Approved by MIGA's Board of Directors on May 22, 2008
Released in accordance with MIGA's Policy on Disclosure of Information

M.I.G.A.
MULTILATERAL INVESTMENT GUARANTEE AGENCY

OPERATIONAL DIRECTIONS FY09-11

Abbreviations and Acronyms

AMS	Agriculture, Manufacturing and Services
BU	Berne Union
CUP	Cooperative Underwriting Program
ECA	Europe and Central Asia
ECA	Export Credit Agency
EMBI	Emerging Market Bond Index
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Services
IEG	Independent Evaluation Group
IFC	International Finance Corporation
LAC	Latin American and the Caribbean
MENA	Middle East and North Africa
OECD	Organisation for Economic Co-operation and Development (OECD)
OGMC	Oil, Gas Mining and Chemicals
PPP	Public/Private Partnership
PRI	Political risk insurance
PwC	Pricewaterhouse Coopers
SIP	Small Investment Program
SSA	Sub-Saharan Africa
TA	Technical Assistance

Table of Contents

Boxes

Tables

Figures

It is the vision of the World Bank Group to contribute to an inclusive and sustainable globalization—to overcome poverty, enhance growth with care for the environment, and create individual opportunity and hope.

Robert Zoellick
October 22, 2007

MIGA's mission is to promote foreign direct investment (FDI) into developing countries, to support sustainable economic growth, reduce poverty and improve people's lives. To this end, the agency's vision is to be a multilateral risk mitigator, providing products and services that support investors going into developing countries and provide comfort against potential political (noncommercial) risks. The agency's core business is the provision of political risk insurance.[1] In addition, MIGA carries out complementary activities—including technical assistance activities (TA), dispute resolution, and knowledge services—to support productive FDI.

MIGA is committed to promoting projects that promise a strong development impact and are economically, environmentally, and socially sustainable. The agency is also dedicated to working with governments that are committed to policies and actions that improve their countries' investment climates.

In all its undertakings, MIGA draws on the complementary strengths of the World Bank Group, leveraging the various products and services across the respective institutions for the benefit of host countries and private investors. In their work, MIGA staff aim to improve client services, partner with others, build capacity, innovate to meet client and market needs, and share and learn from experience.

In pursuing these goals, MIGA operates on a financially self-sustaining basis. It does not seek to maximize financial returns, but funds its administrative budget and pays out claims while maintaining the strength of its balance sheet through a combination of premium income and investment income.

[1] The terms guarantees and political risk insurance are used interchangeably throughout this report.

Executive Summary

As a necessary first step for developing its operational directions for FY09-11, MIGA has reviewed its experience with the strategy it embarked on for the period of FY05-08. MIGA also took into consideration the findings of the 2008 IEG-MIGA Annual Report, as well as client surveys and a market study undertaken by PricewaterhouseCoopers (PwC).

MIGA has had important successes in the FY05-08 period, as evidenced in particular through results to date in the current fiscal year, which point to the agency likely exceeding its fiscal year volume targets. In addition, while MIGA's operational priorities (infrastructure, frontier markets, conflict-affected environments, and South-South investments) were not exclusive objectives but rather areas of special focus, a significant proportion of the projects underwritten during the strategic period were in these areas. Over half of all projects (through FY08Q3) were in IDA countries, and almost 30 percent supported the other priorities. Furthermore, over 30 percent of the projects supported were in sub-Saharan Africa. The results speak to both the business development efforts undertaken by the agency, as well as the fact that the identified priority areas were in line with MIGA's comparative advantage.

MIGA needs to build on these successes going forward. Given MIGA's comparative advantage, the state of the current PRI market, and the agency's projected success for the fiscal year, the strategic themes of the FY05-08 remain broadly as valid today as they were four years ago. The operational directions for the next three years will therefore focus on a similar set of themes, but with an emphasis on improved business delivery.

With respect to the market environment, the main change over the period up to 2007 has been the fall in risk perceptions, reflected in falling Emerging Market Bond Index Global composite stripped spreads, and the higher rate of growth of foreign direct investment (FDI) into developing countries. In addition, the PRI market has progressed significantly with the entry of new private sector players and the growth of operations of existing players. This has altered the competition dynamic by strengthening the bargaining power of customers and has resulted in a more transparent market. Combined with lower perceived political risks, the PRI market has therefore seen significant downward pressure on premium rates.

Nevertheless, since the summer of 2007 a key disturbance in financial markets has been the growing liquidity crunch in credit markets, which resulted from this period of ample liquidity and low interest rates, and was initially triggered by the sub-prime losses in the US mortgage industry, but is now extending to other broader segments. Currently, it is unclear how long the credit crisis is expected to last. However, it is expected to produce two results which will have opposite effects on MIGA. On the one hand, there could be a "flight to quality" which will limit the flow of FDI to higher-risk developing countries, where MIGA has a natural comparative advantage and where MIGA is highly regarded in the market. This would reduce the potential FDI flows which are the basis of PRI demand. On the other hand, increased risk perception and growing spreads may create an incentive to purchase PRI – both on risk grounds and because the growing spreads permit the financing of guarantee premium. MIGA will continue to closely monitor behavior of market participants with the view of maintaining close client responsiveness.

The PwC study and client surveys identified key strengths and weaknesses of MIGA. The agency is well perceived by market participants in its knowledge of developing countries, in particular IDA countries, where there is not much market knowledge available. Clients also appreciate the agency's ability to mediate disputes to the benefit of both investors and governments. MIGA's strong capital base and ability to pay compensation in the case of large-scale losses is also seen as an asset in the market. Finally, MIGA's adherence to strong environmental and social guidelines is appreciated by some clients as a "seal of approval" of good corporate citizenship. On the other hand, clients perceive MIGA to lack flexibility and nimbleness, with limited innovation in terms of product offerings. MIGA is also seen as reactive to new products in the market, rather than as a market precursor. Another concern identified by market participants is the length of time needed to underwrite a transaction and the amount of information required by MIGA to conduct its underwriting. In addition, although cost-effective in certain market segments, the agency is seen as a high cost provider of PRI by market participants.

A review of lessons learned from the FY05-08 strategy confirms PwC's findings. MIGA has the opportunity to strengthen key areas of its business delivery, including: business development; streamlining internal processes to enable the agency to react rapidly to a changing market by supporting innovative financings; and continued development of market intelligence. Over the past four years, MIGA has attempted to be innovative in its product offering in order to respond to market demand and stay within the constraints of its Convention. Examples of such innovation include: (i) guarantees for a 144a placement on a toll receipts securitization issue for a toll road in the Dominican Republic; (ii) guarantees in support of a carbon credit-financed waste management project in El Salvador; and (iii) support for an Islamic-friendly structure to finance a port in Djibouti.

In any given year, MIGA's business tends to be volatile and unpredictable due to the nature of the industry. This demonstrates that, while MIGA is able to broadly pursue its operational priorities and can position itself in the market where its comparative strengths are best revealed, the agency cannot predict with certainty how its portfolio will develop in any given year. This unpredictability underpins the importance of MIGA having successfully implemented a strong risk management framework, which allows the agency to make more informed decisions on new products (on risk and cost-recovery grounds). This framework also allows MIGA to maintain a solid capital and financial footing. The agency is also aware of the need to strengthen its intellectual leadership on guarantees within the World Bank Group.

Given the agency's relative portfolio and development success overall, the operational directions for FY09-11 are based on a continuation of the four main pillars in the current strategy, coupled with three guiding principles that will guide its delivery. The four main operational priorities are:

- *Investments in IDA countries*, a key area of comparative advantage for MIGA.
- *Investments in post-conflict countries*, an area of strengthened engagement for the agency over the past few years and where MIGA remains strongly relevant.
- *Investment in complex projects*, mostly in infrastructure and the extractive industries, often involving government intervention and resulting in a delicate balance of risk-sharing by stakeholders.
- *Support for South-South investments*, given the growing proportion of FDI coming from developing countries and the need to provide underserved corporates with political risk insurance.

MIGA's delivery of these operational priorities will be guided by the need to be:

- *supportive of and complement World Bank Group* strategies articulated for specific countries, as well as its strategic themes
- *client and market responsive* through greater flexibility in service and product delivery across all markets
- *financially sustainable,* which will require an efficient use of MIGA's balance sheet and the maintenance of a balanced portfolio.

During this period, MIGA will continue to monitor its financial performance as one of the bases on which to assess its improvement in key areas of its business. The metrics for performance will be based upon three key variables:

- *Overall gross issuance* - MIGA will strive to maintain a multi-year average issuance of $1.8-$2.2 billion in guarantees.
- *Investment flows to IDA countries* - MIGA will strive to maintain a portfolio composition weighted toward IDA country exposure
- *Financial measurement*: Return on Operating Capital before Provisions (ROOC) with the goal of achieving a return of 7-10% by the end of the strategy period.

These priority areas, operational guidelines and metrics are aligned with MIGA's market niche – supporting underserved markets and clients, while remaining financially sustainable.

I. The FY05-08 Strategic Directions Period

A. Establishing the FY05-08 Operational Focus

The External Context

1. The PRI market in which MIGA operates is a sub-set of the cross-border insurance market. It excludes, by definition, in-country investments, short-term trade finance, as well as broader investment insurance coverage. This means that the market for PRI products competes with a wide array of risk mitigation substitutes, which have been growing in importance in recent years. Up until the early part of the decade, the PRI market was characterized by high capital requirements and long-term liabilities that created high barriers to entry. It was dominated by public insurers, characterized by the relatively low bargaining power of customers and a relatively high degree of cooperation among PRI providers, the majority of which were public insurers (export credit agencies and multilaterals).

