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**Article**

Investment Guarantees of the Federal Republic of Germany

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In the context of the Investment Guarantee Scheme, PwC is tasked with handling contacts with those German investors seeking support and guiding them through the application process. Part of the process is a review of the eligibility for support and the tenability of providing cover with regard to the risk profile of the project. PwC summarizes the conclusions from the project review in an expert’s opinion and presents the findings to the decision-making body, which is known as the Interministerial Committee (IMC). This committee is composed of representatives from the Federal Ministry of Economic Affairs and Energy – lead function –, the Federal Ministry of Finance, the Federal Foreign Office and the Federal Ministry for Economic Co-operation and Development.

The Interministerial Committee meets in person at regular intervals in Berlin to discuss the applications and to decide on granting cover for individual projects on a case-by-case basis. The provision of insurance is subject to German budget law. In addition, specific cover policies apply for each country. A distinctive feature of the German decision-making process is the inclusion of industry, banking and country experts. They support the evaluation conducted by the IMC in an advisory capacity. This is considered to be an important factor in ensuring that the decisions taken by the committee are reasonable and well-founded.

Why offer and use an investment guarantee scheme?

Investment guarantees are a risk management tool for German investors doing business in developing and emerging countries. The objective of the insurance scheme is to support German FDI, which is considered to have a positive impact on both the host country and Germany too.

Investment guarantees protect German businesses and their direct investments abroad against political risks, which can present serious obstacles to an economy heavily engaged in the international arena such as that of Germany. Political risks eligible for cover are nationalization, acts equivalent to expropriation, war as well as moratoriums and convertibility and transfer problems. Breach of contract by authorities and isolated and subject to specific provisions acts of terrorism can be included in the cover on request.

The following recent examples from our crisis management and claims activities illustrate the forms a covered political risk can take for a German investor:

- Court decisions that put investors at a disadvantage
- The arbitrary refusal to pay tax rebates to the project company
- The unlawful refusal by the authorities to grant crucial approvals
- The introduction of capital and exchange controls in conjunction with the impossibility of converting or transferring funds

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Investment Guarantees of the Federal Republic of Germany

Michael Huber-Saffer*

The German government has mandated a consortium formed by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft (PwC) and Euler Hermes Aktiengesellschaft to manage its Export Credit and Investment Guarantee Schemes, as well as the United Loan Guarantee Scheme. All cover provided as part of these promotion schemes is underwritten on behalf and for the account of the Federal Republic of Germany. The German government sets itself overall limits for the maximum liability accepted in the annual Federal Budget Law. These limits currently stand at 160 billion euros for Export Credit Guarantees and 65 billion euros for Investment Guarantees and United Loan Guarantees combined.

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The deprivation of business premises due to unlawful resolutions passed by municipal authorities
The withdrawal of licenses and concessions by governments.

If an insured project company is affected by any such event, the German investor may be entitled to claim an indemnity based on the cover provided by the German government. However, investors generally prefer to ensure the survival of their project – if at all possible – rather than to receive compensation from the political risk insurer.

Thus, one of the key benefits of using investment guarantees as a risk management tool is the possibility of loss prevention, or a reduction of its consequences. The German government is able and prepared to supply all the flanking instruments of political crisis management for the policy holder at the right time. In our experience the number of cases, in which compensation is paid, is rather low compared to the number of crisis management initiatives started during any given year.

Since established German company law requires adequate measures to limit and manage risks, the use of guarantee schemes is a crucial element of entrepreneurial provision for risks within the risk management. In addition the guarantee can be used as a collateral for the (re)financing of the investment abroad. Claims under guarantees may be assigned to the banks forming part of the security measures.

What are the basic rules?

The investor applying for cover has to be German. This is defined as an enterprise or natural person domiciled in Germany. Portfolio investments and export transactions are not eligible for cover. The investment should also involve long-term entrepreneurial activity by the German investor.

The investment can take the form of equity participation, endowment capital and other rights and assets, such as bonds or concession agreements. Another important form is the so-called investment-like loan, which has to meet specific requirements regarding its similarity to equity. The criteria used include long-term duration, moderate interest rates or the appropriate form of contract stipulating the subordination or special controlling rights. Potential applicants may be shareholders or third parties like banks.

