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# Establishing a Political Risk Insurance Mechanism for Ukraine: Background, Concept, and Options

April 2023

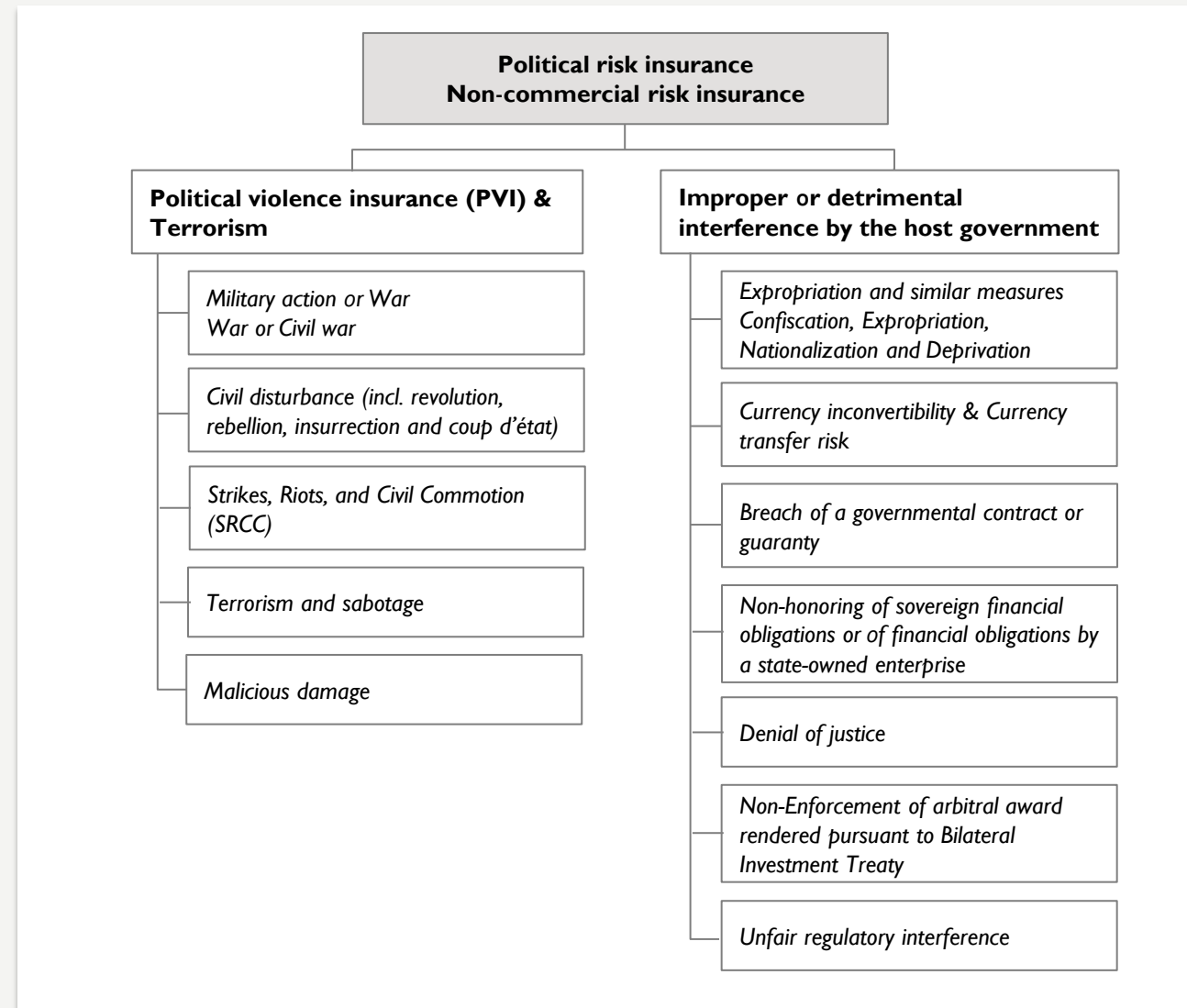
# Political Risk Insurance: Not a panacea, but an important complementary risk-mitigation mechanism for investors

**Political (non-commercial) Risk** – the probability of occurrence of some political event that will change the prospects of the profitability of a given enterprise

There is no generalized methodology for assessing political risks, uniform wording of insurance (guarantee) contracts, or even a single unified classification of risks and terminology in this area.