2. However, towards the end of the 1990s, which saw few reported claims by PRI providers, the role of private providers began to expand. The private providers "came to the scene in the 1970s, primarily through Lloyd's syndicates…[and] have grown from virtually minimal presence twenty years ago to more than 50% of the PRI market today."[2] This growth did not come at the expense of the public providers,[3] but benefited both private and public insurers, who took advantage of the fact that FDI was increasing because investors were seeking diversification and higher returns from their investments.

3. At the time the FY05-08 strategy was prepared, therefore, changes were underway in the market, but there was no consensus as to whether these would result in a significant market shift. For example, the downward pressure on premiums was apparent but there was no agreement in the market as to whether this reflected a temporary market correction or a fundamental market change. In addition, the impact of substitutes for coverage in capital markets, which hedge similar or broader risks, was only beginning to be felt in the industry despite many years of development.

Setting the FY05-08 MIGA Strategy

4. The FY05-08 Strategy[4] was formulated at a time when MIGA was concluding the *MIGA 2005 Review for FY00-04*.[5] The *2005 Review* indicated that the agency was facing a worrisome slowing of momentum. Issuance of new guarantees, which had climbed steadily during the 1990s, had peaked at $2.0 billion[6] in FY01, but by FY04 had fallen to $1.1 billion, the lowest amount since FY98. Similarly, gross exposure, which had also seen steady annual growth throughout the first ten years of MIGA's operations, had leveled off. Instead of year-

---

[2] PriceWaterhouseCoopers, *Political Risk Insurance Market Study*, December 2007, page 17.

[3] Berne Union (BU) data from between 2001 and 2005 indicate an overall increase of 47% in exposure (or 10% CAGR).

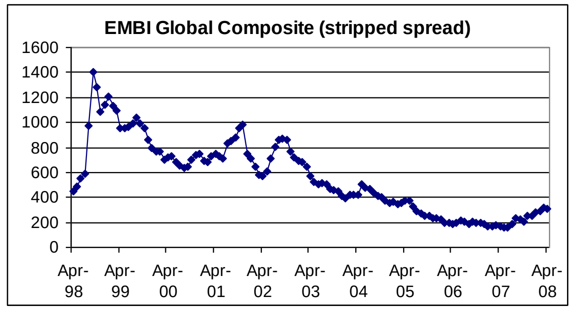
[4] MIGA's FY05-08 Strategy was actually prepared during FY05, under the leadership of the newly appointed Executive Vice President, and was approved by the Board in May 2005.

5 The review was conducted in accordance with Article 67 of MIGA's Convention. This was the third such review in MIGA's history. The first review was undertaken in 1994 and the second periodic review was undertaken in FY02.

[6] Total guarantees issued in FY01 reached $2.2 billion when including guarantees issued under the Cooperative Underwriting Program (CUP).

on-year growth as MIGA had seen throughout the first ten years of operations, the portfolio remained constant, averaging around $5.2 billion a year over the FY00-04 period.

Box 1. The Relationship Between FDI and PRI and Premium Dynamics



Given that the political risk insurance (PRI) industry is focused on cross-border investments, the demand for guarantee products is derived from the volume of investment flows coupled with perceptions of risk. For this reason, a strategy of the PRI sector cannot be divorced from a view of the evolution of FDI flows. Over the past few years, net FDI flows to developing countries have risen to record levels, reaching an estimated $370.1 billion in 2007.[7] At the same time, risk perceptions have been decreasing rapidly over the past few years, as evidenced by the overall decline of the Emerging Markets Bond Index Global Composite[8], notwithstanding the recent increase resulting from the current liquidity crisis in financial markets. The reduction in risk spreads was influenced to some degree by liquidity in the markets (supply side), but also by a genuine decline in overall risk in emerging markets as evidenced by the fall in reported political risk insurance claims paid, which fell by about 45% between the 1970s and 1990s. There were, therefore, two distinct factors operating in opposite directions in the PRI market: (i) an increase in potential demand as FDI flows increased; and (ii) a decrease in both spreads and risk perception (especially up to mid-2007), which created less of a perceived need for PRI. During 2002-2007, the result therefore, was an overall increase in PRI coverage (albeit at a growth level below that of FDI) coupled with falling premium yields.

5. Another concern was the composition of the portfolio, which during the FY00-04 period had shifted, resulting in an increase in exposure in Europe and Central Asia (ECA) and the Middle East and North Africa (MENA) and a decrease in relative terms in Latin America and the Caribbean (LAC). Portfolio shares in terms of volume of guarantees issued in sub-Saharan Africa (SSA) and Asia[9] remained essentially flat. From a sectoral perspective, the proportion of infrastructure projects increased, while agribusiness and manufacturing declined, and the financial sector remained relatively steady. The number of projects in priority areas such as SSA, infrastructure and south-south investments declined comparing FY00 to FY04.

6. In terms of revenues, income from guarantees remained largely flat and investment income declined significantly, largely due to declines in interest rates. Return on operating capital also fell, due to the combined effect of MIGA's strengthened capital base and the decline in net income (before provisions), which in turn was driven by increasing administrative expenses and downward pressure on premium rates for new guarantees.

Aligning Objectives with MIGA's Added-Value

7. Taking into account the above factors, MIGA's management considered how best to deliver on the agency's mandate as it prepared the FY05-08 strategy, with the foremost objective of identifying how MIGA could maximize its value proposition. The exercise was guided by: (a) an assessment of the external environment, including trends in FDI flows

[7] Global Development Finance Advanced (April 2008) database, World Bank.

[8] JP Morgan's Emerging Market Bond Index Global Composite (stripped spread) includes US-dollar-denominated Brady Bonds, Eurobonds, and traded loans. The "stripped spread" refers to the difference between the underlying instruments' stripped yield and the U.S. Treasury yield of equivalent duration.

[9] MIGA accounts for South Asia and East Asia collectively, unlike the World Bank.

around the world and the emerging private market for PRI; (b) an understanding of MIGA's comparative advantages within the PRI market; and (c) the lessons learned from the review of the past five years of operations. Management believed that the agency continued to have an important role and comparative advantage in promoting FDI for development, and that it could remain a financially self-sustainable institution, which complemented the activities of the other World Bank Group members.

8. From a development perspective, long-term economic growth supports poverty reduction and FDI promotes growth by bringing in not only capital, but also jobs, technology, organizational methods and access to global markets. However, FDI flows are disproportionately low in developing countries due in part to the reality or perception of political risks. MIGA's comparative advantage is precisely to manage these risks in these environments, thus complementing the broader agenda of the World Bank Group.

9. MIGA management sought to develop a strategy that would allow the agency to not only to be financially self-sufficient but to face the test of a competitive market, where it would need to complement rather than compete with other public or private PRI providers. It was recognized that MIGA would have a comparative advantage in riskier environments where gains to investors and countries can be high if the risks are well managed.

10. Management also considered whether MIGA should continue to operate as a stand-alone entity within the World Bank Group or be incorporated into the World Bank or IFC. Based on consultations with clients, business partners, as well as Board members and World Bank Group management, it was concluded that MIGA would best meet its development mandate by remaining an independent institution. Effective delivery of PRI requires specialized expertise, and MIGA had built credibility and brand recognition over the years. This acknowledged credibility enabled the agency to mobilize private sector insurance capacity and helped generate investor interest in markets that would otherwise remain underserved. There was concern that an integration of MIGA into another part of the Group would lead to a loss of focus and brand equity that would compromise valuable business linkages and lead to a higher (and uncompetitive) cost structure.

11. The review also concluded that preserving MIGA's independent balance sheet and specialized expertise allowed the agency to innovate in order to respond to changing client needs and market conditions. At the same time, however, it was emphasized that for MIGA to maximize its effectiveness, it must strengthen its relationship with the World Bank and IFC. It was recognized that such collaboration needed to be systematic and coordinated, and that the commitment must be signaled and led by the top management of the respective institutions.

The Strategic Priorities

12. MIGA's operational priorities for FY05-08 were identified taking into account the development needs of the agency's member countries, the demands of a changing FDI environment and PRI market, and the need for MIGA to focus on its comparative advantage and complement other insurers and institutions that provide similar services. With this in mind, management proposed four operational priorities:

- Investment in infrastructure development
- Investment into frontier markets
- Investment in conflict-affected environments
- Investment among developing countries or south-south investment

13. Infrastructure investments are frequently complex, high-risk, and long-term in nature and entail considerable government involvement. And MIGA was seen as having a clear comparative advantage in supporting such activities. At a time when the World Bank Group was renewing its operational focus on infrastructure projects, MIGA could build on the "upstream" policy and regulatory work of the World Bank, and help attract a broad range of quality investors into key infrastucture projects, particularly by playing a lead role in supporting public-private partnerships (PPPs).

14. Frontier markets—high-risk and/or low-income countries—represented both a challenge and an opportunity for the agency. They had the most need and stood to benefit the greatest from FDI, but investors were often wary of investing there. Other insurers were also less prepared to venture there, and would only insure at high premiums and short tenors. As a member of the World Bank Group, MIGA was well-positioned to support investments and lead other insurers into these countries.

15. In conflict-affected countries, which other insurers also typically avoided, MIGA was already a proven presence. In these environments, where there are often considerable opportunities, raising capital and managing risks are key concerns. MIGA guarantees were therefore seen as capable of playing a powerful role in providing investors with the comfort needed to take the first steps and secure resources, as well as having a powerful demonstration effect in terms of attracting further investment.

16. By the beginning of this decade, companies from developing countries were starting to account for a greater proportion of FDI flows into other developing countries. For these investors venturing into unkown markets, political risk insurance was seen as an important risk mitigator. But in many of their countries, the private insurance market was not yet sufficiently developed and national export credit agencies lacked the ability and capacity to offer political risk insurance. MIGA was therefore seen as being able to play an important role in supporting such south-south investments.

