

# INVESTMENT GUARANTEES

## Political Risk Insurance for a Bank Loan - Case Study

Building production facilities or developing sales organizations in a foreign country usually means investing a sizeable amount of money. Normally banks are then approached for additional financing. They may grant a loan to the German company for refinancing or directly to the foreign project companies.

Evaluating the risks of financing investments in foreign countries is further complicated when the host country is a developing or transition country. Then the project risk - which has to be assessed in the light of the country risk and especially the political risk involved - becomes a major factor in the decision-making process. Consequently risk control measures should be taken. It is far too little known that protection against political risk under the investment guarantee scheme of the German Government also includes direct loans granted by banks to foreign companies.

SMEs often find new and innovative ways to finance their investments. An example for this is outlined in the following paragraphs:

The Oiltanking GmbH, Hamburg, is a holding within the internationally operating Marquard & Bahls group. The group is privately owned and it is still structured like a SME. Its activities comprise oil trade and storage facilities for oil and other chemicals.

As the world's second largest storage company for oil and chemicals Oiltanking strategically places itself in the markets. An expansion of the global market share is achieved by mainly concentrating on engagements abroad. With the construction of new storage facilities, a. o. in Estonia and Bulgaria the company started to include transition countries in the scope of its expansion strategy.

Oiltanking reports as follows on the current status of the project in Bulgaria:

*"The new storage facility in Varna is of great importance to Oiltanking Bulgaria as well as the whole of Bulgaria because in the past larger consignments of chemicals were routinely routed through neighbouring countries. With the new storage facility an increase in business is expected.*

*Phase one of the project has already been successfully completed: Two tanks with a capacity of 23,000 tons have been constructed. About 550,000 tons of*

*sulphuric acid are expected to be handled in the first year of operation. Phase two of the project is an increase in capacity to a maximum yearly volume of up to 1.5 million tons.*

*The construction of the storage facility took only ten month. The quay has a length of about 200 metres and a depth of 10 metres. At the moment only ships with a maximum load capacity of 25,000 tons may dock, but after the planned deepening of the dock ships with a load capacity of up to 50,000 tons will be able to dock.*

*Loading stations, a pump station, reservoirs and a generator with enough capacity to run the entire plant were built opposite the quay. All tanks are equipped with double walls and the grounds are provided with a protective surface coating. The entire plant is designed to meet up-to-date safety standards.*

*The necessary infrastructure is available: A 2.5 km railway connection has just been completed and asphalt access roads are already in existence. The cumulated investments so far reach an amount of EUR 6 million.*

*The storage facility in Varna is presently operated by a staff of 17. All staff members have been trained at similar storage facilities in Belgium in preparation for their future tasks."*

The investments were partially financed by the Hamburgische Landesbank which granted a loan directly to the Bulgarian project company in Varna. Therefore the bank had to consider the country risk of Bulgaria and the limits set by the risk management of the bank. The financing had to be structured in a way to limit the political risk and reduce the commercial risk to an acceptable level. Only then a loan could be granted to the Bulgarian company. The good credit history of Oiltanking and the Marquard & Bahls group was a decisive factor for the bank in accepting the commercial risk of this project. For covering the political risk, an investment guarantee by the German Government was considered. The following requirements have to be met in order to be eligible for a guarantee:

Loans granted directly to foreign project companies by German banks have to be investment-like - thus demonstrating the investment interest of the bank - in order to be eligible for cover. Apart from adequate terms of contract, information and controlling rights, influence on the fundamentals of the project and a share in its commercial risk are basic conditions for an investment-like loan. All

essential terms of contract have to be considered as a whole. As a result, the character of an investment-like loan must be very similar to that of a capital investment in the project. The role of the bank therefore goes beyond that of a traditional supplier of funds.

In the case of Oiltanking Bulgaria the Hamburgische Landesbank agreed to a long duration of the loan, interest rates based only on the refinancing costs of the bank and a margin depending on the debt service cover ratio. A low margin may result for the company in difficult times whereas a higher margin has to be paid when the bottom line picks up. This shows the intention of the bank to participate in the results of the Bulgarian company and underlines the investment character of the loan because the bank thus bears commercial risks originating from the project.

The IMC - responsible for granting guarantees under the government scheme - viewed this as clear proof of the investment character of the loan and granted full cover.

Since in contrast to usual banking practice the contractual interest rates are decreased under difficult economic conditions and increased when the situation improves, even the contract clause ruling out premature repayment was accepted as non-detrimental regarding the eligibility for cover. Though tax reasons led Oiltanking to invest in Bulgaria through a 100% subsidiary in the Netherlands, the indirect share of the Oiltanking GmbH in the Bulgarian company was equally accepted, because a letter of comfort issued by Oiltanking GmbH was viewed as sufficient proof of the German economic interest.

As a result of the financing structure, the requirements of both Oiltanking and Hamburgische Landesbank were met, and political risk coverage under the Government scheme was moreover possible. Experience shows that banks are usually familiar with the investment guarantee scheme, but the flexibility of the instrument and the possibilities for cover are mostly underestimated. Consulting PwC, the lead partner of the consortium managing the investment guarantee scheme, on planned project structures and the possibilities for cover can break new ground. Financial institutions may thus discover new methods of accompanying their SME customers into foreign business.