

REGIONAL DEVELOPMENTS IN FDI AND PRI: The Case of the Islamic Corporation for the Insurance of Investment and Export Credit



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This article was written by MIGA in close collaboration with the Islamic Corporation for the Insurance of Investment and Export Credit.

The Middle East and North Africa (MENA) has been benefiting from record levels of liquidity resulting from a prolonged period of high oil prices. GDP growth for the overall MENA region increased to 5.4% in 2006, according to the World Bank's World Development Indicators, and public investment, private sector activity and international trade have also been on the rise.

Capital surpluses for the Gulf Cooperation Council (GCC)¹ states are substantial with a combined current account and fiscal surplus of approximately US\$200 billion in 2006 as compared to China's estimated US\$250 billion.² The abundance of liquidity in the region has investors looking for ways to put their capital to work. The result has been significant capital outflows with the GCC estimated to have US\$1.6 trillion in total foreign assets.² Outflows from the region have taken a variety of forms that include equity, portfolio, and direct investment. UNCTAD estimates that for the Middle East (not including North Africa), FDI outflows alone totaled US\$14 billion in 2006, an increase of 5 percent over the 2005 level.³

MENA investors are actively searching for investment opportunities and casting their eyes abroad in search for higher yields. Much of this activity seems to be focused towards the developed world with GCC outflows alone to the US and Europe estimated to be US\$400 billion over the last 5 years.² In terms of the value of cross-border mergers and acquisitions, investment from the Middle East increased by 78 percent (US\$32 billion), with two-thirds of that amount directed to industrialized countries, while the rest has gone to the developing world – to regional neighbors as well as less familiar foreign markets.

Intra-regional investment levels are significant and have risen notably, with inter-Arab investment flows estimated to be \$US42-45 billion⁴ for 2006. Regional investors have also been making considerable direct investments into sectors such as infrastructure, telecommunications, tourism, and banking. Factors contributing to this include the expansion of capital rich GCC states as well as the emergence of MENA multinationals for which Islamic states represent a natural path for growth as they seek to expand their businesses and market share and where they can benefit from geographic and cultural proximity. Recently, UAE's Emaar signed real estate development deals in Pakistan totaling US\$2.6 billion and has joined forces with Dubai Holdings to make a ten-year US\$9 billion investment

ICIEC Member Countries

35 member countries spanning North and East Africa, the Middle East, and Central and South-East Asia.

Algeria, Bahrain, Bangladesh, Benin, Brunei, Burkina-Faso, Cameroon, Chad, Djibouti, Egypt, Gambia, Guinea, Indonesia, Iran, Jordan, Kazakhstan, Kuwait, Lebanon, Libya, Malaysia, Mali, Mauritania, Morocco, Niger, Pakistan, Qatar, Saudi Arabia, Senegal, Sudan, Syria, Tunisia, Turkey, Uganda, United Arab Emirates, Yemen.

in Morocco's tourism industry. The Al Ghurair Group of the UAE has also invested heavily in Pakistan in food products and petroleum.

Interest in regional investments has also come from abroad. According to the World Bank's latest Global Development Finance, FDI flows into MENA reached an estimated US\$19.2 billion in 2006, a record level, and nearly five times of levels of the first half of this decade. Egypt alone attracted nearly one third of that amount. Turkey, not generally categorized as MENA but part of the broader region and a member of the Islamic Development Bank, attracted more than US\$19 billion in FDI, helped by large financial sector privatization deals and cross-border acquisitions. That figure also represents a large increase over the early part of this decade, when FDI flows to Turkey rarely exceeded US\$2 billion.

International investors are paying greater attention to the region as a result of optimistic growth outlooks, increased commercial activity, and "serious economic liberalization policies and close coordination between the public and private sectors," said ICIEC General Manager Dr. Abdel Rahman Taha. In fact, it is projected that over US\$1 trillion dollars of investment in infrastructure and manufacturing services will be made in GCC states alone.² This is alongside the various privatizations that are occurring in countries such as Turkey, Jordan, and Egypt. International interest in these projects is evident as seen with the Queen Alia International Airport project in Jordan earlier this year; investors from France, Germany, Malaysia, and Austria joined consortiums in the bidding process that finally favored the multinational Alfa Consortium.