PRI providers are developing and using their own proprietary risk assessment methodologies

Respective coverage can be purchased individually or in multiple combinations

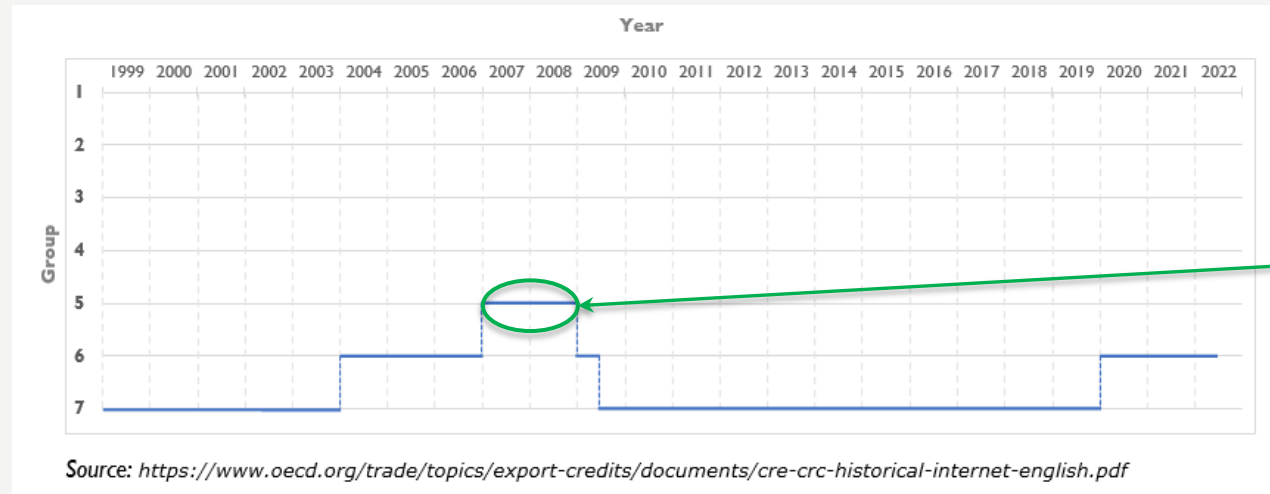




# UKRAINE'S HISTORICAL PERFORMANCE AS A FDI DESTINATION

# Ukraine as a FDI destination

## Position of Ukraine in the OECD Country Risk Classification, 1999-2022



From 1999 to 2013 Ukraine spent 65% of the time in the 7<sup>th</sup> (lowest) group, along with Somalia, Sudan, Libya, Iraq, Haiti, Ethiopia, West Bank and Gaza, Zimbabwe, Yemen, Venezuela, Tajikistan, Sierra Leone, Pakistan, North Korea

Historical peaks of FDI in Ukraine coincide with this period

### Accumulated FDI per capita, 2002-2021<sup>1</sup>:

- Ukraine<sup>2</sup>: USD 1,909
- Hungary: USD 8,084
- Poland: USD 6,677
- Slovakia: USD 8,215

### Conclusions:

- Investors historically perceived Ukraine as a high-risk country in terms of political risks **unrelated** to military actions.
- The investor risk perception was caused by improper or detrimental interference by the Ukrainian government, lack of property rights, lack of contractual enforcement, corruption.
- Any PRI mechanism must respond to both military/terrorism risk and improper government actions.

<sup>1</sup> Sources: UNCTAD World Investment Report 2022. Population data: 2020 mid-year estimates based on the United Nations data. Source: <https://www.worldometers.info/world-population>

<sup>2</sup> Adjusted for the 'round tripping effect', according to the 'Assessment of the volumes of direct foreign investments in which the final controlling investor is a resident (round tripping) for 2010 – 2021', Department of Statistics and Reporting of NBU, Kyiv, 2022



INVESTMENT GUARANTEES OF THE  
FEDERAL REPUBLIC OF GERMANY  
► Direct Investments Abroad



