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POLICY BRIEFING UKRAINE

Investment insurance for Ukraine: Enlarging the options. Summary of results

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1. Introduction

Motivation

- » Investment insurance is a long established instrument for promoting and protecting investments, but it is **limited to the cover of purely political risk**.
- » During the war and in a post-war reconstruction, Ukraine will require **private investment** to find the way to **sustainable economic growth** and green transition.
- » Thereby, two aspects are important both for Ukraine and its partner countries:
  1. **Ambitious rule of law reform agenda** which should go hand in hand with EU accession.
  2. **External security risks,** will not be fully solved even when the war ends.
- » Investments will be a **function** of **both reforms** and **available insurance schemes** addressing the new risk environment.
- » The broad range of economic and infrastructure destructions by Russia since the 24 February 2022 demonstrate the urgent need **for enlarging existing insurance schemes and the development of new ones.**

Purpose of this Policy Briefing

- » This Policy Briefing summarizes the results of Policy Paper 06/2022.
- » It discusses investment insurance enlargement options and proposals for new approaches.

2. Available options

- » The pure **commercial risk** is a typical entrepreneurial risk which cannot be taken over by an insurer.
- » However, different **public institutions** also offer coverage of **political risk** insurance for investments, such as:
  - Export credit agencies
  - Export-import-banks
  - Other national handling agents
  - Multilateral agencies.
- » Also, **private insurers** have entered this market during the last couple of years.

2.1. Domestic options

- Various countries considered proposals to cover investments against domestic political risks but the only existing and operational one is in Iran.
- Such an insurance concept could be characterised as an **insurance against "one-self"**.
- The major problem with any type such 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.**
  - It **does not have** the **mandate to cover investments inside Ukraine**
  - It is **limited** in its activities due to **low capital** and Ukraine's **worsened sovereign rating**

➢ **In Ukraine, under the current fiscal and budgetary restrictions in war times any kind of domestic financial protection of foreign investments is impossible.**

2.2. Global and multilateral options: Public institutions

» 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.

» Multilateral providers such as the **Multilateral Investment Guarantee Agency (MIGA)**, as part of the World Bank Group, or the African Trade Insurance (ATI), benefited from increasing demand in recent years.

Products offered by MIGA

• Breach of contract, • Currency inconvertibility and transfer restriction, • Expropriation, • War and civil disturbance • Non-honoring of financial obligations ➢ **Similar to European countries.**	• Products can be selected individually or • As one package ➢ **More flexible, more targeted to investors than European countries.**	• Asset damage or destruction is part of the war and civil disturbance-coverage • As well as sabotage.	• Business interruption can be included in the coverage.	• Special focus on SMEs including close cooperation with local, international banks.

Source: own illustration

» ATI follows the same strategy but focuses solely on African countries.

2.2. Global and multilateral options: Private institutions

» Specialised private insurers particularly from the anglo-saxon legal area have enlarged their offers of political risk insurance over recent years.

Characteristics of private insurance

They **usually cover the same risks as official providers** of investment guarantees.	Their underwriting approach is **more flexible** and **more selective**.	Growing role goes hand in hand with a **growing role of brokers** in this area and a growing risk appetite by **global reinsurers**.	Their coverage models are **individually adjusted** to the individual case for the same risks that are also **covered by state investment guarantees**.

Source: own illustration

» Private 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.**

» A partial exception exists only in **maritime and aviation** insurance.

» 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 insurance industry.

➢ **Multilateral and private institutions offer more flexible and selective investment insurance schemes than European countries bilaterally**

➢ **Nevertheless, risks of damages caused by war are neither covered**

2.3. Bilateral options

- Most investment insurance providers require bilateral investment protection treaties (BIT) or an equivalent protection by the 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" usually:
  - Include: expropriation, war and civil disturbance, payment embargo or moratorium risk, currency conversion and transfer risk, as well as breach of contract, but usually
  - Exclude: production interruption or partial 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.