MENA investors are, consequently, competing with international investors for a finite number of available projects in the region. As a result, their search for higher yield opportunities has taken them increasingly to emerging economies beyond North Africa and the Middle East. Generally, these more sophisticated globally-minded MENA investors are not only seeking returns but also desire greater access to international markets, global production systems and knowledge networks. Strong

interest has been shown in Africa and South and East Asia – with special attention paid to countries such as China, India, Indonesia, Malaysia, and South Africa. Recent prominent MENA multinational expansions include Emirates Communications' acquisition of Pakistan Telecommunications for US\$2.6 billion; Dubai World's US\$1 billion purchase of Victoria and Albert Waterfront in South Africa; and Thuraya Satellite Communications' US\$5 billion investment in satellite-based mobile phone systems in South Korea. As these South-South deals take investors further away from regions, markets, and risks with which they are familiar and comfortable, the growing importance of political risk insurance in investments has increased.

Trends in Perception of Political Risk and Use of Political Risk Insurance

The notion of political risk insurance is not foreign to MENA investors but, to-date, has not been used significantly. This is due, in part, to different perceptions of risk held by regional investors as compared to other international investors. "The traditional Gulf investors don't see countries like Egypt or Morocco, or even Sudan, as high risk. Political events that may shock an international investor based in London or New York are seen as every day affairs here," explains Dr. Taha.

This trend in the use of PRI is changing, according to Toby Heppel of FirstCity, as a result of a burgeoning private sector and increasing participation in project finance opportunities.

MENA investors, traditionally family-owned trading companies, are becoming increasingly sophisticated, able to manage complex international deals and are knowledgeable about risk management and project finance. They are hiring risk management experts and analysts as part of their project development teams. "They are doing due diligence as they would in the West," Dr. Taha states. "These guys are the ones who will pitch PRI because it can help deal structures."

It helps that there are established regional providers of political risk insurance that include private sector and multilateral groups, such as the Inter-Arab Investment Guarantee Corporation and the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC).

Islamic Corporation for the Insurance of Investment and Export Credit: Overview

The Islamic Development Bank, a multilateral development bank, established the Islamic Corporation for the Insurance of Investment and Export Credit in 1994. ICIEC's mission is to be the premier provider of Shariah compatible export credit and investment insurance and reinsurance with the aim of increasing trade and FDI for its member countries.

Membership is broader than just the Middle East and North Africa and includes countries in Sub-Saharan Africa, Central Asia and South-East Asia that are members of the Organization of the Islamic Conference. Currently, 35 countries are members of ICIEC and

ICIEC Services

Coverage provided for:	Risks covered:
Cross-Border Equity Investments	Transfer and convertibility
Cross-Border Financing	Expropriation
Cross-Border Financing Guarantees	War and Civil Disturbance Breach of Contract

coverage can be sought for investment going into these nations. Currently, 100% of their investment insurance activities can be categorized as South-South transactions.

