JOINT STANDING COMMITTEE ON TREATIES

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Treaties referred on 16 November 2010 and tabled on 9 and 10 February 2011

28 February 2011

SUBMISSION NO. 3

Question: 1

How does the Multilateral Investment Guarantee Agency (MIGA) conduct risk profiles and charge fees for insurance structured for investment risk?

Topic: Multilateral Investment Guarantee Agency (MIGA) operations and risk assesments

Answer:

The Multilateral Investment Guarantee Agency (MIGA) aims to promote foreign direct investment into developing countries by providing political risk insurance (guarantees) to investors and lenders in the private sector.

MIGA issues guarantees against losses resulting from non-commercial risks. Five types of risks are covered:

- currency inconvertibility and transfer restriction;
- expropriation;
- war, terrorism and civil disturbance;
- breach of contract; and
- non-honouring of sovereign financial obligations.

<u>Terms of Coverage</u>

Pricing

Premium rates are determined on a per-project basis but are based on a combination of both country and project risk. Premium rates are primarily determined with a view to reflecting MIGA's actual exposure to loss under the guarantee to be issued. That is, the probability times the magnitude of an underwriting loss.

Duration of Guarantee

MIGA provides coverage for a minimum of three years and a maximum of 15 years (possibly 20 years if justified by the nature of the project). MIGA cannot terminate the contract unless the guarantee holder defaults on its contractual obligations to MIGA, but the guarantee holder may reduce or cancel coverage on any contract anniversary date starting with the third anniversary.

Coverage

MIGA can issue up to $180 million of coverage on its own account for a single project, and can offer additional amounts through reinsurance arrangements.

<u>Risk Assessment</u>

In making an underwriting decision, MIGA assesses the investment project, the risks to be covered by the proposed guarantee, and the effect of the proposed guarantee on MIGA's guarantee capacity and risk portfolio.

MIGA's risk assessment for a proposed guarantee relates to both the investment project and the host country.

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Factors Relating to the Investment Project

Factors Relevant to All Risks

In its assessment of all risks, MIGA assesses factors such as:

- the economic sector of the investment project and the project's size relative to such sector in the host country;
- the size of the investment project relative to the gross national product of the host country;
- the experience and reputation of the applicant and the project enterprise;
- participation of other investors, foreign or domestic; and
- the nature, including the mobility, of the assets contributed to the investment project.

Factors Relevant to Specific Risks

i. Currency transfer risk:
   - the investment project's potential to earn freely usable currency through exports;
   - any arrangement for the accumulation of export proceeds in accounts outside the host country or in free accounts in the host country; and
   - any agreements with the host government giving the applicant or the project enterprise guaranteed or preferential access to foreign exchange.

ii. Expropriation and breach of contract risks:
   - the degree to which the continuity and profitability of the investment project is dependent on actions or omissions of the host government or on the continued participation of the applicant;
   - the nature and terms of any agreement between the applicant and the host government, and in particular the fairness and flexibility of such terms;
   - any provisions in such agreement for the settlement of disputes by international arbitration; and
   - the likelihood that the host country will be able to compensate for an expropriation out of the earnings, and in particular the foreign exchange earnings, of the investment project.

iii. War and civil disturbance risk:
   - the strategic importance of the investment project;
   - the location of the investment project and its vulnerability to physical damage; and
   - the security arrangements for the investment project.

Factors Relating to the Host Country

Factors Relevant to All Risks

An eligible investment may be guaranteed when the legal protection of foreign investment in the host country is adequate. An investment will be regarded as having adequate legal protection if it is protected under the terms of a bilateral investment treaty between the host country and the home country of the investor. In the absence of such a treaty, MIGA considers the consistency of the law and the practice of the host country with international law.

Factors Relevant to Specific Risks

i. Currency transfer risk:
   - foreign exchange position of the host country, including its likely development over the proposed period of guarantee;

- any relevant record of transfer delays for investment in general and in particular for the type of project and investment under consideration; and
- the potential for recovery, including MIGA's ability to use the local currency.

ii. Expropriation and breach of contract risk:
- any recent record of interventions in foreign investments and defaults on contracts of the type proposed to be guaranteed;
- the relevant record of the host country on the settlement of expropriation and breach of contract claims; and
- any relevant pending disputes, and in particular any pending disputes with MIGA, national investment guarantee agencies or private political risk insurers.

iii. War and civil disturbance risk:
- the existence or likelihood of an armed conflict involving the host country, or an insurgency; and
- any internal tensions which might lead to civil disturbance.

iv. Non-honouring of sovereign financial obligations:
- the sovereign credit rating and relevant record of the host country in honouring governmental financial payment obligations or guarantees.

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Question 2: What is the history of the share allocation process and the voting method?

Topic: Share allocation and voting at the International Finance Corporation (IFC)

Answer:

Shares in the IFC are allocated on the basis of the capital subscription of each member (1 share for each US$1,000 of capital). When the IFC was established in 1956, the initial share allocation for each original member was fixed in relation to the member's subscription at the International Bank for Reconstruction and Development (IBRD). New members after 1956 were allocated a number of shares established on the basis of their IBRD subscriptions.

Changes to allocations were made following increases in IFC capital in 1963, 1977, 1985 and two in 1992. The majority of these changes were to admit new members and / or proportionally increase the subscriptions of existing members. The exceptions are:

- Additonal allocations — When the IFC's capital stock is increased, each member has the opportunity to subscribe to maintain its share of capital. However, no member is obligated to subscribe. If a member does not subscribe the shares allocated to it, or does not pay within the specified time period, those shares are transferred to a pool of unallocated shares. The Board of Governors can approve requests to allocate additional shares out of the pool of unallocated shares. On several occasions, members have requested allocation of additional shares particularly when they were under-represented in their IFC shareholding relatively to their respective weight in the IBRD's shareholding structure.

- The 1977 General Capital Increase offered subscriptions in such amounts that, if all were taken up, would realign the subscriptions of members to IFC's capital stock to those in the IBRD, assuming approval of an increase in the capital of the IBRD. This misalignment had been caused by changes in the relative sizes of the IFC and IBRD capital bases, and the additional allocations to take up unallocated shares. Only Argentina opted to enforce its right (described above) to maintain its share of capital.

- An increase in the share allocation to the Russian Federation — following the break up of the Soviet Union — to raise its shareholding to a level equal to that of Canada, India and Italy.

As outlined in the original IFC Articles of Agreement, the voting power of each member is 250 votes plus one vote for each share of capital stock held.