MANAGING THE NEW POLITICAL RISKS: POPULISM, DEMOCRATIC INSTABILITY, AND THE RISE OF POLITICAL RISK INSURANCE IN DEVELOPED DEMOCRACIES

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Developed democracies in the West are facing a surge of political risk. Democratic institutions are showing their weaknesses as polarization, populism, and trade conflicts sweep across the developed world. Firms and investors with multinational interests have been turning to political risk insurance to mitigate potential losses due to adverse government action. Once limited to emerging markets to insure against risks such as civil war or expropriation, political risk insurance is increasingly being purchased to protect assets from emerging risks in developed economies. While private insurers have been able to respond to the increase in demand for coverage, they are not as well-equipped as their public counterparts. Private insurers lack the information back-channels that only government intelligence networks can provide and do not have the political clout to advocate on behalf of their insureds. Public providers of political risk insurance are typically prohibited from offering coverage for investments outside developing markets and are thus unable to respond appropriately to the new political risks emerging in western democracies. This Note argues that these restrictions should be relaxed in light of the new threats facing multinational firms and investors that need the backing and support of their home governments.

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I. INTRODUCTION

Transnational investments and trade are generally recognized as carrying greater risk than transactions performed domestically. This is especially true when the investment is made in a country with a developing economy or unstable political institutions. In addition to the usual economic risks associated with any business or financial venture, investments that cross national boundaries face unique political risks. Dealing internationally often involves dealing with different currencies, unfamiliar forms of government, changing regimes, trade restrictions, capital controls, or, in some regions of the world, political violence and warfare. In fact, investors have ranked political risk as the most significant obstacle to investing abroad.[1] Political risk insurance (PRI) is a form of specialized insurance designed to protect firms and investors against the risks that attach to foreign investment and trade.[2] Historically, PRI has been purchased by firms doing business in developing countries where risks such as civil war or government expropriation were much greater than in developed nations.[3] Today, the market for PRI is evolving. The rise of globalization combined with

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[1] James J. Waters, *A Comparative Analysis of Public and Private Political Risk Insurance Policies with Strategic Applications for Risk Mitigation*, 25 DUKE J. COMP. & INT'L L. 361, 366 (2015); NIGEL GOULD-DAVIES, TECTONIC POLITICS: GLOBAL POLITICAL RISK IN AN AGE OF TRANSFORMATION 13 (2019) (showing that five of the top eight risks CEOs are "extremely concerned" about were of a political nature).

[2] WALTER J. ANDREWS & SERGIO F. OEHNINGER, 2 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 15A.03(6)(b) (2019).

[3] Julian M. Campisi, *Reconsidering Political Risk in Developed Economies*, 4 J. POL. RISK (2016) (explaining that political risks have generally been greater in developing economies but that growing risks in the West warrant further study and consideration); *see also* AREND LIJPHART, PATTERNS OF DEMOCRACY: GOVERNMENT FORMS AND PERFORMANCE IN THIRTY-SIX COUNTRIES 269–71 (2d ed. 2012) (discussing the correlation between democracy in developed countries and political violence).

changing political attitudes towards trade, increasing geopolitical tensions, and challenges facing traditionally-stable western governments has altered PRI as insurance markets respond to investors' new demands and fears.[4]

PRI is an understudied area of insurance and little has been written about the new risks in developed democracies or the inadequacy of coverage options available in these areas. The purpose of this Note is to examine these growing political risks and argue that government-backed PRI should be expanded to include the political threats facing firms and investors in the developed world. Following this introduction, Part II discusses the fundamental aspects of PRI, including the main categories of coverage, the characteristics that separate it from other forms of insurance, and the primary distinctions between public and private PRI. Part III analyzes the new political risks rising in developed democracies and looks at the private insurance industry's response. Part IV argues that public providers of PRI should loosen restrictions and expand coverage options to better serve the interests of firms and their home governments. Current eligibility and coverage restrictions limit access to public PRI and thus leave a gap to be filled by the private insurance market. This shifts the risk of adverse government action onto a private sector that is normally ill-equipped to evaluate or mitigate such risks. The United States International Development Finance Corporation is used as an example of how restrictive requirements and coverage limitations impede important policy goals and leave American firms operating abroad exposed to a greater risk of adverse government action.

II. THE BASICS OF POLTICAL RISK INSURANCE

Political risk insurance typically covers a composite of various non-commercial risks associated with commercial development, investment, and international trade.[5] Unlike other forms of commercial insurance that may

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[4] *Insurance Marketplace Realities 2020–Political Risk Insurance*, WILLIS TOWERS WATSON (Nov. 13, 2019), https://www.willistowerswatson.com/en-us/insights/2019/11/~/link.aspx?_id=32A4E687F855486F92AE5385461D45F6&_z=z; Gabriel Olano, *Willis Towers Watson Reveals Political Risk Loss Figures*, INS. BUS. UK (Dec. 5, 2019), https://www.insurancebusinessmag.com/uk /news/war-political-risk/willis-towers-watson-reveals-political-risk-loss-figures-194043.aspx (discussing that among forty-one major corporations surveyed, sixty-one percent said political risk levels rose in 2019 and seventy percent cited trade sanctions as a concern).

[5] Vishrut Kansal, *Political Risk: Conceptualization, Definition, Categorization, and Methodologies*, 3 J. POL. RISK (2015).

cover risks associated with construction, operation, or solvency, PRI provides multinational firms with protection against adverse governmental action and political instability that may threaten their physical assets, investments, or contracts.[6]

A. THREE TRADITIONAL CATEGORIES OF POLITICAL RISKS

There is no generally accepted definition of political risk, but it has typically been divided into three broad categories: expropriation, currency inconvertibility, and political violence.[7] These categories are neither exhaustive nor meant to be narrowly construed, however, as many policies cover a range of adverse government actions that do not fit neatly into any one category.[8]

Expropriation coverage is one of the most common forms of PRI.[9] It protects foreign investors from government action that either reduces or eliminates ownership and control over an asset or investment. This includes government seizure and nationalization as well as adverse sequences of regulatory changes that combine to reduce ownership or control, a risk known as "creeping expropriation."[10] All investments suffer from a risk that laws and regulations may change in a way that negatively impacts the investment. However, this risk is much greater when dealing internationally in countries with less stable legal structures and fewer protections for investors.[11]

Currency inconvertibility refers to the inability to convert foreign currency for transfer abroad, thereby depriving the investor of profits or other assets.[12] Some governments find currency restrictions necessary to conserve

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[6] Waters, *supra* note 1, at 363.

