

National Interest Analysis [2011] ATNIA 6

with attachment on consultation

**Amendments to the Convention Establishing the Multilateral Investment Guarantee Agency
to Modernise the Mandate of the Multilateral Investment Guarantee Agency,
done at Seoul on 11 October 1985**

**Amendment to the International Finance Corporation Articles of Agreement,
done at Washington DC on 20 July 1956**

[2011] ATNIF 2

NATIONAL INTEREST ANALYSIS: CATEGORY 2 TREATY

SUMMARY PAGE

Amendments to the Convention Establishing the Multilateral Investment Guarantee Agency to Modernise the Mandate of the Multilateral Investment Guarantee Agency, done at Seoul on 11 October 1985

Amendment to the International Finance Corporation Articles of Agreement, done at Washington DC on 20 July 1956

[2011] ATNIF 1

Nature and timing of proposed treaty actions

1. The proposed treaty action constitutes four amendments to the Convention Establishing the Multilateral Investment Guarantee Agency, done at Seoul on 11 October 1985 (the MIGA Convention) and one amendment to the International Finance Corporation Articles of Agreement, done at Washington DC on 20 July 1956 (the IFC Agreement). The MIGA and IFC are two arms of the World Bank Group.

2. The Board of Directors of the Multilateral Investment Guarantee Agency (MIGA) proposed four amendments to the MIGA Convention in its report of 28 January 2010 concerning amendments to the MIGA Convention, which was formally communicated to Australia on 29 January 2010. On 15 July 2010, Australia voted in favour of the amendments to the MIGA Convention. On 30 July, the MIGA Council of Governors adopted the four amendments to the MIGA Convention. The MIGA Convention (Articles 59 and 60) provides that amendments enter into force for all members 90 days after the Vice President and Corporate Secretary of the World Bank Group certifies, by formal communication (unless the Council specifies a different date of commencement), that not less than 60 per cent of the total membership and 80 per cent or more of the total voting power of MIGA has accepted the amendments. The World Bank formally notified Australia of the adoption of the amendments on 16 August 2010 and specified that the MIGA amendments entered into force on 14 November 2010.

3. The proposed amendment to the IFC Agreement requires adoption by the IFC Board of Governors. The Board of Governors of the IFC must cast their vote by 31 March 2011 for the proposed amendment to the IFC Agreement to adjust the allocation of basic votes. The proposed amendment will enter into force for all members three months after the Corporation certifies, by formal communication addressed to all members, that three-fifths of the Governors exercising 85 per cent of the total voting power, have accepted the amendment. Since the proposed amendment was endorsed by the Board of Governors of the World Bank at the Development Committee Spring Meeting in April 2010, an affirmative vote by the member States is anticipated.

Overview and national interest summary

4. The amendments to the MIGA Convention seek to modernise MIGA's mandate and expand its scope, allowing a greater range of projects to be eligible for MIGA coverage. Currently,

the MIGA Convention limits MIGA to providing insurance to a narrow range of investors and investments for four defined political risks (currency transfer, expropriation and similar measures, breach of contract and war and civil disturbance).

5. The amendments will permit MIGA to: provide coverage for stand-alone debt; broaden the process for investor registration; broaden the scope for coverage for existing assets; and eliminate the requirement of a joint application by the investor and the host country to authorize coverage for specific additional non-commercial risks. The amendments do not alter MIGA's core mandate but are aimed at reducing transaction costs and enabling MIGA to insure political risk for projects based on actuarial qualities rather than excluding projects with particular financing structures. These changes were made to allow MIGA to more effectively pursue its development mandate and to respond to the changing demands of MIGA clients.