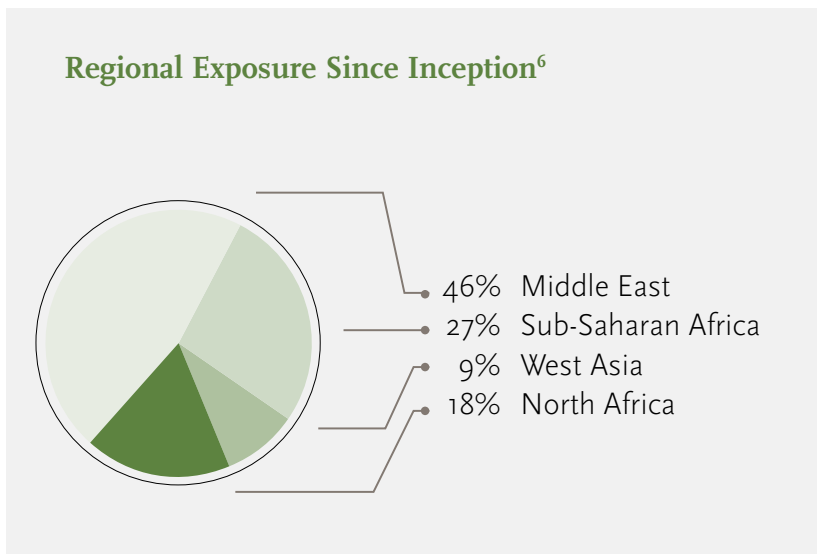
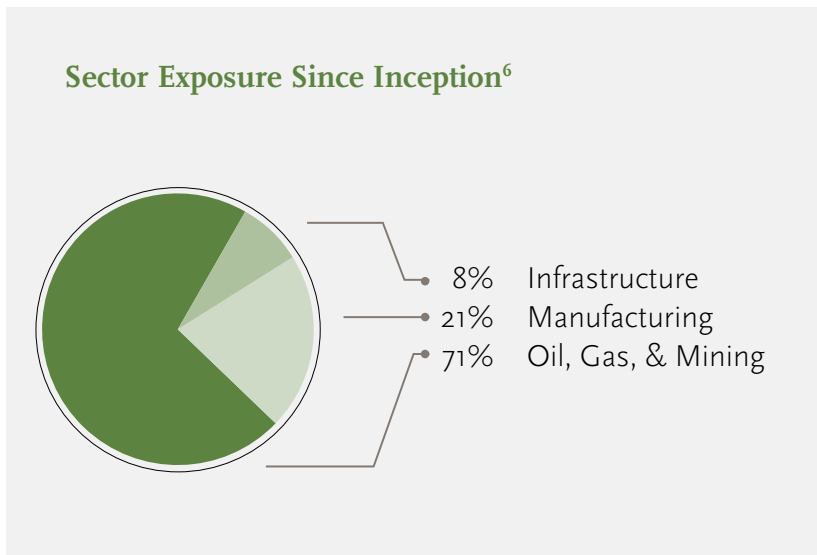
ICIEC has seen interest in the market for political risk insurance for investments and has been active in this regard with overall new insurance commitments for the last year⁵ increasing 73%. However, ICIEC's current exposure to investment insurance is only 4% as the overwhelming volume of its business is in export credit. ICIEC's lower volumes in investment insurance are due to demand characteristics of a market that has higher risk tolerances but also because of capacity related issues. ICIEC's view is that overall demand for political risk insurance is increasing and will continue to grow. Consequently, ICIEC has continued to strengthen its partnerships with organizations such as MIGA and Coface in order to build its investment insurance and reinsurance activities and to expand its capacity, and has built a significant pipeline of business.

Investors have shown high levels of interest in breach of contract and war and civil disturbance coverage with the majority of coverage provided for deals in sub-Saharan Africa. Investor groups and companies that have purchased political risk insurance have been from larger-sized operations; a significant portion of ICIEC's clients include banks seeking coverage for projects they are financing in a variety of sectors.

As a development institution ICIEC also provides technical assistance services in investment promotion to its members. In October 2007, ICIEC joined the Berne Union as the newest member of this international association of private and public providers of export credit and investment insurance.

Shariah Compliance

Islamic banking is on the rise with growth expected to continue. In fact, it is estimated the Shariah compliant products are now at \$250-300 billion globally. The markets and financial services providers are responding to an



increasingly active MENA investor community with strong interest in Islamic friendly financial products. Political risk insurance providers are among the mix of service providers that are working to tailor their instruments to meet Shariah compliant requirements.

“We are seeing a new generation of players in infrastructure, from India, from Malaysia, from the Gulf,” notes Daniel Gabaldon, of Booz, Allen, Hamilton. “This is an interesting challenge for PRI providers, to develop products that will resonate with these players, because they are the ones with

a higher risk tolerance and the ones going to the most challenging places.”

In addition, “PRI can be used to enhance sukuk⁷ by helping corporate bonds improve their credit ratings” says Alatabani. Companies issuing bonds in the MENA region are often constrained by their country's ratings as seen by the international markets. “PRI allows corporate bonds to pierce sovereign ceilings by enhancing the investment grade of the bond and by addressing the overall markets perception of country risk associated with the sukuk issue.”

