ratings, seen as having a lower importance for two SMIs, and of "very high" importance for the other two.

3.3.1.3 SMEs

Many ECAs indicated that the insurance of equity investments of SMEs has "no" importance to them and many ECAs "don't know".

SMEs from both developing and developed countries are clearly not important clients of private (re) insurers; almost 80% of survey respondents say they were of low or no importance. This is likely caused by the relatively low demand for such cover from SMEs, and the lack of knowledge among SMEs regarding instruments to mitigate investment risks. In some cases, it may indicate a limited awareness on real risks linked to equity investments. SME clients from developing countries are for one SMI of "no" importance (25%) and for the other three of "low" (25%), "high" (25%) or "very high" (25%) importance.

3.3.2 Country-level demand

The demand for PRI for equity investments is determined in part by the total volume of FDI, and by perceived investment risk. FDI is defined by UNCTAD as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise), in an enterprise resident in an economy other than that of the foreign direct investor. FDI has basically three components: (1) equity capital, (2) reinvested earnings and (3) intra-company loans, which are often also referred to as shareholder loans.

The vast majority of investment insurance operations of BU members (80% or more) takes place in developing countries, which are rated in risk categories 1 – 7 of the OECD country risk classification system. BU member investment insurance exposure in high-income OECD markets represented 18% of total investment insurance exposure in 2018.

To estimate the share of inward FDI in developing countries that is insured by BU members, a comparison has been made between inward FDI flows and stock for developing countries, based on UNCTAD data, relative to annual investment insurance flows and PRI stock figures for all BU members. These estimates provide a reasonable indication of the share of FDI to developing countries that is insured for political risks.

Two specific adjustments are made to eliminate PRI cover for investments in OECD markets. The total BU annual new PRI commitments have been reduced with 15%, roughly consistent with the share of PRI cover in OECD markets.

The second adjustment reflects the fact that PRI is used in part for third-party loans or non-shareholder loans, which are not part of the UNCTAD FDI statistics. For this purpose, a second adjustment is made to the BU investment statistics – a reduction of 30%. This percentage is based on input received from the survey, where insurers were asked how much of their political risk business concerns equity investments, shareholder loans and 3rd party loans. It was reported that on average, 50% of the PRI business reflects equity investments, 20% shareholder loans, and 30% third-party loans.

Table 3-8 below provides an overview of the inward FDI flows into all developing countries, the adjustments, and the estimated annual new investment insurance business of BU members.

Table 3.8 - Estimated Insured FDI Flows in Developing Countries (Billion USD)

Description	2010	2012	2014	2016	2018	Average 2010 - 2018
Inward FDI Flows	622.301	663.602	677.400	656.290	706.043	673.627
BU Annual New Business	50.728	60.116	61.450	69.024	46.619	57.184
15% Adjustment for FDI into OECD	43.119	51.099	52.232	58.670	39.626	
of which 50% Equity	21.559	25.549	26.116	29.335	19.813	24.303
of which 20% Shareholder Loans	8.624	10.220	10.446	11.734	7.925	9.721
of which 30% 3rd Party Loans	12.936	15.330	15.670	17.601	11.888	14.582
% Insured Equity	3.5%	3.9%	3.9%	4.5%	2.8%	3.6%
% Insured Shareholder Loan	1.4%	1.5%	1.5%	1,8%	1.1%	1.4%
Total % Insured FDI Flow	**4.8%**	**5.4%**	**5.4%**	**6.3%**	**3.9%**	**5.0%**

Source: UNCTAD, Berne Union and OECD data, and calculations.

Roughly 3.6% of the annual new inward equity investments into developing countries during the period 2010 – 2018 was insured by BU members against political risks. For total FDI (excluding third party loans), an estimated 5.0% was insured against political risks, including both equity investments and shareholder loans.

A similar estimate can be made based on the stock of inward FDI into developing countries, compared to insured investment insurance exposure (political risk only) of all BU members. As shown in Table 3- 9, in 2010, only 0.8% of the stock of equity investments into developing countries was insured by BU members, which declined marginally to 0.7% in 2018. For total FDI (equity investments and shareholder loans), 1.1% was insured by BU members in 2010, and 2018 1.0% in 2018.

Table 3.9 - Estimated Insured FDI Stock in Developing Countries (Million USD)

Description	2010	2012	2014	2016	2018
Inward FDI Stock	6.094.494	7.336.413	8.335.269	9.087.389	10.678.872
BU Exposure Year End	121.740	135.309	141.241	145.552	169.443
15% Adjustment for FDI into OECD countries	103.479	115.013	120.055	123.719	144.026
of which 50% Equity	51.739	57.506	60.028	61.860	72.013
of which 20% Shareholder Loans	20.696	23.003	24.011	24.744	28.805
of which 30% 3rd Party Loans	31.044	34.504	36.017	37.116	43.208
% Insured Equity	0.8%	0.8%	0.7%	0.7%	0.7%
% Insured Shareholder Loan	0.3%	0.3%	0.3%	0.3%	0.3%
Total % Insured FDI Stock	1.1%	1.1%	1.0%	1.0%	1.0%

3.3.2.1 Selected Low-Income Countries

Ten Low-Income Countries (LICs) were selected for additional analysis. A key finding is that the insured share of total inward FDI stock in each country varies quite substantially among ten countries. This suggests that the nature of foreign investment activity, and risk perception of the various LIC markets, differ significantly. It also indicates that classification of countries based on per capita income is very different than perceived investment risks in each country.

The highest share of insured FDI stock from 2010 to 2018 was for Rwanda (13%), followed by Afghanistan (10.8%) and Nepal (10.7%). The share of insured inward FDI stock for Ethiopia (1%), Chad (0.9%) and Liberia (0.8%) is much lower. An estimate could not be made for Tanzania due a lack of UNCTAD country data.

For the selected 10 LICs together, the average share of insured FDI stock ranges from 7.5% in 2010 to 3.7% in 2018, with an average of 5.4% for the 9-year period.

Table 3.10 - Estimated Share of Inward FDI Stock Insured, Low Income Countries

Country	OECD Rating (1)	2010	2011	2012	2013	2014	2015	2016	2017	2018	Average 2010 - 2018
Afghanistan (2)	7	11,0%	14,9%	14,0%	12,8%	12,2%	10,1%	8,2%	8,1%	6,3%	10,8%
Benin	6	10,9%	9,7%	6,7%	3,0%	2,6%	3,9%	7,1%	5,7%	3,9%	6,0%
Chad (2)	7	0,6%	0,4%	0,3%	0,3%	0,4%	0,3%	0,7%	4,9%	0,4%	0,9%
Ethiopia	7	1,1%	1,1%	1,3%	1,1%	1,0%	0,6%	0,6%	0,8%	1,2%	1,0%
Liberia (2)	7	1,1%	1,6%	0,6%	0,7%	1,0%	0,3%	0,8%	0,8%	0,6%	0,8%
Nepal	6	15,6%	9,0%	10,4%	12,3%	13,3%	10,9%	8,9%	7,5%	8,4%	10,7%
Niger	7	7,7%	6,6%	4,4%	2,2%	1,6%	0,3%	0,3%	0,2%	0,0%	2,6%
Mozambique	7	8,1%	4,4%	3,0%	1,6%	1,2%	1,5%	1,5%	1,4%	1,1%	2,6%
Rwanda (2)	6	11,5%	15,8%	17,3%	13,1%	11,3%	11,1%	13,1%	12,5%	11,3%	13,0%
Tanzania	6	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Average		7,5%	7,1%	6,5%	5,2%	4,9%	4,3%	4,6%	4,7%	3,7%	5,4%

Source: UNCTAD and Berne Union, calculations SFI

(1) OECD ECA ranking as of January 2020.

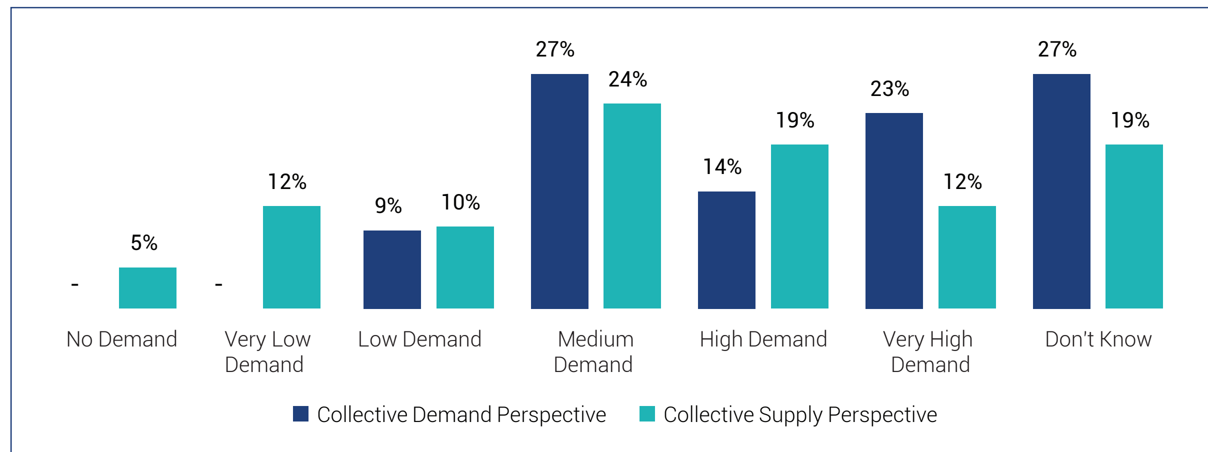
(2) These countries are also classified as fragile states and conflict-affected countries

Detailed assessments of the share of insured inward FDI flows and stock of the 10 selected LICs can be found in Annex VII.

As indicated in Figure 3-3, the ICIEC survey asked about the demand for PRI for equity investments in low income countries. The majority of users of PRI responded that there is a "medium" (27%) "high" (14%) or "very high" (23%) demand for PRI for equity investments in LICs. Six users of PRI (27%) responded that they "don't know" the demand for PRI for equity investments in low income countries.

The survey also asked about the supply of PRI for equity investments in low income countries. Most suppliers think there is "medium" (24%), "high" (19%) or "very high" demand (12%) for cover for equity investments in in low income countries. Eight suppliers, including seven ECAs and one SMI, responded that they "don't know" (together 19% of all suppliers) the demand for PRI for equity investments in these countries.

Figure 3.3 - Views on PRI for Equity Investment in Low-Income Countries



Source: ICIEC survey for the joint MDB G20 stock-take study.

3.3.2.2 Selected Lower Middle-Income Countries

The risk-insured percentages of total inward FDI stock also differ substantially among the selected seven Lower Middle-Income Countries (LIMCs). Myanmar has the highest percentage of insured FDI Lower Middle-Income Countries (LIMCs), averaging 5.2% for the period covered, followed by Ukraine and Kenya. On average, the insured share of FDI for the seven LMICs is 3.8%, which is lower than the average percentage for LICs (5.4%). There are significant differences among the individual countries, again suggesting different foreign investment patterns and market perceptions on FDI risks in individual countries.

Table 3.11 - Share of Inward FDI Stock Insured for Lower Middle-Income Countries

Country	OECD Rating (1)	2010	2011	2012	2013	2014	2015	2016	2017	2018	Average 2010 - 2018
Bangladesh	5	2,7%	4,0%	3,4%	2,8%	1,3%	1,3%	1,3%	1,5%	2,2%	2,3%
India	3	1,4%	1,9%	2,3%	2,3%	1,9%	1,7%	1,8%	1,6%	1,5%	1,8%
Indonesia	3	2,0%	2,1%	1,9%	1,7%	1,9%	2,1%	2,2%	3,0%	3,7%	2,3%
Kenya	6	3,4%	3,4%	2,9%	4,2%	4,3%	4,5%	5,3%	4,7%	3,8%	4,1%
Myanmar (2)	6	2,1%	1,8%	5,6%	5,7%	5,3%	6,4%	7,1%	7,0%	5,9%	5,2%
Ukraine	6	6,7%	5,9%	4,7%	4,3%	4,8%	3,0%	2,6%	3,1%	3,2%	4,2%
Zambia	7	4,0%	2,3%	1,7%	2,4%	1,7%	1,4%	1,4%	1,4%	1,3%	2,0%
Average		**3,6%**	**3,1%**	**3,3%**	**3,7%**	**3,6%**	**3,5%**	**3,7%**	**3,8%**	**3,6%**	**3,6%**

Source: UNCTAD and Berne Union, calculations SFI

(1) OECD ECA ranking as of January 2020.

(2) This country is also classified as fragile state and conflict-affected country.

Detailed assessments of the share of insured inward FDI flows and stock of the 7 selected LMICs can be found in Annex VIII.

3.3.2.3 Selected Upper Middle-Income Countries

The insured shares of inward FDI stock of the selected 5 Upper Middle-Income Countries (UMICs) again differ substantially. Algeria has by far the highest average percentage, at 5.9% of insured inward FDI stock. Other UMICs have substantial lower percentages, such as China at 1.2% and Brazil at 0.6%, which indicates low demand for PRI for equity investments and shareholder loans in many UMICs. The average for the 5 UMICS during the period 2010 – 2018 is 1.9%.

Table 3.12 - Share of Inward FDI Stock Insured for Upper Middle-Income Countries

Country	OECD Rating (1)	2010	2011	2012	2013	2014	2015	2016	2017	2018	Average 2010 - 2018
Algeria	3	8,1%	7,5%	7,1%	6,9%	5,5%	5,1%	4,5%	3,8%	4,7%	5.9%
Brazil	5	0,4%	0,4%	0,4%	0,5%	0,6%	0,9%	0,8%	0,6%	0,7%	0.6%
China PR	2	1,7%	1,5%	1,5%	1,3%	1,1%	1,0%	0,9%	0,9%	0,8%	1.2%
Mexico	3	0,6%	0,6%	0,5%	0,5%	0,7%	0,7%	0,9%	1,0%	1,0%	0.7%
South Africa	5	0,7%	0,8%	0,9%	1,0%	1,0%	1,2%	1,2%	1,1%	1,5%	1.1%
Average		**2,3%**	**2,2%**	**2,1%**	**2,0%**	**1,8%**	**1,8%**	**1,6%**	**1,5%**	**1,7%**	**1.9%**

Source: UNCTAD and Berne Union, calculations SFI

(1) OECD ECA ranking as of January 2020.

Detailed assessments of the share of insured inward FDI flows and stock of the 7 selected LMICs can be found in Annex IX.

3.3.2.4 Selected Fragile States and Conflict Affected Countries

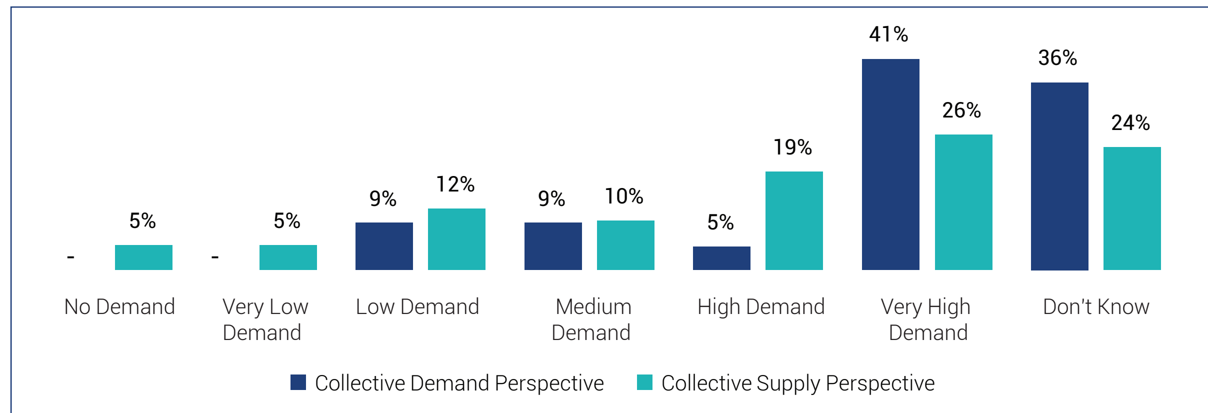
The picture for fragile states and conflict-affected countries looks similar to that for LICs. In general, the demand for PRI for inward FDI into these countries is relatively high, with the exception of Chad and Liberia. Detailed assessments of the share of insured inward FDI flows and stock of the 5 fragile states can be found in Annex X.

Among the fragile states, Rwanda has the highest average share of insured FDI stock (13.0%), followed by Afghanistan (10.8%) and Myanmar (10.7%). Not surprisingly, political risk insurers are most active in the highest risk category of the OECD country classification, category 7.

As shown in Figure 3-4 below, the majority of users of PRI responded that there is a "very high" demand (41%), "high" (5%) or "medium" (9%) demand for PRI for equity investments in fragile states and conflict-affected countries. Eight users of PRI responded that they "don't know" (36%) the demand for PRI for equity investments in these countries.

Most suppliers think there is "medium" (10%), "high" (19%) or "very high" demand (26%) for cover for equity investments fragile state and conflict-affected countries. Ten suppliers, among which seven ECAs, two private (re-) insurers and one MDB, responded that they "don't know" (together 24% of all suppliers) the demand for PRI for equity investments in in these countries.

Figure 3.4 - Demand for PRI for Equity Investments in Fragile States and Conflict-Affected Countries



Source: ICIEC survey for the joint MDB G20 stock-take study.

Overall, only a relatively small share of the inward FDI into developing countries is insured against political risks. Most FDI investments are uninsured. The demand for and actual utilization of PRI for FDI investments is, in broad terms, the highest for fragile states and conflict-affected countries and LICs, followed by LMICs and UMICs. In general, the lower the IBRD income category, the higher the demand for PRI cover. The demand for PRI for FDI investments in fragile states and conflict-affected countries is comparable with the demand for such insurance for FDI investments in LICs.

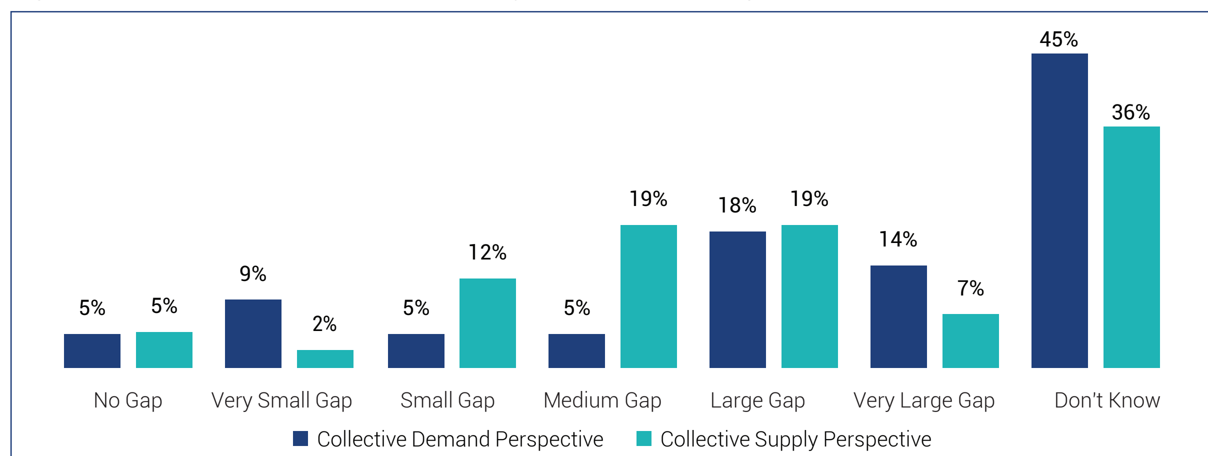
At the same time, there are substantial differences in the insured shares of inward FDI stock of individual countries within the same IBRD income group. The analysis clearly indicates that some countries have less access to other sources of finance and PRI than others, although they are both classified in the same IBRD income category. This implies that risk perceptions of the market on individual countries differ substantially among countries in the same IBRD income category. This notion is important to develop adequate – country specific – risk mitigation strategies.

3.4 POTENTIAL GAPS AND CONSTRAINTS

3.4.1 High-risk markets

While the majority of users and suppliers of PRI think there is indeed a gap for the insurance of equity investments in in higher risk markets, many users (45%) and suppliers (36%) responded that they "don't know" whether there is a gap.

Figure 3.5 - Potential Gap for PRI for Equity Investments in High-Risk Markets

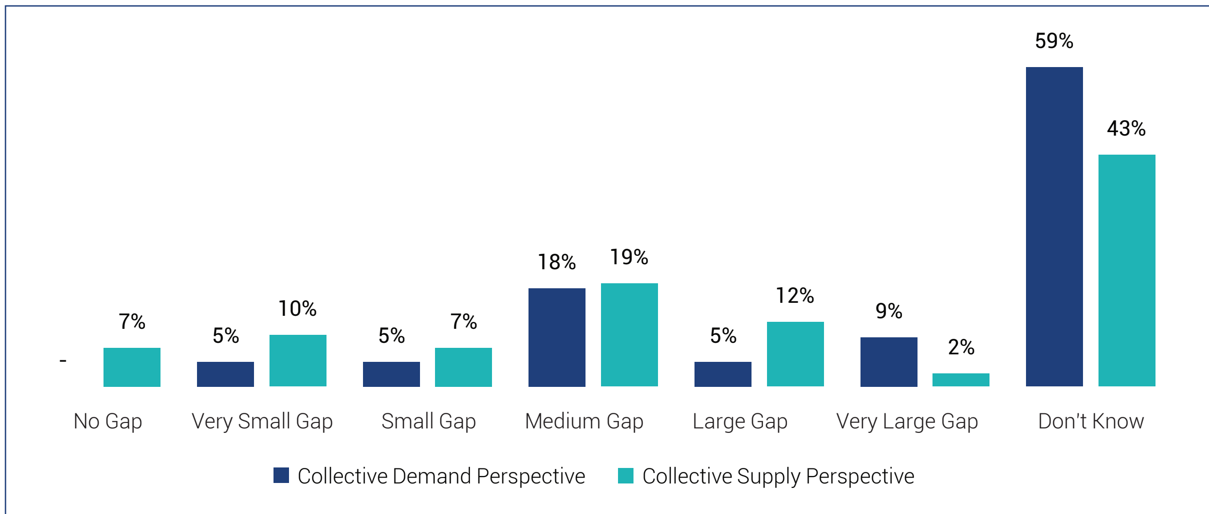


Source: ICIEC survey among stakeholders for G20 Stock-Take study.

3.4.2 South-South FDI

The majority of PRI suppliers think there is indeed a gap for PRI for South-South equity investments, although a majority of users did not know if that was the case. The latter is likely caused by the fact that most users that participated in the survey are based in developed countries.

Figure 3.6 - Potential Gap for PRI of South-South Equity Investments



Source: ICIEC survey among stakeholders for G20 Stock-Take study.