[7] *Id.* at 361.

[8] Kansal, *supra* note 5 ("The expansiveness of political risk highly counteracts any systematized approach towards categorizing its different manifestations."); *see also* Alicia N. Ellis, *Making Political Risk More Politically Relevant*, 7 J. POL. RISK (2019) (stating that political risk can be expanded to include many government measures, both formal and informal, yet it remains an "understudied and little understood niche").

[9] Waters, *supra* note 1, at 365.

[10] *Id.*

[11] S. Linn Williams, *Political and Other Risk Insurance: OPIC, MIGA, Eximbank, and Other Providers*, 5 PACE INT'L L. REV. 59, 62 (1993).

[12] KAUSAR HAMDANI, ELISE LIEBERS & GEORGE ZANJANI, AN OVERVIEW OF POLITICAL RISK INSURANCE 2 (2005), https://www.bis.org/publ/cgfs22fedny3.pdf.

currency when facing balance-of-payments difficulties.[13] Currency devaluation or currency inflation, however, are distinct and uninsurable risks.[14]

PRI also covers property losses from political violence, including civil war, revolution, rebellion, domestic unrest, or other forms of politically-motivated violence that are excluded from standard property insurance coverage.[15] The line between political violence and outright war or terrorism is not always clear.[16] For example, a violent political protest against a government could be classified as political violence or as terrorism. That classification would determine whether the event is covered under a traditional PRI policy or a standalone terrorism insurance policy.[17] This has led some multinational firms to protect themselves using a combination of the two products.[18]

B. ATYPICAL CHARACTERISTICS OF PRI

The nature of political risks separates PRI from other insurance products and helps explain the somewhat atypical characteristics of PRI.[19] Political events can occur over many years and the effects are not always easily assessable. Unlike other insurable risks where the adverse event is said to be independent of the will of the insured, political events may be directly influenced by the insured's specific investor-state relationship.[20] This complicates the idea that insurable risks must include many insureds that can

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[13] Waters, *supra* note 1, at 365.

[14] HAMDANI, ET AL., *supra* note 12, at 8.

[15] Waters, *supra* note 1, at 367. Notably, such losses are generally excluded from property insurance policies. *See* TOM BAKER & KYLE D. LOGUE, INSURANCE LAW AND POLICY 161 (4th ed. 2017) (showing losses caused by war or government action is excluded under an ISO standard form property insurance policy).

[16] Evan Freely, *What's Covered? Distinguishing Among Political Risk, Political Violence, and Terrorism Insurance*, MARSH (July 1, 2015), https://www.marsh.com/us/insights/risk-in-context/distinguishing-among-political-risk-violence-terrorism-insurance.html.

[17] *Id.*

[18] *Id.*

[19] Kathryn Gordon, *Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development, in* OECD INVESTMENT POLICY PERSPECTIVES 91, 95 (2008).

[20] *Id.*

join to form a risk community where risk is shared and diversified.[21] The risk of political activity also cannot be accurately calculated or explained, which means PRI providers cannot rely on statistical modelling to evaluate risks the way other insurance sectors commonly do.[22] These characteristics explain why the PRI sector relies heavily on bespoke insurance products tailor-made for specific risk events.[23] Such situation-specific policies rarely cover all foreseeable political events and increase the likelihood of a dispute over coverage following a claim.[24]

C. PUBLIC VERSUS PRIVATE PROVIDERS

The market for PRI is divided into public and private providers with each carrying their own advantages and disadvantages.[25] The distinctions below are important for understanding why private PRI has grown despite its inadequacies and why public providers are in a better position to insure political risks.

The first providers of political risk insurance were all government agencies. Examples include the Overseas Private Investment Corporation (OPIC), now called the U.S. International Development Finance Corporation (DFC),[26] the Nippon Export and Investment Insurance Agency (NEXI) in Japan, and Export Finance Australia (EFA).[27] Multilateral agencies play a significant role in the PRI market as well, such as the World Bank Group's Multilateral Investment Guarantee Agency (MIGA), which offers PRI coverage to citizens of 179 World Bank members.[28] Public providers of PRI are sometimes considered insurers of last resort as they offer coverage that private insurers either refuse to provide or would otherwise be cost-prohibitive if offered by a private insurer.[29] This perception has not always been the case. In 1969, the Overseas Private Investment Corporation (OPIC)

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[21] Elizabeth A. Kessler, *Political Risk Insurance and the Overseas Private Investment Corporation: What Happened to the Private Sector?*, 13 N.Y.L. SCH. J. INT'L & COMP. L. 203, 207 (1992).

[22] Gordon, *supra* note 19, at 95.

[23] *Id.*

[24] *Id.*

[25] Waters, *supra* note 1, at 374–81.

[26] As of 2018, DFC is the successor agency to OPIC. *Overview*, DFC, https://www.dfc.gov/who-we-are/overview.

[27] See Gordon, *supra* note 19, at 111 for a list of public institutions providing PRI.

[28] Waters, *supra* note 1, at 370.

