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Investment insurance for Ukraine: enlarging the options

Investment insurance is a long established and strong instrument for promoting and protecting investments, but it is limited to the cover of purely political risk. However, Ukraine's economy as it has been resisting Russia's full-scale war, requires new thinking to deal with investment attraction. Both during the war as well as during reconstruction, Ukraine will require private investment to find the way to sustainable economic growth, productivity gains and a green reconstruction. Thereby, two aspects are important both for Ukraine and its partner countries. Firstly, an ambitious rule of law reform agenda which can go hand in hand with EU accession strengthens investment attraction. Secondly, security risk will not be fully solved even when the war ends. Thus, investments will be a function of reforms and available insurance schemes. Existing guarantee options are not able to support private investment in Ukraine in the future. As a result, considerations to enlarge options and the development of new approaches are decisive.

Available options of investment insurance schemes

The pure commercial risk is a typical entrepreneurial one which cannot be taken over by an insurer. However, there are different public institutions such as export credit agencies, export-import-banks, and multilateral agencies that offer insurance for political risks. Also, specialised private political risk insurers have entered this market. The coverage usually includes expropriation, payment embargo or moratorium risk, currency conversion and transfer risk, breach of contract as well as war and civil unrest. But the latter one exclusively covers total or quasi-total war-related loss. Thus, there is an immense gap in insurability of war-related business interruptions and physical assets destructions.

Domestic options

Various countries considered proposals to cover investments against domestic political risks. Such an insurance concept could be characterised as an insurance against "one-self". The only existing operational example is Iran. The major problem with any type of host country insurance is the missing trust of investors in schemes controlled by the host country. Ukraine's Export Credit Agency is only entitled to cover investments beyond Ukrainian borders, not investments inside Ukraine, and is furthermore limited in its activities due to low capital and Ukraine's worsened sovereign rating. In Ukraine, under the current fiscal and budgetary situation in war times any kind of domestic financial protection of foreign investments is impossible. The only possible source of investment insurance during the war and, more realistically, in the period of reconstruction is foreign support in the form of investment insurance. It is, however, questionable whether the existing products meet the challenges Ukraine is facing.

Bilateral and multilateral options

Most investment insurance providers require bilateral investment protection treaties (BIT) or an equivalent level of protection by the host country's national legal system. Ukraine has a broad network of ca. 65 BITs in force and several others signed, but not yet ratified. These treaties represent all relevant investor countries for Ukraine. The "events of loss" in investment insurance usually include expropriation, war and civil unrest, payment embargo or moratorium risk, currency conversion and transfer risk, as well as breach of contract but usually exclude partial production losses. The duration is generally up to 15 years and in addition to handling fees, an annual premium has to be paid which is generally expressed as annual percentage of the invested and covered amount (e.g. annual percentage of invested and covered amount is 0.5% p.a.). A BIT also exists between Germany and Ukraine but not (yet) between the EU and Ukraine. Until the EU makes use of its competence to negotiate and conclude a BIT, the existing BITs of member states are grandfathered and remain in force.
Multilateral providers such as the Multilateral Investment Guarantee Agency (MIGA), as part of the World Bank Group, or the African Trade Insurance (ATI), which is focused on its African member states, benefited from increasing demand in recent years. They offer similar products which can however be selected individually or as one package making the offer more flexible and more targeted to investors than bilateral schemes in European countries.

Private political risk insurance (PRI)

In the last 10 to 20 years, private providers of investment insurance, mostly from Anglo-Saxon countries, strengthened their role. They usually cover the same risks as the official providers of investment guarantees. Their underwriting approach is however more flexible and more selective. The growing role of private providers of PRI goes hand in hand with a growing role of brokers in this area and a growing risk appetite by global reinsurers.

Risks of war and private corporate insurance

Ukraine's requests for insurance cover of war risks are currently not met by appropriate offers of the private market corporate insurers. The insurers of property, business interruption, transport risks etc. regard risks of damages caused by war as incalculable risks, uncontrollable and thus potentially too great to be insured.

War risks usually excluded from cover

Risk sector	Examples
Property insurance	» Buildings » Plants » Technical equipment
Transport insurance	» Transport vehicles » Transported goods
Business interruption	due to: » Lack of power » Lack of communication channels » Supply chain disruptions » Workforce shortages

Source: own illustration

Based on agreements in the London insurance market in the 1930ies, until today damages directly or indirectly caused by acts of war are excluded from cover in all relevant products of the private corporate risk insurance industry. A partial exception exists only in maritime and aviation insurance.

Options to cover risks in Ukraine

The private sector plays an important role in Ukraine's economy. This sector accounted for 79% of gross value added, 76% of employment and 65% of investment in 2020. Similarly, private investment will play the key role for Ukraine's economic recovery and reconstruction. Investment attraction will however require insurance solutions. Ukraine presented in its Lugano National Recovery Plan that war insurance needs would amount to about USD 500 m in 2022 and ca. USD 3 bn between 2022 and 2032. Also, the EU in its Strategic Reconstruction Plan 'RebuildUkraine' highlighted the importance of investment insurance schemes as a compliment to public financial aid.
For the current war situation in Ukraine the risk of physical damages of companies' assets and industrial infrastructure is dominating. If war-related damages potentially covered by an official investment guarantee or private PRI insurance occur, the insurance providers as of now have to decide in case-by-case decisions whether these damages are really covered under the investment guarantees. A general solution cannot be easily found when the war ends, and the reconstruction process begins.

Outlook

Neither public investment insurance schemes nor private property nor business interruption insurance policies protect investments satisfactorily against partial business interruption or physical damages resulting from acts of war. The acceleration of decision making and risk pooling between countries can be considered as enlargement options by public institutions while the coverage of war-induced partial losses by private insurers can also contribute to support the enlargement.
As for the challenges of Ukraine's reconstruction, also the development of new instruments needs to be discussed. There might be options for coordinated actions or partnership between private insurance companies and providers of official investment guarantees. Practical experience rarely exists yet. Such options can for example include insurance premium reduction and inclusion of war risks by private providers with public support. A further option can focus on more targeted and well-coordinated public schemes with risk pooling (e.g. within the EU) including private reinsurance. Nevertheless, many questions remain open. All in all, the development of public-private partnership in the sphere of investment insurance can become an important economic support for Ukraine during the war, during the recovery and reconstruction process.

This newsletter is based on the Policy Paper "Investment insurance for Ukraine: Enlarging the options".

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**Advisory activities in Belarus are currently suspended.*

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