In this context it is important to take the following considerations into account:

- **Most ECAs will only support equity investors from their home country**. ECAs in developed countries with a solid credit rating (S&P single A or above) will likely be able to offer acceptable PRI to equity investors from their home country. However, this will be an issue for developing countries that lack a national ECA or that have an ECA with a too low credit rating (below S&P A) and / or limited capital. Support for equity investments requires the ability to cover LT investments (up to 15 years) and relatively large amounts. For many ECAs in developing countries, relatively large LT investments are likely a too big challenge.

- **Private insurers could (in theory) support south-south investors**, **but most focus on large investors from developed countries,** because there are the largest business opportunities. Most of their PRI for equity investments addresses North-South investments.

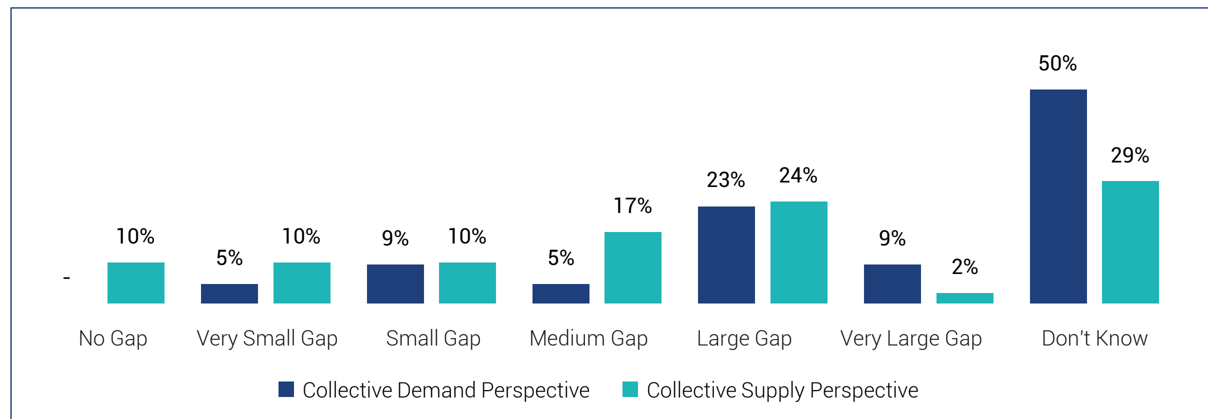
- **SMIs with a mandate to support investments in developing countries have the capability to support "South-South" investments**. Many have also developed a specific strategy to support such South-South investments. In practice, however, the vast majority of the investments supported by SMIs are North-South investments, because there is the largest demand for their insurance products. The relatively low share of South-South investments in the portfolios of SMIs is likely due to (1) the relatively low volume of South-South investments, (2) the lack of knowledge in developing countries about investment risks and how these risks can be mitigated, and (3) the limited marketing of PRI products in these markets.

- **SMIs have much less capital available to support equity investments than ECAs or private insurers.** Most SMIs make active use of reinsurance to create more insurance capacity, but reinsurers would normally expect a substantial risk sharing with the insurer. The possibilities for reinsurance are constrained by the SMI's own capital resources.

3.4.3 SMEs and Small Investments

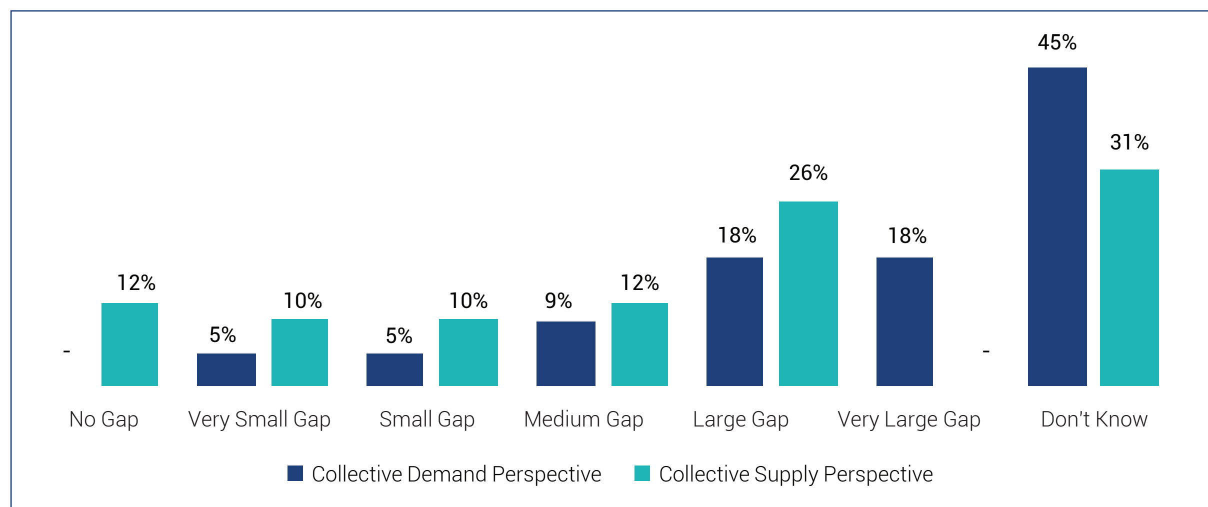
The majority of users and suppliers think there is indeed a gap for the insurance of equity investments from SMEs or small investments below USD 5 million, although around 50% of users said they don't know.

Figure 3.7 - Potential Gap for Equity Investments from SMEs



Source: ICIEC survey among stakeholders for G20 Stock-Take study.

Figure 3.8 – Potential Gap for Small Equity Investments (USD 5 million)



Soure: ICIEC survey among stakeholders for G20 Stock-Take study

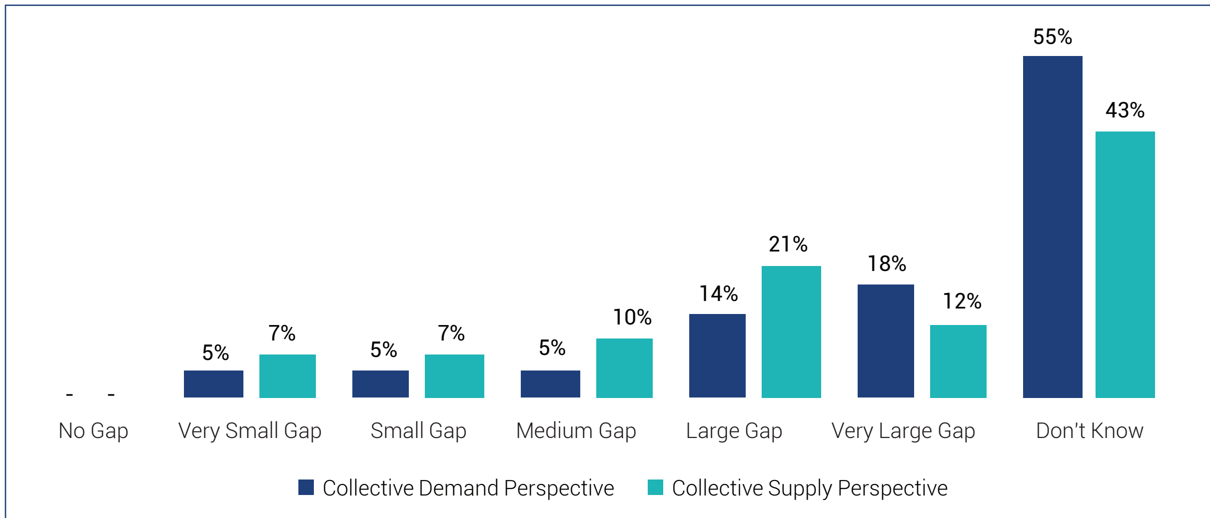
This is potentially another interesting area for cooperation between SMIs and ECAs. Through close cooperation with local ECAs, SMIs could potentially enhance support for equity investments of SMEs. This is likely of particular interest for SMEs from developing countries (i.e. South-South SME investments). Most SMEs in developed markets should be able to obtain adequate investment insurance from their national ECA. Also, private insurers could in this area team up with local ECAs.

3.4.4 Developing Countries Without an ECA

The majority of users and suppliers think there is indeed a gap for the insurance of equity investments from countries that lack an ECA or have a too low rated ECA. This confirms that for South-South investments there is potentially a large gap for countries without an adequate investment insurance scheme. SMIs could clearly play a complementary role, including through cooperation with local ECAs. Cooperation with

local ECAs in developing countries may also be an interesting business opportunity for private insurers (e.g. origination of business).

Figure 3.9 - Potential Gap for Equity Investments from Developing Countries Without ECA [1)]



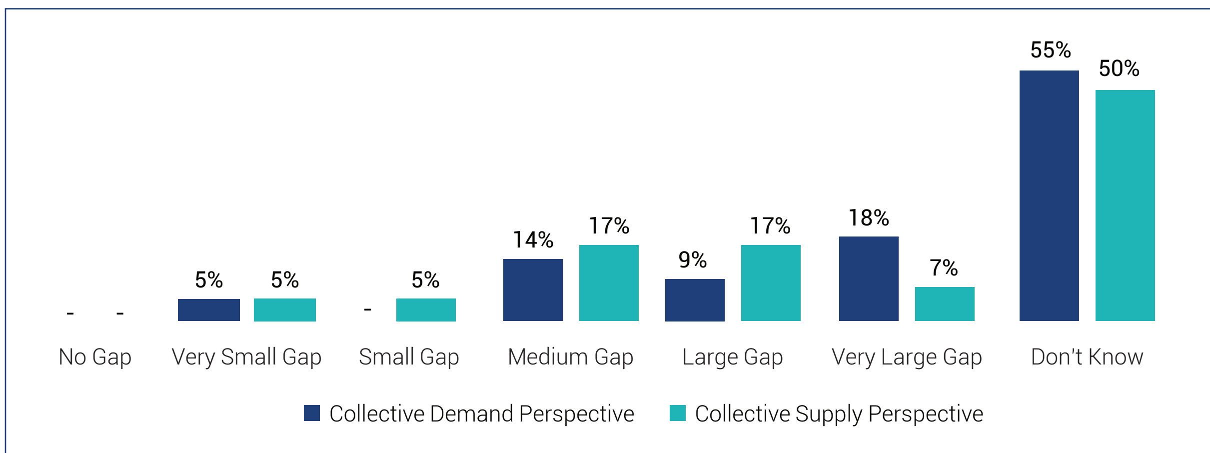
Source: ICIEC survey among stakeholders for G20 Stock-Take study

(1) Includes ECAs with a too low credit rating.

3.4.5 Insurance of Equity Investments against Breach of Contract with Uncertainty regarding Arbitration Procedures and Outcomes

t is usually a requirement that an arbitration be awarded in favour of the insured, in order to obtain a claims payment for a loss that has been caused by a breach of contract. Many users (41%) and suppliers (41%) consider that there is indeed a gap for the insurance of breach of contract, which is relevant for equity and particularly MLT debt investments. This is one of the main reasons why commercial banks have a strong preference for comprehensive cover for project finance loans and explains the growth of such cover in the private insurance market during the past 5 years. Noteworthy is also that most ECAs provide comprehensive cover for project finance loans.

Figure 3.10 - Potential Gap for Breach of Contract Cover Due Uncertain Arbitration Procedures



Source: ICIEC survey among stakeholders for G20 Stock-Take study.

3.4.6 Domestic Equity Investments

Most insurers cover only foreign direct investments, and not domestic investments. It may be worthwhile to investigate whether there is demand from potential domestic equity investors for cover against certain political risks (e.g. breach of contract and war risks). This could potentially be an interesting business area for SMIs and private insurers.

For SMIs, this will likely imply an extension of their current mandates, because most are currently only allowed to cover cross-border investments and not domestic investments. It could also be an interesting area for local ECAs in developing countries, but for many this will also likely require a change of their mandate. Furthermore, for many local ECAs, it may be a challenge to provide LT cover for large equity investments, and their credit rating is likely too low for them to play a substantial role in this area. Private insurers could also potentially play a role in this area.

3.5 POTENTIAL SOLUTIONS

3.5.1 Increased Role for MDBs and SMIs

The question that was asked to stakeholders was the following:

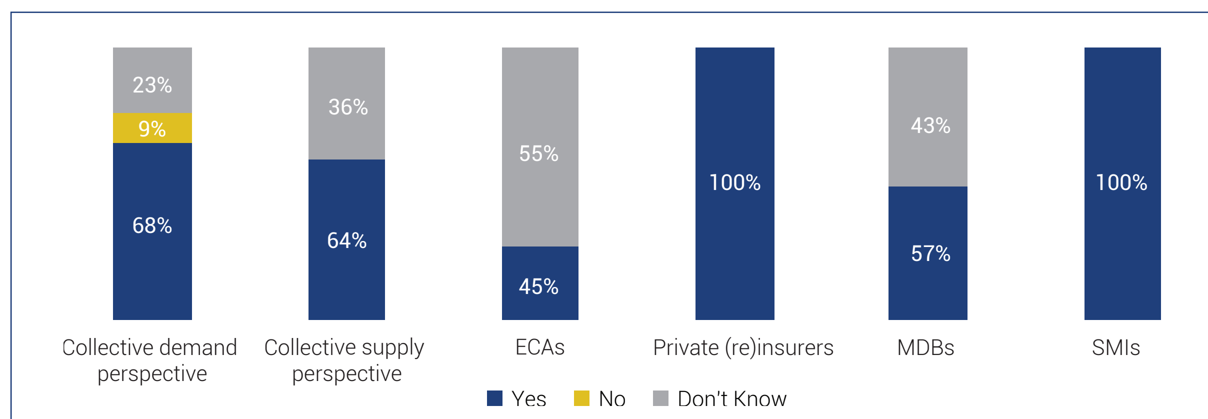
> ***Question to all stakeholders:***
> *Do you believe that MDBs and/or SMIs could play a role in filling potential gaps in the market for PRI for equity investments?*

The vast majority of (potential) users of PRI for equity investments perceive that MDBs and SMIs can play a complementary role in insuring equity investments (68%).

On the supply side 55% of the ECAs "don't know" and 45% consider that MDBs and SMIs can play a complementary role. The views of MDBs are more or less the same with 43% "don't know" and 57% with a positive response.

All private (re-)insurers and SMIs (both 100%) consider that MDBs and SMIs can play a complementary role.

Figure 3.11 – Potential Role for MDBs and SMIs for the Insurance of Equity Investments



Source: ICIEC survey for the joint MDB G20 stock-take study.

Some of the stakeholders also mentioned areas where MDBs and SMIs could play an important role. These include:

1. Several ECAs, from both developed and developing countries, mentioned that MDBs and SMIs should explore close cooperation with ECAs through co-insurance and re-insurance and other forms of cooperation.

2. One ECA from a developing country suggested that MDBs and SMI could provide assistance to local ECAs in developing countries through capacity building.
3. A private insurer mentioned that private insurers may in general have limited interest to insure equity investments in fragile states or other high-risk markets. Private insurers are known to be very selective in their underwriting. For this reason, it was suggested that MDBs and SMIs could focus their operations on these markets.

3.5.2 First loss guarantee for equity investments

Insurers do not have unlimited insurance capacity, be they ECAs, SMIs or private insurers. For some countries, they may experience country exposure constraints due to the high volume of business. For other countries, they may have limited or no risk appetite because of the perceived high risks.

It is against this background that stakeholders were asked whether a first loss guarantee could create additional insurance capacity.

Stakeholders were asked the following:

> ***Question for all stakeholders:***
>
> *Do you think that a first loss guarantee, somewhere between 10% - 20% and funded with grant money (e.g. blending of ODA funds/development aid money) would be useful to mobilize more insurance capacity from insurance providers to cover equity investments in foreign countries?*

Responses were sought for 4 different categories of countries, namely:

- Middle income countries.
- Low income countries.
- Fragile states and conflict-affected countries.
- Countries classified in OECD ECA risk category 7.

3.5.2.1 Middle income countries

The majority of (potential) buyers responded they “don’t know” whether a first loss guarantee would lead to the mobilization of additional insurance capital for equity investments in middle income countries (64%). 18% of the buyers think it will not create additional insurance capacity for these countries.

On the supplier side, the “yes” and “no” responses are almost equal with 36% for “yes” and 33% for “no”. 31% of the suppliers “don’t know”.

3.5.2.2 Low income countries

A majority (52%) of the suppliers of PRI for equity investments think that a first loss guarantee will create additional insurance capacity for equity investments in low income countries. 29% “don’t know” and 19% think it will have no mobilization impact.

The buyers are less optimistic: 55% “don’t know” and 14% considers that it will not lead to additional insurance capacity. 32% responded positively which is 14% higher than for middle income countries.

3.5.2.3 Fragile states and conflict-affected countries

The views of buyers and suppliers regarding the mobilization impact of a first loss for PRI for equity investments in fragile states and conflict-affected is more or less the same as for IBRD low income countries. 59% of the buyers and 26% of the suppliers don’t have an opinion and 52% of the suppliers and 27% of the buyers think a first loss guarantee will have a positive mobilization impact.

2.5.2.4 High-risk countries

The views regarding the mobilization impact of a first loss guarantee for equity investments in high-risk markets (OECD category 7 countries) are more or less the same as for low income countries and fragile states.

3.5.3 Additional PRI capacity

The question that was asked to stakeholders was the following:

> ***Question to all stakeholders:***
> *Do you believe that additional insurance capacity for PRI for equity investment will substantially increase or mobilize additional equity investments in developing countries?*

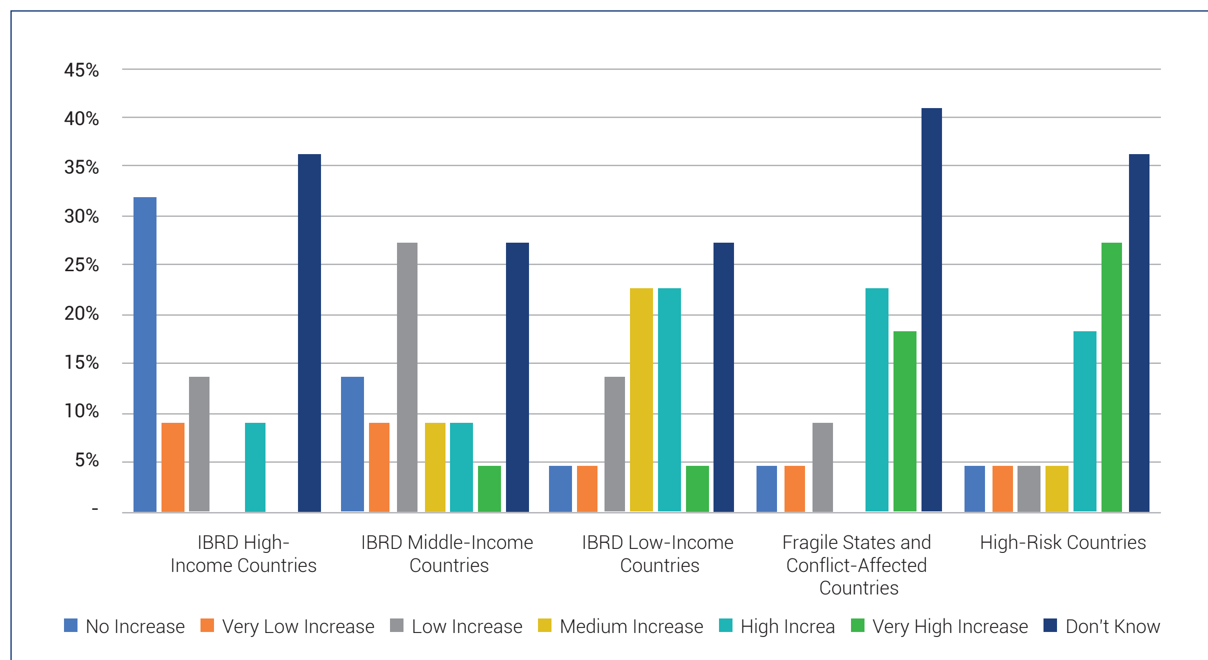
A clear majority of suppliers (71%) and buyers (55%) of PRI for equity investments consider that additional insurance capacity will lead to "no", a "very low" or "low" increase of equity investments in high income countries. Of the buyers 36% "don't know" and of the suppliers 17%.

For middle income countries 27% of the buyers and 19% of the suppliers "don't know whether additional insurance capacity will lead to additional equity investments. 50% of the buyers and 45% of the suppliers think it will have "no", a "very low" or a "low" impact. 13% of the buyers and 12% of the suppliers perceive a "high" or very high" impact.

Both suppliers and buyers are more optimistic about the impact of additional insurance capacity for equity investments in low income countries. A "medium" "high" or "very high" increase of equity investments is expected by 51% of the buyers and 40% of the suppliers. 27% of the buyers "don't know" and this is also the case for 21% of the suppliers.

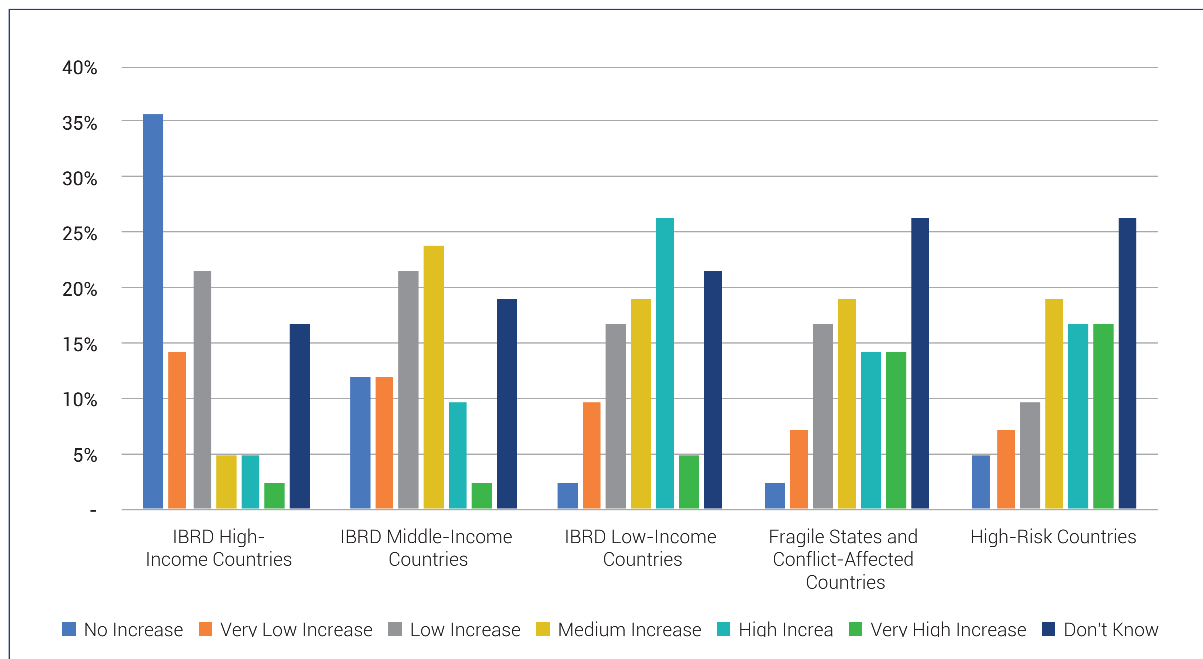
The expectations of buyers and suppliers of the impact of additional insurance capacity for equity investments in fragile states and high-risk countries are more or less comparable with those of low-income countries. Many buyers don't know the impact (36%-41%) and that is also the case for 26% of the suppliers. 41% of the buyers and 47% of the suppliers think that the additional capacity will have a "medium", "high" or very high" impact on equity investments in fragile states. For high-risk markets this is 53%.

