



CONFERENCE REPORT

October 23, 2009

**The Fletcher School of Law and Diplomacy,
Tufts University**

Hosted and Sponsored by:

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Conference Summary

Political risk mitigation techniques have become strategic components to enterprise risk management as uncertainty surrounding government regulation, expropriation, currency inconvertibility, and political violence becomes more common in today's volatile economic environment. On October 23, 2009, professionals from more than 100 organizations and graduate students from academic institutions throughout the northeastern United States gathered at The Fletcher School of Law and Diplomacy, Tufts University for its inaugural political risk conference. Hosted by The Fletcher School's Political Risk Forum (FPRF) and Center for Emerging Market Enterprises (CEME), with corporate sponsorship from ExxonMobil, *Managing Political Risk: A Cross-Sector Conference on Political Risk Measurement and Mitigation* fostered a range of discussions on timely political risk measurement and mitigation trends and techniques from the international investment and business perspective.

Fletcher's one-day conference served as a forum for the dissemination of ideas and best practices on political risk mitigation for business professionals and graduate students focusing on business and international affairs. The conference featured two keynote presentations – Dr. Louis T. Wells of Harvard Business School as the morning keynote speaker, and Dr. Llewellyn Howell of the Thunderbird School of Management as the afternoon keynote speaker – and four distinct panels: Energy and Resource Nationalism; Political Risk and Business Intelligence; Investment and Trade Finance in Conflict-Affected Countries; and Political Risk Insurance (PRI). Moderated by leading Fletcher School scholars, the panels bridged professional and academic expertise in business, law, finance, conflict resolution, and natural resource policy within the political risk sphere.

Conference Panel Overviews

Panel I: Energy and Resource Nationalism

As oil and gas firms vie to secure raw materials around the world, the resurgence of resource nationalism in several producing countries has added a complex layer of risks and opportunities that must be considered carefully prior to investment. This panel explored the various strategies and tactics such firms are implementing to effectively address these issues. A cross-section of industry players with differing perspectives on the matter were represented.

Panel II: Political Risk and Business Intelligence

In today's global economy, processes of political due diligence are a prerequisite to multinational investments. In the current geopolitical climate, investments are subject to a range of risks that include terrorism, unstable governments, and violent domestic groups, to name a few. This panel examined the diverse range of political risks that an investment can be exposed to, the regional variations to political risk, the methods that are often employed to assess them, and opportunities that exist for investing in today's world.

Panel III: Investment and Trade Finance in Conflict-Affected Countries

There are more countries transitioning out of conflict today than there are in conflict. Nurturing entrepreneurship, identifying investment opportunities, ensuring post-conflict reconstruction and development and providing support and encouragement to local businesses are just some of the considerations in modern post-conflict economies. This panel explored risks and opportunities to facilitate trade, business investment, and operations in countries transitioning out of conflict and fragile states. The panel examined such risks from a comparative perspective that included export credit agencies, private and public investors, and private businesses.

Panel IV: Investment Guarantees and Political Risk Insurance

Political violence, expropriation, and inconvertibility: these are risks that hinder investment in regions that could benefit exceptionally from additional business and job creation. Investment guarantees and political risk insurance (PRI) can cover these risks and facilitate investment in these regions. This panel assessed the circumstances in which investment guarantees and PRI are effective tools for mitigating company and project specific risks, as well as how these products can preserve or add value to an investment.

Summary of Conference Addresses and Panel Proceedings

Morning Keynote Address

[Professor Louis T. Wells](#), Herbert F. Johnson Professor of International Management at Harvard Business School, served as the conference's morning keynote speaker. Professor Wells set the tone for the day's proceedings, identifying and subsequently defining what exactly constitutes "political risk." He highlighted the common fallacy held by many firms that political risk insurance provides comprehensive coverage for *all* scenarios when, in fact, it does not. Professor Wells also provided a terse overview of governments' perspective when involved in ventures with private investors.

Professor Louis Wells' Main Points:

- Political risk can be defined as actions taken by a host government that lower an investor's rate of return below projected levels.
- Natural disasters, commercial risk, poor firm management and stiff competition or unfavorable market conditions *cannot* be defined as political risk.
- Political risk insurance can protect firms against actions of nonpayment but do not provide comprehensive coverage for all scenarios.
- Contract renegotiation is more likely in situations when changes in global markets conditions cause the investor to earn windfall profits or if financial crises alter the conditions of a negotiated deal.