B. Implementing the FY05-08 Strategy

17. The FY05-08 strategy introduced a new business model aimed at improving MIGA's financial and operational sustainability in the long term and delivering the agency's core strategic priorities. Key elements to this included proactive marketing and complementary products; a comprehensive risk management framework; and stepped-up collaboration with the World Bank Group. The business model aimed to center on MIGA's unique role as a multilateral risk mitigator, drawing on its governance structure to support development in ways that added value and complemented the activities of others. This, therefore, complemented MIGA's operational priorities, which focused on high-risk areas where MIGA has a comparative advantage.

18. Implementing the new business model led to a number of changes, both outwardly directed or client-focused and internal. The intent was for MIGA to deploy its various products and services in an integrated and tailored way to respond to clients' needs. A guiding principle in directing the agency's efforts was to focus on projects and activities that supported the agenda of the World Bank Group. This also implied working closely with the Bank, investors, and host governments in a selected set of countries to identify projects and programs that fit within the context of country assistance strategies and World Bank regional strategies.

19. *Complementary product lines.* Introducing complementary product lines and proactive marketing led to the merging of MIGA's technical assistance and guarantees programs. It was felt that TA's work to support improvements in a country's FDI environment would yield greater opportunities for guarantees business. In addition, management believed that the regional focus and the on-the-ground knowledge of TA staff would offer insights and business opportunities for MIGA's guarantees, while clients of TA, mainly investment promotion agencies, would benefit from access to MIGA's risk mitigation products. Some examples of linkages envisioned between TA and guarantees included: integrating investor outreach programs, often in coordination with investment promotion intermediaries; using enterprise benchmarking studies and MIGA's online services (IPAnet, FDI Xchange) to disseminate knowledge to potential investors; and knowledge-sharing between TA and guarantees staff to identify key impediments to investments in frontier markets. However, MIGA's experience over the strategic period showed that TA is more complementary with FIAS' work on advising governments on how to improve their investment climate, and as a result, it was decided to merge MIGA's TA activities into FIAS in FY07.

20. *Sectoral focus*. The guarantees business was reorganized along sectoral lines (as opposed to by regions) in order to enable underwriters to have a more intimate understanding of the dynamics of their respective sectors. In addition, a sector focus was thought to enable underwriters to engage with corporate clients at a more strategic level and lead to less overlap in client coverage. There is still more work to be done in improving business development and client relationship management, but the changes have resulted in a better understanding of MIGA's key clients and its overall client base.

21. *World Bank Group collaboration.* Complementing MIGA's proactive marketing strategy was the intent to develop collaborative country relationships. The idea was that MIGA would seek to develop closer relationships with host countries to address key constraints holding back investments in priority areas and then follow-up with guarantee support. Done in close collaboration with the World Bank and organized through the country assistance strategies and similar strategic processes, MIGA has moved much closer to aligning itself with the Bank. One example of the collaborative relationship that has developed is the Bujagali project in Uganda, which deployed the Bank Group's private and public sector instruments. Further opportunities exist for MIGA to work more closely with the Bank through a more strategic dialogue that will filter down to operational staff.

22. *Costing and pricing.* The FY05-08 strategy envisioned implementing an economic capital model, which aimed to establish a sound risk-based analytical basis for the systematic assessment of MIGA's balance sheet strength. This was successfully completed and, together with the introduction of a systemic pricing model in 2003-04, led to changes in the pricing model to reflect the agency's strategic objectives, effective October 1, 2007. The FY08 adjustments took into account detailed work on MIGA's cost profile, and incorporated the work undertaken in developing a capital adequacy model. The result has been the introduction of a pricing methodology that allocates MIGA's costs in alignment with its strategic goals. Management also sought to review legacy reinsurance programs using the economic capital model to assess the appropriate amount of reinsurance that the agency should seek. As a result of the review, MIGA has a new reinsurance program which should result in a more balanced portfolio from a risk point of view.

23. *Supporting innovative projects.* MIGA's management recognized that MIGA must have the flexibility to meet changing investor and country client requirements in order to make its

guarantee products more relevant to today's market needs. Indeed, the FY05-08 strategy outlined a number of expansions to MIGA's product offerings that could enable the agency to more fully meet the needs of the market. Such expansions would take a considerable time to implement, but during the period, the agency found ways to support a number of innovative and award-winning projects despite the limitations of its Convention. Typically, the types of projects where MIGA identified new ways to assist the sponsors were ones where there was a high premium placed by the client on having MIGA's involvement. Examples of such projects include:

- *Islamic finance* – MIGA supported a Sharia-friendly project financing of the Doraleh Container Terminal in Djibouti, which won African Transport/Ports deal of the year
- *Private placement in support of infrastructure* – MIGA provided guarantees for a bond issue in support of revenue of a toll road in the Dominican Republic, the first of its kind in the country
- *Carbon finance* – MIGA's first carbon finance transaction supported the capture and flaring of methane gas generated by a landfill in El Salvador

These transactions are eminently replicable, and MIGA is actively publicizing its role in facilitating these investments in order to try to build new business opportunities.

Box 2. Innovation in Islamic Finance in Djibouti

In FY08, MIGA supported its first Shariah-friendly transaction—the Doraleh Container Terminal Project Financing in Djibouti.

This project is significant to Djibouti, as well as its neighbors, as it will help position the country as a strategic transshipment and re-export hub along the vital East - West shipping corridor. The project consists of the construction, operation and maintenance of a new container terminal in Djibouti under a 30-year concession with a total project cost of $394.6 million. Under the project's Shariah-friendly financing structure, several foreign commercial banks and the local project company entered into a joint venture partnership arrangement known as a "Musharaka," through which the respective contributions to fund the project were channeled. The objective of the Musharaka is to jointly own and build the project, with each Musharaka partner retaining undivided ownership interests in the project's assets.

Working in partnership with the Islamic Corporation for Insurance of Investments and Export Credits and local legal partners, MIGA developed a guarantee product tailored to the needs of the Musharaka structure, using contract language customized to reflect the Musharaka's underlying contractual documents. The project received the Project Finance 2007 African Transport/Ports Deal of the Year award for its innovative structure, complexity, and importance to the region.

MIGA has launched a marketing campaign to promote the deal and its Islamic finance guarantee product, and aims to support projects with similar Islamic finance structures in the future.

24. *Process improvement—the SIP*. In March 2004, the Board of Directors approved management's recommendation to create the Small Investment Program (SIP),[10] dedicated to supporting small investments through the provision of MIGA's political risk mitigation services. Under this approval, the Board agreed, on a pilot basis, to waive the requirement for circulation of SIP guarantees reports prior to their approval by the President. This allowed MIGA to issue eligible guarantees of less than $5 million through a simpler and quicker underwriting and approval process. Based on the successful experience of a three-year pilot period, in January 2008, the Board approved mainstreaming this program and

[10] "MIGA's Role in the Small and Medium Term Enterprise Sub-sector – Establishment of the MIGA Small Investment Program (SIP) and Proposed Application of Waiver of MIGA Operational Regulations, Section 3.35," MIGA/R2004-0005.

increased the eligible investment size to $10 million. This has been an important program that allows MIGA to be more accessible for small businesses, for which the transaction costs (especially time) typically associated with the standard guarantee process are frequently too high. This also provides valuable lessons about process improvements that can inform the rest of MIGA's operations.

25. *Provisioning.* The FY05-08 strategy looked to strengthen MIGA's risk management framework, which built on the previous years' work. Therefore, in FY05, a new provisioning methodology was introduced,[11] which built on two previous years' work developing portfolio risk quantification models using individually assessed loss probabilities for projects at risk and rating-based loss probabilities that are applied to the rest of the guarantee portfolio. The new provisioning methodology was designed to better capture the underlying risk profile of the entire MIGA guarantee portfolio, to bring analytical consistency with MIGA's pricing and economic capital management models, and to address several known limitations with the legacy provisioning methodology, including the use of a proxy portfolio, a single attritional loss ratio, relatively subjective parameters and a very conservative reinsurance credit risk allowance.

Box 3. Innovation in Infrastructure Finance in the Dominican Republic

In FY06, MIGA provided guarantees in support of a $210 million toll road project, which used a 144a private placement to raise the necessary financing.

The project involves the design, construction, operation, and maintenance of the 106 kilometer Autopistas del Nordeste toll road in the Dominican Republic. The 33-year concession—the country's first-ever highway license—was awarded in 1999 through an international bidding process. Given the sponsors' need to attract long-term financing (of up to 18 years), traditional avenues for raising commercial debt were unavailable. By working with MIGA to insure the financing, the project's overall credit rating was increased and a private placement (ultimately 40% oversubscribed) was arranged.

The road's impact on the local economy is significant. The project is expected to lower transportation costs by reducing distance and travel time from 220 kilometers (four hours of travel time) to 120 kilometers (1.5 hours of travel time). Progress on the toll road has already led to investments in a nearby free trade zone. Revenues generated by the project above a specific threshold will be paid to the government and the project is expected to create some 2,400 jobs during the construction phase and about 1,300 once operational.

MIGA's guarantees were considered a critical component of the project's financial structure. MIGA continues to market this transaction and aims to replicate this model whenever its political risk insurance can serve as the necessary credit enhancement to raise capital market financing for infrastructure projects in developing countries.

26. *Investment policy.* Working closely with the World Bank's Treasury Department, MIGA implemented a new investment policy[12] at the beginning of FY05, wherein its asset portfolio was managed to provide liquidity to pay for identified claims and to cover future claims and, to the extent possible, to maximize investment returns to contribute to capital growth.

