



IRMA



Initiative for Risk Mitigation in Africa

Risk Mitigation Instruments in PPP Projects

*Luigi de Pierris, AfDB
Dakar, PPP Conference, June 5th/2012*



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- Public Private Partnerships have gone a long way but we should not forget that they are largely based on Project Financing techniques.
- Project Financing is many things, but it is essentially based on risk identification, risk allocation and risk mitigation.
- When structuring a PPP transaction, we should therefore be extra-careful as to how the various risk elements are identified and allocated to the different parties intervening in the transaction.
- We should always keep in mind the basic principle of Project Financing:

Risks shall be allocated to the parties that are in the best position to control them

Political Risks: Currency Inconvertibility





Political Risks:

- Expropriation
- Creeping Expropriation
- Nationalisation
- Licence Revocation
- Taxation changes
- Power Purchase Agreements not honoured

Credit Risks:
“Can pay, but won’t pay”
- Protracted Default



Terrorism and Sabotage



“On September 11, enemies of freedom committed an act of war against our country.”

- Act of Terrorism
- Political Violence
- Sabotage
- Riots
- Strike
- Civil Commotion
- Malicious Damage
- Burglary
- Insurrection
- Revolution
- Rebellion
- Mutiny
- Coup d'Etat

Political Risks: War





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IRMA - Initiative for Risk Mitigation in Africa

- The Initiative for Risk Mitigation in Africa (IRMA) is a program of the African Development Bank financed by a Trust Fund established by the Italian government.
- The main objective of IRMA is to enhance risk evaluation methodologies and to seek out the best and most cost-effective risk mitigation solutions.
- The initiative aligns with the AfDB's strategy for Public-Private Partnerships (PPPs) across sectors, and notably in infrastructure financing.
- IRMA encourages the effective use of the Bank's risk mitigation products as a catalyst for mobilizing private investment for projects in Africa.
- By paying specific attention to the different layers of risk involved in a transaction, deals can be structured in a coherent and cost efficient way.



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Risk Mitigation and Risk Mitigation Instruments

[Risk Mitigation](#) can be defined as “the [systematic](#) reduction in the extent of [exposure](#) to a [risk](#) and/or the likelihood of its occurrence”. (T. Matsukawa, O. Habeck – Review of Risk Mitigation Instruments for Infrastructure, 2007)

[Risk Mitigation](#) can be achieved by using [Risk Mitigation Instruments](#)

- Risk mitigation instruments can be defined as “financial instruments that transfer certain defined risks from project financiers (lenders and equity investors) to creditworthy third parties (guarantors and insurers) that have a better capacity to accept such risks”.
- The availability of appropriate risk mitigation instruments allows private sector lenders and investors to cover those risks that they are not willing to accept because are perceived as excessive or beyond their control.
- When risk mitigation instruments are effectively used, it becomes possible to undertake commercially viable projects which would not get financing otherwise.



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Categories of Risk Mitigation Instruments

1. *Credit Guarantees* cover losses in the event of a debt service default regardless of the cause of default (that is, both political and commercial risks are covered with no differentiation of the source of risks that caused the default).
 - *Partial Credit Guarantees (PCGs)* fall into this category and cover “part” of the debt service of a debt instrument (regardless of the cause of default). Typically, a PCG would improve the terms of the commercial debt of the borrower, extending the maturity and/or reducing interest rate costs, through the sharing of the borrower’s credit risk between the lenders and the guarantor.
2. *Export Credit Guarantees or Insurance* cover losses for exporters or lenders financing projects tied to the export of goods and services. Export credit guarantees or insurance cover some percentages of both political risk and commercial risk.



3. *Political Risk Guarantees or Insurance* cover losses caused by specified political risk events. They are typically referred to as *Partial Risk Guarantees (PRGs)*, or *Political Risk Insurance (PRI)* depending on the provider.
 - PRGs cover commercial lenders in private projects. They typically cover the full amount of debt. Payment is made only if the debt default is caused by risks specified under the guarantee. Such risks are political in nature and are defined on a case-by-case basis.
 - *PRI*, or *investment insurance*, can insure equity investors or lenders. PRI can cover the default by a sovereign or corporate entity but only if the reason for a loss is due to political risks.



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Political Risk Guarantees or Insurance

Political Risk guarantees or insurance offer risk coverage for traditional political risks, including currency inconvertibility and non-transferability, expropriation, war and civil disturbance, breach of contract.

In recent years, DFIs have introduced new types of instruments designed to cover certain more specific risks, including:

- *Non-performance of the host government* under its contractual payment obligations (for example, termination payments or agreed subsidy payments);
- *Government action or inaction* having a material adverse impact on the project (for example change in law, regulations, taxes, and incentives; negation or cancellation of license and approval; non-allowance for agreed tariff adjustment formula or regime);
- *Contractual performance of public counterparties* (for example, state-owned entities under an off-take agreement, an input supply agreement, etc.)



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The AfDB Guarantee Platform Partial Risk Guarantees (PRGs)

- A PRG is a financial guarantee for lenders to a project, covering debt service defaults that result from the non-performance of a government or a government owned entity on its obligations with respect to the specific project.
- These obligations are usually defined in contracts between the government and the private sponsor responsible for the implementation of the project, which can be a green-field investment project, an expansion or rehabilitation of an existing project, or a privatization project.
- PRGs are available to cover private lenders or investors in both the countries eligible to borrow from the ADB window and those eligible to access the concessional ADF window.



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Partial Risk Guarantees - Covered Risks

- **Breach of contract** including government contractual payment obligations, such as:
 - Termination payments;
 - Contractual performance of public counterparties such as failure by state-owned entities to make payment under an off-take agreement or an input supply agreement;
 - Regulatory risk and change of law such as negation or cancellation of license and approval or non-allowance for agreed tariff adjustment formula or regime;
 - Frustration of arbitration.
- **Expropriation** including confiscation, nationalization, and deprivation (referred to as CEND), or other acts by the host government which may interfere with a foreign investor's fundamental ownership rights



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Partial Risk Guarantees - Covered Risks

- **Currency inconvertibility and non-transferability** (commonly referred to as CI Coverage), to ensure that dividends, profits, fees, share capital and loan proceeds from a guaranteed project are remitted or repatriated from a host country in a timely manner and at prevailing exchange rates.
 - CI coverage does not protect against currency fluctuation, devaluation, or any pre-existing restrictions on conversion or transfer, unless government has expressly undertaken to cover those risks.
- **Political force majeure** risks, such as damages to assets resulting from politically motivated strikes, riots, civil commotion, terrorism, sabotage, war and/or civil war.



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Partial Risk Guarantees - Extent of Coverage

- Loans and other forms of debt instruments.
- Guarantee maturity is dependent on the financing terms that the Host country would be eligible to obtain from the Bank/Fund.
- All or part of the outstanding debt service obligations to a lender.
- May include principal and/or interest payment obligations.
- Equity investments are not eligible for coverage.



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Partial Risk Guarantees - Counter Indemnity

- An AfDB PRG cannot be extended unless the member country in whose territory the investment project is located or who is benefiting from the guarantee provides an indemnity under which the member country agrees to reimburse the Bank/Fund for any payments the Bank/Fund would make under the guarantee.
- Any payment made by the Bank/Fund is immediately due and payable by the country providing the counter indemnity.
- Failure to pay can lead to arrears, similar to failure to make timely debt repayment of a Bank/Fund loan and will trigger the sanction policy and cross default provisions as appropriate.
- However, the Bank/Fund, in its own right and at its sole discretion, may amortize the amount to be paid in the form of a loan over a period of time.



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Partial Risk Guarantees - Transaction Diagram