- Recourse to international arbitration for the settlement of investment disputes remains unattractive for investors and governments alike due to the prohibitive costs of proceedings, the length of the process, the difficulty in enforcing arbitral awards, and the likely destruction of the business relationship.

Panel I: Energy and Resource Nationalism

The Energy and Resource Nationalism panel provided an overview of the energy sector's current structure. The panel sought to address a number of questions, including: the energy industry's approach to political risk assessment; how the current environment of increased resource nationalism will affect the operations of international oil companies (IOCs); and, whether IOCs should invest in local infrastructure. Panelists concurred that political risk in the energy sector runs parallel to the demand cycle in the market. Evaluating the expansion strategies that were being followed by Chinese and Indian national oil companies, the panelists noted that these companies, normally criticized for having low margins, actually have employed strategies more successful than initially anticipated. When commodity prices drop, national oil companies are typically better able to renegotiate the terms of their contracts.

Energy and Resource Nationalism Panelists:

[Mikkal Herberg](#), Director, Global Energy & Economics (former), ARCO

[David Hobbs](#), VP & Managing Director of Global Research, CERA

[Napier Collyns](#), Cofounder, Global Business Network

[Antoine Halff](#), Head of Energy Research, Newedge USA

[Professor Bruce Everett](#), Adjunct Associate Professor of International Business, The Fletcher School (*Panel Moderator*)

Energy and Resource Nationalism Panel's Main Points:

- Only 5% of worldwide oil reserves are privately owned, with the balance controlled by governments. IOCs, therefore, only have access to resources through contract.

- Although all companies that invest abroad conduct some form of political risk analysis, IOCs are guided by the simple imperative of investing where the resources are.
- Political risks in resource-rich countries are continuous and have traditionally shifted along a spectrum according to market cycles; as oil prices rise, governments tend to demand a larger share of the revenue, thus increasing political risks of contract renegotiation or expropriation.
- However, today's IOCs need to consider risks not only stemming from fickle government landlords, but also from a range of other stakeholders.
- Large, integrated IOCs have traditionally been the only organizations capable of efficient production. However, today they are facing new challenges, including the advent of service companies that are more responsive to governments and have become increasingly competitive in terms of their own technology and expertise.
- Chinese and Indian national oil companies (NOCs) were cited as having particularly interesting strategies due to their deep pockets and willingness to absorb greater risks. For instance, the Chinese are often criticized for accepting low margins in exchange for ensuring access to reserves.
- NOCs may be employing a more sophisticated strategy than it initially appears, as they understand the fungibility of contracts; as prices drop, they have been able to renegotiate the terms of their contracts with the governments of Sudan, Angola, and Kazakhstan, among others. Thus, a scenario where IOCs are increasingly crowded out by partnerships between NOCs and service firms could unfold in the coming years.
- Because major IOCs are capable of sustaining through periods of decreased revenues and margins, it is largely expected that they will remain just as relevant in the future as they have been in the past.
- A market's institutional environment largely is largely determinative of the outcome. The more cash that is pumped into an economy characterized by weak institutions and corruption, the more likely it is that it will be used irresponsibly and inefficiently.

Panel II: Political Risk and Business Intelligence

Increasing regulatory and legal scrutiny surrounding today's investment climate fuels a commensurate need for high-quality political risk and business intelligence. While this increased insight should enhance strategic clarity in volatile environments, companies continue to encounter challenges in such situations. The Political Risk and Business Intelligence panel aimed to investigate the gap that exists between information provided by intelligence firms and its incorporation into corporate strategic decision-making mechanisms. The panel focused its discussion on discerning why business intelligence and political risk assessments are not more widely incorporated into firms' strategic decision-making processes, despite clear evidence of the associated benefits. Though the panelists argued that certain sectors of the economy were more responsive to business intelligence than others, they stressed the valuable role that their organizations play in providing clients with salient and actionable intelligence that is not accessible via open, public sources. Furthermore, because business intelligence requires constant monitoring, only political risk firms can provide the timely analysis needed for decision-making. As generic approaches cannot be effectively applied to a wide variety of challenges and risks that may arise, political risk firms are uniquely suited to assist companies in structuring customized solutions.