6. The proposed amendment to the IFC Agreement aims to improve the voice and participation of developing and transition economies in the World Bank by increasing their basic votes. Historically, the fundamental principle underlying the allocation of shares in the IFC has been to reflect each new member's relative weight in shareholding at the International Bank for Reconstruction and Development (IBRD), which broadly reflects members' relative position in the world economy. Currently in the World Bank Group, the voting power of each IFC member is the sum of its basic votes, fixed at 250 votes per member, and its share votes, with one vote for each share of IFC stock held. The proposed amendment would increase the basic votes of developing and transition economies with a view to improving the effectiveness and legitimacy of the World Bank as the leading global development institution and enhancing the influence that developing and transition countries have over governance, policies and decision-making in the World Bank. The proposed voting reform also allows shareholders to achieve voting power adjustments in both the IBRD and the IFC, taking into account different levels of shareholder interest in and support for the different institutions.

7. These amendments introduce no substantive changes to Australia's obligations to either the IFC or MIGA. Australia's actual IFC shareholding will remain unchanged as a result of the increase in basic votes, while its voting share will decline marginally. Australia has an interest in seeing these amendments accepted as they will likely improve the effectiveness of the IFC and MIGA in promoting economic and financial stability, international development and poverty reduction.

Reasons for Australia to take the proposed treaty action

8. The IFC and MIGA advance Australia's interests by supporting international economic development and poverty reduction in developing and emerging economies.

9. MIGA's mission is to promote foreign direct investment into developing countries to help support economic growth, reduce poverty and improve people's lives. Investment environments and perceptions of political risk often inhibit foreign direct investment. MIGA addresses these concerns by providing political risk insurance for foreign investments in developing countries and dispute resolution services for guaranteed investments to prevent disruptions to developmentally beneficial projects. Currently, restrictions in the MIGA Convention that limit MIGA to providing insurance to a narrow range of investors and investments to four defined political risks limit its development impact. The proposed amendments will more closely align MIGA with market practices in the political risk insurance industry and allow MIGA to more effectively pursue its development mandate.

10. The IFC lends to the private sector and advances Australia's interests by financing private sector investment, mobilizing capital in the international financial markets, and providing advisory services to businesses and governments which foster sustainable economic growth in developing countries. The proposed amendment to the IFC Agreement to increase basic votes will assist the IFC's effectiveness in achieving these goals, by strengthening the relative voting power of developing or transition countries, giving them greater representation in the IFC. Reform of the World Bank, to better reflect global developments and increase its legitimacy with developing countries, will enhance the Bank's role in the international development architecture and help ensure that funds invested on behalf of Australian taxpayers are best utilised.

11. The proposed amendments introduce no substantive changes to Australia's obligations to MIGA or the IFC. Rather, they are reforms aimed at improving the capacity and legitimacy of both institutions. Australia has significant interest in seeing these amendments implemented as they will act to improve the effectiveness of MIGA and the IFC in promoting sustainable economic growth in developing countries. The proposed reform package will also assist Australia to fulfil part of its G-20 commitment to strengthen and reform the global development architecture for responding to the world's long-term challenges by encouraging reforms to make the multilateral development banks more relevant, effective and legitimate, and to enhance developing and transition countries' voice and influence in the World Bank through increases in voting power.

Obligations

MIGA Convention amendments

12. The four amendments to the MIGA Convention adopted by the Council of Governors will permit the Agency to:

Allow coverage for stand-alone debt

MIGA is currently prohibited from providing coverage in such cases by MIGA Convention Article 12(b), which allows the Board, by special majority, to extend eligibility to other types

of medium- to long-term investments ‘except that loans other than [shareholder loans] may be eligible only if they are related to a specific [equity] investment covered or to be covered by the Agency’. MIGA is not aware of any other political risk insurance provider that is subject to a comparable limitation. This limitation results in additional costs for sponsors and interferes with their preferred structures, without any improvements in development impact for the country concerned. MIGA has consequently been unable to provide support for many projects which depend on cross-border financing. The proposed amendments will amend Article 12(b) of the Convention to allow MIGA to provide coverage to lenders for loans being made to eligible projects enterprises on a stand-alone basis, even when the Agency is not covering a related equity investment. Coverage of stand-alone debt will be allowed if the debt finances, or is otherwise related to, a project or investment where other direct investment is present. MIGA will be considerably more effective in catalysing inward direct investment into member countries if it is able to provide coverage to lenders for loans when there is no related equity investment being covered by MIGA.

