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PERSPECTIVES: Ongoing Ukrainian crisis highlights role of political risk insurance

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Kirk Pasich, left, and John Heintz

*The crisis in Ukraine and Russia highlights both the role of political risk insurance and the need to evaluate securing such insurance for companies doing business in other hot spots around the world. Kirk Pasich and John Heintz of Dickstein Shapiro L.L.P. discuss the benefits of buying political risk insurance, as well as the types of coverage available.*

Last November set off an escalating chain of events that has plunged Ukraine into a crisis that threatens to splinter the nation. Ukraine's then-president, Viktor Yanukovych, had rejected a trade deal with the European Union in favor of pursuing an economic deal with Russia. After protests forced Mr. Yanukovych from power, Russia seized Crimea and massed troops on Ukraine's eastern border. Pro-Russian protesters, in a number of cities in eastern Ukraine then seized government buildings, declared independence from Ukraine and urged Russia to come in.

These developments have led the United States and the European Union to impose limited economic sanctions on certain Russian leaders and oligarchs, along with one Russian bank, Bank Rossiya. Russia has countered with similar sanctions. In addition, Russia sanctioned Lithuania after Lithuania condemned Russia's move into Crimea. These sanctions include an embargo of a Lithuanian port to block delivery of U.S. and E.U. goods to Russia and other Customs Union countries.

In June, Russia cut off natural gas deliveries to Ukraine over a longstanding dispute over delayed bill payments, and pockets of fighting continue to break out.

The possibility that both sides will impose far more significant sanctions still looms. Wider sanctions pose a real threat to the economic interests of numerous U.S. and E.U. businesses conducting business in both Ukraine and Russia. Russia could retaliate against widened U.S./E.U. sanctions by taking a variety of actions that could adversely affect these companies. Such actions could include interfering with the performance of contracts, blocking the conversion of Russian earnings into U.S. dollars, and imposing additional trade embargos, as well as outright expropriation.

Many of those companies may have political risk insurance, a specialty form of insurance designed to protect a company's assets, investments, or contractual rights in a foreign country against losses caused by a variety of foreign government actions. While underwriters have suspended issuing political risk insurance relating to Ukraine and Russia, the crisis highlights both the role of political risk insurance and the need to evaluate securing such insurance for companies doing business in other “hot” spots around the world.

Political risk insurance has been available for some years from the Overseas Private Investment Corp. and the Multilateral Investment Guarantee Agency, a World Bank affiliate. These organizations insure investments in developing and other countries in order to facilitate such investment and economic growth. The private market for political risk insurance, provided by such insurers as American International Group Inc., Zurich Insurance Group Ltd., and Lloyd's of London, has seen significant growth in recent years. We discuss below the various types of political risk insurance, the markets for political risk insurance and certain issues unique to political risk insurance.

Political risk refers to a wide range of risks, including some that may not come to mind when one thinks of political risks. The most common example of political risk is loss associated with political violence, a terrorist attack, or civil unrest, such as the losses that resulted from the terrorist attacks in Mumbai or the Arab Spring protests in Egypt and subsequent civil wars in Libya and Syria.

Coverage for these types of losses is narrowly written and expensive. However, political risk also includes the risk that a host government may frustrate or repudiate a contract with an international company to build a facility for which the company expects a certain rate of return, or the risk that a foreign government may expropriate or confiscate assets.

Political risk also includes the risk that a foreign government wrongfully calls a line of credit, or blocks currency conversion or the repatriation of funds. Political risk may also include the risk that a company's supply or distribution chain is disrupted due to export/import embargoes, such as the Russian embargo on Lithuania. Political risk insurance currently available in the marketplace, with variations, typically covers one or more of these risks.

Political risk insurance can be obtained from public insurers, such as OPIC, MIGA, and the Export Credits Guarantee Department in the United Kingdom, or from private-market insurers, including the London market, Ace Ltd., Zurich North America, and the AIG group of insurers. The nature of the coverage and the policy forms and terms vary between the public and private markets, with advantages and disadvantages to both types.

OPIC, ECGD, and MIGA, backed by the U.S. and U.K. governments and the World Bank, respectively, have eligibility requirements consistent with their investment and development objectives that may limit access to insurance:

• OPIC requires that (1) the company must be a U.S. company, (2) the investment or project must be registered with OPIC before the company starts the investment or project, (3) the company must obtain the foreign government's approval of the insurance, (4) the project must take place in one of the countries that OPIC services, and (5) the project must not fall into one of OPIC's categorically prohibited sectors.