27. *Systems renewal.* In FY06, MIGA embarked on a multi-year systems renewal process, aimed at replacing the legacy database system with an updated system tailored to support the agency's business needs and to sit within—and benefit from—the World Bank's secure IT

[11] The new methodology was discussed and endorsed by the Audit Committee on November 22, 2004, and subsequently approved by the Board of Directors.
[12] Approved by the Board of Directors in June 2004.

environment.[13] Working in partnership with ISG, MIGA engaged an external contractor to design and build a modern and integrated information system to manage data for all activities supporting the guarantee process. The construction of the replacement system is in the final stages and is on schedule to be operationalized in FY09. The new system will not only allow for a more efficient and reliable database functionality to manage all key guarantee data, but will also enable the entire underwriting process to be done online. The new system will be more efficient, strengthen quality control, and enhance the ability to share information internally and externally with the World Bank Group.

28. *Integration of MIGA's Technical Assistance Activities into FIAS*. In FY07, MIGA's technical assistance services were integrated into the Foreign Investment Advisory Service (FIAS), as it was felt there would be greater synergistic benefits for the World Bank Group from such a move. Combining the investment climate reform work of FIAS with MIGA's investment promotion work provides a unique platform for the World Bank Group to help countries get the framework right for investment, and then market the improved environment. It also creates a more coordinated, single interface for clients, donors and other partners. Day-to-day operations of the integrated facility are run by FIAS, with financial contributions from IFC, MIGA, and the World Bank, as well as bilateral donors. MIGA's interests continue to be represented through its participation in the Supervisory Committee.

29. Based on the experience of the first year of this new arrangement, the early results of the integration have been extremely positive. The merging of both the staff and the work programs occurred with little difficulty, and the benefits from the planning and resource management perspectives have been clear. Coordination with MIGA Senior Management has been open and productive. Going forward, particular attention will be focused on identifying and exploiting opportunities for raising awareness of MIGA PRI products to investors that FIAS and its clients assist through their investment promotion projects and programs. The integration of TA into FIAS has also allowed MIGA, particularly its Operations Department, to focus on its core product—guarantees.

Box 4. Innovation in Carbon Finance in El Salvador

In FY06, MIGA issued guarantees to the BioEnergia "waste-to-carbon credit" project in El Salvador – the agency's first-ever support of a carbon finance transaction.

The project involves the construction and operation of facilities for capturing and flaring methane gas generated by a municipal landfill in San Salvador. By capturing and flaring the methane, the project produces reductions certificates, which, under the Kyoto Protocol, can then be traded and sold. The project company has completed the Kyoto Protocol validation process and began selling credits in 2007; its first carbon trade involved 325,000 credits purchased by the Government of Luxembourg.

Emission reductions from the captured gas are expected to be up to 190,000 tons of carbon dioxide equivalent a year from 2006-2012. Additional reductions could also be realized if the project is expanded to include a power generation station which is planned for phase 2 of the project.

The project's innovative financial structure, business model, and positive environmental impact illustrate the advantages of supporting carbon finance and other "green" sector projects in developing countries. MIGA aims to increase its support for similar projects that mitigate harmful practices associated with global warming.

[13] A capital budget of $3.7 million over two years was authorized by the Board in the context of the FY07 budget discussion to fund MIGA's systems renewal program.

30. *Administrative Expenses*. During the strategic period, MIGA took significant steps to contain the rate of growth of administrative expenses, which had been rising rapidly in the preceding years, and was able to keep actual expenses well within the budget envelope. Cost containment is clearly in MIGA's interest since all administrative costs ultimately have to be passed through to the guarantee clients.[14]

Table 1. MIGA's Administrative Budget, FY05-08 (Real in FY08 dollars)

	FY05	FY06	FY07	FY08
Admin. Budget Request	39,223	40,166	38,952	37,240
Expenses (Spent)	35,397	34,557	33,006	*33,750

* FY08 expenses figure estimated through fiscal year-end

31. *Other initiatives*. During the course of the review period, MIGA has had to adapt to external market conditions or has taken advantage of new opportunities that conformed to its broad strategy. As such, MIGA has implemented changes or made improvements in areas that were not completely foreseen in the FY05-08 strategy. One important initiative was the adoption of new Policy and Performance Standards on Social and Environmental Sustainability, effective for new projects initiated from October 1, 2007. These new standards, prepared by the IFC and adopted by the Equator Banks and others in addition to MIGA, have become a common benchmark, with substantial investor interest. Although these standards "raise the bar" for sponsors, typically requiring increased provision of information and longer processing times, investors recognize that there is also a return to this greater care being taken, in terms of better designed and implemented projects with strong community support. Investors find that the guidance provided by the standards is extremely useful, and that there is considerable value in the "certification" that comes with working with a member of the World Bank Group.

32. Other initiatives that MIGA has undertaken during the review period include the introduction of a new broker policy and the launch of a trust fund to provide technical support to investors in Africa for meeting international environmental and social standards. The fund, which was launched in January 2007 with support from the Japanese government, is open on a case-by-case basis to investors considering new MIGA-supported projects or who are already receiving MIGA guarantees in Africa. Through the trust fund, investors can receive expert advice from MIGA and from special consultants hired by the fund. The goal is to ensure that investors have access to technical support for compliance with MIGA's environmental and social policies.

Overview of Guarantees Results

33. One of the most important measures of performance for MIGA is the volume of guarantees issued and the associated development benefits. Given the drop in guarantees issued—from a peak of $2.0 billion in FY01 to $1.1 billion by FY04—MIGA management sought to increase the level of new issuance at the outset of the FY05-08 strategy.

34. The results have been generally positive. Over the first three years of the new strategy, there was modest but steady growth, with each year seeing an increase over the previous year (13%, 7% and 5%, respectively). Although these gains were important, in

[14] An approximate guide is that every $1 million in administrative budget equates to three additional basis points that need to be charged on the average project for MIGA to cover its costs.

volume terms they fell short of the targets set out in the Strategic Review. The current fiscal year, however, has seen a dramatic increase in volume, with targets exceeded during the first three-quarters of the year and additional business expected to be booked by the end of the year.

35. At the same time, there has been considerable variation in the number of projects underwritten each year. FY05 and FY06 saw figures broadly commensurate with previous years, but FY07 and FY08 saw a smaller number of deals done. Despite few projects, annual volumes have been increasing because the average size of projects has increased.

Table 2. Portfolio Overview

	FY02	FY03	FY04	FY05	FY06	FY07	FY08*
Gross New Issuance ($ b)	1.221	1.372	1.078	1.219	1.302	1.368	1.874
No. Guarantees Issued	59	59	55	62	66	45	30
No. Projects Supported	41	40	41	41	41	29	18
Gross Exposure ($ b)	5.257	5.083	5.186	5.094	5.362	5.301	6.402
Net Exposure ($ b)	3.202	3.204	3.259	3.138	3.31	3.209	3.507

* FY08 data through Quarter 3.

36. *Alignment with Strategic Priority Areas.* The four areas of development priority were not put forward as exclusive objectives but rather as areas of special focus. The results indicate that a significant proportion of the projects that MIGA underwrote during the strategic period did indeed fall into the four priority areas. Over half of all projects during the period (through FY08Q3) were in IDA countries, and almost 30 percent supported the other priorities, i.e., infrastructure, South-South investments, and projects in conflict-affected countries. Furthermore, over 30 percent of the projects supported (41 out of the total of 129 projects) were in sub-Saharan Africa. The results speak to both the business development efforts undertaken by the agency, as well as the fact that the identified priority areas were in line with MIGA's comparative advantage.

Table 3. Projects Supported by Area of Strategic Priority

	FY05	FY06	FY07	*FY08	*FY05-08	*% of Total Projects Supported FY05-08
Total Projects Supported	41	41	29	18	129	
Of which in:						
Frontier markets	20	23	14	11	68	53%
Conflict-affected countries	12	10	8	6	36	28%
Infrastructure	7	14	12	5	38	29%
South-South investments	4	15	12	6	37	29%
IDA-eligible countries	20	21	14	11	66	51%

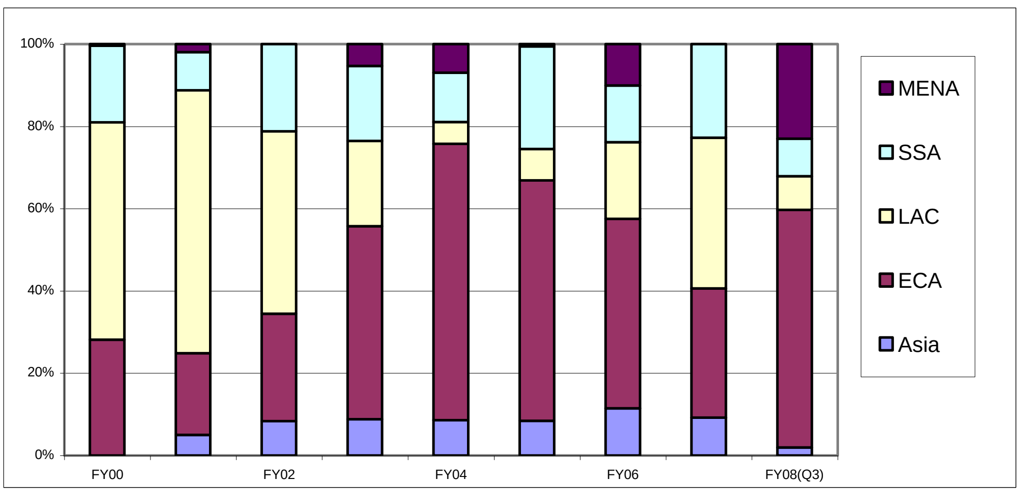
* FY08 data through Quarter 3.