Figure 3.12 –Impact of Additional PRI for Equity Investments on FDI Into Developing Countries (Demand Perspective)



Source: ICIEC survey for the joint MDB G20 stock-take study.

Figure 3.13 –Impact of Additional PRI for Equity Investments on FDI Into Develping Countries (Supplier Perspective)



Source: ICIEC survey for the joint MDB G20 stock-take study.

3.5.4 Preferred Creditor Status

MDBs and SMIs were asked in the ICIEC survey about how their PCS can be beneficial to equity investments and how it might be shared with other insurers. The potential benefits of sharing the PCS concerned (1) lower pricing, (2) longer tenors, (3) more general capital and (4) more capital for relatively high-risk markets. The responses vary substantially, and do not provide a concise or clear picture about whether MDBs and SMIs actually share their PCS in the insurance of equity investments.

MDBs are not currently involved in insuring or reinsuring equity investments, but all MDBs did expect that sharing PCS would have an impact on pricing, tenors or capital.

SMIs are divided on whether sharing PCS will lead to a more favorable pricing and additional general capital from reinsurers.

Around half of MLT equity investors surveyed don't know whether sharing through the insurance of their equity investments by an MDB or SMI would lead to more favorable terms and conditions for their equity investment.

Most private (re-)insurers agree that sharing the PCS will lead to a more favorable pricing, longer tenors and more insurance capital and even more capital for high-risk markets.

ECAs have in general limited experience with reinsurance of SMIs for PRI for equity investments and a sharing of the PCS. It should be noted OECD ECAs can determine their own terms and conditions for investment insurance, because the OECD Arrangement for officially supported export credits with "core standards" regarding among others maximum tenors and minimum pricing, does not apply to investment insurance.

3.6 KEY FINDINGS/CONCLUSIONS

3.6.1 Supply for PRI for Equity

BU net claims were very small for PRI. For 2010-18, investment insurance activities for private sector projects of all BU members were a total of USD 514.7 billion. For the same period, there were USD 1.1 billion claims paid for political risk cover. (ECAs paid 70% of this amount, private insurers 29%, and SMIs 1%). Recoveries were USD 145 million of investment insurance claims paid, so net claims remained under USD 1 billion.

Both Private (re)insurers and Specialized Multilateral Insurers (SMIs) could play a much larger role. ECAs are currently the largest providers. Because they are not restrained by a mandate to only support equity investors from their home country, private (re)insurers and Specialized Multilateral Insurers could, in principle, both play a much larger role as providers of political risk cover for equity investment.

Cover for South-South investment (i.e. investments from one developing country to another developing country) has not been a priority. Private insurers could support South-South investors; however, most private insurers focus their business on large investors from developed countries, because there are the largest business opportunities. Most of their PRI for equity investments addresses North-South investments (i.e. investments from a developed country to a developing country). SMIs with a mandate to support investments in developing countries have the capability to support South-South investments. Many have also developed a specific strategy to support such South-South investments. In practice, however, the vast majority of the investments supported by SMIs are North-South investments, because this is the largest demand for their insurance products. Many countries have an ECA, but those in developing countries often face constraints to cover equity investments (e.g. too low credit rating, challenges in covering long-term tenors (e.g. 15 years), large amounts and likely also a lack of knowledge about risks and risk mitigation products among potential clients in their markets).

There is scope for expanding reinsurance. Insurers that are active in PRI investment insurance have been successful in mobilizing private capital by using reinsurance techniques. This suggests expanding the use of reinsurance merits further examination.

3.6.2 Demand for PRI for Equity

Corporates, project sponsors, and commercial banks from developed markets use PRI. Corporates, project sponsors, and commercial banks from developed markets make the greatest use of PRI for equity investments from ECAs, private insurers, and SMIs.

Only a small share of FDI into developing countries is insured. Overall, only a relatively small share of the inward FDI into developing countries is insured against political risks. Most FDI investments are uninsured.

Substantial differences in insured shares of FDI within the same country income group and among 22 sample countries exist. There are substantial differences in the insured shares of inward FDI stock of individual countries within the same IBRD income group. This implies that risk perceptions of the market on individual countries differ substantially among countries in the same IBRD income category. The high variability suggests that the nature of foreign investment activity, and risk perception of the various markets, differ significantly. It also indicates that classification of countries based on per capita income is very different than perceived investment risks in each country.

There is a relatively high PRI demand in Fragile States and Conflict-Affected Countries. In general, the demand for PRI for equity investment in fragile states and conflict-affected countries is perceived relatively high. Doing more to meet this demand could mobilize necessary capital to strengthen the countries' economies.

Detailed assessments of the share of insured inward FDI flows and stock of the 22 selected developing countries can be found in Annexes VII – IX.

3.6.3 Potential Gaps

Awareness of PRI for equity investments needs to be increased with institutional investors. Greater promotion and increasing awareness of the product among institutional investors might encourage additional capital flows. This is an area for potential growth of the market.

There is potentially a large gap for South-South PRI investment insurance. The majority of PRI for equity investments is provided by ECAs; however, they will only provide support to equity investors from their home countries. As many developing country ECAs still lack an investment insurance scheme and only have limited capital, SMIs could clearly play a complementary role, including through cooperation with local ECAs. Cooperation with local ECAs in developing countries may also be an interesting business opportunity for private insurers.

Domestic equity investments in emerging markets also can face political risks. It may be worthwhile to examine demand from potential domestic equity investors for cover against certain political risks as most insurers only cover foreign direct investments. This could be relevant for cover against insurrection risk and breach of contract risk in PPP projects, in which local investors make an equity investment. This could potentially be an interesting business area for SMIs and private insurers.

There is limited supply of insurance for equity investments from SMEs and small value investments. SMEs and small investment appear to be underserved for political risk cover. This is a potentially interesting area for cooperation between SMIs and ECAs.

3.6.4 Potential Solutions

Enhanced cooperation between MDBs and SMIs and other risk mitigation providers may address identified market gaps. Survey respondents indicate that MDBs and SMIs could play a more prominent role through co- and re-insurance and other forms of cooperation. They are also seen to tackle the unmet demand PRI of equity investments in fragile states or other high-risk markets. Another opportunity to address market gaps in developing countries is by providing capacity building to local ECAs.

First loss guarantees can help to unlock additional insurance capacity. The survey results, which varied considerably by group, suggest a first loss guarantee can help to create additional insurance capacity in low income markets, fragile states and conflict-affected countries, and high-risk OECD category 7 countries. First loss guarantees are not new, and there are various examples of concessional funds being used on a transaction basis and as a facility. For example, in FY 2018 IDA created a special risk mitigation facility for MIGA to catalyze private sector investment in IDA-only countries, with a focus on fragile and conflict-affected states (FCS). The IDA -MIGA Guarantee Facility (MGF) amounts to a first loss insurance capacity of USD 500 million, which allows MIGA to expand its insurance operations to markets where it has no or very limited insurance capacity / risk appetite. Since 2018, MIGA has used the IDA first loss guarantee regularly. The IDA first loss exposure outstanding at the end of FY 2019 was USD 89 million[36]. Given the success of MIGAs first loss facility it makes sense to explore whether first loss arrangements can be broadened and developed for other official equity insurance providers (e.g. SMIs and official ECAs). first loss support from concessional windows of MDBs and bilateral ODA Aid Agencies could enhance the availability of insurance for equity investments in relatively high-risk markets. Annex XIII provides some ideas on how official insurance / guarantee providers can enhance their operations for relatively high-risk markets by making use of first ODA loss guarantees.

Greater promotion of the PRI product with new client segments such as investors from developing countries and institutional investors may mobilize additional private sector funds.

36 Source: IDA Financial Statements FY 2019.

04

Political Risk Insurance and other Insurance Solutions for MLT Debt Investments

04 Political Risk Insurance and other Insurance Solutions for MLT Debt Investments

4.1 INTRODUCTION

Chapter 4 examines the issue of the availability and use of political risk insurance for MLT debt, which was also part of the remit from the G20. It uses a similar outline to that used in Chapter 3. The chapter begins by discussing the supply of PRI cover for MLT debt financing. It then examines areas of demand for and use of this cover, by client and by country. It considers in detail the composition of the external debt of 22 selected developing countries, notably low-income countries and fragile states, with a specific focus on the MDB share of each country's debt and the scope for innovation in providing PRI cover for (additional) debt. Next, it turns to the survey conducted by ICIEC and probes the possible gaps in PRI cover for MLT debt financing, and the limitations or constraints in the current market. Potential solutions and ways to close potential market gaps are outlined, and some conclusions are reached.

4.2 SUPPLY OF POLITICAL AND CREDIT RISK INSURANCE FOR DEBT INVESTMENTS

4.2.1 MDBs

Guarantees – partial risk and partial credit guarantees - currently play a very modest role in the development finance operations of MDBs. During 2010-18, the gross guarantee exposure of nine leading MDBs increased from USD 7.3 billion to USD 17.8 billion. This was mainly attributable to the growth of guarantee business for ST trade finance and the exposure exchange arrangements between various MDBs (in particular IBRD).

Table 4.1 - Annual Gross Guarantee Exposure Outstanding of all MDBs (Million USD)

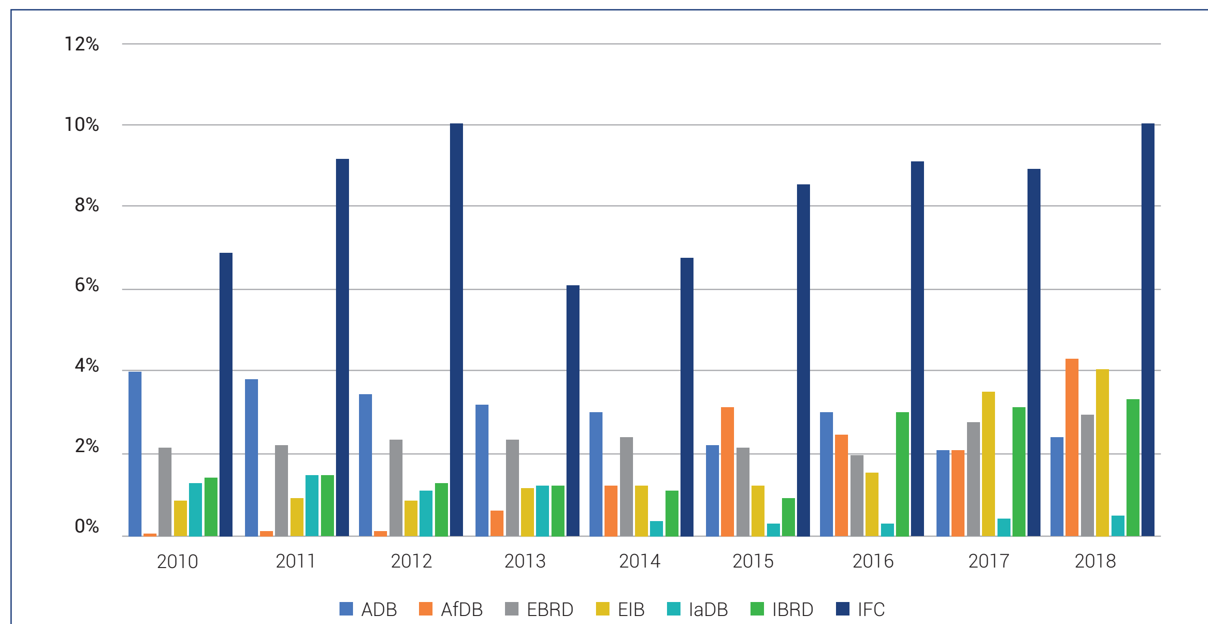
MDB	2010	2011	2012	2013	2014	2015	2016	2017	2018
ADB	1.969,10	1.995,20	1.904,90	1.780,00	1.740,00	1.407,00	2.105,00	2.173,00	2.631,00
AfDB	2,82	14,1	20,12	104,03	231,4	626,65	565,47	552,88	1.239,47
AIIB									
EBRD	525,45	624,89	708,51	708,51	709,64	650,88	638,45	898,35	1.003,44
EIB	340,77	416,23	410,58	571,48	617,49	624,97	766,04	1.786,60	2.087,59
IaDB	814	980	761	871	251	207	230	353	454
IBRD	1.726,00	1.969,00	1.753,00	1.744,00	1.713,00	1.367,00	5.198,00	5.658,00	6.325,00
IFC	1.889,00	2.932,00	3.420,00	2.070,00	2.474,00	3.168,00	3.478,00	3.528,00	4.096,00
IsDB									
Total	**7.267,14**	**8.931,42**	**8.978,11**	**7.849,02**	**7.736,53**	**8.051,49**	**12.980,95**	**14.949,83**	**17.836,50**

Source: Annual reports relevant MDBs.

Note: EIB in this table represents Non-EU exposure (10% of total exposure)

The graph below shows the development of the share of the guarantee business in the overall business portfolios of those MDBs that provided guarantees, for 2010-18. It includes all MDBs except the AIIB and the IsDB. AIIB is a relatively new MDB and was during the reference period not involved in guarantee operations. The IsDB has a separate insurance agency (ICIEC) that provides insurance services on behalf of the IsDB group. As noted, the guarantee business of IFC, EBRD, ADB, IaDB and AfDB concerns mainly ST TFP business. MDBs have not seen much of an increase in their guarantee operations. The main activity of most MDBs in 2010-18 was direct lending. Annex II provides a comprehensive overview of the guarantee operations of MDBs during the period 2010 – 2018.

Figure 4.1 - Outstanding Guarantee Exposure as a Proportion of Total Exposure of MDBs



Source: Annual reports relevant MDBs

Note: figures include ST Trade Finance Guarantees, MLT PRGs and MLT PCGs.

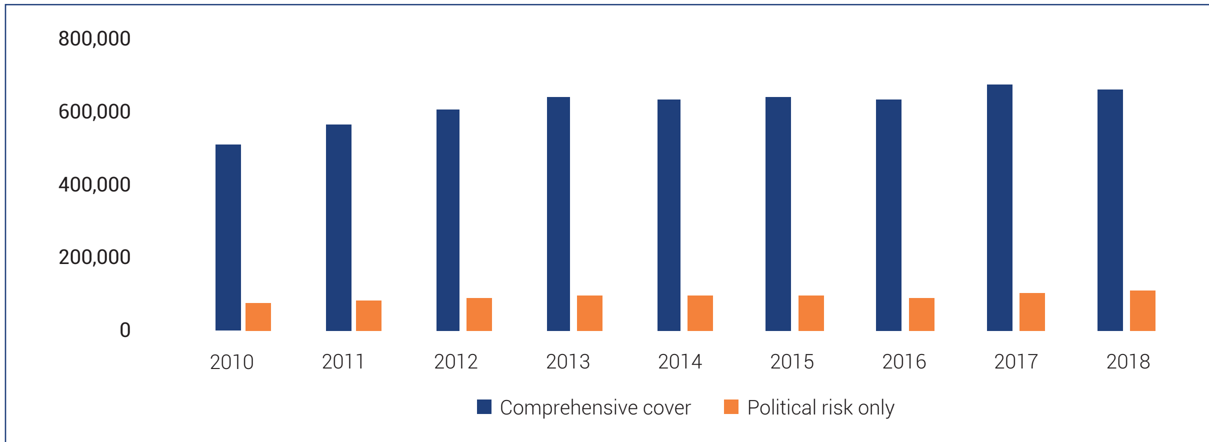
Limited use of MLT guarantees is due to various internal and external factors. Annex XV provides a general overview of the main factors that hinder the optimal utilization of guarantees by MDBs, based on various evaluations and studies[37] of the guarantee operations of multiple MDBs. It should be noted that not all factors apply to all individual MDBs. Furthermore, there is a fundamental difference between sovereign (non-market based) and non-sovereign (market based) operations of MDBs.

4.2.2 ECAs

Comprehensive credit insurance is the most commonly used insurance product for official ECAs. In 2010, 86.7% of all their MLT policies concerned comprehensive cover policies and only 13.3% for political risk, mainly used for equity investments and shareholder loans. In 2018, comprehensive cover represented 85.5% of the exposure of ECAs, and 14.5% for political risk only, which concerns mainly cover for equity investments.

37 See among others: (1) independent evaluation of the World Bank Group Guarantee instruments 1990 – 2007, which can be found via the following link: https://ieg.worldbankgroup.org/sites/default/files/Data/Evaluation/files/guarantees_eval_full.pdf
(2) ADB's corporate evaluation "Boosting ADB's Mobilization Capacity: The Role of Credit Enhancement Products", which can be found via the following link: https://www.adb.org/sites/default/files/evaluation-document/172894/files/cep-redacted.pdf
(3) WEF report" Building on the Monterrey Consensus: The untapped potential of development finance institutions to catalyze private investments, which was published in 2006.
(4) Essay of Center of Global Development "Billions to Trillions? Issues on the Role of Development Banks in Mobilizing Private Finance', November 17, 2017 Author: Nancy Lee The essay can be found via the following link: https://www.cgdev.org/sites/default/files/Billions-trillions-issues-role-development-banks-mobilizing-private-finance.pdf
It is unknown whether these preferential MDB sovereign loans will be reported as concessional or non-concessional loans under the new ODA framework. It will depend on the concessionality level of the MDB loans.

Figure 4.2 - MLT Outstanding Exposure of Official ECAs by Type of Insurance Policy (Million USD)



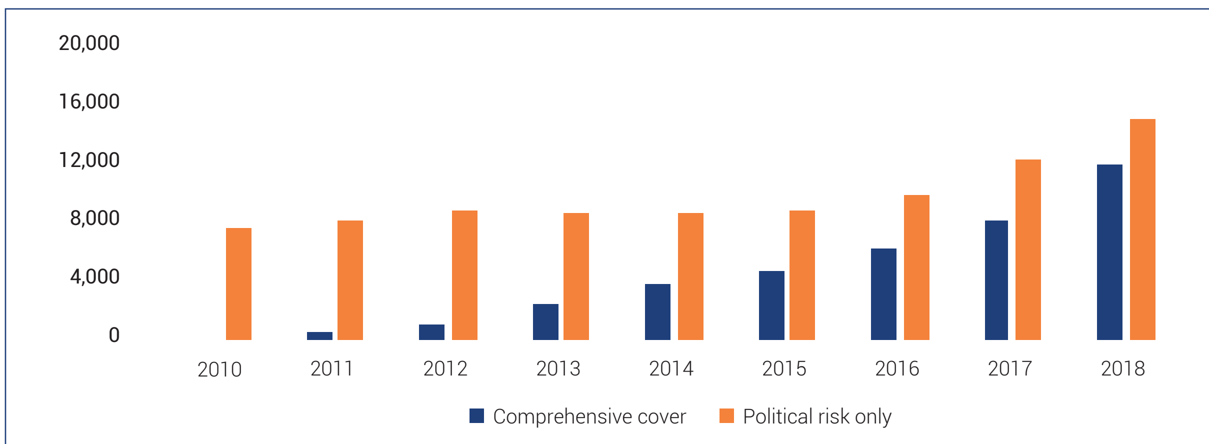
Source: Berne Union.

4.2.3 SMIs

SMIs in general have different experiences with comprehensive cover. MIGA, which is one of the largest Investment insurers in the BU, is mainly mandated to cover MLT investments and non-commercial risks. It is not allowed to cover MLT commercial risks and, unlike ATI, ICIEC and Dhaman, it lacks an (explicit) mandate to support ST and MLT trade transactions. MIGA, therefore, does not provide comprehensive (both political and commercial risk) cover for private sector borrowers or projects. It does, however, provide comprehensive cover for loans to public sector borrowers (e.g. NHSFO-cover), because payment risks on these public sector entities are considered political / non-commercial risks. ICIEC and ATI are also quite active in providing such cover. Within the World Bank group, comprehensive cover for private sector borrowers (PCGs) can be provided by IFC, but it has very limited experience with the product.

The graph below shows the development of the two main types of policies within the SMI community. It shows that comprehensive cover has grown substantially during the past 9 years. In 2011 this was slightly less than 7% of the overall exposure of SMIs, which had grown to 44% in 2018. The key comprehensive cover insurance product that led to the growth concerns the so-called Non-Honoring (Sovereign) Financial Obligation (NH(S)FO cover, which is used to cover payment obligations on sovereign and sub-sovereign borrowers and SOEs. MLT cover for commercial risk is much less common in the SMI community. It is likely that most PRI business of SMIs concerns cover for equity investments and shareholder loans.

Figure 4.3 - MLT Outstanding Exposure of SMIs by Type of Insurance Policy (Million USD)

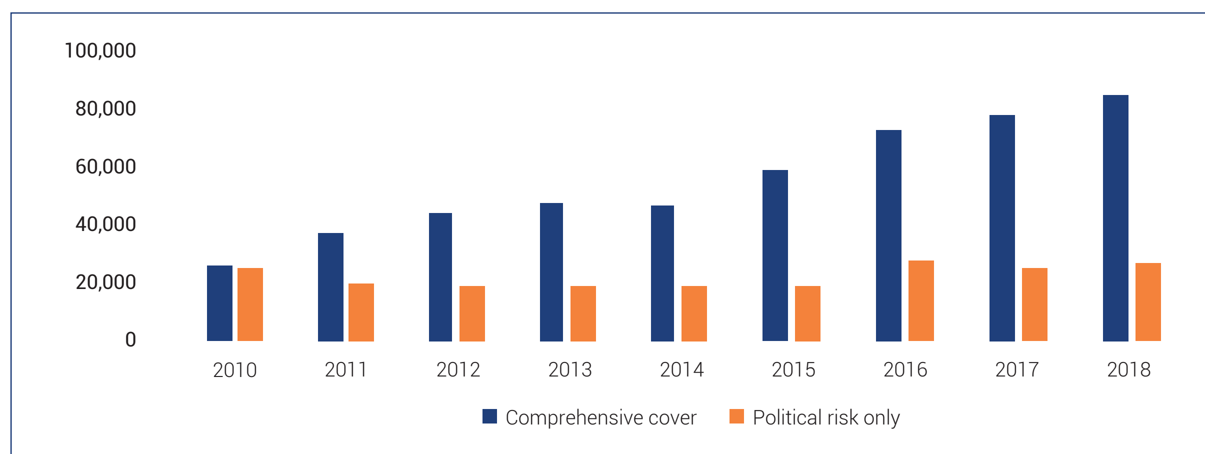


Source: Berne Union.