# POLITICAL RISK INSURANCE MECHANISM PROPOSAL AND IMPLEMENTATION OPTIONS

# PRI Mechanism: Purpose and Tasks

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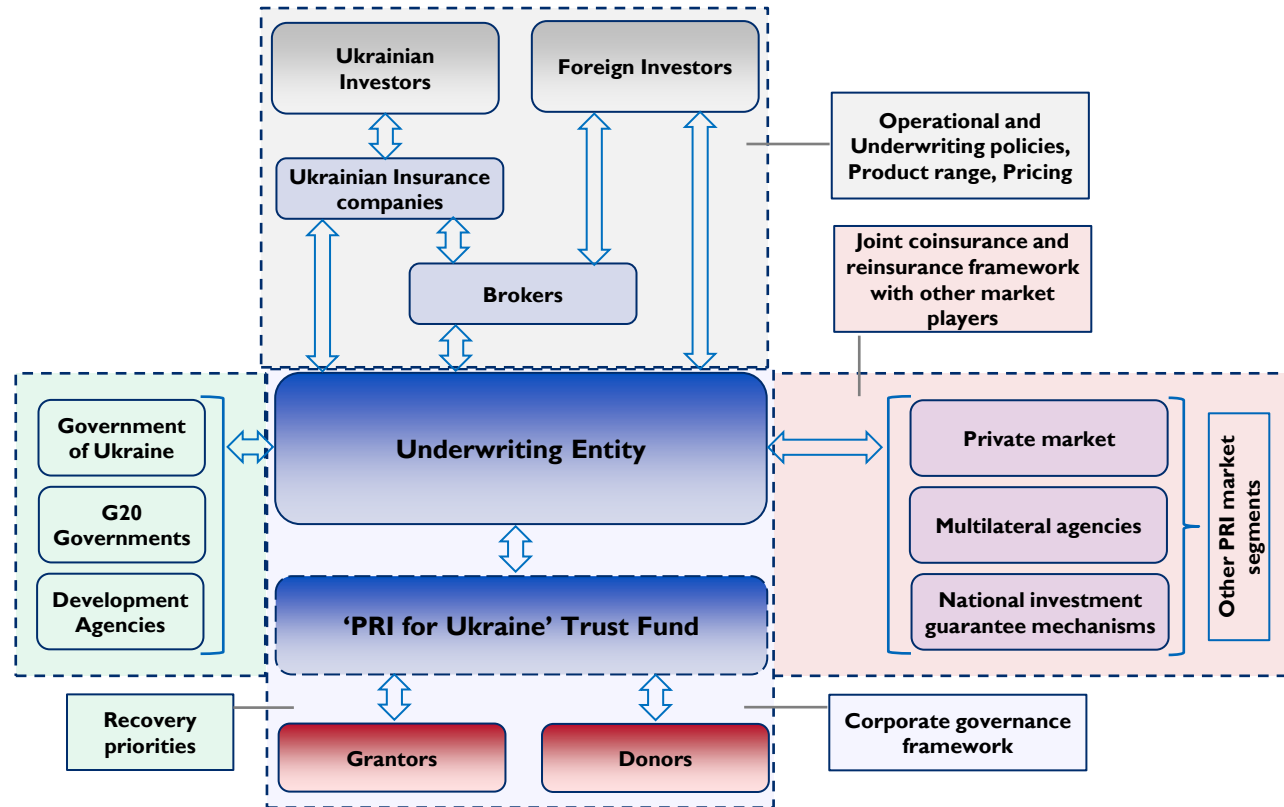
**The purpose** of a dedicated PRI mechanism for Ukraine is to provide the requisite protection to lenders and investors while attracting additional PRI providers to cover Ukrainian risk. It needs to serve immediate transactional demands while building the marketplace so that the Mechanism can be retired within 5-10 years when Ukraine can be sufficiently served by pre-existing PRI providers

The Mechanism should perform **the following tasks**:

- Ensure the accumulation and targeted use of a money pool that acts as a carrier of political risks related to investments in Ukraine.
- Crowd in private commercial PRI insurance providers and make effective use of the existing infrastructure of the domestic insurance market (i.e., representative offices of international insurance brokers, representatives of international surveyor groups).
- Create a 'first risk layer' that can absorb a significant part of the losses under PR insurance contracts, thereby protecting other PRI market participants.
- Carry out insurance indemnities for insured events related to political violence and government interference.
- Provide Ukrainian investors with the similar protection options as foreign ones.
- Offer reasonable, simplified eligibility requirements and procedures in terms environmental standards to match market conditions and expedite reconstruction financing.
- Transfer knowledge and develop national expertise in risk assessment and underwriting of PRI.