According to German budget law, an investment has to enjoy sufficient legal protection in the host country in order to be eligible for cover. This requirement is considered fulfilled if a bilateral investment protection treaty (so-called BIT) between Germany and the respective host country is in place. The treaties provide comprehensive legal protection for investments on the basis of international law. This makes it easier for investors – and particularly for small and medium-sized enterprises – to enter foreign markets despite the often weak and unpredictable local legal systems. The most important elements of such treaties are usually:

- Mutual treatment of foreign investors like residents and most-favoured-nation treatment in respect of investments in either country,
- Guarantee of the free transfer of capital and earnings,
- Protection of property, fair compensation in the case of expropriation and the guarantee to take legal action,
- International arbitration in case of disputes between the investor and the host country.

With almost 130 bilateral investment protection treaties in force, the German government has established a dense network of binding provisions for protecting German investments abroad. With the coming in force of the Lisbon Treaty in December 2009, competence for foreign investment – including investment protection regulation – was transferred from the EU member states to the European Union.

If there is no BIT in place with a host country, the necessary legal protection may be ensured by the legal system in the particular host country. Subject to verification at the time of a decision by the IMC on a guarantee application, this presently applies to investment in, for example, Brazil, Dominican Republic, Colombia and Taiwan.

In addition to legal protection, the German authorities also review and determine the current economic and political situation of a country for the purpose of defining the requirements to be fulfilled by investors and the terms of coverage. Embassies and consulates are regularly included in the evaluation of the current situation of a country.

Projects also have to pass a review of their environmental and social impacts in the host country, as well as their effects on Germany, in order to be eligible for
cover. Positive effects in the host country with regard to employment, transfer of technical know-how and economic and social development are essential preconditions for an approval of guarantee applications. German investors usually aim to open up new market opportunities abroad by expanding their service outlets and production facilities in the host country. Direct investments abroad strengthen the competitiveness of German enterprises and thus support the safeguarding, or even an increase in employment in Germany.

How are the environmental and social impacts of projects reviewed?

Every project is subject to a formalized assessment procedure. Firstly, the projects are screened for their potential environmental and social impacts and categorized accordingly:

- Category A denotes projects assumed to have strong environmental and/or social impacts that mostly appear to be not locally limited and/or irreversible. This particularly applies to projects affecting nature reserves or settlement areas of indigenous peoples or entailing large-scale resettlements.
- Category B projects are assumed to have limited environmental and social impacts that usually appear to be locally limited and reversible.
- Category C includes all projects for which no or only insignificant environmental and social impacts are to be expected.

The scope of information required for a successful review is then tailored to the specific project and may include environmental and social impact assessments by a third party. The minimum requirement is that all local environmental standards, regulations and laws are observed. The German Government also expects international standards to be adhered to. IFC Performance Standards and EHS Guidelines of the World Bank Group are used as benchmark for this assessment. Environmental and social aspects in relation to an investment project are subject to regular monitoring over the lifetime of the guarantee provided.

During the application process, the German investors are also made aware of the OECD guidelines on multinational enterprises and the German Sustainability Code adopted by the ‘Council for Sustainable Development’ (Deutscher Nachhaltigkeitskodex). These non-binding recommendations provide an important benchmark for corporate conduct relating to foreign investment. They can make a significant contribution to the general benefits deriving from direct investment and to sustainable development, particularly in developing countries.

Provided that there is a bilateral investment protection treaty in place, a standard premium rate of 0.5 percent p.a. applies for the investment guarantee (expropriation, political violence and transfer/inconvertibility). From this starting point the premium and scope of cover are adapted to the specifics of each investment considered for cover by limitation or exclusion of particular risks and/or the calculation of a risk-related top-up premium rate, for example. If there is no treaty in place with the host country, the starting point for the premium calculation would be a minimum premium of 0.55 percent p.a. The usual term of a cover policy is 15 years, which can be renewed for additional terms of 5 years. Investments of any size can be covered. For example, in 2014 guarantees were assumed for amounts ranging from some 21,500 euros up to 2.1 billion euros.

Crisis management experience

The German Investment Insurance Scheme focuses on the avoidance of claims through early identification of problems and close cooperation with the investor concerned. Active crisis management kicks in after the initial notification of problems by the policyholder. This may consist of supporting the project company in negotiations with the competent authorities in the host country, sending trial observers to legal proceedings or discussions as well as letters and notes verbales up to and including the highest diplomatic levels. In addition, the federal government may participate in the costs of litigation or similar measures undertaken by the investor or the project company abroad to prevent losses.