4.2.4 Private Insurers

Private insurers can offer both comprehensive cover and political risk only policies for MLT debt investments. The graph below shows the developments during the past 9 years regarding the type of insurance policies. It shows a substantial growth of comprehensive cover and a rather stable supply of political risk only business. Comprehensive insurance in 2010 was approximately 51% of their total MLT exposure, which increased to 76% in 2018. This is mainly offered for loans to public sector borrowers, but increasingly also for private sector borrowers, including project finance loans in PPP projects. The share of political risk-only business in total insurance operations went from 49% in 2010 to 24% in 2018. The PRI business of private insurers concerns mainly cover for equity investments.

Figure 4.4 - MLT Insurance of Private Insurers by Type of Insurance Policy (Million USD)



Source: Berne Union.

4.2.5 Competition among providers

All public and private insurers and guarantors that provide insurance for MLT debt investments cooperate with one another in large infrastructure projects, but they also often compete against one another. To avoid unfair competition between ECAs detailed regulations on officially supported export credits have been developed in the OECD. They do not apply to non-OECD ECAs, investment loans or insurance and / or other official insurers (i.e. MDBs, SMIs).

For corporates, project sponsors, and arranging financing banks, there are various insurance options available, among which those offered by the market (private insurance, commercial bank guarantees) and those that are offered by official insurers / guarantors (official ECAs, MDBs, SMIs and OAAs). Sophisticated users of credit and political risk "shop around" to find the most favorable insurance solution, which to a certain degree fuels the competition.

4.2.6 Exposure analysis

4.2.6.1 RISK PROFILE OF OFFICIAL EXPORT CREDITS

The table below provides a snapshot of the risk profile of the export credit operations of official ECAs for 2010-18, for a selection of the even years, by OECD country risk category. The complete picture can be found in Annex VI.

28.9% of MLT export credits exposure of all BU ECAs in 2018 was outstanding on OECD countries that are member of the OECD arrangement on officially supported export credits. For 2010, the share was essentially the same - 29%. Therefore, in both 2010 and 2018, 71% was outstanding in developing countries.

In absolute terms, MLT export credit exposure of ECAs with borrowers/projects in OECD markets has increased substantially, from USD 152 billion in 2010 to USD 198 billion in 2018. PPP projects (in particular renewable energy projects) explain this growth in OECD markets. These projects required LT financing, even as banks increasingly faced regulatory Basel constraints to provide such LT financing. Many banks therefore opted for cover from ECAs for these projects.

The OECD risk category with the second highest share of insured exposure in 2018 was category 5 (15.8%), which includes countries like Algeria, Brazil, Bahrein, Bangladesh, Egypt, Jordan, Kazakhstan and Uzbekistan.

OECD risk category 3 had a share of 12.2% in 2018 of the export credit exposure of BU ECAs. In January 2020, category 3 included countries like Costa Rica, India, Indonesia, Mexico, Morocco, Peru, Philippines and Uruguay.

The insured export credit exposure on category 6 and 7 countries was respectively 10.9% and 10%, which indicates that a material share of ECA business is conducted in relatively high-risk markets. The MLT export credit exposure on these countries increased from approximately USD 66 billion in 2010, to USD 143.5 billion in 2018.

Table 4.2 - Global MLT Export Credit Exposure of Official ECAs at Year-End by OECD ECA Risk Category (Million USD)

OECD Risk Rating	2010	2012	2014	2016	2018	Share in 2010	Share in 2018
0	152.231,68	181.509,46	186.980,97	182.707,27	198.376,24	29,0%	28,9%
1	-	-	-	-	-	0,0%	0,0%
2	62.698,85	71.918,38	73.143,80	61.324,21	58.284,03	11,9%	8,5%
3	85.442,34	97.759,83	85.522,43	75.317,41	83.617,73	16,3%	12,2%
4	56.743,27	75.324,43	69.687,08	71.254,79	54.612,98	10,8%	8,0%
5	69.277,11	81.702,64	83.425,94	96.452,40	108.326,43	13,2%	15,8%
6	28.552,73	36.022,27	48.460,82	62.694,27	74.807,00	5,4%	10,9%
7	37.422,05	39.033,74	55.841,45	60.244,75	68.738,70	7,1%	10,0%
#N/A (1)	33.003,55	44.844,77	47.024,94	43.388,34	38.796,12	6,3%	5,7%
Total	**525.371,58**	**628.115,52**	**650.087,42**	**653.383,44**	**685.559,23**	**100,0%**	**100,0%**

Source: Berne Union.

(1) #NA refers to business in countries that are not rated by the OECD.

4.2.6.2 Risk Profile of State Obligation Insurance

BU investment insurance data also include a category on the cover against sovereign payment risks, which includes comprehensive cover. Most of the exposure reported under this item concerns business from private insurers and SMIs.

The vast majority of "state obligation-insurance" in 2018 was provided for countries rated in risk category 5 (26.4%), followed by countries rated in categories 6 (20.6%) and 4 (15.5%). Noteworthy, 5.8% concerns exposure on OECD governments, which was likely only covered by private insurers.

The comprehensive cover business for sovereign loans has increased substantially during the past nine years. In 2010, the total exposure was USD 27.5 billion, which increased to USD 50.8 billion in 2018. This growth is mainly attributable to private insurers and the introduction of NHSFO products by SMIs.

Table 4.3 - Total Annual Exposure at Year-End for State Obligation Cover Investment Insurance (Political Risk Only) Business of All BU Members by OECD Risk category (Million USD)

OECD Rating	2010	2012	2014	2016	2018	Share in 2010	Share in 2018
0	1.696	2.059	2.050	3.084	2.937	6,2%	5,8%
1	-	-	-	-	-	0,0%	0,0%
2	2.780	2.705	2.822	4.591	4.622	10,1%	9,1%
3	5.758	4.285	3.584	6.254	6.030	20,9%	11,9%
4	6.349	8.105	7.846	10.148	7.869	23,1%	15,5%
5	5.931	5.913	5.487	12.262	13.430	21,6%	26,4%
6	4.766	5.493	5.952	8.342	10.474	17,3%	20,6%
7	1.649	1.328	2.138	3.118	4.078	6,0%	8,0%
#N/A	-1.441	- 895	- 736	721	1.357	-5,2%	2,7%
Total	**27.487**	**28.993**	**29.142**	**48.521**	**50.797**	**100,0%**	**100,0%**

Source: Berne Union and OECD.

(1) #NA refers to business in countries that are not rated by the OECD.

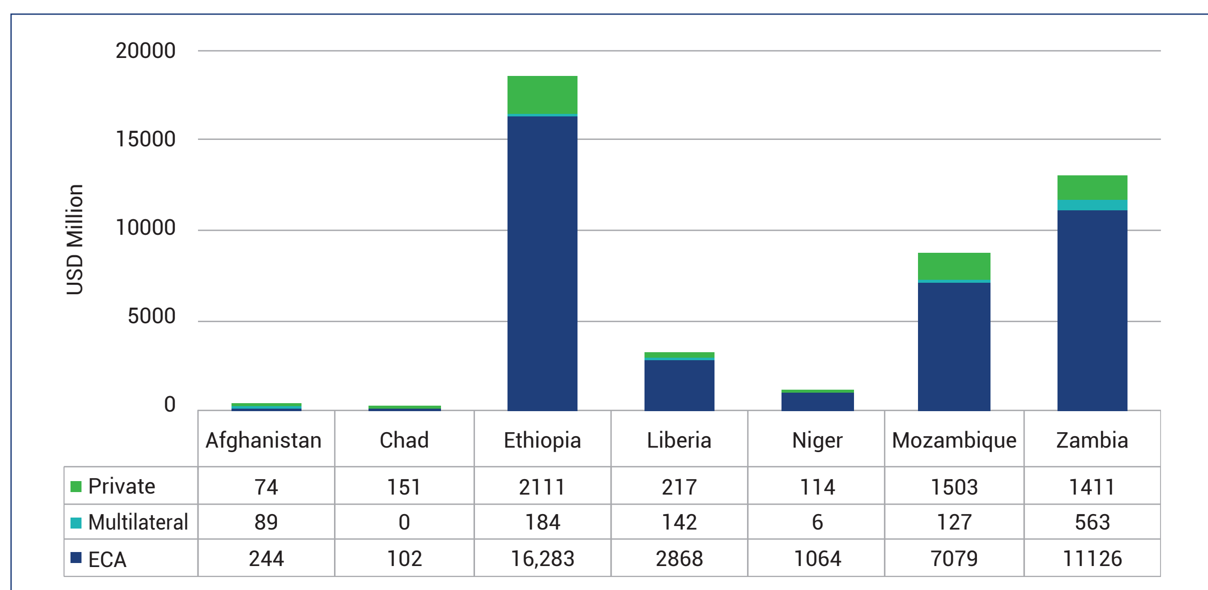
Berne Union statistics for investment insurance includes also a 3rd category of "other cross border trade insurance", which can be found in annex VI.

4.2.6.3 MLT Insurance in selected OECD Category 7 Markets

Among the selected 22 countries analyzed, 7 are rated in OECD risk category 7, the highest risk category. These are Afghanistan, Chad, Ethiopia, Liberia, Niger, Mozambique and Zambia.

For these countries, the cumulative annual new BU business for 2010-2018 is displayed in the below figure. It includes all MLT export credits as well as all three insurance activities reported under BU investment insurance statistics (political risk only, cross border trade/investment transactions, state obligation insurance), for private insurers, SMIs and ECAs.

Figure 4.5 - New Business in terms of MLT export credit and investment insurance (2010-2018) (Million USD)



	Afghanistan	Chad	Ethiopia	Liberia	Niger	Mozambique	Zambia
Private	74	151	2111	217	114	1503	1411
Multilateral	89	0	184	142	6	127	563
ECA	244	102	16,283	2868	1064	7079	11126

Source: Berne Union.

The shares of the three different types of BU members (ECAs, private insurers and SMIs) during the period 2010-18 differ substantially. The ECA share ranges from 40.43% for Chad to 89.91% for Niger; that of private insurers, from 6.72% for Liberia to 59.57% for Chad.

The SMI share is understandably more modest, since it concerns the business of only 4 entities with substantial less capital than ECAs and private insurers. The SMI share ranges from 0% for Chad to 21.93% for Afghanistan. In absolute terms, the four SMIs played important roles in Zambia where they underwrote USD 563 million of new business during 2010-18. Other important countries for SMIs were Ethiopia (total underwriting of USD 184 million), Mozambique (USD 127 million) and Liberia (USD 142 million).

4.2.7 Claims and recovery experience

4.2.7.1 Claims and Recoveries under Official MLT Export Credits of ECAs

Official ECAs have under their export credit operations a substantial claims payment track record. During 2010-18, they paid a total amount of USD 28 billion of claims, of which 69% concerned commercial claims and 31% political claims. The latter concerns in particular the non-payments of sovereign borrowers.

The data clearly show that commercial risks have a substantially higher risk profile than political risks. Furthermore, the total claims during the nine-year period under export credits of USD 28 billion is many times higher than the total claims of all BU members under investment insurance for ("classical" / "extended") political risks, which were in total USD 1.1 billion (see par. 2.6.3.).

For 2010-18, ECAs recovered a total amount of USD 35 billion, of which USD 28.7 billion of political risk claims (82%) and USD 6.3 billion of commercial claims (18%). The vast majority of recovered political risk claims concerns repayments of sovereign borrowers under various Paris Club rescheduling agreements[38].

4.2.7.2 Claims and Recoveries under "State Obligation Insurance"

In business with sovereign borrowers reported under investment insurance, BU members experienced a total amount of USD 376.8 million of claims during 2010-18, of which 89% was compensated by private insurers, 6% by SMIs and 5% by ECAs. As explained above Most of the sovereign claims of ECAs were experienced in the MLT export credit business.

In BU members recovered during 2010-18 a total amount of USD 259 Million regarding business with sovereign borrowers, of which 94% was recovered by private insurers, 5% by SMIs and 1% by ECAs.

Claims and recovery experiences regarding "cross border trade" (other than MLT ECA export credits) that are reported under BU investment insurance can be found in Annex VI.

4.3 DEMAND FOR POLITICAL AND CREDIT RISK INSURANCE FOR DEBT INVESTMENTS

4.3.1 By Clients

There are a variety of clients for whom credit and political risk insurance brings benefit.

4.3.1.1 Commercial Banks

Commercial banks from developed markets are much more important than commercial banks in developing countries as clients for the MLT insurance operations of ECAs, due to the following factors:

1. Most ECAs in developing countries are rated below S&P "A" and are therefore not an acceptable counterparty risk to cover MLT risks for international banks. The same applies to many local banks in developing countries.

38 Detailed information about Paris Club rescheduling and its members can be found on the website of the Paris Club: https://clubdeparis.org/en

2. In many developing countries, credit and political risk insurance is not yet recognized as an adequate risk mitigation instrument, which partially explains the low utilization of these products in developing countries.

ECAs generally only support exports or outward FDI from their home country. This explains why local banks in developing countries are for OECD ECAs not major clients. The local banks may be involved in imports into their country when they guarantee payment obligations of a local importer, but in such a case they are not the insured party that benefits from the ECA cover.

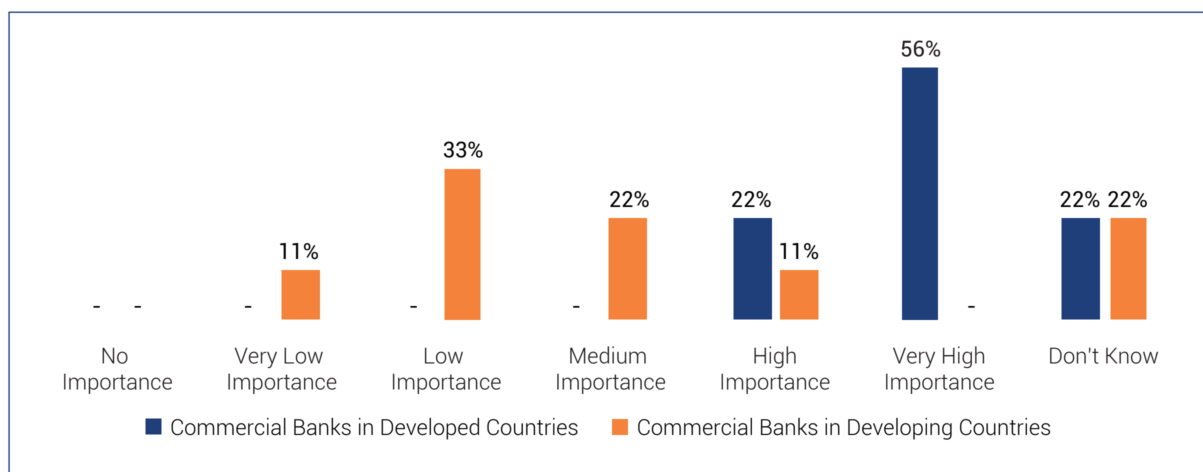
Among private insurers, there is a clear majority that consider commercial banks from developed markets of "high" or "very high" importance to their MLT business (together; 77%). 22% of the private (re-) insurers responded to the survey that they "don't know" how important commercial banks are in their MLT business.

Most private insurers are very selective in their underwriting and prefer to conduct their business with well-known and reputable clients with substantial experience in financing international trade and investments. This partially explains why banks from developed countries are so important in their MLT insurance operations.

Similar to ECAs, the vast majority of private insurers consider the business with banks in developing countries of "very low" to "medium" importance (together 66%). This reflects the fact that many banks and their regulators are not familiar with credit and political risk insurance. In many countries, these products are not recognized as an adequate risk mitigation instrument, which leads to underutilization of the product in many developing countries.

In addition, most commercial banks in developing countries have no or limited experience with MLT financing, as they find it difficult to refinance themselves on an MLT basis (i.e. most of their funding is on a ST basis).

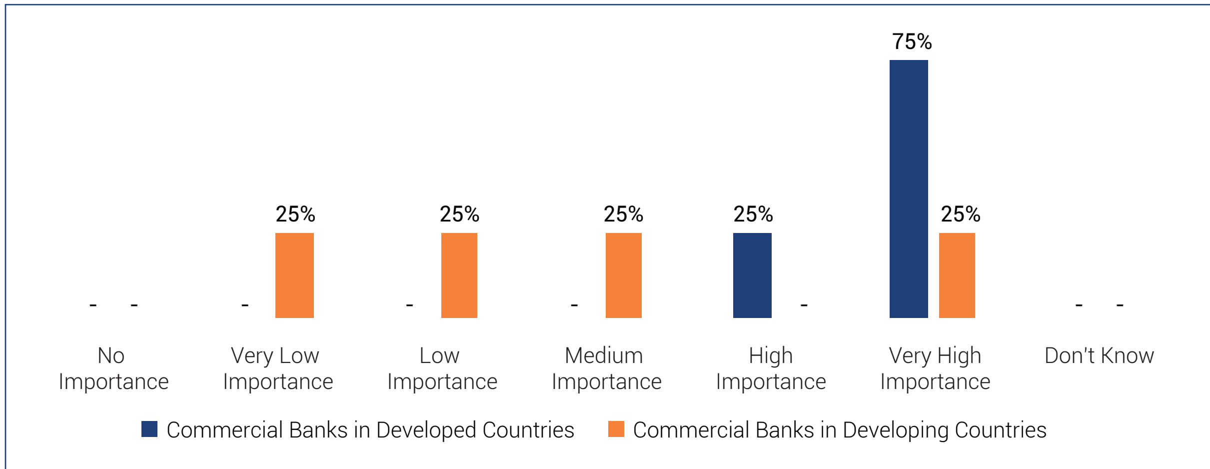
Figure 4.6 - Relevance for Private (Re-)Insurers to Conduct MLT Business with Commercial Banks



Source: ICIEC survey among stakeholders for G20 Stock-Take study

All four SMIs responded to the survey that commercial banks from developed markets are of "high" (25%) or "very high" (75%) importance to their MLT operations. Commercial banks from developing countries are of less interest to 3 out of the 4 SMIs. In doing business with local banks in developing countries, SMIs face similar challenges as ECAs and private insurers. Insurance products are not recognized as adequate risk mitigation instruments in many developing countries. There may also be less business opportunities for SMIs to pursue insuring MLT loans of local banks in developing countries.

Figure 4.7 - Relevance for SMIs to Conduct MLT Business with Commercial Banks

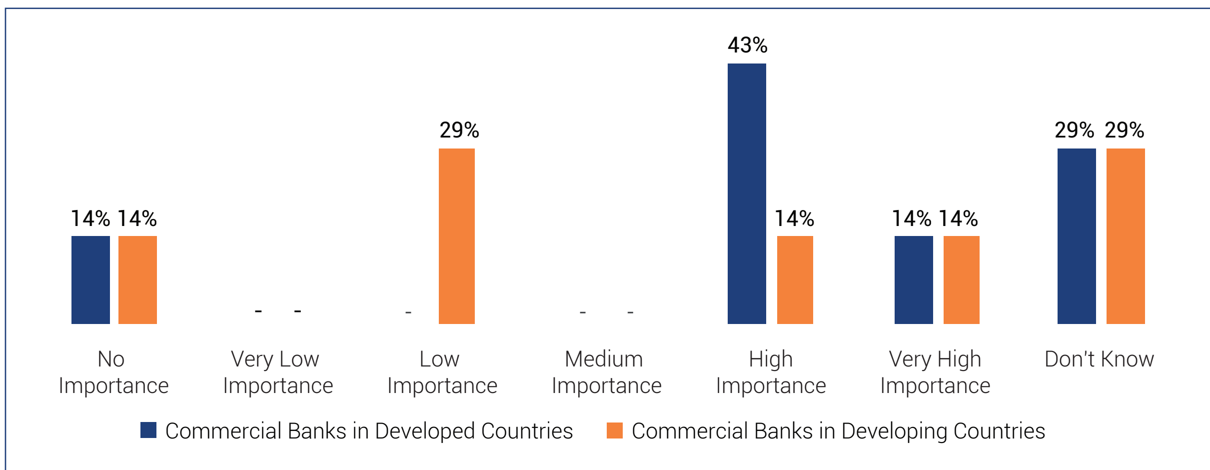


Source: ICIEC survey among stakeholders for G20 Stock-Take study

It is noteworthy that 29% of the MDBs responded they "don't know" how important commercial banks are in their MLT guarantee operations. One MDB (14%) responded that commercial banks in both developed and developing countries are of "no importance" in their MLT guarantee business. These three MDB responses are likely caused by the fact that they have no or hardly any MLT guarantee operations.

For the majority of MDBs, commercial banks in developed countries are of "high" (43%) or "very high (14%) importance. Banks in developing countries are of lower importance.

Figure 4.8 - Relevance for MDBs to Conduct MLT Business with Commercial Banks



Source: ICIEC survey among stakeholders for G20 Stock-Take study

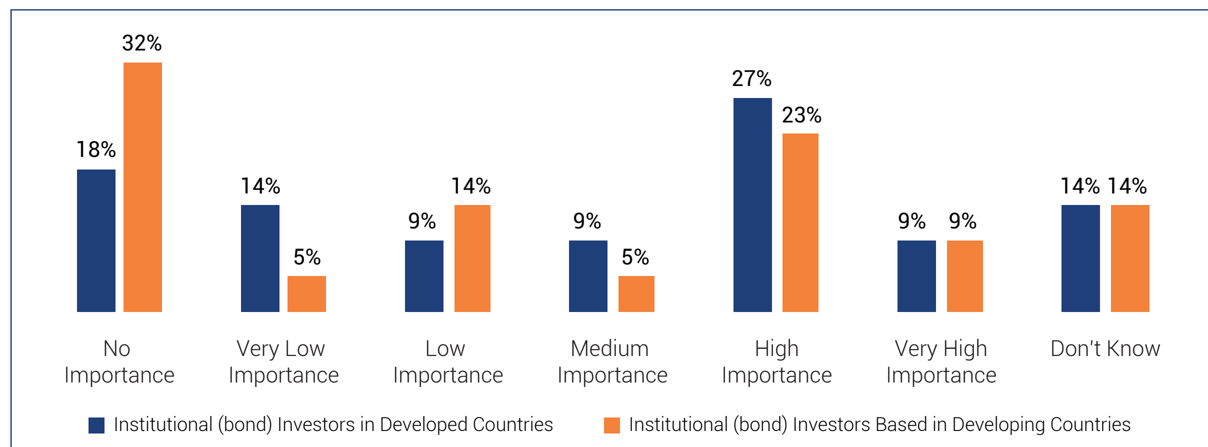
4.3.1.2 Institutional Investors

Some ECAs in developed markets have experience with so-called MLT funding guarantees that are provided to institutional investors to fund MLT export loans provided by commercial banks. These funding guarantees were developed in response to the 2008 financial crisis, which caused liquidity problems in the inter-bank market. This negatively affected the (funding of) MLT export finance business of many commercial banks. The ECA funding guarantees gave comprehensive cover to institutional investors and protected these investors against non-payment by the commercial banks. Cover was in general only available against payment risks on banks in developed countries.