[29] Gordon, *supra* note 19, at 104.

was formed out of the United States Agency for International Development, which guaranteed investments under the post-World War II Marshall Plan.[30] The goal was to eventually encourage a private PRI industry to insure developments that investors might otherwise avoid without such coverage.[31]

In the 1970s, Lloyds of London and American International Group (AIG) began expanding into the field. At the time, many in the business community felt that political risk could not be insured by the private sector and were drawn to the status of OPIC as a government entity.[32] Only those rejected by OPIC sought private coverage, leaving private PRI providers with greater risk and higher prices due to an information gap. This gap was due to the fact that governments are in a better position to evaluate risk and obtain information about foreign regimes.[33] For example, U.S. embassies monitor American interests abroad and the U.S. State Department routinely shares its information with DFC.[34] Prior to fast-speed electronic communication, the government held a significant advantage in its ability to understand and evaluate political risks. Technological developments have helped private insurers neutralize the information advantage once held by government-backed insurance agencies.[35] As communication improved and information flowed more quickly, private providers began to monitor risk more effectively.[36] While private providers still lack the information backchannels available to public providers, technological advancements have helped them reduce the information gap enough to allow them to expand their PRI coverage options.[37] Private options have also become more attractive to insureds unwilling to comply with the social, environmental, and labor standards that apply to those insured by public insurers.[38] As the

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[30] Waters, *supra* note 1, at 363; *Political Risk Insurance*, NAT'L ASS'N INS. COMM'RS, https://content.naic.org/cipr_topics/topic_political_risk_insurance.htm (last modified Mar. 4, 2020).

[31] Jennifer M. DeLeonardo, Note, *Are Public and Private Political Risk Insurance Two of a Kind? Suggestions for a New Direction for Government Coverage*, 45 VA. J. INT'L L. 737, 741 (2005).

[32] *Id.* at 742.

[33] Waters, *supra* note 1, at 375.

[34] DeLeonardo, *supra* note 31, at 756.

[35] *Id.* at 755.

[36] *Id.*

[37] *Id.* at 751–53.

[38] Waters, *supra* note 1, at 377; Gordon, *supra* note 19, at 120 (providing a summary of agency monitoring of client compliance with contractual obligations). For an example of the social and environmental requirements often imposed on

PRI market has matured, private providers have made significant gains in market share and no longer face poor stigma as they did before.[39] Today, there are over 60 companies offering political risk insurance.[40]

III. CHANGING POLITICAL RISKS AROUND THE WORLD

Political risk is surging around the globe.[41] Historically, risk-prone regions such as the Middle East, Africa, and South America continue to face substantial threats from terrorism, war, sanctions, and government instability. The most noteworthy changes, however, come not from developing economies, but rather the large-scale political risks emerging in advanced western democracies and the geopolitical tensions spanning from Asia to North America.[42] More firms and investors in North America and Europe are facing threats on a macro level.[43] These include trade tensions

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insureds covered by public PRI, see *Investment Policies*, DFC, https://www.dfc.gov /what-we-offer/eligibility/our-investment-policies.

[39] Waters, *supra* note 1, at 377–78.

[40] NAT'L ASS'N INS. COMM'RS, *supra* note 30.

[41] GOULD-DAVIES, *supra* note 1, at 16–17 ("A wider range of actors and transactions, more exposed to political risks than ever before, now faces a more rapid growth in these risks than at any time since 1945."); s*ee, e.g., Marsh's Political Risk Map 2019: Unprecedented Uncertainty Ahead*, MARSH (Feb. 27, 2019), https:// www.marsh.com/us/media/political-risk-map-2019.html; MARSH, POLITICAL RISK MAP 2019: RISING GEOPOLITICAL TENSIONS (Feb. 2019) [hereinafter MARSH RISK MAP 2019] ("Businesses have arguably never faced such a breadth of challenges as they do today."); AON RISK SOLUTIONS, RISK MAPS 2019: AON'S GUIDE TO POLITICAL RISK, TERRORISM & POLITICAL VIOLENCE (2019) [hereinafter AON RISK MAP 2019]; *see also* Bethan Moorcraft, *What is Political Risk Insurance?*, INS. BUS. ASIA (Mar. 19, 2019), https://www.insurancebusinessmag.com/asia/guides/what-is-political-risk-insurance-162505.aspx ("The geopolitical risk landscape is more tumultuous and diverse than it has been in decades.").

[42] In a survey report, WILLIS TOWERS WATSON, HOW ARE LEADING COMPANIES MANAGING TODAY'S POLITICAL RISKS? 2019 SURVEY AND REPORT 12 (2019), one panelist noted: "Most political risk issues previously related to 'third-world problems.' However, increasingly I have more concerns about the US and the UK." A second panelist agreed: "The political risks we see in more mature economies are longer term and perhaps more fundamental in nature. There is a crisis in democracy and institutions, and the opposition isn't from traditional parties; it's from populist parties and civil society."

[43] Terry Gangcuangco, *OECD Countries Now More Vulnerable to Credit and Political Risk?*, INS. BUS. UK (Feb. 22, 2019), https://www.insurancebusiness mag.com/uk/news/war-political-risk/oecd-countries-now-more-vulnerable-to-credit

between the United States and China, the uncertainties following Great Britain's exit from the European Union, or Brexit, and rising political instability among western democracies. The risks differ both in nature and scope from risks in other parts of the world, which continue to involve losses of physical assets by expropriation or political violence.[44] The widescale political risks arising in developed democracies threaten the institutions that set these countries apart from those in the developing world.[45]

A. POPULISM AND DEMOCRATIC INSTABILITY

It is generally understood that democracy decreases political risk. This is because democratic institutions tend to protect the status quo and provide opportunities for investors to influence the policy-making process or at least observe and anticipate policy changes.[46] There are circumstances, however, when democracy increases political risk. It has long been acknowledged that political polarization has an adverse effect on government stability.[47] As parties become more polarized, passing legislation can become nearly impossible and changes in administration have a more significant impact when there is greater ideological conflict between controlling parties.[48] This increases the risk that policy will become unstable

-and-political-risk-159726.aspx; Georgi Kantchev, *The Return of the Political Risk-Trade*, WALL ST. J. (June 11, 2018), https://www.wsj.com/articles/political-risk-returns-to-markets-as-tide-of-stimulus-wanes-1528719648; Brenna H. Neghaiwi & Carolyn Cohn, *Demand Rises for Political Risk Cover as Buyers Think the Unthinkable*, INS. J. (Apr. 25, 2017), https://www.insurancejournal.com/news/international/2017/04/25/448835.htm.

