This article was originally published in the Policyholder Advisor, *Volume 23, Issue 3 (May/June 2014)*

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POLICYHOLDER ADVISOR
The Policyholder Law Firm

What You Need to Know About Political Risk Coverage

By Mark Garbowski

Recent economic crises and political upheavals have intensified the risks connected with engaging in international trade and investment. In the last five years, industries or entire business entities have been nationalized in Argentina, Bolivia, Greece, Ireland, Pakistan, and Venezuela, among others. Foreign bank deposits were seized and devalued during the Cypriot bank crisis of 2012–2013. And currency controls are currently in effect in dozens of countries.

Accordingly, a careful review of your political risk policy terms is very much worthwhile. Political risk policies vary greatly, including those sold by the Overseas Private Investment Corporation, a self-financing government-created entity. Also, most policies are tailored from an assortment of possible coverage options, and it is critical to be certain that you have selected the best and necessary options.

Coverage Grants and Types

Most political risk policies offer some combination of the following types of coverage:

- **Expropriation Risk** covers the possibility that the host government will seize all or some substantial portion of your assets, or those of a borrower or business partner that is then unable to make payments
- **Moratorium Risk** covers the chance that a government forbids a borrower or business partner to make payments (e.g., a moratorium on debt payments, foreign debt payments, banking in general, etc.)
- **Currency Transfer Risk** and Inconvertibility can cover a host of ills, including when the government does not allow: 1) a borrower or counterparty to convert currency into dollars, 2) you to convert into the local currency to make payments, or 3) you to transfer funds out of the country. Some policies may also explicitly include coverage for the risk that currency exchange or transfers are nominally legal, but other government policies made it impossible to function.
- **Political Violence** covers events such as war, insurrection, civil strife, terrorism and sabotage.

Exclusions, Conditions and Random Traps

Ambiguous Definitions: Some policies include ambiguous definitions of "government"

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or "government authority" that might, for example, be read to refer only to a central bank.

Limited Coverage: Policies typically limit their coverage to a specified country or countries. Be careful — especially where boundaries and political power might be in a fluid situation, such as what we are now seeing in Ukraine.

Hidden Language: Sometimes exclusionary language is tucked inside the coverage grants or policy definitions. Besides making them harder to find, insurance companies might argue that this means they should not be subject to the rule that exclusions should be read narrowly. That argument should not stand unopposed.

Excluding Government Acts: Some policies exclude acts performed by a government entity in a business capacity. In one instance we have seen, the government was acting to guarantee the loan that was the subject of the policy. As such, it had commercial rights that could have interfered with the ability of the borrower to repay.

Pre-Existing Conditions: Another exclusion is for pre-existing conditions. Be wary of broader language that excludes restrictions that the policyholder "should have known about," or that targets proposed restrictions, or those "publicly known to be under consideration."

Disproportionate Exclusions: Another policy we experienced covered currency risks, but measured damages using the government-approved exchange rate. So if you are allowed to convert currency, but only under a government-imposed exchange rate that is out of line with the real market, you effectively might have no coverage.

Outside Interference: If your host country is a client state, or otherwise subject to outside interference, check for language excluding loss due to a government law, regulation or other action having legal effect, but issued by another country.

Conclusion

As with most types of insurance coverage, policy language is key, and because each policy is usually adapted to specific risks, there is more opportunity to properly craft (or fail to craft) the proper coverage in advance. Policyholders should work closely with their brokers and insurance companies to make sure they are buying coverage that actually suits their needs.