ECAs have in general limited experience in providing guarantees to institutional investors for the financing of projects or borrowers in developing countries. Most of the financing to projects or borrowers in developing countries is provided by commercial banks.

Among ECAs, there is very limited to no experience with insuring debt investments of institutional investors from developing countries.

Figure 4.9 - Relevance for ECAs to Conduct MLT Business with Institutional Investors



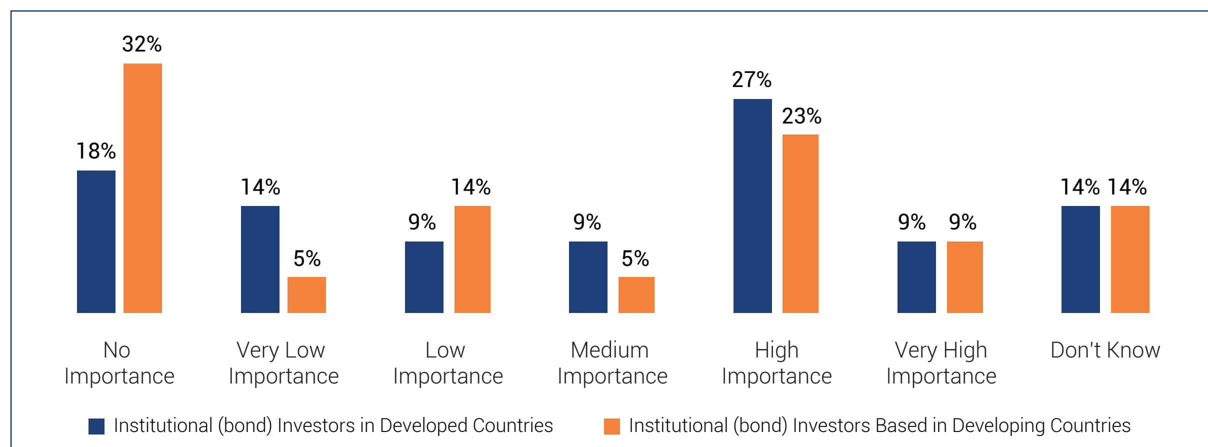
Source: ICIEC survey among stakeholders for G20 Stock-Take study

Institutional investors of both developed and developing countries are for most private(re-) insurers of "low" or "very low" importance (both together: 66%). 22% of the private (re-) insurers responded they "don't know" how important these investors are to their business.

The main reasons why private (re-)insurers are not much involved in insuring MLT debt investments of institutional investors are likely the following:

1. Most private insurers are mainly offering MLT insurance products and not unconditional guarantees.
2. Most institutional investors have limited experience with MLT debt investments in developing countries, which is partially caused by rating constraints.
3. Most institutional investors are not familiar with the use of credit and political risk insurance in their MLT business.
4. For institutional investors in developing countries, it is likely also relevant that there is no clarity whether credit and political risk insurance can be recognized as an adequate risk mitigation tool.

Figure 4.10 - Relevance for Private (Re-)Insurers to Conduct MLT Business with Institutional Investors



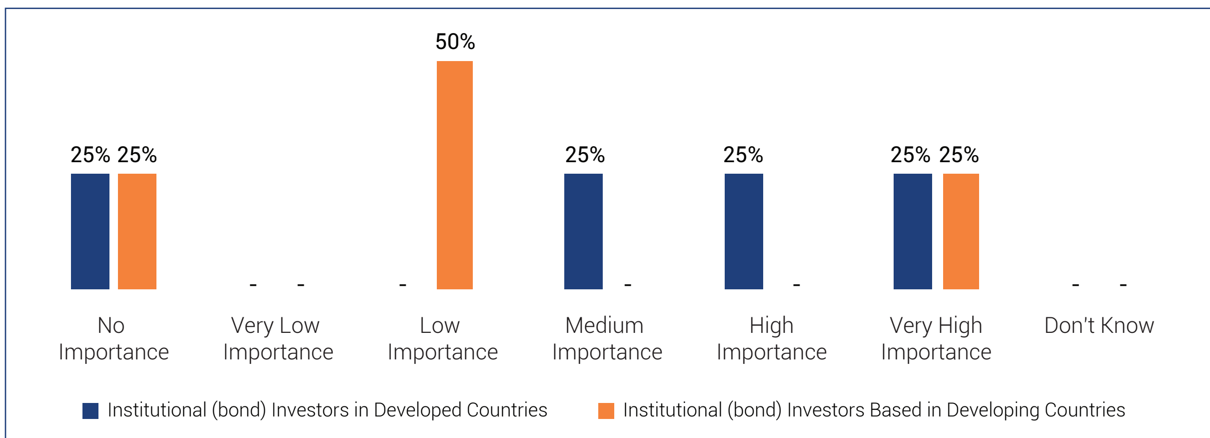
Source: ICIEC survey among stakeholders for G20 Stock-Take study.

Like ECAs and private insurers, SMIs have limited experience in general with selling insurance products to institutional investors. Three out of the four SMIs consider business with institutional investors of "medium" to "very high" importance (together 75%). One SMI considers business with institutional investors from both developed and developing countries of "no importance".

There are only a limited number of transactions in developing countries whereby SMIs cover capital market bonds. MIGA has provided cover against transfer and convertibility risks on some capital market transactions, which led to an upgrade of the rating of a bond from foreign currency rating level to local currency rating level. Similar transactions have been done by OPIC (USDFC) and some private insurers.

Today, these types of partial coverages for capital market financing are no longer common. Transfer and inconvertibility risks are no longer perceived as major risks in international finance. The rating differences between foreign and local currency ratings of most developing countries have substantially decreased during the past 15 – 20 years. Partial (political) risk cover for capital market bonds has therefore become less relevant.

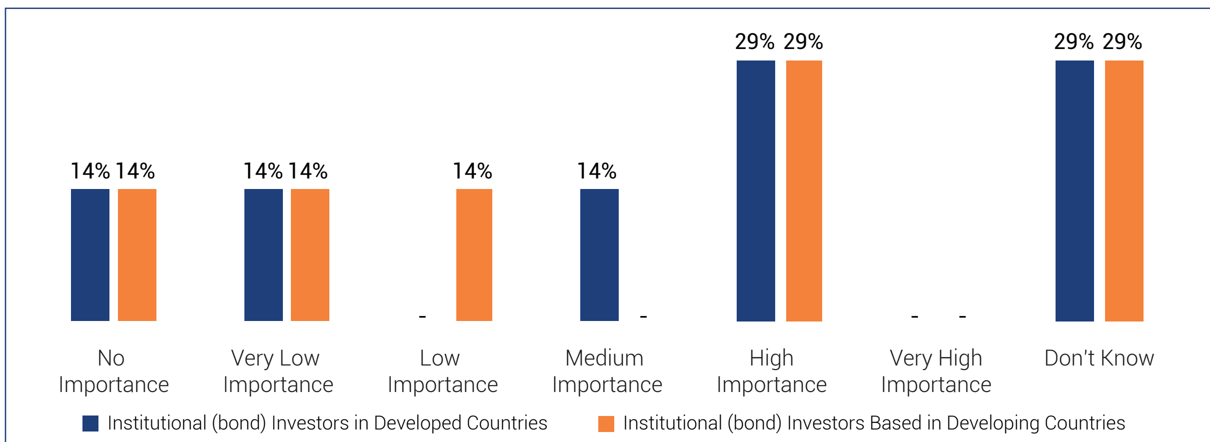
Figure 4.11 - Relevance for SMIs to Conduct MLT Business with Institutional Investors



Source: ICIEC survey among stakeholders for G20 Stock-Take study

Many MDBs responded that they "don't know" the importance of institutional investors in their MLT guarantee operations. Two MDBs responded that these MLT debt investors of both developed and developing countries are of "no" (14%) or "very low" (14%) importance. One MDB considers institutional investors from developed countries of "medium" (14%) importance and those of developing countries of "low" importance (14%).

Figure 4.12 - Relevance for MDBs to Conduct MLT Business with Institutional Investors



Source: ICIEC survey among stakeholders for G20 Stock-Take study

Comfort building regarding the value of credit and political risk insurance/ guarantees is likely very important to create a greater interest among institutional investors to make use of these products for their MLT debt investments in developing countries. The GEMS risk database[39] could play an important role in this area, by collecting data about the claims payment track records of the main insurance and guarantee providers.

4.3.2 By Countries

An analysis has been conducted on the composition of the external debt of 22 selected developing countries. In general, if the share of a country's MDB debt is relatively low, it suggests there is both more capacity to meet payment obligations on schedule to MDBs and commercial creditors, and potentially more room for MDBs to consider innovative approaches for mobilizing additional private foreign investment, like targeted risk-sharing with other creditors. Conversely, if the share of a country's MDB debt is relatively high, the capacity to meet scheduled payment obligations to both MDBs and commercial creditors may be more constrained, and MDBs may also be less willing to consider innovative approaches for private capital mobilization.

The analysis is based on the data available in the Joint External Debt Hub (JEDH), which is a joint initiative of IMF, IBRD, BIS and the OECD. The purpose of the analysis is to determine the shares of MDB and other debt of the 22 selected developing countries.

Under MDB debt, the following items are included:

1. Multilateral loans from MDBs that report their exposure to the JEDH. Currently the JEDH database receives information from AfDB, ADB, IADB IBRD and IDA. Exposures from other MDBs such as AIIB, EBRD, EIB, IsDB and NDB are therefore not included. It is likely that current JEDH statistics on MDB debt cover the majority of MDB debt of developing countries. Nevertheless, the database could be substantially improved by capturing information about loans from other MDBs.
2. Multilateral loans from the IMF.
3. SDR allocations from the IMF. A Special Drawing Right (SDR) is an interest-bearing international reserve asset created by the IMF in 1969 to supplement other reserve assets of member countries. An SDR allocation is a low-cost way of adding to members' international reserves, allowing members to reduce their reliance on more expensive domestic or external debt for building reserves.

Non-MDB debt includes the following items:

1. Cross-border loans from BIS reporting banks, which concerns commercial bank debt.
2. Debt securities held by non-residents (international bonds), which concerns commercial debt.
3. Official bilateral loans (e.g. bilateral development loans or loans from EXIM banks to sovereign borrowers). This concerns bilateral official debt.
4. Paris Club claims (ODA and non-ODA). This is bilateral debt of a country that has been rescheduled in the Paris Club and which is still is outstanding. These claims can include ODA (aid) credits and non-ODA (aid) credits. The latter could include loans from EXIM banks, bilateral DFI loans that do not meet the ODA threshold, and ECA covered export credits.

Detailed assessments of the composition of the external debt of the 22 selected developing countries can be found in Annexes VII – IX.

4.3.2.1 Upper Middle-Income Countries

The share of MDB debt to total external debt differs substantially among the 5 UMIC countries. MDB debt of Algeria increased from 16.5% in 2010 to 57.7% in 2018, which was mainly due to significantly increased

39 For more information about the GEMS risk database it is referred to its website http://www.gems-riskdatabase.org/members/index.htm

MDB lending to the country. During the same period, the share of MDB debt of China decreased from 10.4% to 4.1%, mainly due to a huge increase in credit from other sources, not a decrease in loan volumes from IBRD and ADB. At the end of 2018, outstanding MDB loans to China stood at approximately USD 33 billion.

The share of MDB debt to total external debt of Brazil, Mexico and South Africa did not change much from 2010 to 2018. Their MDB debt ranged between 5.5% to 12.7%, which is modest compared to the MDB shares of low-income countries (see below). In absolute amounts, the MDB debt of these countries can be very high. For example, MDB debt for Brazil was in 2018 USD 32.2 billion, and for Mexico USD 30.4 billion, whereas for South Africa it was USD 4.3 billion. The relatively low share of MDB debt for most of these UMIC countries indicates that these countries have good access to commercial finance. It also shows that there is room for a financial innovation to mobilize more private capital (assuming of course that these countries manage their overall external debt burden without constraints). More in-depth analysis would be needed for each individual country to determine the scope for MDB financial innovation and risk-sharing.

Table 4.4 - MDB Debt as Share of Total External Debt, Selected UMICs

Country	OECD Ranking	2010	2011	2012	2013	2014	2015	2016	2017	2018
Algeria	5	16.5%	15.8%	31.0%	33.5%	36.6%	42.8%	54.0%	57.7%	62.6%
Brazil	5	9.3%	6.9%	6.4%	7.3%	7.5%	8.2%	8.6%	10.1%	9.9%
China	2	10.4%	7.4%	6.9%	4.0%	3.6%	4.6%	5.1%	4.1%	4.0%
Mexico	3	12.7%	11.5%	9.8%	9.6%	9.2%	9.3%	9.2%	9.0%	9.3%
South Africa	4	5.5%	5.7%	6.0%	6.7%	6.9%	7.1%	6.8%	6.3%	6.0%
Average		**10.9%**	**9.5%**	**12.0%**	**12.2%**	**12.7%**	**14.4%**	**16.7%**	**17.4%**	**18.4%**

Source: JEDH Database and SGFI calculations.

4.3.2.2 Lower Middle-Income Countries

The shares of MDB debt in total external debt of the selected seven middle income countries ranged in 2018 from 53.8% for Bangladesh, to 11.9% for Indonesia. Bangladesh had the highest share of MDB debt among this group in 2010, at 73.1% of the country's total external debt, which has decreased over time. This change was mainly due to a substantial increase in commercial debt, from USD 2.3 billion in 2010, to USD 13.6 billion in 2018. During that same period, MDB lending to Bangladesh increased from USD 17.9 billion (2010) to USD 24.3 billion (2018).

Two other LMIC countries have a relatively high share of MDB debt -- Ukraine (39.6%) and Kenya (30.3%). Four others have a share of MDB debt below 25%, which suggests they have reasonably good access to commercial finance.

The apparent exception to this pattern in this group is Zambia. Zambia saw its MDB debt share fall sharply between 2010 and 2018, which suggest it was able to access commercial credit fairly easily. Indeed, Non-MDB debt of Zambia increased from USD 1.2 billion in 2010 to USD 10 billion in 2018. However, Zambia has seen its creditworthiness plunge and is now rated in OECD risk category 7. Most OECD ECAs are off cover for such high-risk markets or face serious constraints to provide cover for large amounts. So, a low MDB share does not tell the whole story.

More in-depth analysis is required for each individual country to determine the role of MDBs there and the scope for innovative approaches.

Table 4.5 – MDB Debt as Share of Total External Debt, Selected LMICs

Country	OECD Ranking	2010	2011	2012	2013	2014	2015	2016	2017	2018
Bangladesh	5	73.1%	70.5%	68.6%	67.6%	63.6%	59.6%	57.6%	53.9%	53.8%
India	3	16.6%	16.4%	15.9%	17.2%	17.2%	17.0%	18.4%	16.9%	19.7%
Indonesia	3	13.1%	12.8%	12.5%	12.8%	11.5%	11.8%	12.0%	10.9%	11.9%
Kenya	6	42.1%	42.3%	42.1%	40.5%	35.7%	29.7%	28.6%	27.7%	30.3%
Myanmar	6	30.1%	30.3%	31.8%	19.4%	24.5%	13.8%	13.6%	14.9%	20.2%
Ukraine	6	40.5%	44.2%	36.8%	26.7%	36.8%	37.6%	38.5%	37.9%	39.6%
Zambia	7	60.1%	54.8%	43.9%	42.3%	31.3%	20.6%	18.0%	16.8%	18.1%
Average		**39.4%**	**38.7%**	**35.9%**	**32.3%**	**31.5%**	**27.2%**	**26.7%**	**25.6%**	**27.7%**

Source: JEDH Database and SGFI calculations.

4.3.2.3 Low Income Countries

The table below shows wide diversity in the shares of MDB debt for these LIC countries. Rwanda and Nepal have a very large share of MDB debt, exceeding 80% in 2018. Others have a relatively low MDB debt share. For example, the 2018 share of MDB debt for Mozambique (at 36.7%) was far below the 2018 average of these 10 LICs, which stood at 53.5%.

The analysis suggests that some of these LIC countries have reasonably good access to commercial finance. This is in particular true for countries rated in OECD ECA risk category 6, which include Benin, Nepal, Rwanda and Tanzania. The IMF/WB debt sustainability framework (DSF) applies to all these LICs and that implies that some of the sovereigns in these countries have no or a limited possibility to borrow on commercial terms.

Table 4.6 – MDB Debt as Share of Total External Debt, Selected LICs

Country	OECD Ranking	2010	2011	2012	2013	2014	2015	2016	2017	2018
Afghanistan	7	49.2%	54.4%	53.6%	50.9%	50.8%	48.4%	46.1%	44.8%	48.2%
Benin	6	81.9%	83.7%	84.2%	88.5%	90.2%	80.2%	81.4%	76.2%	64.6%
Chad	7	91.5%	91.0%	93.2%	83.5%	63.0%	26.6%	28.7%	29.1%	31.8%
Ethiopia	7	69.8%	76.3%	79.4%	81.2%	70.5%	44.1%	43.6%	43.4%	48.0%
Liberia	7	0.8%	0.9%	1.0%	1.3%	1.7%	1.9%	2.2%	3.0%	3.4%
Mozambique	7	52.6%	50.1%	49.8%	42.5%	45.1%	36.8%	36.1%	34.3%	36.7%
Nepal	6	85.2%	85.3%	87.2%	88.6%	89.4%	84.3%	82.6%	81.4%	86.0%
Niger	7	83.5%	86.3%	80.9%	70.4%	80.2%	67.9%	63.6%	58.8%	69.9%
Rwanda	6	79.8%	73.3%	86.6%	67.5%	65.7%	69.0%	74.6%	76.9%	84.4%
Tanzania	6	77.4%	75.4%	71.5%	68.9%	69.5%	56.7%	54.1%	55.7%	62.0%
Average		**67.2%**	**67.7%**	**68.7%**	**64.3%**	**62.6%**	**51.6%**	**51.3%**	**50.4%**	**53.5%**

Source: JEDH Database and SGFI calculations.

4.3.2.4 Fragile States and Conflict Affected Countries

Among the 5 selected fragile states and conflict-affected countries, two are rated in OECD risk category 6, which suggests ECAs from the OECD and other countries are in general prepared to consider loans or

guarantees to the sovereign of these countries. This is likely more complicated for countries rated in risk category 7, although this will vary among individual ECAs.

Table 4.7 - MDB Debt as Share of Total External Debt, Fragile States & Conflict-Affected Countries

Country	OECD Ranking	2010	2011	2012	2013	2014	2015	2016	2017	2018
Afghanistan	7	49.2%	54.4%	53.6%	50.9%	50.8%	48.4%	46.1%	44.8%	48.2%
Chad	7	91.5%	91.0%	93.2%	83.5%	63.0%	26.6%	28.7%	29.1%	31.8%
Liberia	7	0.8%	0.9%	1.0%	1.3%	1.7%	1.9%	2.2%	3.0%	3.4%
Myanmar	6	30.1%	30.3%	31.8%	19.4%	24.5%	13.8%	13.6%	14.9%	20.2%
Rwanda	6	79.8%	73.3%	86.6%	67.5%	65.7%	69.0%	74.6%	76.9%	84.4%
Average		**50.3%**	**50.0%**	**53.2%**	**44.5%**	**41.1%**	**31.9%**	**33.0%**	**33.7%**	**37.6%**

Source: JEDH Database and SGFI calculations.

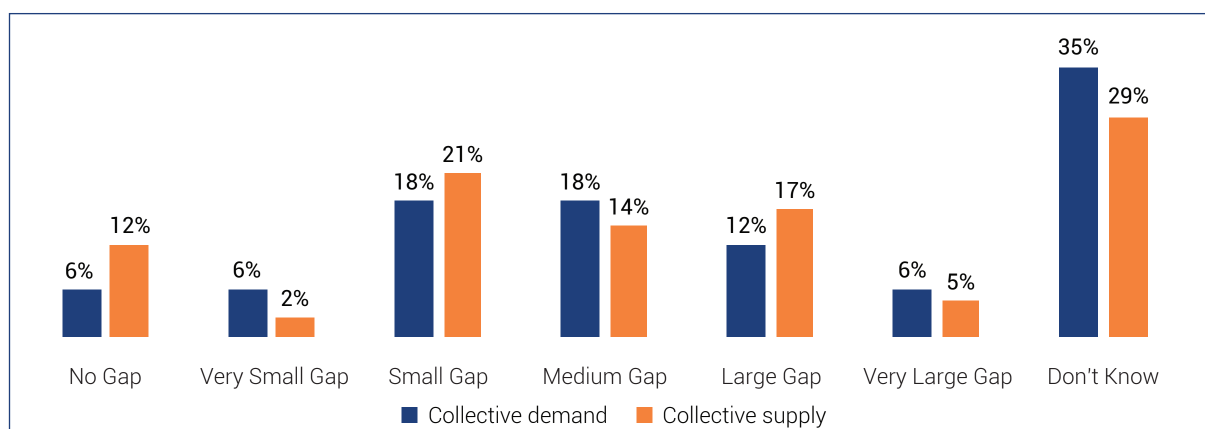
4.4 POTENTIAL GAPS AND CONSTRAINTS

4.4.1 High-Risk Markets

There is a mixed picture on whether there is a gap for "classical" political risk insurance for MLT debt investments in high-risk markets. Only 18% of buyers think here is a "high" or "very high" gap for "classical" political risk insurance for MLT debt investments in high-risk markets, whereas 32% believe there is "no", a "very small" or "small" gap for this product. A number of stakeholders on both the demand (35%) and supply (29%) sides of the market "don't know" whether there is a serious gap.

The picture looks much the same among suppliers. Some consider there is "no gap" (12%), a "very small" (2%), or small gap (21%), whereas others consider there is a "medium" (14%), large (17%) of "very large" (5%) gap.