• ECGD requires that (1) the company be conducting business in the United Kingdom and (2) the investment must be made in an enterprise outside of the United Kingdom.

• MIGA requires that (1) the company making the investment be in a MIGA member country, (2) the investment be made in a MIGA member country, and (3) the proposed investment project must be economically viable, environmentally sound, and consistent with the labor standards and development objectives of the host country.

Insurers in the private political risk insurance market are not backed by any governmental or international banking entity and do not have strict eligibility requirements imposed by those entities. Private-market insurers also have greater flexibility to tailor a policy to a company's specific needs or to offer coverage for risks that the public insurers do not insure. In fact, many private political risk underwriters typically “manuscript” their policies to address particular needs and situations. Many businesses also appreciate the fact that the purchase of private-market political risk insurance can be kept confidential, unlike policies issued from government or quasi-government providers.

Obviously, what a political risk insurance policy covers depends on how the policy is drafted. Unlike other types of insurance policies, private political risk insurance policies are more likely to be tailored to the specific needs of the company purchasing the policy. Companies may also decide to mix and match coverage, obtaining coverage for certain investments with official providers and coverage for other projects with private providers. For example, if a company is opening a new hotel in a historically unstable region, it may consider purchasing political risk insurance to cover that region. Likewise, if a company is working with a government with whom it has not worked before on a particular project, it may want to insure just that project. Although political risk insurance is generally considered for work abroad, it may protect a company in its home country in the event of a terrorist attack or unfavorable actions by the government if drafted broadly enough. Because of these wide variations, the pricing of the policies will likely be dependent on the scope of the project, the length of the policy period and the risk associated with certain regions. Similarly, because of the specialized nature of these types of policies, it is important to review the policy terms to ensure the policy accurately reflects the scope of coverage sought.

**Arbitration clauses:** Many political risk policies contain a mandatory arbitration provision applicable to any dispute arising under the policy, while some policies allow for litigation in the U.S. Arbitration has both advantages and disadvantages that a company should weigh when considering political risk insurance containing a mandatory arbitration provision.

**Choice of law clauses:** Most political risk policies have choice of law clauses, often designating the laws of England as the controlling law. English law differs in various respects from the laws of many U.S. states and should be carefully considered.

**Notice provisions:** Most political risk policies contain a provision requiring that the insured immediately provide notice to the insurer upon the occurrence of any event likely to give rise to a claim under the policy. Because notice is typically identified as a condition precedent to coverage, political risk insurers often will attempt to deny coverage if the insured does not fully comply with a notice provision. For this reason, it is crucial that insureds provide notice as soon as possible and comply with the explicit terms of their policies, including providing notice in the proper medium and through the designated party. That being said, although courts may enforce notice provisions as a condition to coverage, in some jurisdictions an insured’s failure to give timely notice may not bar coverage if the insurer is not prejudiced by the late notice.

**Disclosure requirements:** Political risk insurance policies also typically impose a continuing obligation on the insured to disclose certain information to the insurer not only prior to the policy’s inception but on a continuing basis thereafter. One such disclosure requirement may be that the insured had no knowledge at the policy’s inception of any circumstance that could give rise to a loss under the policy. If an insured does not satisfy a disclosure obligation, the insurer may seek to void or rescind the policy ab initio. Companies should communicate clearly and openly with underwriters during the negotiation of any political risk policy and following placement to ensure that disclosure obligations are being met.

**Mitigation or due diligence:** An insured also should be aware that many political risk policies contain a due diligence clause requiring the insured to do everything “reasonably practicable” to protect or remove insured property and to avoid or diminish any potential loss in the event of a political situation. Some policies require the insured to take steps to mitigate its loss. In conjunction with some coverages, some policies impose a “waiting period” during which the insured must make a diligent effort to enforce its rights and seek available remedies before the insurer becomes obligated to pay a claim. The due diligence requirement in a political risk policy requires the insured to take only “reasonable” efforts to minimize the loss. Thus, an insured is not required to undertake measures that would be impractical or futile, beyond the insured’s financial means, or otherwise unreasonable under the circumstances.

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