37. *Portfolio Diversification.* Although MIGA seeks to maintain a balanced portfolio, year-to-year variations in new issuances are to be expected. This is due to the demand-driven nature of the guarantee business, as well as the fact that MIGA does not control the timing of project closings. This is particularly true for the projects MIGA takes on that are complex and in difficult environments, such as in the infrastructure, oil, gas and mining sectors where delays in reaching financial closings are not uncommon. This is borne out in a

review[15] by the Independent Evaluation Group, which shows that overall processing time for guarantees has increased over the past four years. This is a result of MIGA's focus on supporting more complex project finance deals that take longer to close.

38. With respect to regional trends, by FY04, MIGA's portfolio was heavily weighted towards financial services projects in the ECA region, and a large proportion of this business was with one client. Although the claims risk that MIGA bears is not based on the financial performance of clients but rather the economic and political stability of host countries,[16] it was nevertheless understood by MIGA management that developing a broader client base from a business origination perspective was important. FY05-07 saw a steady improvement in this regard, as the share of new business in ECA decreased (to 58 percent, 46 percent, and 31 percent respectively). Guarantee volumes in sub-Saharan Africa and LAC increased, while Asia remained fairly constant. And the number of projects in sub-Saharan Africa increased from just five in FY04 to an average of 11 a year over the next three years.

Figure 1. Percentage Share of MIGA's Annual Gross Issuance by Region



39. However, the year-to-date figures for FY08 show a shift back to a high share of new issuances in ECA, with the region representing 58 percent of new business issued and 28% percent of projects underwritten. A large share of the new business was for Turkey (a previously under-represented country) and for a more diversified client base. Although a significant amount of the new exposure has been in countries where MIGA already has exposure, such as Ukraine, there has been diversification at the country level. There has also been a significant increase in new issuances in the MENA region, with two projects underwritten in the first three quarters of the year, representing 23% of the volume. In contrast, in FY06, there were three projects guaranteed in the region (accounting for just over 10 percent of new volume) and no projects in FY07. This bears out the point that given the relatively few projects that MIGA underwrites, it is important to look at trends across years.

15 Independent Evaluation Group-MIGA 2008 Annual Report (MIGA/R2008-0017).
16 MIGA is not taking the commercial risk of a client, but if a host country takes political steps that lead to a claim on a project, then there would be an impact on MIGA's balance sheet.

Table 4. Projects Supported by Region

	FY02	FY03	FY04	FY05	FY06	FY07	FY08*
Number of Projects							
Asia	4	2	3	3	6	8	3
ECA	15	21	28	22	6	4	5
LAC	12	6	4	5	13	6	1
MENA	0	2	1	1	3	0	2
SSA	10	9	5	10	13	11	7
Share of New Volume							
Asia	8.4%	8.8%	8.6%	8.4%	11.5%	9.2%	2.0%
ECA	26.1%	47.0%	67.2%	58%	46%	31%	57.8%
LAC	44.3%	20.7%	5.4%	7.6%	18.6%	36.7%	8.2%
MENA	0.0%	5.3%	7.0%	0.5%	10.1%	0.0%	23.0%
SSA	21.2%	18.2%	11.9%	24.9%	13.8%	22.7%	9.1%

* FY08 data through Quarter 3.

40. Looking at the FY05-08 results from a sectoral perspective, the volume of business in infrastructure has been fairly constant. The average size of both infrastructure and financial sector deals has increased considerably over recent years to $143 million and $160 million respectively. This contrasts with average project sizes of $40 million and $33 million respectively, over the previous three years. The oil, gas, mining and chemicals sector has booked the least amount of business during FY05-08, but it should be noted that there is considerable inherent volatility in deal flows in this sector as project preparation is long, unpredictable and typically involves many stakeholders and counterparts.

Table 5. Projects Supported by Sector

	FY02	FY03	FY04	FY05	FY06	FY07	*FY08
Number of Projects							
AMS	10	11	13	5	16	8	6
Finance	10	14	18	22	10	8	7
Infrastructure	21	12	9	11	13	12	5
OGMC	0	3	1	3	2	1	0
Share of New Volume							
AMS	7.6%	14.8%	6.7%	5.3%	13.0%	25.7%	2.2%
Finance	20.0%	27.4%	56.0%	59.5%	18.3%	34.5%	59.7%
Infrastructure	72.4%	47.4%	26.8%	27.4%	36.0%	36.1%	38.1%
OGMC	0.0%	10.4%	10.5%	7.7%	32.8%	3.6%	0.0%

* FY08 data through Quarter 3.

41. *Claims Record*. Two claims were paid from FY05 up to the third quarter of FY08. These claims totaled $1.54 million and were paid out to investors for losses in Argentina and Nepal. These bring the total number of claims paid by MIGA since inception to three. As of March 31, 2008, MIGA had three pending claims, two of which are the subject of active settlement negotiations. During FY05-08, MIGA also monitored 28 situations in 17 countries that could possibly lead to claims if unresolved. In most of these cases, MIGA participated in settlement negotiations or advocated a resolution.

42. MIGA continues to devote considerable resources to helping investors and member countries reach amicable settlements of disputes. MIGA's management of claims is designed to avoid claims whenever possible by resolving disputes and assuring that valid claims are

dealt with fairly and promptly. MIGA aims to help investors continue to operate the developmentally beneficial projects it supports and to avoid claims, which can negatively impact the reputation of host countries. Since its inception, MIGA has proactively facilitated more than 50 disputes relating to MIGA-guaranteed projects.

Table 6. Projects in Claim or Pre-Claim Status, by Sector

	FY05	FY06	FY07	FY08
AMS	3	5	5	4
Finance	0	1	1	0
Infrastructure	7	7	6	4
OGM	1	1	1	2

* FY08 data through Quarter 3.

Table 7. Projects in Claim or Pre-Claim Status, by Region

	FY05	FY06	FY07	FY08
Asia	0	2	0	1
ECA	4	2	2	2
LAC	4	6	5	4
MENA	0	1	1	0
SSA	3	3	5	3

* FY08 data through Quarter 3.

Overview of Technical Assistance Results

43. MIGA provides technical assistance to facilitate FDI in its developing member countries, and has traditionally focused on working with investment promotion intermediaries to improve their ability to respond effectively to investors. These initiatives help countries formulate strategies for attracting and retaining FDI, and to implement them on a sustainable basis. During FY05-08, the Technical Assistance program (first as a component of MIGA's Operations Department and subsequently as a FIAS operational unit) delivered analytical, diagnostic, and implementation advisory services to more than 50 client countries and supported 21 projects with a regional and/or global scope. Of the projects implemented during the period, 25% provided support to African economies.

Table 8. Technical Assistance Projects at Year-end, FY05-FY08(Q3)

Region	FY05	FY06	FY07	*FY08
Africa	11	13	10	11
East Asia & Pacific	8	7	8	10
Eastern Europe and Central Asia	14	9	8	3
Latin America and the Caribbean	9	6	5	5
Middle East and North Africa	5	4	3	2
South Asia	3	2	2	2
Global	4	4	8	5

* FY08 data as of end FY08 Q3.

44. In FIAS' Investment Generation practice area, major highlights of FY08 to date include: helping Bogota's investment promotion agency attract $137 million of new investment (already at 50% of the three-year target) and over 3,300 new direct jobs; and the

Invest-in-Western-Balkans program, which has generated 10 investments (€145m, 500 direct jobs, 750 indirect).

45. Though focused on helping countries attract and retain foreign direct investment, the TA work program spans a range of activities, including: assessments of local investment promotion agencies and intermediaries, analyses of foreign investment in key business sectors, investor outreach campaigns, investment policy and special economic zone development, and local institutional capacity building. Highlights from the period include the development of a National Investment Promotion Strategy for China, the publication of several Enterprise Benchmarking Studies, testing and proving the potential for successful sector-focused investor outreach in Africa (Senegal, Tanzania, Ghana), the completion of the first phase of the European Investor Outreach Program for the West Balkans, and the strengthening of African investment promotion agencies in Ghana, Lesotho, Madagascar, Senegal, and Tanzania.

Overview of Online Investment Information Services Results

46. MIGA's Online Investment Information Services were originally developed as an off-shoot of MIGA's technical assistance program with a focus on providing research, promoting learning, and sharing knowledge and experience on FDI. With the move of technical assistance into FIAS, MIGA repositioned its websites to support MIGA's branding as a "thought leader" in FDI and political risk insurance. The process resulted in the consolidation of several websites (IPAnet, PrivatizationLink and FDI Xchange) into one integrated portal site — FDI.net (www.fdi.net), which was reconfigured into an investor focused portal combining business-geared resources with World Bank Group analysis. The agency is also the principal content provider of FDI-related information for the World Bank's Development Gateway. FDI Promotion Center, geared towards investment promotion practitioners, is now operated by FIAS.

47. As part of MIGA's continuing efforts to disseminate knowledge on political risk insurance to investors and to be a thought leader in this area, during FY07, MIGA launched a new service on political risk insurance and management—the PRI-Center (www.pri-center.com). This new knowledge portal provides information on the insurance market, featuring political risk analysis, research, tools, directories, news, and events. This move was in line with Board and IEG-MIGA feedback and MIGA management's desire to reap greater synergies and explore complementarities among MIGA's various product lines. Filling an information gap, the PRI-Center is a knowledge center for the investor community and the PRI industry. The site provides free access to resources on political risk management and insurance. MIGA has collaborated with well-established organizations in the industry and has taken on more responsibility for gathering, presenting and creating new intellectual content on industry-relevant matters.

48. The online services have increased visits since the consolidation of the investment information websites into a single portal and the launch of PRI-Center. As a measure of its impact, 23% of respondents to a recent survey (see IEG-MIGA Annual Report 2006) said MIGA's online services had directly impacted investment decisions, while nearly 40 percent reported that the services had led to a change in perception.