# Conceptual framework of the proposed PRI Mechanism

## Conceptual framework of the proposed PRI Mechanism



Different stakeholders are estimating amounts ranging from USD600 billion to USD750 billion and even one of USD1 trillion as potential damages to Ukraine

**PRI Mechanism** – a Political Risk Insurance vehicle established by the international community to encourage investments - in Ukraine's post-war recovery

The core PRI Mechanism's **objective**: set up the **Underwriting Entity/Unit** to provide Political Risk Insurance to investors (both foreign and Ukrainian) in line with recovery priorities defined by the GoU and other stakeholders

**'PRI for Ukraine' Trust Fund** is the critical element and financial basis of the Mechanism: as the foundation of (re)insurance capacity and as a source of covering administrative expenses. The sources for filling the Trust Fund will be the contributions from *grantors* and *donors*

The Trust Fund's participants would play the key governance role. They appoint representatives to the Mechanism's Supervisory Board (SB) to act on its behalf to set the key policies and ensure the **PRI Mechanism's corporate governance**, underwriting and claims administration



# Corporate Governance and Establishment of the PRI Mechanism

**Trust Fund Champion** – a politically significant and internationally renowned institution to lead the international promotion of the PRI Mechanism idea, convene international donors' conference, and collect contributions to the Trust Fund

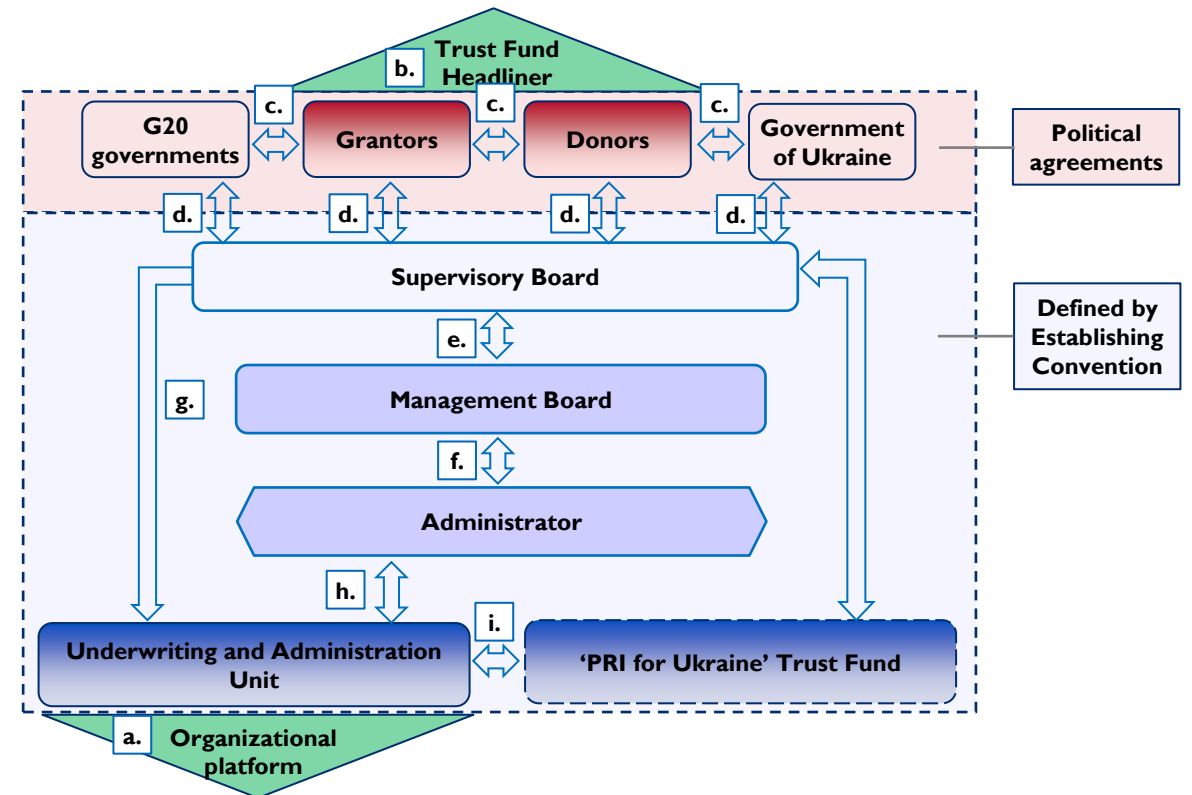
The GoU must “buy-in” to the mechanism to help with legal/regulatory risk.