[44] *Insurance Markets and Risk Priorities in 2019*, MARSH, https://www.marsh.com/us/insights/research/insurance-markets-and-risk-priorities-in-2019.html; *see* WILLIS TOWERS WATSON, *supra* note 42, at 5 (showing that trade sanctions were the highest rated political risk outside Africa and the Middle East).

[45] WILLIS TOWERS WATSON, *supra* note 42.

[46] NATHAN M. JENSEN, GLEN BIGLAISER, QUAN LI, EDMUND MALESKY, PABLO M. PINTO, SANTIAGO M. PINTO, & JOSEPH L. STAATS, POLITICS AND FOREIGN DIRECT INVESTMENT 31–32 (2012).

[47] ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY 120 (1957) ("[Political polarization] means that government policy will be highly unstable, and that democracy is likely to produce chaos.").

[48] JENSEN ET AL., *supra* note 46, at 31–32 (discussing the relationship between political risk and policy swings resulting from changes in administration); BARBARA SINCLAIR, UNORTHODOX LAWMAKING 140–42 (4th ed. 2012) (arguing that polarization has forced Congress to adopt unorthodox procedures even for legislation that just keeps government functioning).

and that political leaders will pursue policies to obtain short term political gains at the expense of long term investment.[49]

The same societal issues increasing polarization may trigger waves of populism.[50] Polarized governments are less effective at finding solutions and these failures may be exploited by populists from both the left and the right.[51] Targeting multinational firms can be politically popular and political leaders will often resort to such tactics when trying to gain the support of voters.[52] Globalization has nearly been put on hold as these sentiments gain ground in many governments.[53] Prominent members of both major parties in the United States are skeptical of multilateral trade agreements and populist parties critical of the E.U. have increased their share of votes in Germany, France, Sweden, Italy, and Spain.[54]

Changes in trade policy are now among the top concerns for investors. Surveys of large corporations and PRI providers show that the uncertain future of American trade policy and Brexit are driving much of the increased demand for PRI.[55] This has redrawn the map for PRI as more businesses are concerned about how these developments will impact their supply chains. The British automobile industry, for instance, has shown concern over Brexit's impact on their supply chain. As a result, the industry is moving some investments to continental Europe so they remain in the E.U.

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[49] JENSEN ET AL., *supra* note 46, at 31–32.

[50] WORLD ECON. FORUM, THE GLOBAL RISKS REPORT 2019, at 10 (14th ed. 2019); Jean-Francois Lambert, *Trade in Flux*, *in* BERNE UNION YEARBOOK 2019, at 58–61 (2019) (describing the deep-rooted issues affecting trade tensions around the world); s*ee also* David Fontana, *Unbundling Populism*, 65 UCLA L. REV. 1482, 1486–95 (2018) (explaining the issues driving populism in the United States and differentiating between left- and right-wing populism); Ariane Chebel d'Appollonia, *A Transatlantic Perspective on Populism(s): What's Going on*, 12 Revista Internacional Pensamiento Político 189, 191–92 (2017) (offering a European perspective on the causes of populism, such as economic inequality and cultural backlash).

[51] Bart Bonikowski, *Three Lessons of Contemporary Populism in Europe and the United States*, 23 BROWN J. WORLD AFFS. 9, 21 (2016); Frances E. Lee, *How Party Polarization Affects Governance*, 18 ANN. REV. POL. SCI. 261 (2015).

[52] JENSEN ET AL., *supra* note 46, at 32–33 (describing how elected leaders may target multinationals when facing populist pressures).

[53] MARSH RISK MAP 2019, *supra* note 41, at 1 ("Isolationist and protectionist sentiments and practices have risen in some countries, halting, at least momentarily, the process of globalization.").

[54] AON RISK MAP 2019, *supra* note 41, at 7 ("Populism, aided by subtle and divisive use of multi-media platforms, has gained ground and continues to spread.").

[55] Waters, *supra* note 1, at 366–67; Olano, *supra* note 4.

customs zone.[56] The European aircraft manufacturer Airbus, which exports to Britain, has also demonstrated concern over its future presence in the U.K. following Brexit.[57] Even Lloyds of London, an insurance market founded in 1688, opened a Europe-focused subsidiary in Brussels in case London becomes less attractive for business.[58] Most businesses have some concerns with the cost of compliance if tariffs or other trade barriers arise; while capital mobility has been raised as another potential risk for businesses doing trade in the region.[59]

This mirrors concerns of American businesses with interests in China, or even Mexico and Canada where U.S. actions have resulted in retaliatory tariffs by all three nations.[60] The potential consequences of a trade conflict can be devastating for some industries. Tariffs could destroy the economic viability of many businesses, which would disrupt supply chains and lead to a loss of income for any investor along the chain.[61] Tariffs on vital resources for example have wide-ranging impacts that increase business costs for any manufacturer requiring those materials.[62] Other trade barriers that restrict certain products entirely could destroy industries that fail to secure alternative sources or severely dampen their competitiveness.

It is important to note that avoiding the disruption of a supply chain may carry risks of its own. When a relatively stable, developed country announces a series of new import taxes or trade restrictions, firms may be forced to relocate to less economically developed countries with greater political risks.[63] In fact, some have suggested that the only way to

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[56] *Uncovering New Markets and New Products Amid Brexit Uncertainty*, THE ONE BRIEF, https://theonebrief.com/uncovering-new-markets-and-new-products-amid-brexit-uncertainty/.

[57] *Id.*

[58] *Our Base in the Heart of Europe*, LLOYD'S BRUSSELS, https://lloydsbrussels.com/about/; *see* Oliver Suess & Ross Larsen, *Lloyds of London Chooses Brussels for Post-Brexit EU Hub*, BLOOMBERG (Mar. 30, 2017, 2:23 AM), https://www.bloomberg.com/news/articles/2017-03-30/lloyd-s-of-london-picks-brussels-for-post-brexit-eu-headquarters.

[59] *Brexit: Business Uncertainty Does Not End if the U.K. Leaves the EU*, THE ONE BRIEF, https://theonebrief.com/brexit-global-business-uncertainty/.

[60] *U.S. and China: Navigating Trade Uncertainty*, THE ONE BRIEF, https://theonebrief.com/u-s-and-china-navigating-trade-uncertainty-2/.