C. Overall Lessons Learned

49. In determining the operational directions of the FY09-11 cycle, it is useful to highlight lessons learned during the FY05-08 period. There have been important successes during FY05-08, particularly related to portfolio diversification and support for investments in priority areas, which are expected to be strengthened going forward. Furthermore, given MIGA's comparative advantage in the current PRI market, the strategic themes of the FY05-08 remain broadly as valid today as they were four years ago. The FY09-11 period will therefore focus on delivering broadly similar operational directions.

50. MIGA is aware of the need to strengthen key areas of its business delivery: marketing, streamlining internal processes to make the agency nimble and flexible to react rapidly to a changing market, and continued development of market intelligence. This includes being more responsive to clients and investors both in its product offerings and its service delivery. In addition, MIGA recognizes the need to strengthen its intellectual leadership on guarantees within the World Bank Group. These issues were reinforced by client surveys and market studies that MIGA commissioned for the purposes of developing MIGA's FY09-11 Operational Directions.

51. *Adapting to Change*. Probably the most important message relates to the importance of being able to adapt to constantly evolving market environments. A key aspect of this is providing the market with products that meet its needs. As financial tools become more sophisticated and political risk insurance products more flexible, MIGA also needs to be at the forefront in enabling developing countries to benefit from such financings. During the review period, MIGA was involved in a number of such financings such as supporting a Shariah-friendly project financing in Djibouti, supporting the securitization of mortgages in Kazakhstan, and enabling a bond issue representing revenues from a toll road in the Dominican Republic. Such innovations were achieved despite the limitations of the Convention, and MIGA will continue to explore providing flexibility in its coverages.

52. *Unpredictability*. In any given year, MIGA's business tends to be volatile and unpredictable. For example, FY08 is likely to show a high proportion of business in the financial sector. This demonstrates that, while MIGA is able to broadly pursue its operational priorities and can position itself in the market where its comparative strengths are best revealed, the agency cannot predict with certainty how its portfolio will develop in any given year. This unpredictability points to the importance of having a strong risk management framework, which MIGA was successful in enhancing during the FY04-08 period. This will allow the agency to make more informed decisions on new products (on risk and cost-recovery grounds), and will also allow MIGA to move to a less risk-averse position to issuing guarantees, while at the same time maintaining a solid capital and financial footing.

53. *Strengthening and Aligning Internal Processes*. Although MIGA established a robust underwriting and approval process and improved its *ex-ante* review of projects in terms of development impact, it is not clear that the agency was flexible enough in terms of timing, contractual terms and informational requirements. For MIGA to stay relevant in today's market, the agency will need to focus on aligning its internal processes with clients' needs. This is not to say that MIGA will loosen its standards in any way, rather that the agency will strive to meet and exceed client expectations through improvements in internal processes.

54. *Collaboration with the World Bank Group*. MIGA made great strides in strengthening its relationship within the World Bank Group during the review period. MIGA has, in this sense, done "internal marketing" to seek ways of collaboration on new business. This collaboration has also included de-selecting projects on the advice of the World Bank and delaying projects until an appropriate policy framework is in place, to ensure full consistency with country strategies and World Bank advice. There is further scope for collaboration with the World Bank Group, however, with a key goal of providing intellectual leadership regarding guarantees.

55. *Focus on Core Business*. The initial effort to integrate TA with guarantees (under the Operations Department) did not yield all the anticipated benefits, as the links between providing expert advice on creating the optimal environment for attracting new FDI on the one hand, and then originating new guarantees business on the other hand, did not materialize to a meaningful degree. Further review within the broader World Bank Group context led to the Technical Assistance group of MIGA being integrated within FIAS, further strengthening links with the rest of the Group.

II. The FY09-11 Operational Directions

A. The Current Market Context

56. There have been important changes in the PRI market in the past few years, particularly with the fall in risk perceptions and growing rates of FDI since 2002. Partly as a result of this, there have been new entrants in the market and growing business for private sector providers and some public insurers.[17] While there is a real difficulty in obtaining reliable information on the PRI market, it is clear that the combination of new entrants and expanded operations of existing players have significantly increased the liquidity available in the market. In addition, new forms of risk management have been available both inside and outside the PRI market[18]. This seeming reduction of barriers to entry and emergence of substitute products has altered the competition dynamic in two very fundamental ways: it has strengthened the bargaining power of customers and it has resulted in a more transparent market.

57. A corollary of the above is that the PRI market has witnessed a significant downward pressure in premium rates (i.e., prices) reflecting the combination of lower perceived political risks, increased competition, and falling spreads in loans that finance PRI. Berne Union (BU) statistics, although based on an incomplete sample, point to a reduction of average premium rates of 49% between calendar years 2001 and 2007[19]. Anecdotal evidence points to similar conclusions across the broader PRI market outside the BU. MIGA, on the other hand, has not reduced its premium rates as rapidly or extensively as the broader market. Its effective premium rate fell only by 9% between FY01 and FY07. In parallel, MIGA's share of the expanded market fell from about 8% in 2001 to some 5% in 2007 based on BU member figures.[20]

58. Despite pressure on premium rates, many market providers have begun to offer broader PRI coverage (such as comprehensive coverage) or more specialized covers (such as insurance against sub-segments of traditional coverage categories). Furthermore, for particular risks, hedging of key risk components has also been possible via capital market products, thus increasing the scope of substitutes for PRI. This has been a relatively recent occurrence, in part stimulated by recent crises. For example, the 2001-02 crisis in Argentina led some financial institutions to explore alternatives to traditional PRI coverage for certain types of risks, because they faced losses that were not covered with their traditional PRI coverage (transfer restriction/inconvertibility). This has put MIGA and other public providers of PRI at a relative competitive disadvantage, as private players are able to modify their contractual terms and offer new products more readily than public providers.

---

17 The growth in exposure of private members of the Berne Union increased by some 40% in the five years up to 2005, and continued to grow rapidly in the subsequent two years, and public sector providers grew at roughly similar rates. It is worth noting that key providers such as the Lloyd's syndicates are not part of the Berne Union. PwC Study, pages 17-19.

18 A consequence of these market shifts is that the definition of what constitutes PRI has expanded and now includes coverages which Agencies such as MIGA are not able to provide due to Convention Constraints

19 Berne Union Secretariat, April 2008.

20 Berne Union Secretariat, April 2008. Given the fact that the market size is not clear, PwC estimated the fall from 11% to 8% based on a narrower definition of the market. Also, PwC study pages 23-30.

Box 5. Current Turmoil in Financial Markets

Since the summer of 2007, there has been a growing liquidity crunch in credit markets, initially triggered by the sub-prime losses in the US mortgage industry, but now extending to other broader segments. According to a recent report by the International Institute of Finance (IIF), the causes of the crisis resulted from a period of ample liquidity and low interest rates, which "led to compressed spreads, and increasing aggressive and sometimes lax lending and underwriting standards."[21] At the same time, the new nature of financial markets moving to an "originate-to-distribute" model in which credit that once would have been retained by banks on their own books was converted into products of increasing sophistication and complexity,"[22] aggravated the nature of the crisis. It is precisely through these sophisticated instruments, which proved to be very volatile and whose risk was not adequately captured through ratings that the original mortgage crisis spread to other financial sectors. The resulting rating downgrades of mortgage-backed securities led to "elevated uncertainty about ratings, asset value and creditworthiness of counterparts. Faced with high potential demands for liquidity, banks became reluctant to participate in money markets beyond very short terms. At the same time, non-bank participants in money markets became averse to investing in credit instruments of private issuers beyond very short terms. With this, sub-prime credit problems turned into a systemic liquidity crunch."[23] Currently, it is unclear how deep and prolonged the current liquidity crunch will be.

59. The current liquidity crunch in the markets is expected to produce two results which will have opposite effects on MIGA. On the one hand, there could be a "flight to quality" which will limit the flow of FDI to higher-risk developing countries, where MIGA has a natural comparative advantage. This would reduce the potential FDI flows which are the basis of PRI demand. On the other hand, increased risk perception and growing spreads may create an incentive to purchase PRI—both on risk grounds and because the growing spreads permit the financing of guarantee premium. For MIGA's strategy, the assumption is that the crisis may continue for a year or so, after which market conditions could revert to the broader trends prevailing prior to this crisis, and with both effects broadly canceling each other out. But there could be implications in terms of the expected future composition of the portfolio, as FDI flows adjust to the heightened risk perception in terms of entry into certain emerging market segments. However, MIGA Management is aware that it needs to be able to respond to market conditions in support of its mandate and thus will exercise its judgment over the next four years as to how best to position the agency depending on the evolution of the external situation

60. Notwithstanding the current turmoil in financial markets, the secular trend remains one of a market where there will be greater choices for customers. This will be reflected in broader product offerings, client-driven response times, and with tight premium rate constraints. Thus, the challenge for PRI providers will be to provide a high-value-added product, rapidly and at low cost. MIGA's challenge is to provide such a product, including innovative coverages where possible, with strengthened delivery capabilities within the dictates of its Operational Regulations and Convention.

[21] IIF, Interim Report of the IIF Committee on Market Best Practices, April 2008, page 2.
[22] Ibid, page 3.
[23] Ibid, page 4.

Box 6. Risk Mitigation Trends in the Market

According to the PwC market study, while most internationally active companies assess and manage political/country risk in some way, a significant share of them are more likely to self-insure than mitigate political risk through insurance or other forms of protection. Among those that do insure, global or portfolio coverage is seen as a more cost effective option by some companies, in particular in the retail, manufacturing, consumer goods, and hotel industries. Such global policies generally require that the insurer provide coverage for existing as well as new investments (a requirement MIGA currently cannot meet as it can only cover new investments). Companies buying traditional project PRI, especially commercial banks, generally prefer comprehensive coverage, which is more akin to a financial guaranty. This preference for comprehensive coverage, in particular from higher rated guarantors, is expected to continue and likely increase as such insurance coverage will be accepted under the Basel II capital rules as a financial guaranty (see Box 9). Other trends include increasing demand for local currency financing, and demand for innovative/new products mentioned by brokers/insurers such as currency convertibility and transfer wrap for collateralized products (for high-quality assets); denial of justice coverage, hybrid risk participation agreements; insuring the delivery of carbon credits; greenhouse gas emissions caps; trade disruption (multi-country sourced production processes); and intellectual coverage (this coverage, while much discussed and requested, is not currently being offered in the market due to the difficulties of establishing estimated losses associated with it). MIGA can and has, in fact, offered some of these products, such as transfer restriction coverage for high-quality mortgage-backed securitizations and the delivery of carbon credits. However, MIGA needs to continuously innovate to remain relevant in this dynamic business environment.