In recent years crisis management has become an even more substantial part of the work of the IMC. One of the insights we gained from our experience with the different problems of German investors is that the occurrence of political risk events does not necessarily correspond with risk indicators like the OECD country risk categories or external country ratings. Instead, our experience shows that political risk events tend to occur all across the country portfolio of an investor.
The federal government successfully averted impending claims in 2014 through active crisis management. The parties involved found a consensual settlement of problems in the case of two projects in Russia by intensive ongoing support for the policyholders. In one of these cases, a local authority took over the project itself following a compensation payment to the German investor for the fair value of the investment. In another case, support was given to the policyholder to exit the project in an orderly fashion by selling the investment to a local company. The federal government was also active in preventing losses in a project in Ukraine, which was experiencing difficulties due to inappropriate administrative action by government agencies. While a recovery case against Ukraine is still pending, negotiations with the Bulgarian government on the recovery of amounts indemnified in respect of a project were also brought to a successful conclusion.

Development of the German investment insurance scheme

Based on the dynamics of FDI over the past decade and the important share that German investors hold in global FDI stock – particularly in areas that are perceived to have significant political risk – the portfolio of German investment guarantees has more than doubled from about 16.5 billion euros at the end of 2005 to a new all-time high of 36.3 billion euros at the end of 2014.

The regional breakdown of the guarantee portfolio – ranked by number of guarantees issued – sees China topping the ranking ahead of Russia, India, Ukraine and Turkey.

In 2014 applications worth a total of five billion euros were approved for cover. This is a substantial increase compared to the previous year’s figures. An analysis of the changes in guarantees during the year 2014 revealed that one of the crucial factors responsible for this development was increased risk awareness due to the ongoing political crises and armed conflicts in different parts of the world. This led to a general increase in demand for investment guarantees, especially among small and medium-sized companies that account for over 25 percent of guarantees issued. Furthermore, in 2014 over 30 percent of guarantees were issued in favour of investors using Investment Guarantees for the first time. The regional focus of covered investment was America and Asia. Due to a single major project, Mexico led the list of countries with the highest cover volume for the first time.

Not only developed countries, but also a growing number of developing and emerging countries are offering public investment insurance schemes. Alongside these guarantee schemes, a number of multilateral investment guarantee agencies, such as MIGA as part of the World Bank Group, and private insurance companies also offer political risk insurance for investment projects.

The German Investment Guarantee Scheme is represented through membership of PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft at the International Union of Credit & Investment Insurers (Berne Union) with its headquarters in London. This organisation brings together public and private export credit and investment insurers from all over the world. Besides fostering cross-border contacts, the meetings of Berne Union members primarily serve the purpose of creating internationally recognised standards and promoting cooperation with regional and international financing institutions and development banks.

In 2014 the German investment guarantee scheme maintained its leading position in terms of the guarantee portfolio among all members of the Berne Union.
worldwide. With its associated organisation ‘Prague
Club’, the Berne Union has a dedicated network for
information exchange between new and maturing in-
surers of export credit and investment. The Prague
Club was started in 1993 by the Berne Union with
funding from the European Bank for Reconstruction
and Development (EBRD). The group was named af-
after the city where its inaugural meeting was held.
Prague Club members were initially Central and
Eastern European agencies; with membership subse-
quently expanded to include members from Asia and
Africa.

Figure 2

![Chart showing new business by most important countries](source: PwC)

Conclusion

According to a poll carried out by the DIHK in the spring of 2015
an increasing number of German industrial companies plan to in-
vest abroad. 47 percent of re-

sponding industrial enterprises
want to make use of funds for this
purpose in 2015, which is a higher
number than ever before. A signif-

cant share of German FDI is in-

vested in emerging economies, ex-

posing investors to a significant
level of – at least perceived – po-

litical risk. International political
crises and armed conflicts put
‘political risk’ back on top of the agenda for investors
and banks involved in the financing of FDI. Hence,
the question on how to mitigate and manage invest-
ment risk becomes increasingly important for all com-
panies with substantial investment exposure abroad.
Against this background, investment guarantees of
the German Government will continue to make a cru-
ial contribution to supporting German companies
abroad.