Figure 4.13 - Potential Gap for "Classical" PRI in High-Risk Markets

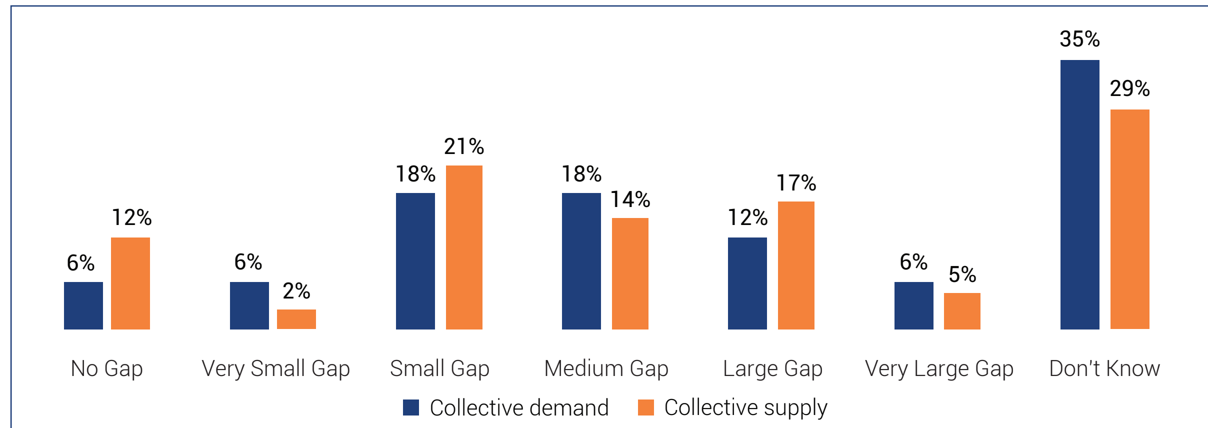


Source: ICIEC survey among stakeholders for G20 Stock-Take study

A majority of buyers and suppliers consider there is a gap for "extended" political risk cover for PPP projects in high-risk markets. They think there is a "medium" (18%), "large" (12%) or even "very large" (12%) gap for such cover. There are, however, a substantial number of buyers and suppliers that "don't know". Stakeholders on both the demand (35%) and supply (29%) sides of the market "don't know" whether there is a serious gap.

Most MLT suppliers also consider there is a "medium" (19%), "large" (24%) of "very large" (12%) gap for this product in the market. A minority considers there is "no", a "very small" or "small" gap for this type of cover (together 16%).

Figure 4.14 - Potential Gap for "Extended" PRI in High-Risk Markets

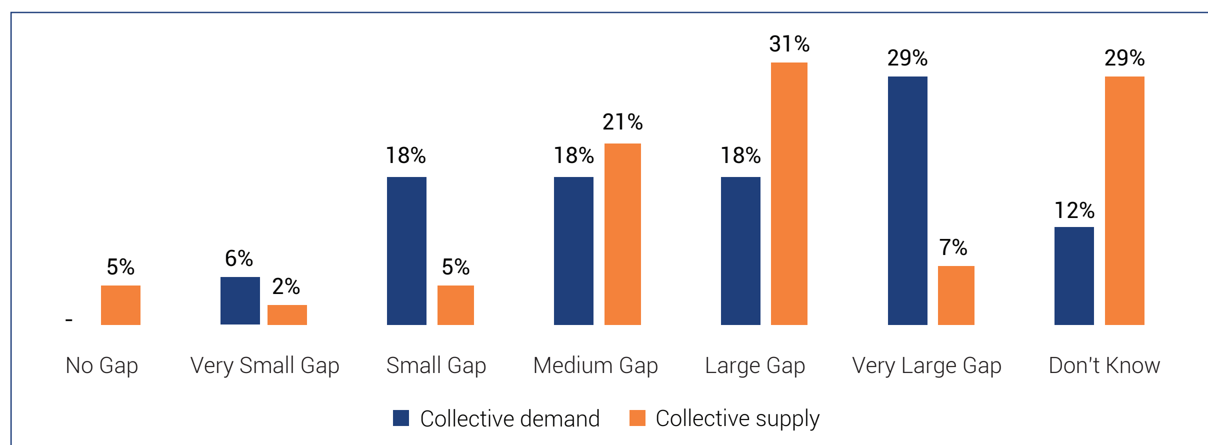


Source: ICIEC survey among stakeholders for G20 Stock-Take study

Most buyers and suppliers consider there is a serious gap for comprehensive cover for MLT loans to public sector borrowers in high-risk markets. A substantial share of buyers (47%) and suppliers (38%) think there is a "large" or "very large" gap for this cover. A medium gap is perceived by 18% of the buyers and 21% of the suppliers. There is also a substantial number of suppliers (29%) that "don't know".

Among potential buyers, only 12% of the buyers responded this time they "don't know", almost 3 times higher for the partial political risk coverages (35%).

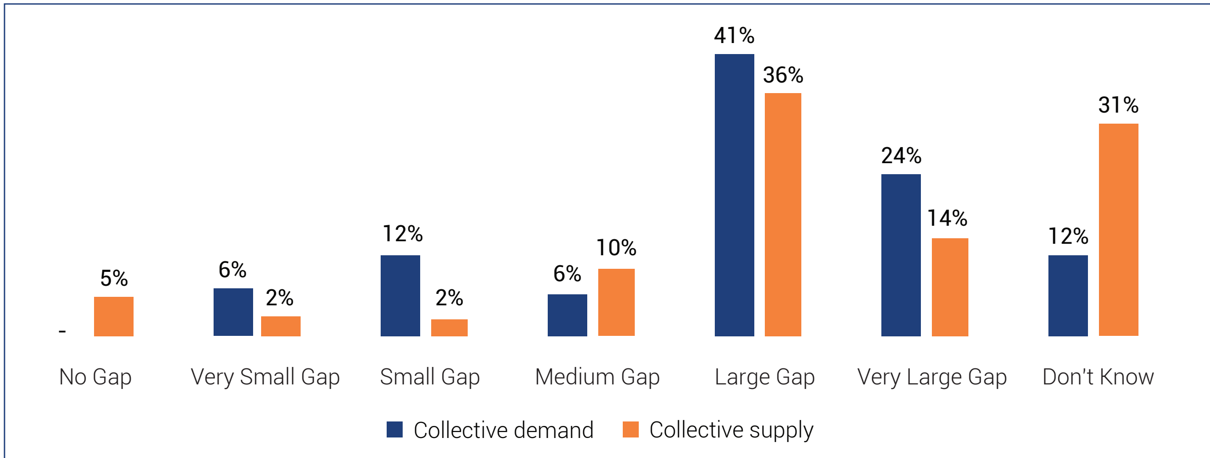
Figure 4.15 - Potential Gap for Comprehensive Cover for MLT Loans to Public Borrowers in High-Risk Markets



Source: ICIEC survey among stakeholders for G20 Stock-Take study

Most buyers and suppliers consider there is a gap for comprehensive cover for MLT loans to private sector borrowers in high-risk markets. A large majority of buyers considers there is a "large" or "very large" gap (together 65%). This view is shared by 50% of the suppliers. Almost one third of the suppliers (31%) "don't know" whether there is a gap for this cover, which is also the case for 12% of the buyers.

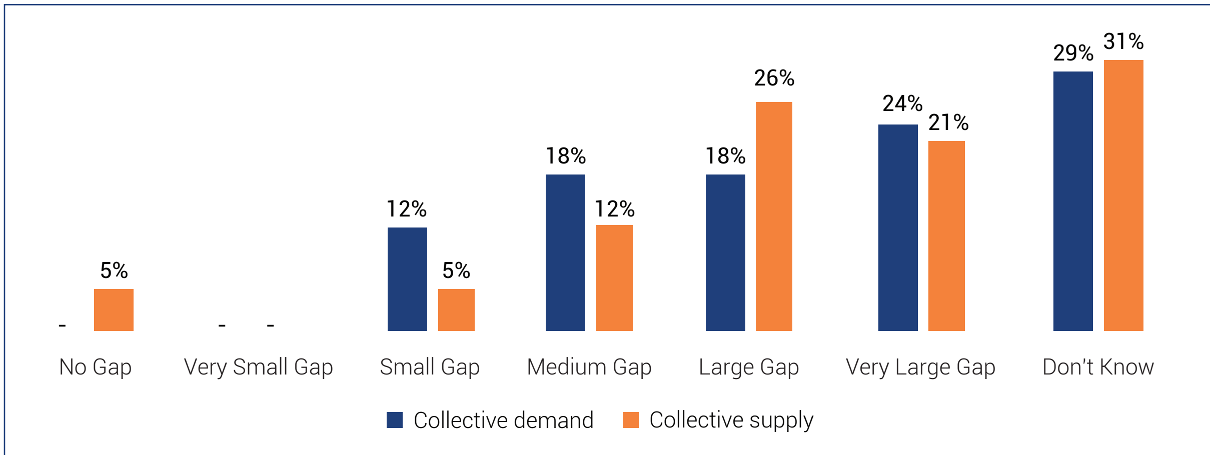
Figure 4.16 - Potential Gap for Comprehensive Cover for MLT Loans to Existing Private Borrowers in High-Risk Markets



Source: ICIEC survey among stakeholders for G20 Stock-Take study

Most buyers and suppliers consider there is a gap for comprehensive cover for MLT loans for project finance of PPP projects in high-risk markets. Most buyers think there is a "medium" (18%), "large" (18%) or "very large" (24%) gap (together 60%). The collective view of suppliers is more or less the same (together 59%). There are also a substantial number of buyers (29%) and suppliers (31%) that "don't know".

Figure 4.17 - Potential Gap for Comprehensive Cover for MLT Project Finance Loans for PPP Projects in High-Risk Markets

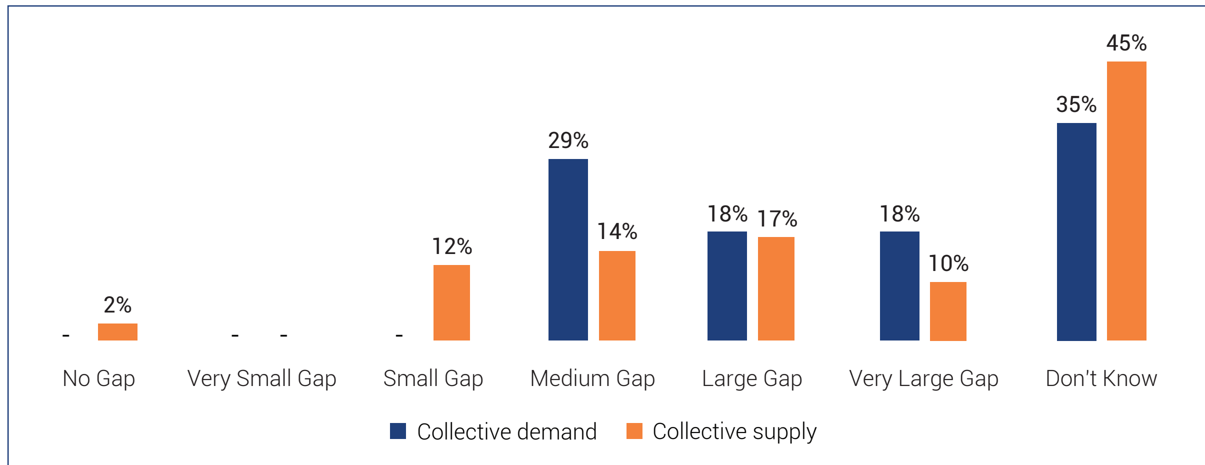


Source: ICIEC survey among stakeholders for G20 Stock-Take study

4.4.2 South-South MLT Debt Investments

Most buyers and suppliers consider there is a "medium" to "very large" gap for South-South MLT debt investments. The majority of buyers (together 65%) think there is a "medium" (29%), "large" (18%) or "very large" gap for these types of debt investments. This view is shared by 41% of the suppliers. Only 12% of the suppliers think there is a "small gap" and 2% see "no gap". There is also a substantial number of buyers (35%) and suppliers (45%) that "don't know".

Figure 4.18 - Potential Gap for MLT South-South Debt Investments

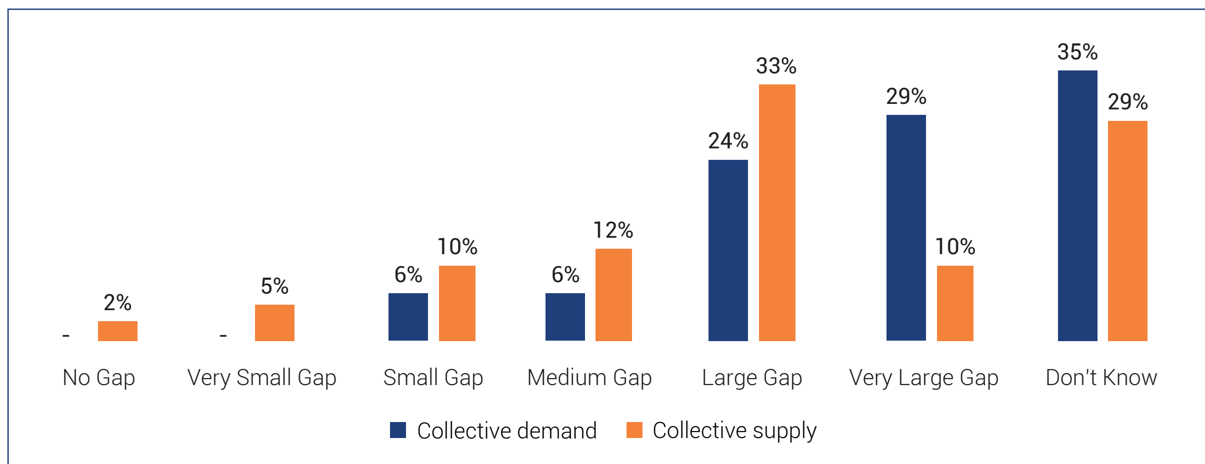


Source: ICIEC survey among stakeholders for G20 Stock-Take study

4.4.3 SMEs

Most buyers and suppliers consider there is a "large" to "very large" gap for MLT debt investments for SMEs in developing countries. A "large" or "very large" gap is perceived by most buyers (together 53%) and suppliers (together 43%). 6% of the buyers and 12% of the suppliers perceive a "medium" gap. A substantial number of buyers (35%) and suppliers (29%) "don't know".

Figure 4.19 - Potential Gap for MLT Debt Investments for SMEs in Developing Countries

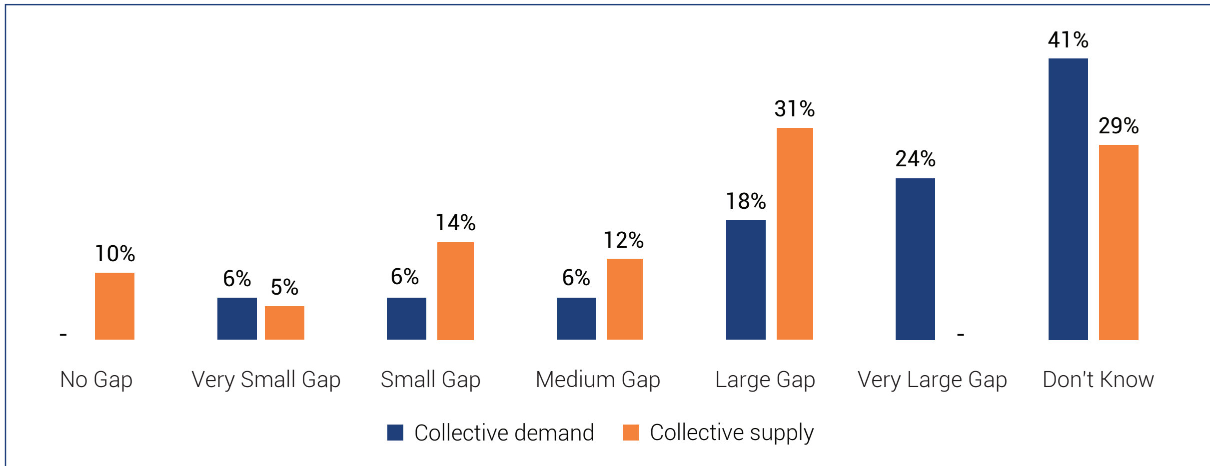


Source: ICIEC survey among stakeholders for G20 Stock-Take study

4.4.4 Low value MLT Debt Investments

Most buyers and suppliers consider there is a "medium" to "very large" gap for relatively low MLT debt investments (below USD 10 million). Most buyers that have a view think that there is a "large" (18%) or "very large" (24%) gap. On the supply side 31% considers a "large" gap and 12% a "medium" gap. A substantial number of buyers (41%) and suppliers (29%) "don't know".

Figure 4.20 - Potential Gap for Relatively Low MLT Debt Investments (I.e. Below USD 10 million)



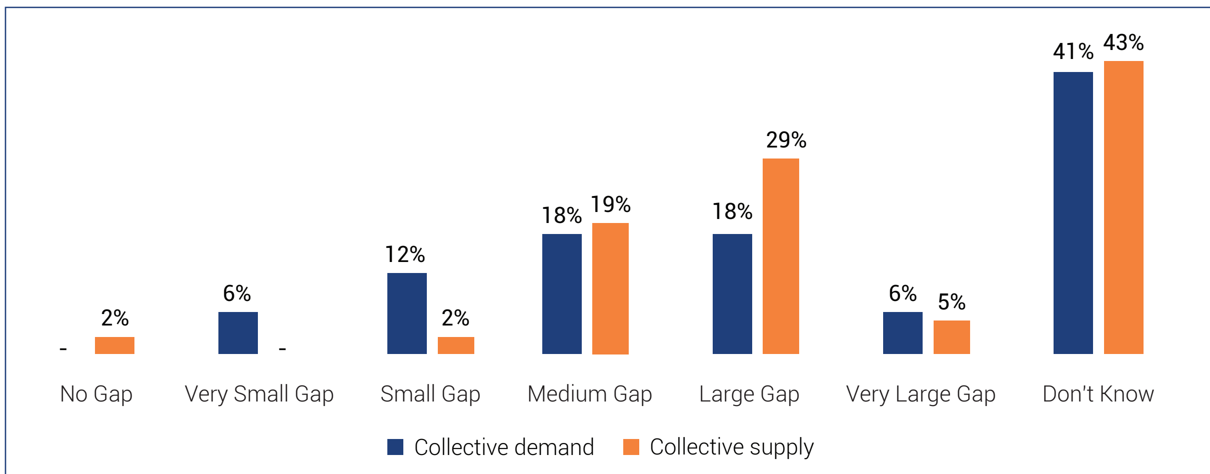
Source: ICIEC survey among stakeholders for G20 Stock-Take study

4.4.5 Local Banks in Developing Countries

Many buyers (41%) and suppliers (43%) "don't know" whether there is a gap for insurance of MLT loans provided by local banks in developing countries. Most suppliers and buyers that have a view think there is a "medium" to "large" gap.

A challenge for local banks in many developing countries is the lack of knowledge of, experience with, and clarity on the solvency benefits of credit insurance products. Capacity building on the use of credit insurance/guarantee products towards local banks and their national regulators is key to mobilize more capital from local banks.

Figure 4.21 - Potential Gap for Insurance of MLT Loans Provided by Local Banks in Developing Countries



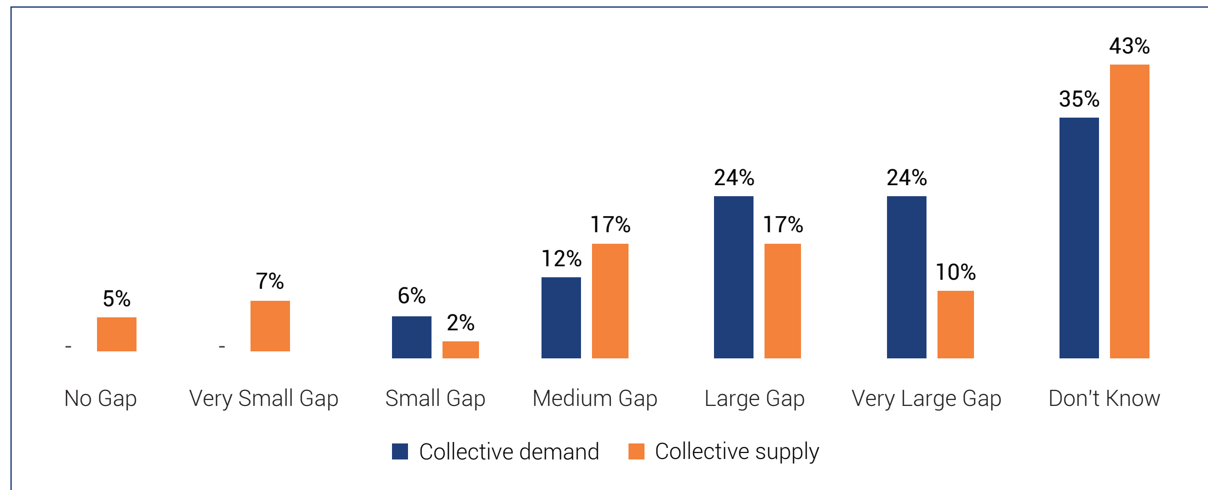
Source: ICIEC survey among stakeholders for G20 Stock-Take study

4.4.6 Institutional Investors

Most buyers that have an opinion think there is a "medium" (12%), "large" (24%) or "very large" (24%) gap (together 60%) for insurance on MLT debt investments provided by international institutional investors (international capital market bonds) This is also the case for most suppliers (together 44%), although many buyers (35%) and suppliers (43%) "don't know" whether there is a gap.

The survey outcome is likely due to the fact that most suppliers currently provide their MLT insurance products only or mainly to commercial banks. ECAs, private (re)insurers, SMIs generally have very limited experience with providing cover to international institutional investors. Some MDBs have provided cover through their PCGs for international bond issues, but in general their experience with bond enhancement is also limited. Given the enormous amounts of capital that are available to institutional investors, there are interesting opportunities to mobilize capital from these international institutional investors.

Figure 4.22 - Potential Gap for Insurance of MLT Debt Investments Provided by International Institutional Investors

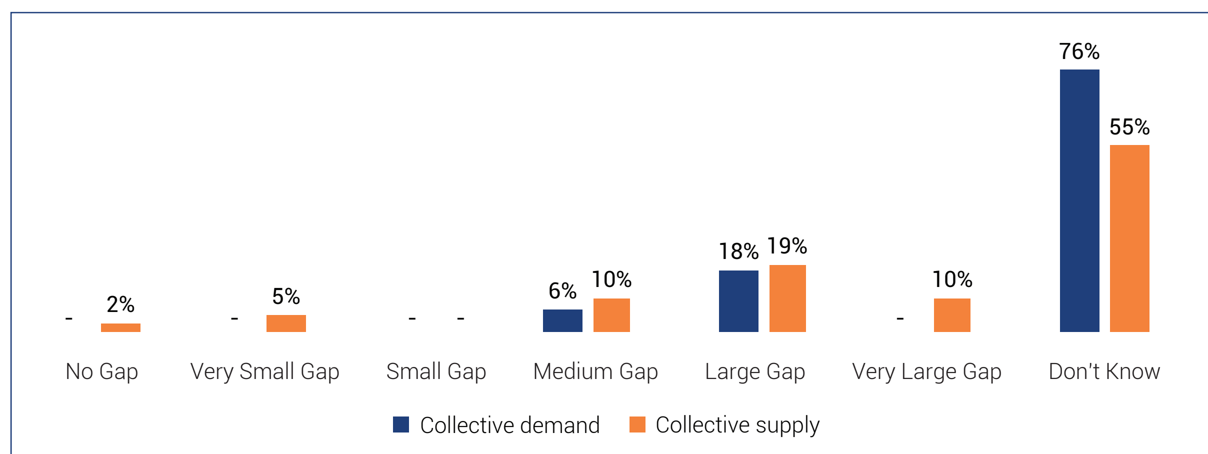


Source: ICIEC survey among stakeholders for G20 Stock-Take study

Most buyers (76%) and suppliers (55%) "don't know" whether there is a gap for the insurance of MLT debt investments provided by institutional investors in developing countries (i.e. domestic capital market bonds). Those that have an opinion think there is a "medium" to "very large" gap.

