

## Political Risks Briefing for Contract Frustration.

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This document is a general description of the use of political risk insurance for a company that exports or imports goods or performs work under contract in emerging or developing countries.

Companies that enter trade contracts for the supply (or importation) of goods or services with either government or private entities in foreign emerging countries are often exposed to a number of underlying political risks.

Most governments seek to promote free trade of goods or services. Despite WTO rules, many governments often threaten or act – either unilaterally or under sponsorship of the UN – to revise or introduce new legislation that prevents or restricts the international trade of goods and services. Poor economic management of a country's finances can lead to payment default by government entities, or their restriction of hard currency payments to overseas companies. Trade embargoes and sanctions are sometimes used by governments to seek to enforce foreign policy objectives or influence domestic public opinion, and political violence is regrettably becoming more prevalent as political instability in many parts of the world continues. This makes much overseas contract work exposed to unforeseeable political risks.

Although unpredictable, loss due to political action can be insured in many circumstances. An export (or import) commercial contract can be repudiated or frustrated either before or after delivery of the goods for a variety of political reasons that are beyond the exporter's (or importer's) control.

Insurable risks include:

### ***Before shipment / delivery:***

- ◆ unilateral termination of the contract by the buyer, where the buyer is a government entity;

- ◆ cancellation of previously valid import or export licenses;
- ◆ imposition of any law which prevents the import or export of goods; or
- ◆ frustration, and thus termination of the contract due to war or civil war which prevents performance of the contract.

### ***After shipment / delivery:***

- ◆ failure or refusal of the buyer to pay sums due, where the buyer is a government entity or bank;
- ◆ failure of a government buyer or bank to honor an arbitration award in favor of the exporter, as made in accordance with the dispute resolution terms of the contract; or
- ◆ failure of the appropriate government foreign exchange authority to transfer the currency specified in the contract to the exporter once a private buyer has deposited the equivalent local currency with the authority.

The available insurance can provide indemnity to the exporter for 90 – 95% of its loss ***before shipment*** relative to:

- ◆ direct costs incurred before the contract is terminated;
- ◆ contractual penalties paid to suppliers in order to terminate sub-contracts; and
- ◆ an allowance (typically up to 10%) for net loss of profit,

or its loss of:

- ◆ contractually due amounts (that include profit), which remain unpaid ***after shipment***.

Contract Frustration insurance should be considered particularly for exports to or imports from countries when:

- ◆ the buyer or seller is a government or payment is being made by a government bank; or
- ◆ the goods are manufactured to the buyer's specific requirements and would be difficult to resell if the contract was terminated; or
- ◆ the terms of payment are under the contract are not 100% secure – for example, by obtaining a letter of credit that is confirmed by its / a western bank.

Currently the insurance can be available for terms of up to 3 – 5 years, or if a buyer holds sovereign status up to 10 years. Premium rates are fixed for the term of the insurance and unless otherwise agreed, the policy is non-cancelable so that insurers cannot remove cover if the political circumstances in a country change. The insurance responds after a “waiting period” which allows “normal” collection efforts to occur.

Most commercial political risk policies are confidential, and therefore their existence cannot be disclosed to third parties and the foreign country government in particular. They are provided on a non-admitted basis in order that true ‘risk transfer’ from the (foreign) risk country can be achieved.

Political risk exposures and managed solutions vary depending on the industry sector and countries in which your company operates. In order to assess your company's potential financial loss associated with these and other government actions, please contact your local MMC Enterprise Risk or Marsh representative to consult our team of Political Risk specialists.

**About the Political Risk Practice:**

The Political Risk practice is part of MMC Enterprise Risk. Our specialists work with many of the world's leading companies to evaluate the risks associated with their global business, and to design and implement tailor-made political risk management solutions to address corporate concerns that local conditions may strategically impact future profitability or financial stability. For more information and contacts, see our web-site: [www.marsh.com](http://www.marsh.com) or contact Ken Horne: phone # 212 345 0923, or e-mail: [Kenneth.G.Horne@marsh.com](mailto:Kenneth.G.Horne@marsh.com)

**About MMC Enterprise Risk:**

MMC Enterprise Risk, an operating entity of Marsh & McLennan Companies (MMC), provides consulting services and customized financial solutions that enhance shareholder value by addressing financial, strategic, operational and hazard risks.

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