Political Risk and Business Intelligence Panelists:

[Mike Baker](#), President & Founder, Diligence LLC

[Nelson Cunningham](#), Managing Partner, McLarty Assoc.

[David Gordon](#), Director of Research, Eurasia Group

[Peter Nolan](#), VP Corporate Investigations, Control Risks Group

[Andrew Marshall](#), Managing Director, Kroll

[Professor Brian Ganson](#), JD, Adjunct Professor of International Negotiation, The Fletcher School (*Panel Moderator*)

Political Risk and Business Intelligence Panel's Main Points:

- The key value proposition of business intelligence is providing timely analysis that answers the right questions.
- Political risk assessment should look beyond individual projects; it should concern itself with how to structure a portfolio.
- The reason that some companies are more eager to invest in risky opportunities, while others are more conservative in approach, often comes down to personalized decision-making.
- Business intelligence is about constant monitoring and contingency planning. It must be conducted *ex-ante*, and as each dispute is unique, it must be addressed with tailored approaches.
- Though the internet and other public sources provide easy access to generic information, it rarely translates into substantive and actionable information.
- Responsiveness to business intelligence varies by sector. Extractive and financial services firms are very responsive to intelligence, whereas retail firms are less so. Clients that are sensitive to the consumer environment tend to be more attuned to the political environment as well.
- Assessing corruption issues in a new operating environment is crucial to a firm's success. American companies feel a competitive disadvantage due to the Foreign Corrupt Practices Act, which contributes to why they are the leading consumers of business intelligence.
- The three stages that firms undertake are identifying, understanding, and applying business intelligence to mitigate political risks. The shift from the second to the third stage is the most difficult.

Afternoon Keynote Address

[Dr. Llewellyn Howell](#), Emeritus Professor of International Management of The Thunderbird School of Management, delivered the conference's afternoon keynote address. Focusing his discussion on political risk methodology, he argued that effective political risk assessment should not be limited to the macro or even country level of analysis. In fact, he posited that it should incorporate analysis of local economic and political conditions, as well as ethnic and religious issues. Dr. Howell claimed that this more granular approach is critical in today's globalized world as ethnic factions, terrorist organizations, and other sub-national and regional entities exert a greater ability than in the past to affect cross-border investments.

Dr. Llewellyn Howell's Main Points:

- The units of analysis in political risk assessment should not lie at the country level, but should rather consider the interplay of various sub-state actors and their impact on the social, political, and economic environment.
- The risk appetite of a given investor is dependent on firm-specific, industry, and macro-economic factors.
- It is important to calculate the probability of an event occurring, which implies a quantitative element of political risk assessment. The probabilities have to be calculated in a systematic way, so as to enable a comparative analysis of countries using the same set of metrics.
- The components of political risk assessment include government stability, socioeconomic issues, investment profile, internal and external conflict, corruption, law and order, and social and ethnic issues associated with economic risk.
- Political risk assessment has transitioned from a focus purely on host governments to the incorporation of various actors and stakeholders that could affect the investment, such as ethnic groups, terrorist organizations, domestic and international civil society groups, and other sub-national and regional entities.

Panel III: Investment and Trade Finance in Conflict-Affected Countries

Aiming to discern the chief risks to firms that invest and operate in environments characterized by ongoing conflict or lack of effective governance, the Investment and Trade Finance in Conflict-Affected Countries panel touched on several topics, including comparisons between trade promotion and investment, investments in *ex-ante* versus *ex-post* environments, and initial investment considerations versus real-time adjustments during a project. The countries in question were defined as primarily failing or failed states and characterized by: presiding conflict; a weak rule of law or even lawlessness; a lack of functioning capital markets and productive investment opportunities; rampant inflation; and controlled exchange rate regimes that contribute to black markets and informal economies. Due to the changing nature of conflict, products designed to protect firms' interests have evolved to cover losses not only in cases of damage to assets but also business interruption. Panelists noted that risk-pricing models are project-specific, and take into account a range of objective and subjective factors in the host country in order to determine risk premiums, including the threat of the actor and the vulnerability of the particular business. Participants concurred that insurance providers have started to focus more on "comprehensive" guarantees.