This survey outcome reflects the fact that most suppliers currently provide their insurance products only or mainly to (international) commercial banks. ECAs, private(re)insurers, MDBs and SMIs have in general no or very limited experience with providing cover to domestic institutional investors.

Figure 4.23 - Potential Gap for Insurance of MLT Debt Investments Provided by Domestic Institutional Investors

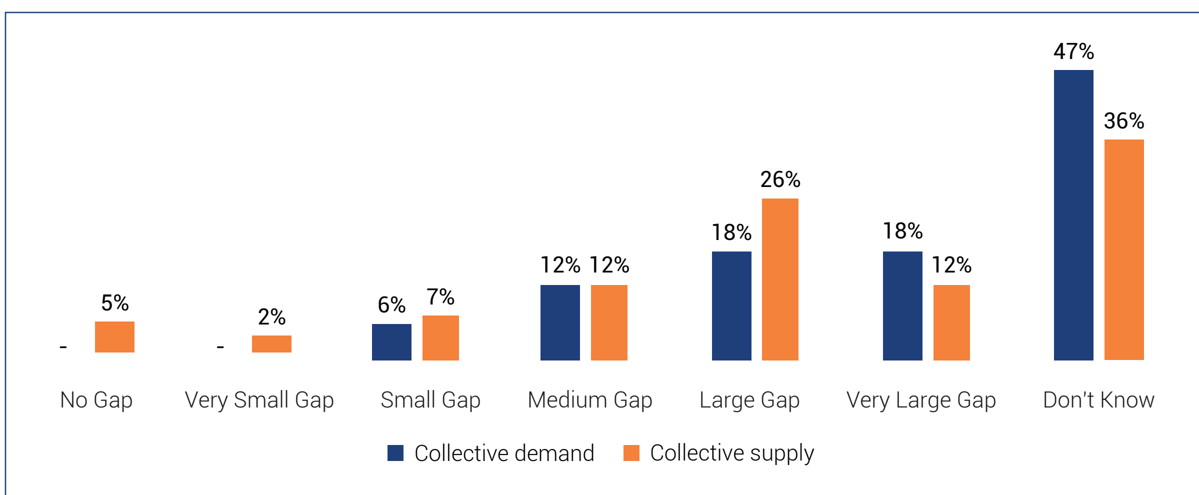


Source: ICIEC survey among stakeholders for G20 Stock-Take study

4.4.7 Local currency

Views are divided on a gap for the insurance of local currency loans. Many buyers think there is a "medium" (12%), "large" (18%) or "very large" (18%) (together: 48%). Suppliers share this view (together: 50%). But a similar number of buyers (47%) "don't know" whether is a gap for local currency loans.

Figure 4.24 - Potential Gap for Insurance of MLT Debt Investments in Local Currency



Source: ICIEC survey among stakeholders for G20 Stock-Take study

4.5 POTENTIAL SOLUTION

4.5.1 Roles of MLT Debt Insurance Providers

Stakeholders were asked which insurance and guarantee providers are currently the most important for the insurance of their MLT debt investments.

Question for all stakeholders:

When you look at the global market for the insurance of MLT debt investments, based on your experience, could you indicate the level of importance of various categories of insurance providers?

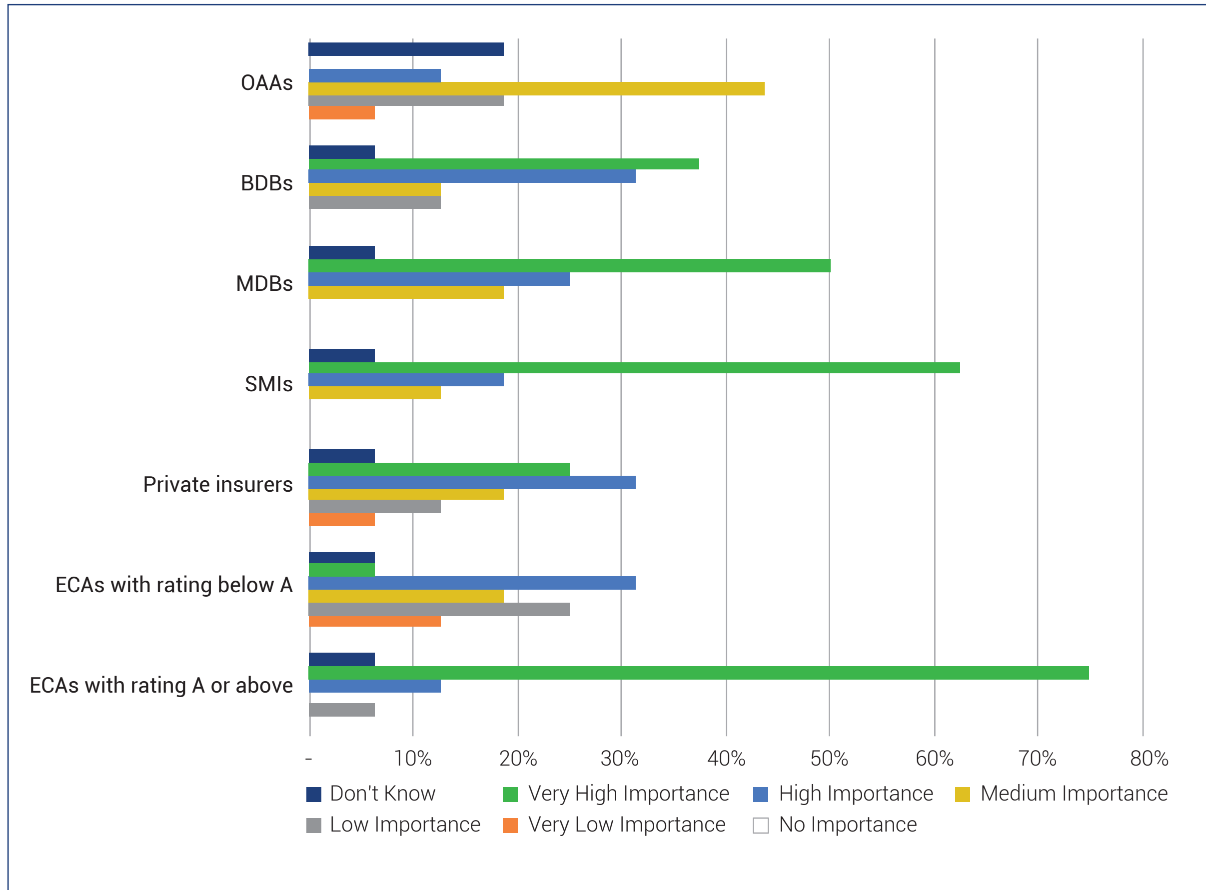
The feedback from MLT debt investors indicates that ECAs from countries with a S&P "A" rating or higher are the most important. 88% of the MLT debt investors value their insurance "high" or "very high". For ECAs with a rating below S&P A, the scoring is substantially lower, namely 37% for "high" or "very high". Most banks require the rating of their insurer be at least S&P single A, which explains the relatively low scoring of below single A rated ECAs.

SMIs are the 2nd category of insurers that are important to MLT debt investors, with a combined scoring of 82% for "high" and "very high" value. Private insurers score in total 56% on "high" or "very high" value.

Given the relatively limited guarantee operations of MDBs, it is surprising that 75% of the MLT debt investors attach a "high" or "very high" value to MDB guarantees. Cover from Bilateral Development Banks (BDBs) or ODA Aid Agencies (OAAs) is clearly of less importance to MLT debt investors. This feedback basically confirms the findings from desk research.

In general, "official guarantees" from MDBs, ECAs and SMIs have greater value for the market than private insurance. This is likely due to the fact that private insurance is less favorably treated in Basel II and III regulations than official insurance/guarantees.

Figure 4.25 - Importance of Insurance/Guarantee Providers for MLT Debt Investors



Source: ICIEC survey among stakeholders for G20 Stock-Take study

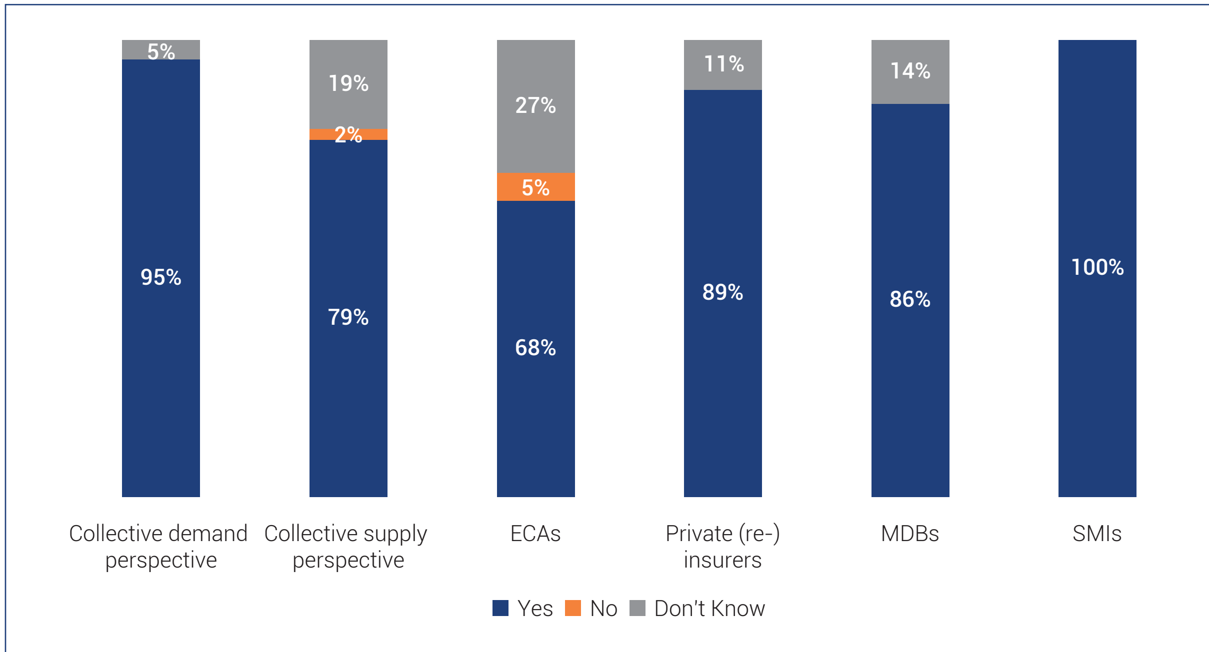
In addition, stakeholders were also asked which if MDBs and/or SMIs could play a role in filling potential market gaps.

> ***Question to all stakeholders:***
> *Do you believe MDBs and/or SMIs could play a role in filling potential gaps in the market for credit and political risk insurance for MLT debt investments?*

An overwhelming majority of buyers (collectively 95%) and suppliers (collectively 79%) think MDBs and SMIs can play an important additional role in the insurance/market for MLT debt investments. But there are ECAs (27%), private(re-)insurers (11%), and MDBs (14%) that said they "don't know". All four SMIs (100%) think that they and MDBs can play an important complementary role. These survey findings basically confirm the key recommendations in the G20 EPG report.

The response shows it is important for a structural dialogue to be established for cooperation a between various insurance/guarantee providers. It basically supports the recommendations in the EPG report.

Figure 4.26 - Perceived Potential for a Complementary Role for MDBs and SMIs



Source: ICIEC survey among stakeholders for G20 Stock-Take study

Stakeholders were also asked about potential complementary roles of MDBs and SMIs. A number of responses were provided, with an array of views on how MDBs and SMIs could complement other risk mitigation providers. The demand and supply observations can be found in Annex XII.

4.5.2 Using insurance to mobilize capital

Prominent risk mitigation providers for MLT debt investments are official ECAs, private insurers and SMIs, which all operate primarily as insurers and not as financial guarantors.

During the period 2010-18, total MLT insurance exposure outstanding at year-end for ECAs, private insurers and SMIs increased from USD 710.1 billion (2010) to USD 1,002 billion (2018). The ECA share in this exposure in 2018 was 84.9%, the shares of private insurers 12.2%, and that of SMIs 2.9%.

In absolute terms, private insurers increased their insured exposure from USD 56.7 billion in 2010 to USD 122.4 billion in 2018. SMIs also experienced substantial growth, from USD 8.4 billion in 2010 to USD 29.5 billion in 2018. ECAs increased their exposure from USD 645 billion in 2010 to USD 850 billion in 2018. The total outstanding exposure of BU members in 2018 was USD 1,002, or almost twice the total outstanding exposure of 8 MDBs, of USD 563 billion.

The “insurance model” of ECAs, private insurers and SMIs helps to explain their success in cooperating with MLT commercial debt financiers, particularly commercial banks, mobilizing capital from these debt investors, and mobilizing capital through reinsurance[40].

40 As explained all insurers make extensive use of reinsurance to manage their risks and exposure. It's part of their core business. Through this risk transfer activity they mobilize substantial (re)insurance capital from other sources.

Table 4.8 - MLT Exposure at Year-End: MLT Investment Insurance & MLT Export Credit (Million USD)

Business Exposure	2010	2012	2014	2016	2018	Share 2010	Share 2018
Investment: Maximum Liabilities Outstanding							
ECA	119,643	141,037	154,840	145,595	165,178	16.8%	16.5%
Private	56,675	69,878	72,028	110,523	122,377	8.0%	12.2%
Multilateral	8,447	10,980	13,765	17,684	29,468	1.2%	2.9%
Total Investment	184,765	221,895	240,632	273,802	317,022	26.0%	31.6%
Export Credit: Outstanding Commitments Before Re-Insurance							
ECA	525,372	628,116	650,087	653,383	685,559	74.0%	68.4%
Total Export Credit	525,372	628,116	650,087	653,383	685,559	74.0%	68.4%
Total	**710,137**	**850,011**	**890,720**	**927,186**	**1,002,581**	**100.0%**	**100%**

Source: Berne Union.

4.5.3 Successful mobilization strategies require comprehensive cover

Comprehensive cover is an effective insurance product for mobilizing capital from 3rd parties. It is effective because it provides adequate cover against all payment risks, and it leads to important capital relief benefits for commercial banks. This explains why commercial banks have a strong preference for comprehensive cover, and the resulting growth of the supply of comprehensive cover in the private insurance market and among SMIs during the past 5 years. For SMIs, the main product for this substantial growth was their Non-Honoring (Sovereign) Financial Obligation Cover (NHSFO), which provides comprehensive cover for loans to sovereign, certain sub-sovereign borrowers and some State-owned Enterprises.

In around 2008, the potential insurance capacity of the private insurance market per risk for both Credit Risk (CR) insurance cover for private borrowers and comprehensive cover for sovereign payment risks ("Contract Frustration" = CF) was less than USD 1 billion. At the end of 2018, the overall capacity for CR policies reached USD 2.4 billion and for CF policies, USD 3 billion. Approximately 20 large private insurers are able today selectively to provide comprehensive cover for project finance transactions, which most MDBs and SMI prefer to cover with "extended" political risk cover[41].

Of the total MLT insurance exposure outstanding for BU members in 2018 of USD 1.002 billion, 83.1% was covered with comprehensive cover policies, and 16.9% on the basis of political risk-only policies. The majority of the political risk-only business is for cover for equity investments and shareholder loans (approximately 70%), while 30% is used for 3rd party investment loans.

Comprehensive cover can successfully mobilize capital from international and domestic institutional investors, and local banks in developing countries.

4.5.4 MDB use of risk transfer techniques for balance sheet optimization

The lending activities of MDBs (and most BDBs) have been dominated by a "buy and hold strategy", meaning that loans were provided and kept on the MDBs (or BDBs) balance sheet until maturity. Most MDBs have had limited experience with buying insurance for their loans or reinsurance for their

41 "Extended" political risk insurance is available for project finance transactions. The main risks that can be covered are transfer risk, inconvertibility risk, (civil) war, expropriation and the breach of contractual obligations that are vital for the project. Breach of contract can for example cover the reputation of long-term off take contracts by the off taker.

guarantees. Yet insurance of MDB loans or reinsurance for MDB guarantees can be very effective risk transfer tools to mobilize capital from 3rd parties and improve an efficient utilization of MDBs' own scarce capital resources.

During the past two years, some interesting insurance transactions were carried out by IFC and AfDB to cover part of their private sector loan portfolios. Cover was mainly bought for a portfolio of MDB loans to commercial banks in developing countries. The risk transfer operations led to substantial capital relief and allowed both institutions to expand their lending operations. ADB has also used insurance on its private sector loans to both infrastructure and financial institutions.

Such risk transfer operations are more challenging for the sovereign lending operations of MDBs, primarily due to non-market based (or "blended") pricing practices for sovereign loans of MDBs. Also, reluctance to share the PCS in sovereign loans with 3rd parties may be an issue. Given the large shares of sovereign operations of most MDBs it is important to develop a risk transfer strategy for this exposure.

Table 4.9 - MDB Proportionate Sovereign and Non-Sovereign Operations (FY 2018)

MDB	% Sovereign	% Non-Sovereign
IBRD/ IDA	100%	0%
IFC	0%	100%
AIBB	74%	26%
AfDB	78%	22%
ADB	95%	5%
IaDB	94%	6%

Source: MDB annual reports 2018

Risk transfer in the form of reinsurance of guarantee exposure is a common practice among insurers. Private insurers, ECAs, and SMIs all make use of this technique. MIGA, for example, reinsured 64.4% of its gross exposure in 2019 mainly with private insurers and some ECAs. In 2010, the share was substantially lower at 44.4%. Other SMIs such as ATI and ICIEC also have a strong reinsurance strategy. In 2018, ATI reinsured approximately 79% of its gross exposure, and for ICIEC it was around 64%.

4.5.5 Mobilizing additional capital from local banks and institutional investors

The main clients for MLT guarantee and insurance products have been international banks. Most insurers have very limited experience in providing cover to projects or borrowers in developing countries for MLT debt investments of international institutional investors. This is due in part to the fact that the value of investments from institutional investors in infrastructure in developing countries is small.

Local bank and domestic institutional investors in developing countries are in general not important clients to most insurers. Private insurers are not or hardly active in supporting debt investments from local banks. Some local ECAs in developing countries may have experience with local banks. This differs among countries. Many ECAs in developing countries encounter challenges in providing cover to the banking sector, namely their often too low credit rating, capital constraints, and limitations to cover MLT business and relatively large amounts.

MDBs and SMIs are also not or hardly active in insuring loans from local banks in developing countries. They are, however, quite active in supporting through (guarantees for) credit lines funding of local banks, but risk sharing in the on-lending activities of local banks is a different story. In this area lies an important opportunity to mobilize more capital from local financial institutions by providing insurance to local banks for the local lending operations of these banks. Many MDBs have currently strategic partnerships with many local banks in developing countries, mainly through (cover for) funding lines and cooperation under

the ST Trade Finance Programs. Providing liquidity to local banks is indeed important. However, it is even more important to help them to assume MLT risks on their customers by providing MLT credit insurance for their on-lending operations. Insurance could support and enhance the availability of working capital, pre-export finance, access to finance for SMEs or finance other important SDG relevant projects (e.g. renewable energy, energy efficiency, water and other important policy areas).

Providing insurance or guarantees to local banks is particularly important under the current COVID-19 crisis. Banks in the developed world encounter huge problems in their lending to the business community for which reason many governments have created new or substantially improved existing domestic guarantee schemes to support bank lending to local corporates. The problems for many banks in developing countries are likely even much bigger than those of banks in the developed world. Hence a unique chance for an additional role of MDBs and SMIs. In this area it may also be worthwhile to explore strategic cooperation with private or public insurers. The risks for the insurance of (a portfolio of or individual) loans from local banks are obviously more complex and higher than the risk of insuring or providing funding lines to local banks, but the developmental impact is likely much higher as well.

However, there are also challenges. Many investors and banks in developing countries and their regulators are unfamiliar with credit and political risk insurance and the benefits the product can provide. This is a challenge for an effective use of credit and political risk insurance in developing countries and reduces the potential for domestic resource mobilization substantially. Another complicating factor is the fact that some developing countries do not allow foreign (private) insurers to provide insurance in their country, but this would not be a problem for insurance provided by MDBs and SMIs. The Basel II and III issues for credit and political risk insurance are further explained in annex IV

4.5.6 First Loss Guarantee

Question to all stakeholders:
Do you think that a first loss guarantee, somewhere between 10% - 20% and funded with grant money (e.g. blending of ODA funds/development aid money) would be useful to create more insurance capacity from insurance providers to cover MLT debt investments in (1) IBRD Middle-Income developing countries, (2) Low-Income Countries, (3) Fragile States and Conflict Affected countries and (4) Countries classified in OECD ECA country risk category 7?

Stakeholders responses address the following country categories:

1. Middle income countries;
2. Low income countries;
3. Fragile states and conflict-affected countries; and
4. High-risk countries (i.e. countries classified in OECD ECA risk category7, which is the highest risk category of the OECD ECA country classification system).

The feedback indicates that many buyers and suppliers "don't know" whether a first loss guarantee can create more insurance capacity. This is understandable because the market has in general limited experience with first loss arrangements. Most buyers of insurance expect it will positively impact insurance for low income countries (64%), fragile states (59%) and OECD high risk markets (59%) but are less optimistic for high income countries.

The collective view of suppliers is similar. Most suppliers also expect a positive impact in the insurance for low income countries (57%), fragile states (50%) and OECD high risk markets (52%).

To conclude, first loss guarantees can be useful to increase insurance capacity for relatively high-risk markets, fragile states and LICs. They may also be helpful for business in middle income countries, but the added value of first loss guarantees is likely much lower than for relatively high-risk markets. Given the need for comprehensive cover it is important that first loss arrangements have the capability to cover both political and commercial risks.