[61] *Id.*

[62] *Id.*

[63] ASIAN DEV. BANK, ASIAN DEVELOPMENT OUTLOOK 2019 UPDATE 12–15, 21–24 (2019) (explaining how global trade conflicts and supply chain disruptions

realistically improve the trade balance between the United States and China may be to shift a portion of the U.S.–China trade deficit to third-party countries.[64] If this is correct, and the U.S. remains committed to its current goals, such a shift may be inevitable.

There is also a risk that new import taxes or even heated political rhetoric will encourage host governments to take retaliatory action against foreign investors.[65] American companies operating in countries targeted by import taxes may face additional scrutiny or regulatory burdens.[66] Such action may not be as significant as a trade embargo or outright nationalization, but a series of regulatory actions can compound to have a crippling effect on industry by making projects or contracts impossible to complete. This form of so-called "creeping expropriation" places the actions squarely within the realm of traditional PRI.[67]

B. THE PRI MARKET'S RESPONSE TO INCREASED DEMAND

Multiple insurers, brokers, and risk management firms expect demand for PRI to rise even further.[68] Uncertainty in the U.K. and Europe will persist for many years after Brexit.[69] The change in administration in the United States will not reverse the impact trade conflicts have already had on

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have caused companies to shift production to less economically developed countries).

[64] AON RISK MAP 2019, *supra* note 41, at 11.

[65] *See, e.g.*, Dave Graham, *Mexican Senator to Propose Anti-Trump Expropriation Law*, REUTERS (Sept. 2, 2016, 5:45 PM), https://www.reuters.com/article/us-usa-election-mexico-idUSKCN1182PL (discussing possible retaliatory action if the U.S. causes Mexico economic harm in order to fund construction of a border wall).

[66] *Tariffs and Trade Wars: Dealing With Uncertainty, Planning For The Future*, THE ONE BRIEF, https://theonebrief.com/tariffs-and-trade-wars-dealing-with-uncertainty-planning-for-the-future/; *see also* Mercedes Ott, *Stop Tariffs From Decimating Your Supply Chain with these 3 Insurance Products*, RISK & INS. (July 11, 2018), https://riskandinsurance.com/stop-tariffs-from-decimating-your-supply-chain-with-these-3-insurance-products/.

[67] *Types of Coverage*, DFC, https://www.dfc.gov/what-we-offer-our-products/political-risk-insurance (last visited Oct. 24, 2020); *Expropriation*, MIGA, https://www.miga.org/product/expropriation (last visited Oct. 24, 2020) (specifying that "creeping expropriation" is covered).

[68] *See supra* text accompanying note 41.

[69] *See* THE ONE BRIEF, *supra* note 59.

supply chains across the globe.[70] The events of the past few years have shaped the world's appetite for PRI for years to come and private providers have grown to meet it.

The PRI market is expanding both in size and in its variety of coverage options. Many insurers see opportunity and thus are expanding their PRI options or are entering the field for the first time.[71] There are around sixty carriers around the world today, compared to only thirty a decade ago.[72] Political risk claims now account for nearly one-third of all credit and investment claims among Berne Union insurers, a group of eighty-five public and private insurance agencies.[73] Claims among this group doubled between 2017 and 2018.[74] In 2018, nearly half of new commitments covered risks in North America, Western Europe, and East Asia while total indemnifications were seventy five percent higher than the annual average over the last ten years.[75] However, while some see opportunity, others view the risks as too uncertain.[76] Unlike other forms of insurance which can

[70] *See* Lambert, *supra* note 50, at 58–61 (explaining the deep-rooted issues affecting trade tensions around the world).

[71] Waters, *supra* note 1, at 368; Matthew Lerner, *Demand for Political Risk Cover Increasing*, BUS. INS. (May 1, 2019), https://www.businessinsurance.com/article/20190501/NEWS06/912328040/ (reporting that Willis Towers Watson and Aon PLC are both growing their PRI practices while others, such as Hartford Financial Services Group, have recently joined the PRI market).

[72] Natasha Keats, *When Stakes are High: Political Risk and Trade Credit (Re)Insurance*, AXCO INS. INFO. SERVS. (Dec. 9, 2018), https://www.axcoinfo.com/press/political-risk-and-trade-credit-(re)insurance.aspx.

[73] BERNE UNION, INDUSTRY REPORT 2019 H1 (2019), https://www.berneunion.org/DataReports; *see also Political Risk: A Market for All Seasons*, REACTIONS (June 11, 2019), https://reactionsnet.com/ articles/3592449/political-risk-a-market-for-all-seasons (providing industry commentary on the 2019 Berne Union data report).

[74] Paul Heaney, *Rainclouds on the Horizon: Temporary Break in Sunshine, or Impending Storm?*, *in* BERNE UNION SPRING PERIODICAL 11, 13 (2019), https://www.berneunion.org/Newsletter.

[75] *Id.*

[76] CEO Evan Greenberg of Chub Ltd., one of the largest insurance companies in the world, has warned that there is too much uncertainty for PRI providers to be taking on more risk. *See* Jonathan Levin, *Lloyd's Sees Political Risk Insurance Opportunity in Trump, Brexit*, INS. J. (Feb. 15, 2017), https://www.insurancejournal.com/news/national/2017/02/15/441797.htm ("I wish them a lot of luck because that's all they got going for them.").

benefit from data collected over many decades, PRI involves bespoke coverage of more complicated risks that are difficult to quantify.[77]

Despite the challenges involved, coverage is still obtainable and prices remain relatively low due to overcapitalization.[78] This sets the current wave of political risks apart from previous risk events where coverage soon became nonexistent. For example, insurers stopped offering coverage in Ukraine following political unrest and Russian aggression in 2014.[79] The binary nature of the market for PRI means that coverage is usually either cheap and abundant or unavailable.[80] Today, total capacity per risk has more than doubled from a decade ago as PRI markets see an increase in capital.[81] However, this will not last forever and analysts urge investors affected by U.S. trade policy and Brexit to seek coverage while markets remain competitive.[82] Capacity is already diminishing in some markets, including China and Mexico, where political risks have risen since the United States has taken a more populist stance on North American trade.[83] It is uncertain what will happen to the PRI industry in the event of a catastrophic geopolitical event. PRI is a volatile business and is not profitable without loss recoveries. Many newer entrants to the market may not have the

[77] Gordon, *supra* note 19, at 93.