➢ **Ukraine has 65 BITs in place for the coverage of political risk insurance**

➢ **However, production interruption or partial losses are usually not covered**

2.3. Bilateral options: Public investment insurance in Germany (1/2)

- Such a BIT does not exist between EU-Ukraine **but between Germany-Ukraine**.
- Until the EU makes use of its competence to negotiate and conclude a BIT, the existing BIT is grandfathered and remains in force.
- The German public investment insurance system has been mandated by the German Federal Government to PwC Germany as the handling agent.
- PwC administers the whole instrument from taking in applications through risk assessment up to proposals for decisions and claims management if necessary.
- The final decision regarding coverage are taken in an Inter-Ministerial Committee (IMC) consisting of four ministries:
  1. Ministry of Economic Affairs and Climate Action,
  2. Ministry of Finance,
  3. Foreign Office,
  4. Ministry of Economic Cooperation.
  - The decision-making is also supported by experts from large corporates and industry associations as well as representatives of PwC, but without own voting rights.

2.3. Bilateral options: Public investment insurance in Germany (2/2)

Characteristics of the public investment insurance in Germany

Duration	• The guarantee is up to 15 years.
Coverage, up to 100%	• Equity participations, • Investment-like loans, • Participations through holding companies, • Endowment capital, rights qualifying as assets, • Other earnings might be included: dividends, interest on capital investment or investment type subordinated loans.
Fees	• Applications with max EUR 5 m (cover for capital and for earnings) are free. • For exceeding amount, a handling fee of 0.05% is charged, with a max of EUR 10,000.
Premium	• Premium p.a.: 0.5% of max. guarantee amount for the capital cover (invested capital).

Source: own illustration

» If earnings (dividends, interest) are included, a p.a. premium based on earnings covered at the beginning of the guarantee year and corresponding to the same percentage as for the cover for capital is charged.

» For several years since 2017, no cover for GER investments in Ukraine has been granted.

» Due to earlier temporary transfer restrictions in Ukraine, earnings like dividends and interest payments, were not covered, substantial cause of loss “conversion and transfer risk” was excluded.

» This made official German investment guarantees for Ukraine unattractive for investors.

» Exposure of EUR 400 m in Ukraine: **Top-10** country for investment guarantees for GER, but GER FDI position in Ukraine was **USD 3 bn in 2021**

➢ **There is an established BIT between GER and UKR but future enlargement is possible**

3. Special investment insurance features for Ukraine during/after the war (1/2)

- UkraineInvest survey of foreign investors in Ukraine:
  - strong interest in investment insurance even under war,
  - 95% of the respondents wish to cover their assets in a physical way.
- War insurance is a very rare product, mainly common in marine and aviation insurance.
- Promoting investment would **reduce the need of public investment financed from official financial aid disbursements by partner countries** and thus would **limit crowding out effect of public spending**.
- For the current war situation in Ukraine **expropriation**, **payment embargo** or **moratorium**, **currency conversion** and **capital transfer risk** occur for investors.
- So do other sectoral risks which are hardly covered by current insurance schemes in war times

War risks usually excluded from cover

Risk	Examples
Property insurance	• Buildings, • Plants, • Technical equipment
Transport insurance	• Transport vehicles • Transported goods
Business interruption	Operational interruptions due to: • Lack of power, • Lack of communication channels

Source: own illustration

3.Special investment insurance features for Ukraine during/after the war (2/2)

Only the "**total loss**" or "**quasi-total loss**" is treated as an insured "cause of loss"

Similar wording in bilateral schemes

Similar wording in the "Operational Policies" of MIGA

» Reasons:
  - Systematic and substantial difference between investment guarantees and property **insurance.**
  - **Investment guarantees protect the investment as such, to a much** lesser extent individual assets.

» Private insurers covering these sectors exclude coverage of war-caused damage because they regard it as incalculable.

» However, damages of these three sectors are estimated **at 79%** of total infrastructure damages recorded in Ukraine which are estimated at **USD 121 bn**.