Broaden the process for investor registration

The MIGA Convention requires that would-be clients register their potential investment with MIGA prior to commencing project implementation. Past experience has shown that potential clients routinely fail to file a Preliminary Application before investing funds, thus rendering their investment ineligible for coverage, despite the fact that they have discussed their pending projects with MIGA at an early stage in the project development. This problem was partly addressed when MIGA’s management changed the Operational Regulations. However, MIGA is seeking to broaden the registration procedure to permit other satisfactory evidence of investor intent in addition to the Preliminary Application. The proposed amendment to Article 12(c) will help to eliminate a minor procedural step and help lessen overall transaction costs for the client.

Broaden the scope for coverage for existing assets

The MIGA Convention was structured to limit MIGA coverage to new foreign direct investment. Coverage for existing assets was restricted by Article 12(d), and a new incoming foreign investor acquiring an existing asset would only be able to obtain MIGA political risk insurance if the acquisition was accompanied by an expansion, modernization or financial restructuring. Under recently approved changes to MIGA’s Operational Regulations, coverage was expanded to include instances where the acquisition leads to enhancements to the business that resulted from intangible benefits, such as non-monetary contributions. However, it is currently not possible for MIGA to provide political risk insurance in the event of a brownfield acquisition. This is a limitation that prevents MIGA’s participation in a large part of the foreign direct investment market. By expanding the scope to provide coverage for existing assets, the proposed amendment to Article 12(d) will allow MIGA to promote developmental impacts by making brownfield investments more attractive.

Eliminate the requirement for a joint application by the investor and the host country to authorise coverage for specific additional non-commercial risks

The MIGA Convention does not allow for the possibility of MIGA providing political risk insurance cover for additional non-commercial risks beyond the four categories specifically laid out in Article 11(a) (currency transfer, expropriation, war and civil disturbances, and breach of contract), with some flexibility for the Board provided in Article 11(b). However, this flexibility is subject to significant procedural hurdles which have limited MIGA's ability to expand its product offerings, as Article 11(b) requires that each host country specifically apply for issuance of any new such coverage jointly with the potential investor seeking the coverage. This administrative step also requires that the host country acknowledge that investors perceive special categories of political risk that are not typically applicable in other countries, which many governments may be reluctant to do. The proposed amendment to Article 11(b) will allow the Board to authorise other non-commercial risks by special majority vote, without the requirement of a joint application of the investor and host government.

Proposed IFC Agreement amendment

13. The proposed amendment to Article IV of the IFC Agreement will increase the number of basic votes allocated to each member. Voting share in the IFC is determined by a combination of basic votes and share votes. Basic votes are allocated equally to all members, reflecting the principle of equality of States. Share votes are allocated on the basis of shareholdings (one vote for each share of stock held) and are indicative of the relative economic weight and role of each member in the global economy. The relative voting power of developing and transition countries has eroded over time, partly because the number of basic votes has remained unchanged while the number of share votes has increased markedly.

14. The realignment principles are based on a broad and flexible alignment between IFC and IBRD shareholdings, which take into account different levels of shareholder interest in and support for the different institutions. The IFC voting reforms propose an increase in basic votes in parallel with a selective capital increase open for subscription to those members interested in increasing their shareholding and support for IFC. Australia, along with most developed countries, will not take up any additional shares in the selective capital increase so as to facilitate an overall increase in the representation of developing or transition economies. The basic votes of each member shall be the number of votes that result from the equal distribution among all members of 5.55 per cent of the aggregate sum of the voting power of all members, provided that there will be no fractional basic votes. An increase in basic votes for all members at the IFC will strengthen the relative voting power of small and low-income members, most of which are developing or transition countries, giving them greater representation.