**Organizational platform** – an institution with practical experience in PRI to perform the legal, methodological, and technical preparations for the launch of business activities of the Underwriting entity

## Establishment of the Mechanism:

- (a) Drafting *organizational agreement with supporting Govts, grantors and donors (Establishing Convention)*, the operational policy and developing other basic documents
- (b, c) Organizing the *International Donor Conference*, Approving the *Establishing Convention* and setting the size of the *Trust Fund*
- (d, e, f) Participating governments, *grantors* and *donors* make contributions to the *Trust Fund* and appoint their representatives to the *Supervisory Board*. The *SB* elects members of the *Management Board*. The *Management Board* appoints the *Administrator (Chairperson)*
- (g) The *SB* sets the limit of guarantee capacity and the reinsurance limit
- (h, i) The *Administrator* manages the *PRI Mechanism's* everyday business activities, The *Underwriting Unit* does the recourse to the callable portion of the *Trust Fund's* capital to pay claims or allocates net income to reserves





## Corporate governance framework of the PRI Mechanism





# PRI Mechanism dedicated to Ukraine: Implementation options

## Possible organizational and operational setups for the PRI Mechanism

Option	Preparatory and establishment phase 		Regular business activities phase
	Trust Fund Headliner / Label	Organizational platform	Underwriting and Administration Unit
1 'PRI for Ukraine' Trust Fund within an existing PRI agency	Multilateral or national agency with PRI expertise	Multilateral or national agency with PRI expertise	Multilateral or national agency with PRI expertise
2 Existing PRI expertise within a new governance structure	Institution of a Trust Fund's founding state	Multilateral or national agency with PRI expertise	Multilateral or national agency with PRI expertise
3 New PRI Agency descended from an existing one	Institution of a Trust Fund's founding state	Multilateral or national agency with PRI expertise  Turnkey UW unit blueprint	Full-fledged in-house Underwriting and Administration Unit
4 New PRI agency based on the global PRI market's best practices	Institution of a Trust Fund's founding state	Private Contractor  Turnkey UW unit blueprint	Fully-fledged in-house Underwriting and Administration Unit
Result	Preparatory work done, Establishing Convention adopted by the donors' conference, Trust Fund established and attracts contributions, methodological basis and organizational blueprint for the Underwriting Entity completed 		PRI Mechanism's insurance-technical and administrative functions are performed

- There are four suggested Options for starting normal business activities by the Underwriting Entity/Unit – depending on who will perform roles of Champion and Organizational Platform
- All four suggested options have pros and cons
- Establishing the right governance mechanism and corporate culture is critical
- The first and second options are faster and easier, since there is an opportunity “just” to adapt the existing expertise, methodology and processes
- Options 3 and 4 will require somewhat longer internal capacity building

# Options for Implementation

## OPTION 1: Trust Fund and Underwriting Unit within an existing PRI agency

In theory, a well-established PRI agency (i.e. MIGA, DFC, Germany's DIA, EU entity) could create special Ukrainian Fund under their umbrella.

*Advantages from time savings, existing expertise and market confidence might be reduced by weaker response to particular market and situation requirements in Ukraine*

## OPTION 2: Existing PRI expertise within a new governance structure

Under this hybrid option, a sponsoring state or institution establishes the Trust Fund in combination with an experienced PRI agency as the Organizational Platform and the Underwriting Unit. *Similar to Option 1, it also requires operating under two different paradigms and two sets of policies and basic documents, working within an existing culture, and will likely stretch the limit of any agency's resources*

## OPTION 3: New PRI Agency ascends from an existing one

As with Option 2, an influential institution or state will act as Trust Fund Champion. A national or multi-lateral PRI agency will act as the Organizational Platform and will incubate an Underwriting Unit, transferring knowledge, skills and systems. It will spin off a fully equipped Underwriting Unit into new legal entity. *The legal "home" of the Underwriting Unit needs to be negotiated or established*

## OPTION 4: New PRI agency based on the global PRI market's best practices

An influential institution or state will act as Trust Fund Champion. The operational platform and underwriting could be provided by the private PRI market. The contractor would be selected through a transparent procedure and would manage everyday work to a private entity (e.g. an insurance company or a broker), with decision-making vested in the Mechanism's Board of Directors. *Appointment of a private entity for a global role is unprecedented and might affect the Mechanism's prospects in a way not easily to predict*

# Key Next Steps