➢ **There is an immense gap in insurability of physical assets against damage or destruction by war.**

3.1. Public investment insurance

» The goal to increase investment attraction in Ukraine could be achieved with a few **enlargement measures by public bilateral and multilateral schemes** that might be the following:

Enlargement	**Acceleration**	**Preferential conditions**	**Coordination**	**Risk pooling**	**Marketing measures**
Enlargement of the risk catalogue	Acceleration of the decision process	Preferential conditions for pre-determined regions	Coordination with EU partners and within the International Union of Credit and Investment Insurers (Berner Union)	Risk pooling between individual EU member states or on the EU level	• Strong political signals • E.g. Introduction of high coverage amounts

➢ **Enlargement options for public investment insurance are worth considering to meet Ukraine's challenges**

3.2. Private investment insurance

» The enlargement of asset and wealth insurance by private insurers can also contribute to meet the challenges Ukraine is facing, e.g.:

Waiver of the clause on exclusion of war risks	All-risks coverage	Premium reduction	Damage cap
	Special focus on SMEs	E.g. with public support	E.g. with XL coverage by the state (see Extremus AG)

➢ **Enlargement options for public and private investment insurance can be a first important step for attracting investment despite war damages**

3.3 Public-private partnership (1/2)

» Public nor private insurance policies protect satisfactorily against physical damages from acts of war.

» There might be, however, options for cooperation in the **form of a public-private partnership (PPP).**

» Practical experience exists only in the terrorism insurance schemes (Extremus AG)

Terrorism insurance: An example of public-private partnership

→ Private insurers regarded terrorism as too big and incalculable with their risk valuation models.
→ In GER an arrangement was achieved between the private insurance industry and the government following the events on 11 September 2001.
→ Insurers accepted to abolish the exclusion of terror risk clause from their **property risk/business interruption** insurance policies
→ They established a specialised insurance company for extreme risks, Extremus Versicherungs-AG.
→ Extremus covers no terrorist risks below EUR 25 m– this insurance cover must be provided by the private first insurer – and takes risks up to ca. EUR 2.5 bn in total.
→ In the case of even larger damages Extremus can draw a sovereign government guarantee of another ca. EUR 6.5 bn. Extremus' cover is only available for terrorist acts in Germany.

Source: own illustration

» But opportunities of further harmonised and coordinated approaches are worth exploring especially for Ukraine's reconstruction.

» These approaches might include:

- **Reinsurance** cover by large private reinsurers or other forms of risk pooling.
- **Additional (partial) sovereign guarantees** and/or official support for **insurance premium**.

3.3 Public-private partnership (2/2)

» However, number of very complex questions evokes, like the following:

- Which instrument is used at which time period: war time and/or post-war reconstruction?
- What is the target group for which instrument: domestic investors and/or foreign investors?
- What kind of PPP can be established?
- Which instruments can be brought to PPP and which need to be enlarged or newly established?
- What are stakeholders for PPP?
- What are coordination mechanisms needed to be aligned for PPP?
- What kind of institution is needed for monitoring?

➢ **In addition to enlargement options, the development of new international schemes can become a second important step for Ukraine's economy**

➢ **Reinsurance, other forms of risk poolings and sovereign guarantees can be included in such approaches**

4. Conclusion

- Investment insurance schemes are long-established instruments to protect investment against political risks
- However, war-caused risks are hardly covered by existing public and private schemes
- Therefore, enlargements of existing public and private options would be a first important step.
- For investments during the war in Ukraine, schemes beyond the current existing are worth being considered, e.g. **Public-private partnerships**
- One suggestion can include bundled offers by public guarantees **with private asset or wealth insurance including private partial reinsurance**.
- Thereby, a coordinated approach within the EU and possibly other countries would support long-term reconstruction of Ukraine.

About the German Economic Team

Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.
**Advisory activities in Belarus are currently suspended.*

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