Figure 4.27 - Capital Mobilization in Middle-Income Countries

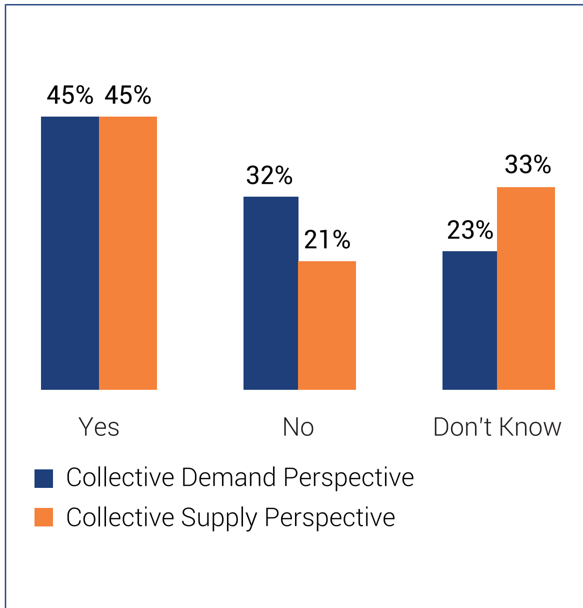


Figure 4.28 - Capital Mobilization in Low-Income Countries

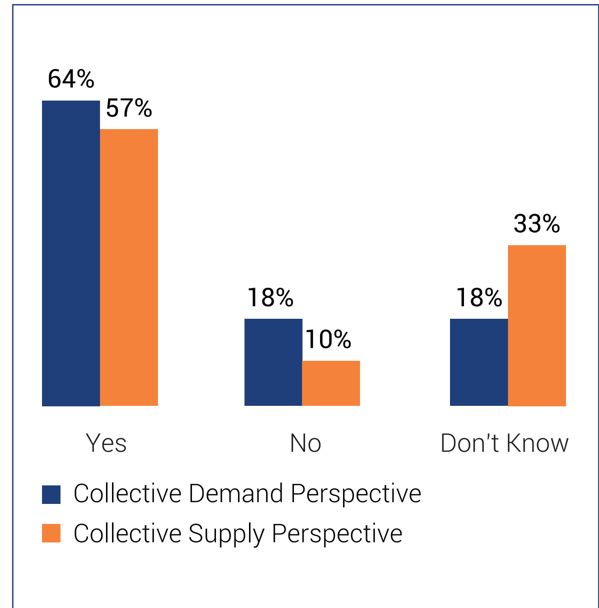


Figure 4.29 - Capital Mobilization in Fragile States and Conflict Affected Countries

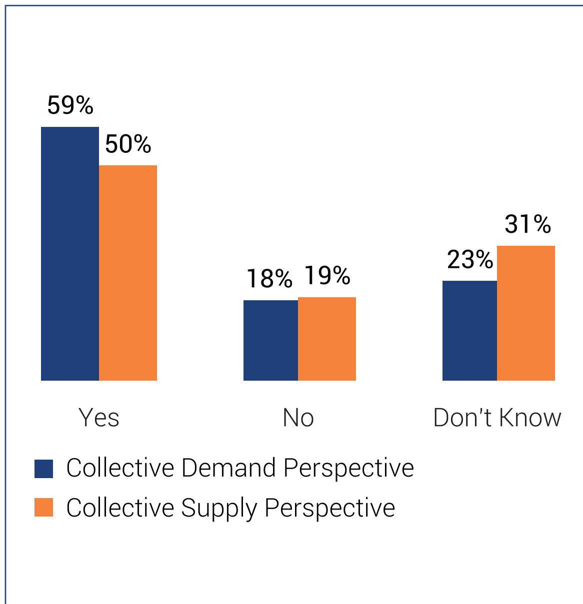
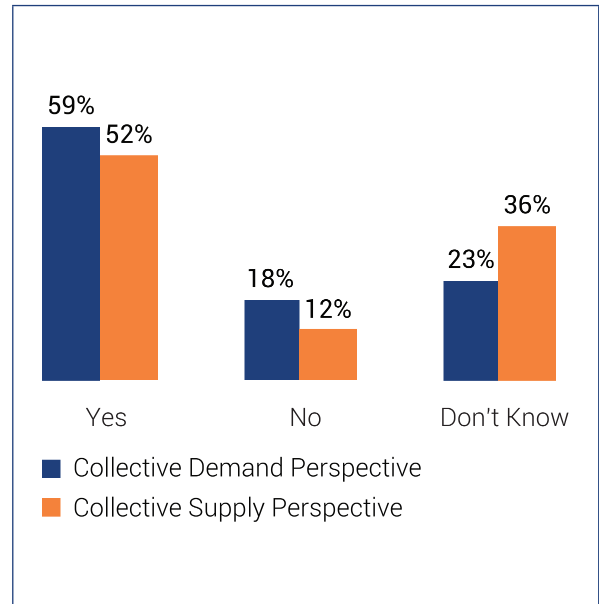


Figure 4.30 - Capital Mobilization in OECD ECA Risk Category 7



Source: ICIEC survey among stakeholders for G20 Stock-Take study

4.5.7 Additional Debt Insurance Capacity

Stakeholders were asked the following:

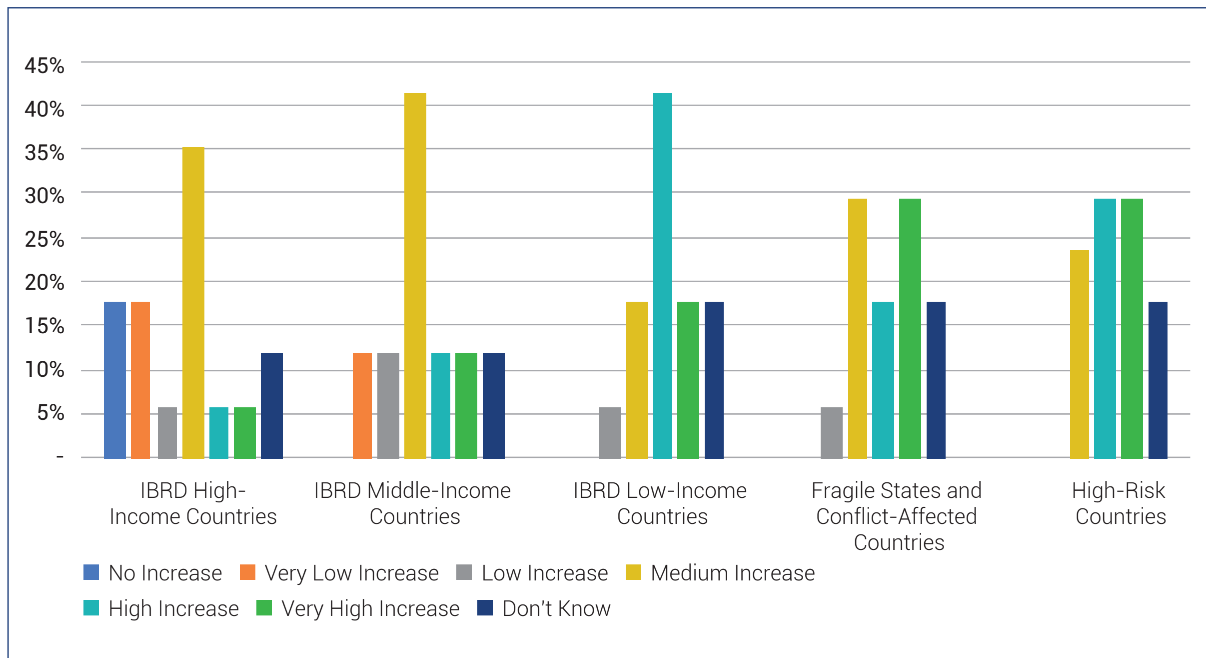
> ***Question to all stakeholders:***
> *Do you believe that additional insurance capacity for credit and political risk insurance for MLT debt investment will substantially increase or mobilize additional MLT debt investments in foreign countries?*

Stakeholder views were sought on the potential of additional capital for the following country categories:

- High income countries
- Middle income countries
- Low income countries
- Fragile states and conflict-affected countries
- High-risk countries (i.e. countries classified in OECD ECA risk category 7, the highest risk category of the OECD ECA country classification system)

On the demand side, MLT debt investors and insurance brokers think additional insurance capacity will have a positive impact for relatively high-risk markets (e.g. low-income countries, fragile states and conflict-affected countries and countries in OECD country risk category 7). The majority of buyers think there will be "medium" impact on high income countries and middle-income countries. Some respondents "don't know" (from 12% to 18%). Many buyers also think that additional insurance capacity will lead to "no" increase of MLT debt investments for high income countries, or a "very low" or "low" increase (together 42%).

Figure 4.31 - Additional Insurance Capacity for MLT Debt Investments and the potential Increase of MLT Debt Investments for Developing Countries (Demand-side Perspective)

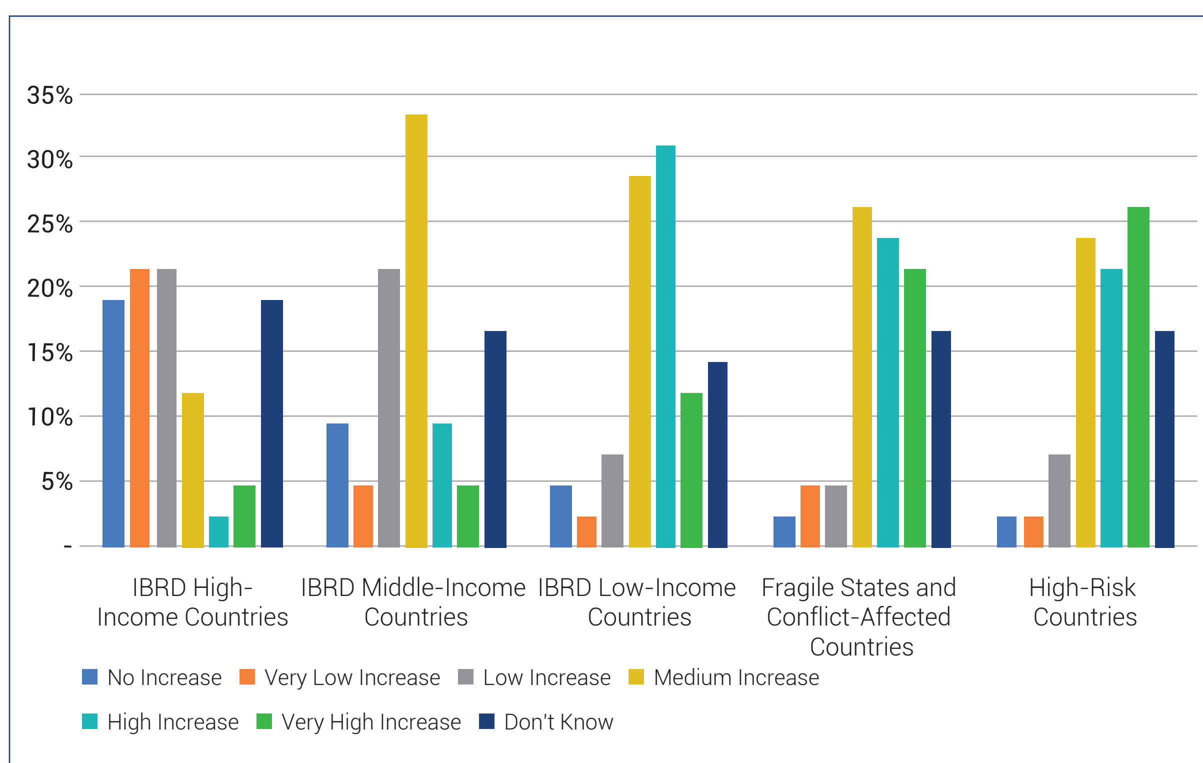


Source: ICIEC survey among stakeholders for G20 Stock-Take study

For suppliers, there is a similar picture. All suppliers expect additional insurance capacity will have a positive impact on the availability of MLT debt investments for relatively high-risk markets (e.g. low-income countries, fragile states and conflict-affected countries and countries in OECD ECA risk category 7). The majority of suppliers think additional insurance capacity for high income countries will not lead to additional MLT debt investments (19%) or a "very low" increase (21%) or "low" increase (21%).

For middle income countries, a majority of suppliers (33%) expect a "medium" increase. There are also quite some respondents that "don't know" (ranges between 14% and 19%).

Figure 4.32 - Additional Insurance Capacity for MLT Debt Investments and the ptential Increase of MLT Debt Investments for Developing Countries (Collective Supply Perspective)



Source: ICIEC survey among stakeholders for G20 Stock-Take study

In conclusion, the survey indicates that additional insurance capacity for relatively high-risk markets will substantially improve the availability of MLT debt investments for these countries. In determining which countries would benefit from additional insurance capacity, it is important to assess the perceived market risk on that country and its ability to attract finance or insurance capital from other players in the market, which is mainly determined by the risks involved and not by the income category of a country. There are substantial differences in the risk profile of individual countries in the same IBRD income category.

Additional insurance capacity for middle income countries is also expected to have a medium positive impact on the availability of MLT debt investments, but here again the risks on individual countries in the middle-income category differ substantially from one another.

4.5.8 Preferred Creditor Status

As noted in Chapter 3, sharing MDBs' Preferred Creditor Status (PCS) with other financial institutions (e.g. commercial banks, insurers or reinsurers) has been a sensitive issue. MDBs have had PCS since their inception, recognizing the foundational role they play in the global financial system when little or no credit is available from private and public sector sources.

Sharing the PCS is quite common in non-sovereign (private sector) transactions[42], but unclarity exists regarding such sharing in sovereign operations. There appear to be two different schools of thought within the MDB/SMI community about the potential for risk-sharing. Some MDBs or SMIs see their PCS as a cornerstone of the global financial system and are against any form of risk-sharing. Others are more open to considering risk-sharing with other stakeholders, reducing a barrier to mobilizing additional financing for development, private investment, and trade. These stakeholders could be, for example: a B loan participant in a sovereign loan; an insured commercial lender that also benefits from MDB/SMI insurance for its sovereign loan; or a reinsurer of an MDB or SMI that provides insurance through a PCG or NHSFO policy for a loan to sovereign borrower.

The key policy question regarding PCS and political risk for MLT debt investment is whether, and under what conditions, a MDB would be prepared to consider engaging in risk-sharing with other credit providers, guarantors, and insurers, thus sharing its PCS; and if so, what the terms of that risk-sharing might be.

One advantage of MDBs using selective risk-sharing is that the MDB may not have to raise additional capital – either from shareholders or the capital markets – while it is able to increase total lending to developing countries. This would help contribute to aid efficiency and aid effectiveness. Risk-sharing commercial partners could be able to offer better terms and conditions. Interest rates might not be comparable to MDB lending rates, but commercial rates could be expected to be lower than what markets would normally charge.

The survey indicates that while some stakeholders think sharing PCS in sovereign lending operations can lead to more favorable pricing, longer tenors, more general insurance/finance capital and more capital for high-risk markets, there are also many dissenters on the benefits of sharing PCS.

There could perhaps be benefits for risk-sharing for sovereign operations rather than for private sector transactions, given the higher volume of the PCS in sovereign lending. The MDB share of a country's total external debt also matters. Any potential mobilization impact would be transaction- and country-specific, and would also depend on the strength of the relevant MDB's PCS. Some MDBs or SMIs have a stronger PCS than others.

4.6 KEY FINDINGS/CONCLUSIONS

4.6.1 Supply for Political and Credit Risk Insurance for MLT Debt Investments

Among providers of guarantees and/or insurance, the importance of these instruments varies. However, comprehensive credit insurance is the dominant insurance and its business share has significantly increased with SMIs and private insurers. Guarantees currently play a very modest role in the operations

42 For example, sharing of the PCS is very common in private sector A/B loan structures whereby the MDB acts as lender of record for B loan participants. Many MDBs have a dedicated A/B loan program.

of MDBs. ECAs in contrast make significant use of insurance and guarantees; comprehensive credit insurance represents 85.5% of ECA exposure in 2018. Political risk cover, generally used for equity investments and shareholder loans, represented only 14.5% of ECA cover. For SMIs, comprehensive cover has grown substantially, from less than 7% of overall SMI exposure in 2011, to 44% in 2018. The supply of political risk-only business by private insurers has been stable, and its share fell from 49% in 2010 to 24% in 2018. For private insurers comprehensive cover, representing 76% of their total insurance portfolio in 2018, is the main insurance product to support MLT debt investments.

There is, in general, good insurance coverage for debt investment in upper- and middle-income countries. These countries have good to reasonably good access to commercial finance, and there seem to be good opportunities for selective risk-sharing by MDBs with commercial parties through:

- The insurance of MDB sovereign loans (with blended pricing)
- MDB/SMI insurance of sovereign loans provided by commercial debt financiers
- Reinsurance for MDB/SMI insurance of sovereign loans provided by commercial debt financiers.

In many developing countries there are good opportunities for cooperation between MDBs/SMIs and ECAs and private insurers through among others insurance of MDB loan exposure or reinsurance of MDB / SMI guarantee exposure. Annex XI provides a comparison of outstanding exposures of MDBs that report to the JEDH database and BU members in the selected 22 developing countries, which basically shows the enormous overlap in operations, particularly in UMICS and LMICs.

However, cover in selected OECD Category 7 countries varies substantially. Risk cover for MLT debt in selected OECD Category 7 countries from ECAs, multilateral and private insurers varied significantly, from a high in Ethiopia to a low in Chad.

4.6.2 Demand for Political and Credit Risk Insurance for MLT Debt Investments

Commercial banks from developed markets are the most important clients. Commercial banks from developed markets are much more important than commercial banks in developing countries for the MLT insurance operations of SMIs, ECAs and private insurers. At the same time commercial banks in developing countries have little experience with MLT financing. Furthermore, credit and political risk insurance instruments are not well known and/or recognized as adequate risk mitigation instruments by national regulators. As a consequence, local banks in many developing countries do not or hardly make use of credit and political risk insurance. And this negatively affects the mobilization of capital from local banks in developing countries.

Institutional investors from both developed and developing countries – as clients for insurance – play a less important role for ECAs, private insurers and SMIs. This is caused by limitations on the product side (i.e. recognition as risk mitigation tool, lack of unconditional guarantees, portfolio versus transaction investment approach), as well as limited experience of institutional investors in developing countries and lack of knowledge about credit and political risk insurance products.

Access to commercial credit decreases in line with the country's falling income level and increasing OECD Country risk rating. There are, however, substantial differences between countries in the same IBRD income group. While potential for risk sharing in private sector transactions might exist in these countries, sovereign borrowers need to increasingly rely on funded MDB support.

4.6.3 Potential Gaps

There are many gaps in cover for MLT debt investments. Many potential gaps have been identified in the market for commercial and political risk insurance for MLT debt investments, with a range of views from stakeholders on the size and severity of the various gaps. However, a large percentage of buyers and suppliers of insurance agree on a significant gap for comprehensive insurance of public as well as private sector investments in high-risk markets, as well as for comprehensive insurance of SMEs and low value MLT debt investments.

4.6.4 Potential Solutions

ECAs, SMIs and MDBs are considered the most important providers of insurance/guarantees for MLT debt investors. Official guarantees from MDBs, ECAs and SMIs have greater value for the market than private insurance, likely due to the fact that private insurance is less favorably treated in Basel II and III regulations than official insurance/guarantees.

MDBs could use more risk transfer techniques. The lending activities of MDBs have been dominated by a "buy and hold strategy". Yet insurance of MDB loans and reinsurance of MDB guarantee exposure can be a very effective risk transfer tool to mobilize capital from third parties and improve an efficient utilization of MDBs' own scarce capital resources.

Insurance can mobilize capital. The insurance model of ECAs, private insurers and SMIs helps to explain their success in cooperating with MLT commercial debt financiers, particularly commercial banks. Especially, comprehensive cover is an effective insurance product for mobilizing capital from 3rd parties. It is effective because it provides adequate cover against all payment risks and leads to important capital relief benefits for commercial banks. Furthermore, IFC, ADB and AfDB have executed risk transfer operations that led to substantial capital relief and allowed both institutions to expand their lending operations.

Local banks and institutional investors present an untapped opportunity to mobilize additional capital to strengthen the private sector– however challenges exist. Given the risk factors in providing insurance to local financial institutions, many suppliers such as ECAs, SMIs and private insurers have in general limited experience doing so. However, given the demand for local currency financing and strengthening of local financial sectors, local banks constitute an important source to improve access to finance for the developing countries' local economies.

Use of first loss guarantee arrangement is of potential interest. first loss guarantees are regarded useful to increase insurance capacity for relatively high-risk markets, fragile states and LICs. They may also be helpful for some business in middle income countries, but the added value of first loss guarantee is likely much lower than for relatively high-risk markets. It is important that first loss arrangements can be used to provide comprehensive cover.

Additional insurance capacity could have an impact in higher risk markets. The survey indicates a view that additional insurance capacity for relatively high-risk markets will substantially improve the availability of MLT debt investments for these countries. This also matches the survey results with regard to the potential gaps.

There is no consensus around sharing Preferred Creditor Status in (insuring) MLT debt investments. While there could be benefits to mobilize capital from sharing PCS for sovereign operations, this is less valuable for private sector transactions. However, the MDB share of a country's total external debt matters. Any potential mobilization impact would be transaction- and country-specific and would depend on the strength of the relevant MDB's PCS. Some MDBs or SMIs have a stronger PCS than others.

05

Recommendations

05 Recommendations

5.1 INTRODUCTION

MDBs were requested by the 2020 G20 Presidency, the government of Saudi Arabia, to conduct a stock-take study on the use of political risk insurance for equity investment and MLT debt and other insurance solutions. At the request of the G20 chair, this study has been coordinated by ICIEC.

This stock-take exercise was intended to assess the current state of the MLT guarantee/ insurance market for equity and MLT debt investments. It provides evidence and findings on current and potential practices, challenges, and potential market gaps, for both users and providers of credit and political risk cover for equity and debt. It considers options and potential solutions for how the identified market gaps could be addressed, particularly for low income countries and fragile states.

Based on this paper's analysis, key findings and conclusions, the following broad recommendations have been developed:

5.2 RECOMMENDATIONS

RECOMMENDATION #1: FOSTER INCREASED AWARENESS OF CREDIT AND POLITICAL RISK INSURANCE IN ORDER TO MOBILIZE ADDITIONAL PRIVATE CAPITAL FOR DEVELOPMENT FROM LOCAL BANKS AND INSTITUTIONAL INVESTORS (INTERNATIONAL AND DOMESTIC).

RECOMMENDATION #2: CONSIDER EXPANDING INSURANCE AND GUARANTEE OFFERINGS OF MDBs AND SMIs.

RECOMMENDATION #3: EXPAND THE COMPLEMENTARY ROLE FOR MDBs AND SMIs TO COVER EQUITY INVESTMENTS.

RECOMMENDATION #4: ENCOURAGE THE MDBs TO CONTINUE COLLECTING AND SHARING RISK INFORMATION AND DATA SUCH AS GLOBAL EMERGING MARKETS ("GEMs") RISK DATABASE.

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