[78] For example, a commodities trader could purchase $100 million in coverage across 50 countries for about $750,000. *See* Neghaiwi & Cohn, *supra* note 43.

[79] *Political Risk Insurance: Implications of Political Instability in Ukraine and Russia*, MARSH, https://www.marsh.com/uk/insights/research/political-risk-insurance-implications-of-political-instability-ukraine-russia.html.

[80] Stephen Kay, managing director for political risk at Marsh USA, has explained that volatility is a problem in PRI. The combined ratio for PRI can be as low as forty percent then spike to 130 percent when there is a series of loss events. *See* John Dizard, *No Insurance Policy Covers the Perils of a Trump Presidency*, FIN. TIMES (Mar. 4, 2016), https://www.ft.com/content/f436b44c-e200-11e5-8d9b-e88a2a889797 (interviewing various insurance insiders, including Mr. Kay, regarding the rising demand for PRI).

[81] WILLIS TOWERS WATSON, *supra* note 4 ("The total capacity per risk has surpassed $3B, more than doubling the capacity of $1.3B available a decade ago, which has kept the marketplace competitive."); CREDIT AND POLITICAL RISK INSURANCE: REPORT AND MARKET UPDATE, ARTHUR J. GALLAGHER 18 (July 2018).

[82] MARSH RISK MAP 2019, *supra* note 41, at 7.

[83] WILLIS TOWERS WATSON, *supra* note 4 ("[W]e are starting to see capacity shrinking in high-demand countries, such as China and Mexico, where rates may rise due to increased political risk.").

resources to pursue these recoveries and makes their long-term outlook less optimistic.[84]

IV. PUBLIC PRI OPTIONS SHOULD BE EXPANDED TO INCLUDE COVERAGE FOR INVESTMENTS IN DEVELOPED DEMOCRACIES

Political risk around the world has changed and the efforts to manage that risk must change with it. It is no longer limited to large, multinational corporations investing in developing economies.[85] Today, political risk also affects small- to medium-sized businesses and investors with interests in more familiar places, such as the E.U. or U.K.[86] Though the largest corporations may have enough political influence to shape policy, this is not true of small- to medium-sized firms or investors, and even large corporations may still be unfairly targeted by political leaders.[87]

There is very little a targeted firm can do to manage political risks without the protection of their home-government.[88] Unfortunately, public PRI providers do not offer the proper kind of coverage for recent risks and restrict coverage to new investments in developing countries.[89] Government-backed PRI is typically unavailable for firms wishing to protect existing assets in North America or Europe that may be adversely affected by trade

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[84] Dizard, *supra* note 80; *see also* Kessler, *supra* note 21, at 214 (noting that in 1992 only a handful of private insurers offered PRI due to the "the enormous expertise required to underwrite political risk policies").

[85] GOULD-DAVIES, *supra* note 1, at 18 ("Political risk is no longer only a concern of big western companies. It no longer arises only in developing countries. It is no longer caused only by states. It is no longer synonymous with 'sovereign risk' or 'emerging market risk.' And it can no longer be dealt with in the old ways.").

[86] *Id.* at 19 ("[C]ompanies have found, to their costly surprise, that political risks are among the biggest they face—not only in 'different and difficult' countries like China, but familiar democratic western ones.").

[87] Ellis, *supra* note 8 ("[T]rade policy is often a reflection of the most powerful business interests, the effect of which has been to relocate jobs to areas where lower wages and no benefits are the norm."); JENSEN ET AL., *supra* note 46 (mentioning that large foreign corporations may become political targets).

[88] Ellis, *supra* note 8 ("The only real insurance policy a firm has against this type of political risk is the power of the U.S. government and the world institutions backed by that power.").

[89] Waters, *supra* note 1, at 368–70 (describing public PRI providers' eligibility and compliance issues).

conflicts, Brexit, or other hostilities towards foreign investment.[90] The high transaction costs of private PRI may prevent smaller investors from obtaining any coverage at all, placing them at severe risk of loss in the event of further escalation.[91] For those that can afford it, private options still lack the special benefit of deterrence inherent in public coverage. To better serve the needs of investors and government policy interests, public providers of PRI should be allowed to expand their coverage options to insure the political risks emerging in the developed world. This should include expanding eligibility for new and existing investments in developed countries in order to combine the flexibility of private PRI with the inherent advantages of government-backed coverage. Doing so will protect the interests of many small-to-medium-sized firms while also advancing government foreign policy goals.

A. PUBLIC PRI IS UNIQUELY SUITED FOR THE NEW POLITICAL RISKS

Government-backed PRI has a clear advantage over coverage offered by private insurers because public providers possess unique abilities to assess risks and prevent or recover losses.[92] Despite the improvements made by private insurers and the regulatory drawbacks of public options, there are clear advantages to purchasing coverage through a public insurer. These advantages cannot be replicated by the private sector because they stem from a public provider's position as a government entity. A government-backed insurer such as DFC is in the best position to be aware of current trade negotiations as well as other possible retaliatory actions by host-governments. In contrast to private PRI options, public providers have the tools and resources to assess, prevent, and mitigate losses resulting from adverse government actions.[93] They can use their existing diplomatic

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[90] *Id.* at 369–70; Williams, *supra* note 11, at 76.

[91] Waters, *supra* note 1, at 376.

[92] Gordon, *supra* note 19, at 105 ("[I]n this sector, governments have unique competitive strengths . . . primarily from governments' ability to use their diplomatic networks as risk management and asset recovery tools—in this way, governments create economies of scope by using their existing assets to provide services that private sector insurers cannot produce.").