Investment and Trade Finance in Conflict-Affected Countries Panelists:

[John Greenwood](#), VP Credit & Agency Finance, Citigroup

[Jim Williams](#), Director, Insurance, Africa, the Middle East, and Southern Asia, Overseas Private Investment Corporation (OPIC)

[David Drysdale](#), Deputy Director for Trade, Finance, and Investment Negotiations, U.S. Department of the Treasury

[Dominick Donald](#), VP Country Analysis, AEGIS

[Rashmi Nehra](#), Assistant VP PRI, Chartis

[Professor Laurent Jacque](#), Walter B. Wriston Professor of International Business, The Fletcher School (*Panel Moderator*)

Investment and Trade Finance in Conflict-Affected Countries Panel's Main Points:

- Threats posed by specific actors and the vulnerability of the given business must both be assessed in order to determine specific exposure to losses. The utilization of exposure fees is based on various elements, many of which are categorical or loosely defined. Most claims are categorized as being commercial, as opposed to political, risks.
- It is often easier to define political risk in terms of what it is not (i.e. things that are not in the control of a given company).
- Firms have started to focus more on “comprehensive” insurance guarantees that include “nonpayment” coverage. OPIC and other providers are responding to this demand through sovereign non-honoring provisions.
- It is almost impossible for a bank to meet target hurdles when sovereign risk ratings are incorporated. There is generally little relief through PRI coverage, except via comprehensive coverage through an AAA-rated agency.
- The questions insurers raise include what portion of an investment can actually be recovered and whether investors have the technical experience to undertake a commercially viable project. They also look to see whether the company attempts to mitigate some of the vulnerabilities itself. Insurance should simply be considered as a layer on top of other risk mitigation efforts.
- Since the Cold War, civil and ethnic conflicts have proliferated in developing countries, and these can have a significant impact on a company’s operations. As a result of these changing circumstances, products have also evolved to cover losses not just stemming from damage to facilities and other assets, but also due to foregone income.
- Risk premium pricing models are very project-specific, incorporating both objective and subjective factors and taking into account relevant events occurring in the host country at the time.
- In conflict zones, it is almost impossible to conduct transactions without securing revenue from export flows. It is much easier to work with projects that will generate trade flows, as they produce hard currency earnings which can be kept offshore and

then used to make loan payments or dividend returns to asset owners.

- For energy projects that experience windfall profits, the government often exerts pressure to renegotiate contracts, which can result in expropriation. Many international financial institutions are signing onto the “Equator Principles,” under which contracts are structured to ensure a more equitable division of revenues between the parties.
- A recent trend observed in the context of global financial crisis is the wide fluctuation of commodity prices. This is important to consider, as it changes the perceptions of what the government should receive as a “fair” revenue allocation.

Panel IV: Political Risk Insurance and Investment Guarantees

Topics of discussion for the Political Risk Insurance and Investment Guarantees panel included: a current overview of political risk insurance (PRI) products; the use of Basel II compliant PRI policies; and the outlook for the PRI market in the foreseeable future. The panelists noted that the current economic crisis has adversely impacted the PRI industry. With fewer projects being undertaken in emerging markets, there has been a drop-off in demand for PRI products. Globally diminished trade credit and project-lending volumes have exacerbated this issue. The panelists stressed that a distinction should be drawn between credit risk and political risk. Credit risk refers to the *ability* of counterparties to pay, while political risk includes considerations of sovereign entities’ *willingness* to pay. The panel and the conference concluded with the panelists identifying intellectual property rights protection as a potential area for PRI product development. The panel topics of discussion included an overview of PRI product offerings and a discussion on how to optimize PRI policies. Panelists also discussed the use of Basel II-compliant PRI policies, how PRI could eventually be extended to cover intellectual property rights, and a near-term outlook on the PRI industry.

Political Risk Insurance and Investment Guarantees Panelists:

[Rod Morris](#), VP, Political Risk Insurance, OPIC

[Mac Johnston](#), Advisor, PRI Arbitration, Robert Wray PLLC

[Julie Martin](#), VP, PRI Brokerage, Marsh

[James Bond](#), COO, Multilateral Investment Guarantee Agency (MIGA), The World Bank Group

[Barker Keith](#), VP and Assistant General Counsel, Sovereign Risk Insurance

[Professor Jonathan Brookfield](#), Associate Professor of Strategic Management and International Business, The Fletcher School (*Panel Moderator*)

Political Risk Insurance and Investment Guarantees Panel's Main Points:

- PRI involves political events that can be clearly observed and measured. A partial list of coverage areas includes: war and civil disturbance; breach of contract; currency inconvertibility; and the non-honoring of a government's commitment to an investor's project.
- The current economic crisis has adversely impacted PRI business, with fewer projects in emerging economies leading to a decreased demand for PRI products. Also, many PRI providers are experiencing credit supply issues and are in turn reducing PRI availability.
- Despite the current economic downturn, there is adequate capacity, and those companies seeking coverage can get it. PRI should, however, be the last line of defense in managing a company's risks.
- Three steps should be taken in order to prevent errors when writing and updating PRI policies:
 - 1) Seek out expert consultation when considering PRI coverage. PRI is different than other insurance policies in that it is highly tailored to firm needs.
 - 2) Identify the proper underwriter. In political risk insurance, an underwriter who knows the industry and associated risks is more valuable than the firm's reputation: "Pick the person, not the firm."
 - 3) Involve the project manager in the policy formation process.
- Basel II-compliant PRI policies dictate two key points. First, credit risk indicates a counterparty's ability to pay, while political risk considers a government's willingness to pay. Second, for a product to be Basel II-compliant, it needs to mitigate credit risk, which means the policy cannot include specific exemptions; the policy needs to be "bulletproof."

- There is discussion in industry circles for a potential new PRI product intended for intellectual property right protection. Before a firm's intellectual property rights can be insured, they must be legally protected through patents and trademarks in the relevant jurisdictions.

Conference Report Conclusion

The Managing Political Risk conference covered a comprehensive range of issues relevant to the political risk sector. The broad spectrum of panelist sectors and areas of specialty provided comprehensive perspectives on the state of risk management. Bringing together experts in business intelligence, political risk insurance, financial services, and energy, the conference reinforced the importance of political risk as an increasingly relevant factor as the world moves into the second decade of the 21st century.

The political risk industry has become highly specialized, particularly in business intelligence, where companies are compelled to find a unique competitive advantage over other industry contenders in order to set themselves apart. Awareness and understanding of political risk is an important component to scenario planning in the energy sector, which must be conducted on a regular basis while keeping in mind that forecasts do not always provide reliable predictions.

The rise and expansion of multinational corporations indicate that foreign investors now face a broader base of stakeholders; they must take into account perspectives of both local and national actors. The nature of risks when operating abroad has varied greatly, from the expropriation and nationalization risks in the 1960s and the 1970s to convertibility issues and damage due to civil strife. These developments have increased the need to understand, measure, and hedge against political risk.

The degree and the implications of political risk and political risk insurance are complex and cross conventional borders. It does not only affect corporate actors and their bottom line, but actors involved in nation-building in post-conflict environments. By partnering with the

private sector, public risk insurance mechanisms, like MIGA and OPIC, can spread out risk and make these important investments possible, aiding to break the conflict-poverty cycle.

Conference Sponsors

Established in 2007, the [Center for Emerging Market Enterprises](#) at [The Fletcher School](#), Tufts University, serves as one of the leading global hubs for research, study and networking devoted to enterprises in the emerging markets. Promoting understanding and engagement that contributes to global prosperity and stability, CEME draws on an extensive network of professionals in private, public, academic, and non-government enterprises in emerging and developed countries. Under its [Emerging Market Enterprise Strategy](#) and [Emerging Market Local Capital Markets](#) research programs, CEME plans to continue its exploration of political risk in the 2010/2011 academic year. Management and investment in emerging and frontier markets, particularly post-conflict environments, is becoming an increasingly prevalent challenge for global corporations. CEME's upcoming programming will include examinations of bond markets, market valuation, management practices, and stakeholder relations—and their inclusion in risk assessments—in emerging and frontier markets.

Founded in 2008, the [Fletcher Political Risk Forum \(FPRF\)](#) is a graduate student organization at The Fletcher School, Tufts University, facilitating research and discussion amongst students with career and academic interest in political risk in the fields of finance, consulting, business intelligence, and business strategy and operations. FPRF student organizers created and coproduced the “Managing Political Risk” conference in 2009 to help fill a gap in the dissemination of political risk analytic methodologies and mitigation strategies that have applicability across business sectors.

The world's largest publicly traded international oil and gas company, [ExxonMobil](#) provides energy that helps underpin growing economies and improve living standards around the world. Using innovation and technology to deliver energy to a growing world, ExxonMobil explores for, produces and sells crude oil, natural gas and petroleum products. ExxonMobil

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