Implementation

15. Australia's current obligations pursuant to the MIGA Convention and the IFC Agreement are given effect in Australian law by the *International Finance Corporation Act 1955 (Cth)* and the *Multilateral Investment Guarantee Agency Act 1997 (Cth)*. The IFC Agreement and the MIGA Convention form schedules to the relevant Acts. The *International Financial Institutions*

Legislation Amendment Act 2010 that amends the relevant Acts to update these schedules for the proposed amendments to the IFC Articles and the MIGA Convention received Royal Assent on 24 November 2010, and therefore has given effect to the changes to the MIGA Convention under Australian law. The proposed amendment to the IFC Agreement still requires adoption by the IFC Board of Governors, who must cast their vote by 31 March 2011.

Costs

16. The amendments to the MIGA Convention and the IFC Agreement will not result in additional costs to the Australian Government, or State or Territory Governments.

Regulation Impact Statement

17. The Office of Best Practice Regulation, Department of Finance and Deregulation has been consulted and confirms that a Regulation Impact Statement is not required.

Future treaty action

18. Article 60 of the MIGA Convention sets out the procedure for amendment of this Convention. A proposal for amendment may emanate from a member, Governor or Director of MIGA and requires Board approval before submission to the Council of MIGA for its approval under Article 59. Upon Council approval, MIGA certifies the amendment by formally communicating such amendment to its membership. Amendments enter into force for all members ninety days after such formal communication, unless the Council specifies a different date. Any amendment to the MIGA Convention must be approved by Governors representing (i) not less than 60 per cent of the total membership and (ii) 80 per cent or more of the total voting power of MIGA.

19. The IFC Agreement provides, at Article VII, that the Agreement may be amended by vote of three-fifths of all the Governors exercising 85 per cent of the total voting power. Moreover, an affirmative vote of all Governors is required in respect of certain specific modifications. Where an amendment has been duly adopted, the IFC so certifies by means of formal communication to the members, and amendments enter into force for all members three months after the date of such formal communication unless the Board of Governors specify a shorter period.

Withdrawal or suspension

20. The amendments do not alter the withdrawal or suspension provisions specified in the IFC Agreement or the MIGA Convention. For MIGA, any member may, after the expiration of three years following the date upon which the Convention has entered into force with respect to such member, withdraw from MIGA at any time by giving notice in writing. Any withdrawal shall become effective ninety days following the date of the receipt of such notice by MIGA. For the IFC, any member may withdraw from membership in the IFC at any time by giving notice in writing. Withdrawal shall become effective upon the date such notice is received.

21. If a member fails to fulfil any of its obligations under the MIGA Convention or the IFC Agreement, MIGA or the IFC may, by a majority of its members exercising a majority of the total voting power, suspend its membership. The suspended member shall automatically cease to be a

member one year from the date of its suspension unless the IFC or MIGA decides to extend the period of suspension or to restore the member to good standing.

22. A decision to withdraw from the IFC or MIGA would be subject to Australia's domestic treaty-making process, including tabling in Parliament and consideration by JSCOT.

Contact details

Development Banks Unit
International Finance and Development Division
Department of the Treasury

ATTACHMENT ON CONSULTATION

Amendments to the Convention Establishing the Multilateral Investment Guarantee Agency to Modernise the Mandate of the Multilateral Investment Guarantee Agency, done at Seoul on 11 October 1985

Amendment to the International Finance Corporation Articles of Agreement, done at Washington DC on 20 July 1956

[2011] ATNIF 2

CONSULTATION

23. A formal domestic consultation process was not undertaken prior to the amendments to the Convention Establishing the Multilateral Investment Guarantee Agency, done at Seoul on 11 October 1985 (the MIGA Convention) and the International Finance Corporation Articles of Agreement, done at Washington DC on 20 July 1956 (the IFC Agreement) being adopted by the World Bank Board of Governors. Consultation was considered unnecessary on the basis that there were no domestic stakeholders who would likely be affected by the proposed amendments who had not already been consulted directly by the World Bank. Australia's position on these issues was clearly stated in the public domain and interested parties were afforded transparency through publicly available documents and statements, for example through Australia's constituency statements at the World Bank Annual Meeting in October 2008 and the Spring Meeting in April 2010.