[93] P. Georgia Bullitt & Laura I. Lagomarsino, *Protecting Intellectual Property Rights Abroad: New Uses for Political Risk Insurance and Standby Letters of Credit*, 5 INT'L TAX & BUS. LAW. 283 (1987) (noting that given public agencies' information advantage collection abilities, "it is difficult to conceive of how the private market could adequately compete with it").

networks to obtain information about pending government actions in host-countries. Public insurers can then intervene to prevent the action or recoup the value of the loss later.[94] By utilizing their information-sharing networks to quickly gather and disseminate intelligence, public PRI providers use their political clout to discourage adverse governmental action.[95] They would also be able to alert investors as events are unfolding to allow them to mitigate any potential losses.

Allowing public options such as DFC to insure risks arising from political conflicts in developed nations would in effect shift government-created risks away from the private sector. Placing that risk in a government agency would then encourage the sharing of information about the potential impact of proposed home-government actions. Just as DFC and MIGA closely monitor risks in developing nations and hold discussions with host-governments when necessary, the agencies could similarly share their risk assessments with their own governments regarding possible retaliatory action.[96]

PRI backed by the U.S. government or the World Bank has a built-in deterrent effect and these agencies often use their positions to prevent or mitigate losses.[97] A host government may be less likely to seize assets or enact adverse legislation knowing they will face repercussions if they cause a loss to assets insured by a government entity. Besides having a passive deterrent effect, public coverage may also have the benefit of active deterrence. Public options like DFC and MIGA can use their global information networks to learn of potential threats and then use their political weight to pressure a host government against retaliatory actions.[98] Thus, having the backing of the U.S. government or the World Bank is a significant advantage for not only insuring assets, but also for proactively protecting them. Some public insurers may intervene to dissuade a host government

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[94] Gordon, *supra* note 19, at 94 (discussing agency interventions, known as "advocacy").

[95] *E.g.*, *id.* at 102 (describing an instance where OPIC, DFC's predecessor, sent a letter to a provincial tax ministry to defer enforcement actions until the case was fully adjudicated).

[96] Waters, *supra* note 1, at 376 (discussing the information back channels available to public insurers and OPIC's close consultation with the U.S. State Department).

[97] Gordon, *supra* note 19, at 94 ("If the host government believes that the home government is more of a force to be reckoned with than the investor, then it is less likely to engage in the behaviour . . . .").

[98] Waters, *supra* note 1, at 376.

from taking action that adversely impacts assets that they insure.[99] For example, MIGA policies require prompt notification of any event that might lead to a loss in order to give MIGA the ability to use their political influence as part of the World Bank Group to prevent adverse government actions.[100] Public insurers may also use their position to mitigate losses even where they are unable to prevent the adverse action from occurring. For instance, a government-backed provider facing a currency inconvertibility claim can simply buy that currency and sell it to its local embassy to use for other government purposes.[101] This procedure—which is not available to any private insurer—allows the agency to sidestep a central bank's currency restriction and significantly reduce losses.[102]

Another advantage is that government-backed PRI providers function more as tools of foreign policy than as for-profit enterprises.[103] Volatility is high in PRI and one adverse event or series of correlated events may extinguish years of profits.[104] Therefore, private providers set premiums far in excess of expected losses because they have no method of reliably assessing risk or calculating probability.[105] In contrast, public insurers only operate on a break-even basis and may rely on their network of embassies and intelligence agencies to collect information to help them assess risk and set premiums. Though private insurers have narrowed the information gap by turning to private consultants, they are not privy to confidential information that can only be accessed by government actors.[106] These consultants will always lack access to communications between state actors, such as a host government's interactions with the U.S. State Department.[107]

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[99] *Id.* at 377.

[100] *See* MULTILATERAL INV. GUAR. AGENCY, CONTRACT OF GUARANTEE FOR EQUITY INVESTMENTS, art. 12.1(i) (2018), https://www.miga.org/sites/default/files/2020-06/MIGA%20Equity%20Investments%20Template%20October%20 2018.pdf.

[101] Gordon, *supra* note 19, at 105; Robert B. Shanks, *Insuring Investment and Loans Against Currency Inconvertibility, Expropriation, and Political Violence*, 9 HASTINGS INT'L & COMPAR. L. REV. 417, 426–27 (1986).

[102] Shanks, *supra* note 101, at 427.

[103] Waters, *supra* note 1, at 375; Kessler, *supra* note 21, at 224.

[104] HAMDANI ET AL., *supra* note 12, at 4–5.

[105] *Id.* at 4 ("Given this potential for catastrophic loss, as well as the difficulties in assessing the underlying risk . . . [i]t is not surprising that PRI, like other insurance lines with catastrophe potential (e.g., earthquake), exhibits prices well in excess of expected losses.").

[106] DeLeonardo, *supra* note 31, at 756.

[107] Waters, *supra* note 1, at 375–76.

DFC regularly consults with the State Department and can obtain confidential information from the Central Intelligence Agency.[108] This intelligence gathering network allows them to set higher premiums for riskier investments and reduce premiums for those of a lower risk grade.[109] While calculating probability is a challenge for public providers due to the nature of the risks involved,[110] they still benefit from superior intelligence-gathering, deterrence, and lack of profit-motive.

Public providers' ability to remove profit from the equation results in a significant price-advantage that appeals to smaller businesses and investors. Because PRI policies are often tailor-made for each investment, they carry significant transaction costs that often make private options cost prohibitive for smaller investments.[111] This is particularly true when examining the kinds of threats facing firms and investors in developed democracies. These businesses may be less likely to suffer losses from political violence than they are from adverse actions taken by politically-motivated populist leaders. This is precisely the kind of political risk event that is impossible to predict and which private insurers are powerless to prevent.[112] Most off-the-shelf political risk indicators attempt to measure risk on a country-level basis and users relying on such data will still have to conduct extensive analysis because political risks are often industry- or firm-specific.[113] In many situations, there will be few to zero similar events in the past from which to calculate probabilities and past events may be difficult to define, such as differentiating between legitimate regulatory action and creeping expropriation.[114]

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[108] Kessler, *supra* note 21, at 207.

[109] Waters, *supra* note 1, at 375.

