

THE RESURGENCE OF PRI

in the context of International Project Financing

As recently as only a few years ago, PRI was seen by project finance lenders merely as a “tick the box” exercise, which was required to expeditiously navigate their deals through credit committees. However, at the outset of the millennium, certain events such as the Argentina credit meltdown (2001) unfortunately led to disputed and failed bank claims and to the questioning of PRI as a useful risk mitigant as well as to an ensuing downturn in lender demand for the product. Basel II discussions also had an effect as banks no longer accorded the same provisioning benefit to PRI. These events served to highlight the importance for buyers of clearly understanding the scope of the insurance purchased and the importance for insurers of dealing with perceived ambiguous coverage before signing insurance contracts. That said, several recent factors have led to a resurgence in demand for PRI from lenders, and Export Development Canada (EDC) has experienced this increased demand most markedly for project financings in the extractive industries sector.

Aside from 9/11, which raised awareness of political risk, the primary driver for increased PRI interest from lenders in the extractive industries sector is quite plainly the increase in project development opportunities brought on by the ongoing commodities boom. Indeed, major mining and oil and gas companies are flush with cash and are eager to get assets up and running in order to increase production to further benefit from the peak of the industry cycle.

At the same time that overall project activity is increasing, the financial market has experienced a surge in liquidity. These competitive conditions have contributed to a relaxing of credit criteria on capacity, tenor and pricing, and of late, investment banks have

shown increased appetite for project finance opportunities involving junior and intermediate developers as well.

All in all, this has led to more projects, and most of this foreign investment is being undertaken in emerging markets such as Venezuela, Ecuador, Bolivia in Latin America or Guinea, Zambia and Democratic Republic of Congo in Africa. While a number of these countries previously boasted liberalized and pro-market investment and trade policies (mostly brought on in the mid to late 90s as fiscally-strapped governments attempted to attract much needed foreign capital to aid in the development of their economies), many governments of resource-rich countries are now reconsidering investment and sector legislation. In some cases, governments are unilaterally renegotiating concession and royalty agreements struck with foreign investors a decade ago when commodity markets were depressed. In Latin American countries such as Venezuela, Ecuador and Bolivia, governments’ recent unfriendly foreign investment attitudes have been motivated by nationalist political agendas. In Africa, certain governments, who had previously awarded very generous investment contracts to foreign investors, are now in the process of reviewing sector legislation (e.g. mining) in order to reverse the perceived commercial inequities of these agreements and at the same time increase local participation in returns from their national resources.

Clearly, in this environment, project finance banks are lending to more risky projects on structure alone, and in jurisdictions which are experiencing heightened political risk. Against this backdrop, lenders are once again turning to the benefits of PRI to help mitigate these risks.