Shariah Compliance Explained

Technically speaking and in terms of operations, an Islamic insurer is not different at all from any other conventional insurer. Nevertheless, there are four non-technical unique characteristics of Shariah compliant insurers vis-à-vis conventional insurers.

The main difference between ICIEC (or for that matter any other Islamic investment insurer) and conventional investment insurers is the peculiar governance and accounting structure that Shariah compliant insurers adopt. To be Shariah compliant, an insurance entity has to have separate accounts for its shareholders who support the Corporation but are not supposed to receive income from its insurance activities. Islamic insurance is based on the concept of “takaful”, which means cooperative insurance where shareholders manage an insurance portfolio that aims to provide a service for the benefit of the community and for the common good of society. As a result, they are not supposed to earn profits from the technical surplus through the provision of this service. This does not preclude them from charging management or agency fee for administering the insurance portfolio. Any surplus of premium over claims and other expenses should go to the policyholder’s account as a reserve.

Another key area of difference is that a Shariah compliant investment insurance entity is not allowed to insure goods and services that are not compatible with Shariah such as alcohol, gambling, prostitution, weapons and goods derived from pork products. A third area where Shariah compliant insurers differ from conventional insurers is that its liquid funds cannot be invested in non-Shariah-compliant transactions. Finally, when it comes to insuring loans, a Shariah compliant insurer cannot cover interest and can only insure the principal amount.

Case study

Algeria – Hikma Pharmaceuticals

In the late 1990s and early 2000s, Algeria was struggling to put a decade of violent civil unrest behind it and had succeeded in stabilizing the political and security situation. However, the country, which has enormous hydrocarbon and other natural resources, was finding it difficult to convince investors to return.

On its part, Hikma Pharmaceuticals Co., a private Jordanian Corporation, had been exporting its drugs, manufactured in its Jordan-based facilities, to Algerian customers since the early 1990s. In a move to encourage FDI into the country, the Algerian government imposed local production requirements on many pharmaceutical products, including those Hikma had been importing into the country. The new regulatory requirement meant that unless these particular products were produced locally they would be denied access to the lucrative Algerian market. This would lead to the elimination of 40% of Hikma’s exports, which made the backbone of the company’s sales.

Consequently, and to safeguard its market share, Hikma decided to establish three drug manufacturing

facilities in Algeria. The total project cost was over US\$10 million. But the company perceived the political risks in the country to be prohibitive. Thus, in 2004, Hikma Co. requested PRI coverage from ICIEC for the risk(s) of Transfer Restriction, Expropriation, and War and Civil Disturbance for a period of 5 years.

With annual sales of US\$1.2 billion, Algeria’s pharmaceutical sector is comparatively large – one of the largest in Africa. There are now about 30 pharmaceutical companies in the Algerian market. Hikma is the only regional Arab company in the sector and faces tough competition from the state-owned companies as well as the multinationals.

Today, partly as a result of ICIEC’s PRI cover, Trust Pharma, the project enterprise, boasts 20 locally manufactured products and 70 imported from Jordan and its other affiliates across the world. Since its establishment, Trust Pharma’s performance (and that of Hikma for that matter) has been stellar. It has secured a preeminent position in the highly competitive Algerian pharmaceutical market, occupying the number one position in local sales and growth rate. With gross sales of US\$50 million a year, Trust Pharma accounts for almost 25% of Hikma’s total annu-

al sales of US\$214 million. But more importantly, Trust Pharma plans to increase its annual sales to US\$100 million in the coming five to ten years. It has now 200 employees. With the management team and some of the high skilled professionals coming from Hikma Jordan, this investment is also contributing to the development of Algeria through transferring knowledge, technology and managerial and other professional skills.

Footnotes

1. *Gulf Cooperation Council states include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.*
2. *The Institute of International Finance, 2007.*
3. *UNCTAD, World Investment Report, 2007*
4. *Inter-Arab Guarantee Agency, UNCTAD; these flows are not limited to FDI and include all asset classes.*
5. *The last year according to the Islamic calendar is 1427 which would be the equivalent approximately to the time period from January 2006 to January 2007.*
6. *All figures in the charts refer to ICIEC investment insurance operations since inception.*
7. *Sukuks are asset-backed bonds structured in accordance to Shariah principles.*