[110] *E.g.*, Derek Baas, *Approaches and Challenges to Political Risk Assessment: The View from Export Development Canada*, 12 RISK MGMT. 135, 158 (2010) (explaining the challenges that Canada's primary public provider of PRI has experienced when trying to calculate the probability of political risk events).

[111] Waters, *supra* note 1, at 376.

[112] Jason Webb Yackee, *Political Risk and International Investment Law*, 24 DUKE J. COMPAR. & INT'L L. 477, 487 (2014).

[113] *Id.* at 484 (explaining that project-specific analysis is important because even in countries rated as low-risk, the risk of a specific permit being denied may be quite high).

[114] *Id.* at 485–88.

B. FLEXIBLE PUBLIC PRI OPTIONS ADVANCE POLICY GOALS

The restrictions placed on public PRI providers leaves private insurers with a gap to fill in the market. The success of the private PRI market can be attributed to private insurers' policy flexibility and general lack of categorical prohibitions. Investors that are unable to comply with the eligibility requirements of public insurers like DFC or MIGA may instead choose a private policy.[115] Public options, such as DFC or MIGA, have coverage restrictions and insureds must comply with various social and environmental standards.[116] Public providers restrict coverage to a limited set of risks in developing nations and typically set upper limits on the amount covered under the policy.[117] MIGA has restrictive requirements, requiring not only that insureds be citizens of member states, but that the investment be new and be carried out in a member state covered under a Bilateral Investment Treaty or be protected under a local law or local agreement with MIGA.[118] Additionally, public providers must follow any applicable statutory mandates, such as DFC's mandate from Congress to promote the development of new projects in emerging markets.[119]

Loosening eligibility restrictions would end the requirement to refuse coverage to an expanding U.S.-based firm moving a production plant from the U.K. to Italy, now under the control of populists, but provide insurance if they moved it to a risk-prone developing state in South Asia. This forces firms to choose between investing in a lower risk but politically volatile country with inadequate private coverage, or a higher risk unstable emerging market with the full backing of their home government. It may be desirable to refuse support for business actions that harm domestic workers, such as off-shoring jobs, but allowing agencies to extend PRI coverage to firms with existing interests in developed countries would not necessarily violate such mandates. There may be good policy reasons for promoting

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[115] Waters, *supra* note 1, at 377.

[116] *Id.* at 377; Williams, *supra* note 11, at 75–76; *Who We Are*, DFC, https://www.dfc.gov/who-we-are (last visited Mar. 11, 2021); *What We Do*, MIGA, https://www.miga .org/products (last visited Mar. 11, 2021).

[117] *See, e.g.*, *Eligibility Checklist*, DFC, https://www.dfc.gov/what-we-offer-eligibility/eligibility-checklist (offering coverage up to $500 million for projects in lower- and middle-income countries subject to environment and worker rights policies); *Our Process*, MIGA, https://www.miga.org/our-process (Mar. 11, 2021) (limiting coverage to investments in developing member countries for up to $250 million).

[118] Williams, *supra* note 11, at 83–85.

[119] *Id.* at 76; Waters, *supra* note 1, at 369.

development in emerging markets but there are also compelling reasons to protect existing investments in developed economies.

Countries such as China have actively promoted development in continental Europe and government-backed Chinese companies have invested billions of dollars throughout the region.[120] The United States has taken some action in response, such as passing the Better Utilization of Investment Leading to Development Act[121] (BUILD Act) in 2018, but the act was limited to low- and middle-income countries.[122] The United States may understandably have no need or desire to actively promote American investment in the E.U. but it does have a legitimate interest in protecting assets of citizen-investors in the region. At the very least, the BUILD Act should have loosened restrictions to allow purchases of PRI in more regions. This makes sense given that the BUILD Act was passed, at least in part, in response to China's investments in Europe. The Act states that DFC is meant to serve as an alternative to authoritarian government-backed investments.[123] By excluding entire regions such as Europe, where China's influence is growing, this limitation undercuts one of the purposes of the Act. Therefore, allowing public insurers to offer more flexible coverage for the emerging political risks in developed countries not only satisfies the needs of small- to medium-sized businesses but also advances home-government policy goals.

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[120] FRANÇOIS GODEMENT & ABIGAËL VASSELIER, CHINA AT THE GATES: A NEW POWER AUDIT OF EU–CHINA RELATIONS, 37–39 (2017); *see also* Janosch Delcker, *Germany's Chinese Investment Problem*, POLITICO EUR. (Nov. 25, 2016), https://www.politico.eu/article/germanys-chinese-investment-problem-sigmar-gabriel-eu/ (reporting the conflict arising from China's plan to invest heavily in Europe).

[121] The BUILD Act was enacted as Division F of the FAA Reauthorization Act of 2018, Pub. L. No. 115-254 § 1401 et. seq., 132 Stat. 3485.

[122] Under the BUILD Act, §§ 1402 and 1411, DFC's activity is limited to low- and middle-income markets. This is in contrast to its predecessor OPIC's governing statute, 22 U.S.C. § 2191, which only required that developing countries be given preferential treatment. *See* SHAYERAH ILLIAS AKHTAR & MARIAN L. LAWSON, CONG. RSCH. SERV., R45461, BUILD ACT: FREQUENTLY ASKED QUESTIONS ABOUT THE NEW U.S. INTERNATIONAL DEVELOPMENT FINANCE CORPORATION 1, 14 n.27 (2019).

[123] The BUILD Act, Pub. L. 115-254, 132 Stat. 3486, does not mention China by name but alludes to it in § 1411 by stating that one of the Act's goals is to "to provide countries a robust alternative to state-directed investments by authoritarian governments . . . . "

V. CONCLUSION

The market for political risk insurance is evolving. Public options are often preferable but are less flexible than private policies. New political risks emerging in the developed world, primarily as a result of rising populism, democratic instability, and trade conflicts, are currently not insurable by public PRI providers. In the absence of eligibility changes, investors must rely on private coverage to fill the gap in the PRI market. Allowing government-backed options to expand coverage and loosen eligibility requirements would combine some of the flexibility seen in the private market with the widely recognized benefits inherent in public PRI coverage.