B. MIGA's Strengths and Weaknesses

61. The decision of an investor to purchase PRI is part of the investment decision-making process, which involves a series of steps such as the identification of markets, structuring of the investment, allocation of risk, managing the project and its risk, resolving potential difficulties that may arise with local authorities, and reaping the financial rewards of the investment. MIGA can be a partner to investors seeking opportunities in developing countries through its expertise in some of these steps in the decision-making process.

62. Client surveys[24] and the PwC study have identified two key areas where MIGA is well perceived by market participants: (i) its knowledge of developing countries, in particular IDA countries, where there is not much market knowledge available; and (ii) its ability to mediate disputes to the benefit of both investors and governments. MIGA's strong capital base and ability to pay compensation in the event of large-scale losses is also seen as an asset in the market. Finally, MIGA's adherence to strong environmental and social guidelines is appreciated by some clients as a "seal of approval" of good corporate citizenship.

63. These surveys also point to areas where MIGA is perceived to be weak. Lack of adequate flexibility and nimbleness with limited innovation in terms of product offerings are seen as major issues. MIGA is seen as reactive to new products in the market, rather than as a market precursor.[25] Another concern identified by market participants is the length of time needed to underwrite a transaction and the amount of information required by MIGA to conduct its underwriting. In addition, although cost-effective in certain market segments, the agency is seen as a high cost provider of PRI by some market participants.

[24] Client Survey by Booz, Allen & Hamilton conducted for the FY05-08 strategy, which led to similar conclusions to the one conducted by IEG for the FY08 Annual Report. Findings are also similar to those of the PwC client survey conducted as part of its market review in December 2007.

[25] Political risk mitigation is much broader than PRI, and new products, such as a variety of capital market instruments, are constantly being introduced that have the effect of mitigating some of the risks of the traditional PRI market.

64. As a result of the above, MIGA tends to be sought out by market participants for projects that are associated with higher perceptions of political risk due to the country environment, the sector, the size or structure of the deal, and/or risk covers sought. Another factor is that given current historically low market premium rates, MIGA's relatively higher premium rates are more acceptable for investors considering complex projects or investing in countries perceived to be risky. But MIGA's premium rates are also attractive for other types of projects, and this helps maintain a well diversified portfolio.

65. MIGA's operational directions must be based on building upon the strengths and addressing the weaknesses outlined above. The added value that MIGA brings to stakeholders derives from its core competencies, and these stem from its structure as a multilateral organization and member of the World Bank Group. This gives MIGA a unique advantage and position from which to support FDI for development. These competencies include:

- *Resolving disputes and preventing losses* through MIGA's relationship with host governments. With the interests of both investors and countries in mind, MIGA is in a strong position to mediate mutually agreeable resolutions. This helps retain investments with all their attendant development benefits, as well as safeguard country reputations regarding investment climate. This ability is highly valued by investors and governments alike.
- *Market knowledge* of countries and relationship with governments, both through MIGA's in-house knowledge, its corporate governance structure, and its membership of the World Bank Group and participation in broader policy dialogues.
- *Financial strength*, which allows for claims to be paid quickly. MIGA's ability to seek recoveries where appropriate is also a strength that is unique to the agency.

C. MIGA's Operational Directions FY09-11

66. In considering how best to deliver on MIGA's mandate and stay relevant in a rapidly changing global environment, MIGA management has been guided by: market studies and client surveys; an assessment of the current external environment and PRI market; and the lessons emerging from the past review period. A key concern has been to stay focused on supporting the needs of MIGA's developing member countries, while complementing the activities of other public and private insurers. Management has concluded that, based on MIGA's core competencies and comparative advantage, the operational priorities of the past FY05-08 period, with some minor adjustments, remain valid today and should continue to guide the agency as it strives to maximize its development impact in the future. These four priorities focus on:

- Investments in IDA countries.
- Investments in conflict-afflicted environments.
- Support for complex deals, especially those involving project finance, environmental considerations and social issues (such as in infrastructure and extractive industries).
- Support for South-South investments.

67. MIGA will continue to support other projects with high development impact that do not fall within the four categories above in order to help diversify its portfolio and manage risks. The agency's business delivery will be guided by the need to be:

- *supportive of World Bank Group strategies*, including for overarching priorities and specific country strategies
- *client and market-responsive* through greater flexibility in service and product delivery across all markets
- *financially sustainable,* which will require the efficient use of MIGA's balance sheet, the maintenance of a balanced portfolio and the optimization of premium and investment income.

Box 7. Complementarity of MIGA's Operational Direction with the World Bank Group

MIGA's future activities will strive to complement and support broader World Bank Group priorities for:

- *Poorest Countries*. Work in these countries is where MIGA has a comparative advantage vis-à-vis the private market for PRI, and management sees MIGA as having a key role to play in these markets.
- *Fragility and Conflict*. This remains one of MIGA's operational priorities and an area where MIGA can have a powerful impact in terms of promoting FDI.
- *Middle Income Countries*. MIGA's support of FDI in these countries can potentially include large, complex projects, as well as support of projects at the sub-sovereign level and for certain sub-sectors where MIGA can enhance the confidence of market participants. Another key area of MIGA engagement is in support of South-South investments, which typically originate in these countries.
- *Arab World*. MIGA sees an opportunity to expand its business in the region, particularly through its ability to guarantee Islamic finance structures.
- *Global Public Goods*. MIGA sees opportunities to support this priority by creating new products that the market can emulate, such as support for projects involving Islamic finance structures and environmentally friendly/climate change initiatives.
- *Knowledge*. MIGA can provide intellectual leadership within the World Bank Group on guarantees-related issues as well as for the public-at-large through its online knowledge services. It can also provide knowledge on FDI through its own work and that of FIAS

68. These priority areas and operational guidelines are aligned with MIGA's market niche of supporting underserved markets and clients. In addition, the market test that MIGA faces involves providing value to projects in these priority areas without subsidizing its costs[26]. MIGA's support for investments in these priority areas should result in a balanced and growing portfolio, which would in turn result in a more efficient utilization of MIGA's capital base.

69. The FY09-11 operational directions will focus to a greater extent on the delivery of business results with a special focus on flexibility. Flexibility for MIGA should be understood in two distinct ways: (i) operational flexibility, meaning that there should be financial/budgetary space to be able to innovate, hire staff to fill gaps, and engage in other complementary activities. This could be measured over time as the ratio of administrative expenses to net premium income plus commissions with the goal of achieving an 85% ratio

[26] As a product-specialized financially self-sustainable organization, MIGA cannot subsidize pricing overall and remain financially viable. However, a recent review of MIGA's cost structure and pricing model (conducted in FY08) eliminated some hidden cross-subsidies embedded in the previous pricing model. The revised model now ensures that all projects can be reviewed on the basis of their own merits and costs. There are two elements of MIGA's business that do not fully recover costs: (i) SIP, where products contribute to direct costs of underwriting but are not expected to contribute towards fixed costs; and (ii) small projects where full cost recovery would price MIGA out of the market. The total cost of these two types of transactions has been estimated at some $0.8-$1.5 million per year.

in FY11, down from the 91% of FY07;[27] and (ii) being an organization that reacts fast to market changes by building on the strengths, fixing the gaps, and adapting where change is happening. It also involves improving underwriting time while making the process more client-friendly.

D. Delivery of the Operational Directions

70. MIGA has already developed many of the operational tools it needs to implement its operational directions. Most of these were developed in the FY05-08 period, with the most important one being the revised pricing model, which sends a signal to the market regarding areas of interest for MIGA engagement. MIGA will continue to refine the pricing model to try and ensure that outcomes reflect not only MIGA's need to cover its costs but also MIGA's priorities. While FY08 has been a good year in terms of higher business volume and income, more can be done to increase the number of operations per year, so that MIGA's development impact can be extended. Market perceptions of MIGA also point to the need for improvement in other operational areas as outlined in the following sections.

Continued Strengthening of Effectiveness of Business Delivery

71. MIGA will align its strategy with its internal incentives and organization in such a way as to have the whole agency working harmoniously towards the same expected results. This means that as MIGA seeks to strengthen its delivery capabilities, within the current constraints of the Operational Regulations and Convention, it will do so in a way that reinforces its overall operational directions.

72. *Business development*. MIGA will focus on strengthening business development with a view to maintaining its delivery volume of FY08 and increasing the number of projects. The goal is to move beyond a strategy of increasing brand recognition and awareness to one of establishing closer relationships with potential clients and key actors in the PRI market. The strategy will focus on specialized marketing approaches for sub-sectors of the market where MIGA's comparative advantage is perceived differently by different players and where the drivers of the decision-making process are diverse. For example, marketing for financial sector transactions aimed at funding subsidiaries in emerging markets focuses more on the regulatory and risk advantages of PRI as perceived by risk officers in those institutions. Marketing for infrastructure in complex projects in difficult countries, in contrast, may involve a closer relationship with the senior management of key sponsors, who value the aspects of MIGA coverage, such as the environmental and social "seal of approval" MIGA support brings in difficult environments. While some of this work is underway, the goal is to make it more systematic in the coming years. This will be greatly facilitated by the revised Guarantees Database and a Client Management System, which is expected to come on line in FY09. Business development, therefore, will involve a greater degree of client customization in line with market trends.

73. *Product innovation*. An integral part of the effort to strengthen marketing will involve new product development to better meet client demands in an evolving market. MIGA has managed to be innovative in its product offering, within the current constraints as set forth by the Convention and the Operational Regulations. This has allowed MIGA, for example, to broaden its engagement in regions such as MENA through its support of Islamic finance

[27] An interesting private sector benchmark for PRI is the sub-sector of title insurance, which is characterized by small margins, large turnover of business volume, and infrequent and relatively large (compared to premium) losses. In this sub-sector administrative expenses are roughly 80% of premium revenue.

deals. However, more needs to be done to further the customization of MIGA's products to remain in line with market evolution. With this in mind, MIGA has approached business development as a three-stage process:

- An initial effort aimed at strengthening productivity and innovation within the current operating constraints of the agency. This has already led to higher business volumes in FY08 and greater flexibility in product offerings.
- Over the medium-term, revisions of MIGA's Operational Regulations to respond to the changing nature of client needs and the PRI market, and the need for MIGA to keep pace with these developments. MIGA will put forward to the Board suggested changes which would involve relaxing some of the restrictions it currently operates under.
- A longer-term effort aimed at reviewing the constraints imposed by MIGA's Convention and assessing ways in which they can be addressed.

Box 8. New Product Development

There are two areas where MIGA will place emphasis over the FY09-11 period regarding new product development/adaptation.

Islamic Finance. MIGA intends to build on the significant learning opportunity presented by the Doraleh Port Project (Djibouti) Islamic financing by seeking to develop customized products for this rapidly expanding and dynamic sub-segment of the global financial system. Based on the high degree of positive market reaction to the "Shariah-friendly" guarantee for the Doraleh project, MIGA sees this as an area of opportunity and growth.

Renewable/Sustainable Energy. MIGA has participated in a carbon-financed transaction in El Salvador. Uncertainties over the post-Kyoto rules have limited the appetite and applicability of coverage. However, MIGA will seek ways to adapt its own guarantees to the needs of carbon-financed projects, but will not limit itself to this. There is an ongoing effort to seek out investors in renewable energy who may require PRI. This effort will involve a new marketing strategy specifically tailored for this sub-sector. MIGA thus hopes to expand its coverage of renewable energy projects in the coming FY09-11 period.

74. *Operational Improvement*. MIGA will also move aggressively to address market perceptions in areas where it is not viewed positively, by improving its flexibility in terms of timing, contractual terms, and informational requirements. This is an effort of continuous operational improvement, which is an integral part of any strategy in successful private sector firms. As such, MIGA will maintain a policy of "delivery before requirement," meaning that MIGA should be in a condition to sign a contract of guarantee before the financial closing of complex transactions. Rather than focusing on an arbitrary number of underwriting days for each transaction, the focus will be on the clients' timetable.

75. *Monitoring Development Impact*. Self-evaluation and monitoring of development impact will be strengthened. Given MIGA's mandate, at the end of the day it is the quality of the projects which matters most to the agency. Financial sustainability is a means towards this end, and it is important not to make financial sustainability an end in and of itself. Thus, strengthening monitoring of development impact through enhanced participation of underwriters in this process will serve two purposes: (i) providing lessons learned to be incorporated into future transactions; and (ii) creating an incentive to seek out a particular type of high impact project or client through marketing.

Box 9. Basel II: Challenge or Opportunity?

> The world's largest and most internationally active banks, a pool that delivers most MIGA banking clients, have been preparing to move to a new capital adequacy framework known as Basel II. Under the previous capital adequacy guidelines, Basel I, there was a comparative advantage which MIGA, along with bilateral ECAs enjoyed for business development in the financial sector. Under these guidelines a MIGA guarantee for a loan against transfer and convertibility risks produces in some jurisdictions three effects: (i) it creates a low risk-weighting for loans (as low as 0% in some jurisdictions) in terms of capital adequacy ratio purposes; (ii) it waives the country risk reserve requirement; and (iii) it exempts the loan from counting towards the exposure limit to a particular jurisdiction. With these three effects, the benefits of a more efficient use of their balance sheet outweighed the cost of the guarantee for many banks. However, Basel II is changing the treatment of a MIGA guarantee given its emphasis on the requirement of an explicit AAA/Aaa rating. (MIGA has an implied rating but, for a variety of reasons, has not been required to obtain an explicit one). While the full extent of the impact is still unclear, the consequences for MIGA will be felt during the FY09-11 period. MIGA has been following this debate and will inform the Board of its conclusions. In consultation with the World Bank Group, MIGA will also explore the possibility and impact of a move to obtain an explicit rating.

Increased Use of Existing Financial and Risk Tools to Support and Measure Business Delivery

76. Risk management work in the past three years has focused on creating the final building blocks of the comprehensive risk management framework, including seeking Board approval of MIGA's capital adequacy assessment approach. Work also commenced in FY07 and continued through FY08 in terms of using the components of the risk management framework and associated analytical models to unlock the strength of MIGA's balance sheet. With this strong analytical basis for optimizing the use of resources and a pricing system that is fully integrated with costing and risk models, MIGA is positioned for more aggressive growth in prioritized market segments and for guaranteeing larger, more risky projects.

77. In addition, with more selective retention of risk, MIGA will optimize the base over which premium income is earned. This will be achieved through sustained relationships with MIGA's treaty reinsurance partners, helping to ensure that reinsurance capacity will be there when needed, from a risk perspective. Over the next few years, management expects to see the effects of this system of active and selective retention of risk in the form of increasing net premium income and reinsuring some of the spikes of risk while retaining a more balanced portfolio. Ultimately, this exposure management strategy will be a critical component in ensuring MIGA's financial sustainability in the face of increasing competition. Closely associated with management of exposures and portfolio risk will be a continued focus on administrative costs and their recovery through the pricing of MIGA's guarantees. Work carried out in FY07 and FY08 on identifying and allocating direct and overhead costs will continue to be refined over the strategy period, as more detailed and useful cost data is generated.

78. MIGA's economic capital model is designed to model not only losses stemming from guarantee risk (liabilities) but also the risk of losses on the investment portfolio (assets). Management plans to further develop the approach to analyze the two loss distributions in an integrated fashion, for the purpose of enhancing the analytical basis for investment of MIGA's liquid assets and optimize the structure of the balance sheet. MIGA's current investment policy has been in effect for four years, and will be reassessed as part of broader strategic efforts to ensure the financial sustainability of the agency. The financial risk management framework and economic capital-based risk modeling tools will be utilized

directly in this process, and may be complemented with an additional model application for asset-liability management to be developed in-house.

Intellectual Leadership on Guarantees within the World Bank Group

79. Given that MIGA is the only World Bank Group institution specializing in guarantees and is in the forefront of the industry in terms of risk and cost measurement, it can exercise intellectual leadership within the World Bank Group when it comes to knowledge of the product, market trends, and new instruments. In this respect, in the future the agency will seek to organize periodic conferences and workshops on subjects relating to PRI and investment risk in emerging markets.

E. Risks and Scenarios

80. FY08 has been a year of a rebound for MIGA with overall volume expected to be $1.8-2.2 billion and net premium income of $[37-39] million. As of the third quarter of FY08, MIGA's Return on Operating Capital (ROOC) before provisioning stood at 7.0% compared to 6.1% in FY07[28].

81. Following upon the results of FY08, the business plan forecast for FY09 would be in the range of some $1.6-2.2 billion with slow, steady growth in the portfolio and premium income over the forecast period. This section lays out scenarios of business, income and expense evolution, and their implications for MIGA. It is important to bear in mind that MIGA's business model does not permit a forecast of actual operations in the medium term, neither regarding region nor sector. Thus, the forecast is tentative and, more importantly, aggregate. In addition, the financials of a PRI provider such as MIGA are expected to see volatile swings (either in volume or income) throughout the business cycle. The reason is that MIGA is not the initiator or driver in a project cycle. Rather, as an insurer, MIGA's role is that of servicing clients and acting as a risk mitigator.

82. The baseline scenario is underpinned by the following: (i) a carry-over of work already underway in FY08 of $300-500 million; (ii) 3-6 projects with exposure of more than $150 million resulting in a total business of $500-900 million; (iii) medium-sized projects totaling $570-625 million; and (iv) SIP exposure of some $22-35 million. Thus, the baseline scenario's mid-point assumes some $1.8 billion for FY09, with a band of around $300 million, and net revenue income growing to $41-42 million. The baseline scenario sees new guarantee issues increasing to just under $2 billion in FY11, within a band of around $400 million in that year. This scenario is also dependent on external events, including continued FDI flows to developing countries, containing of the sub-prime lending crisis so that credit markets are not squeezed to the point that investment decisions have to be postponed, etc.

83. Two other scenarios are possible: an improved scenario, resulting in an overall yearly increase of business of $400-500 million; and, a down-turn scenario, where product innovation in the market proceeds without MIGA adapting and/or the traditional PRI market does not evolve. MIGA is then generating enough business to keep its portfolio broadly constant, but facing a continued fall in revenue. Under this scenario, where new business equals cancellations, effective premium rates fall by 10% over the period, and

[28] MIGA's ROOC (before provisions) fell from a high of 7.6% in FY01 to 2.9% in FY05. In the period from FY04-07 it averaged 3.6%.

administrative expenses would increase to more than 100% of net premium income plus commissions, raising questions about the long-term financial viability of the agency.

Evaluation Metrics

84. MIGA will continue to monitor its financial and development performance as a basis to assess improvement in key areas of its business. The metrics for performance will be based upon three key variables:

- *Overall Gross Issuance.* MIGA will strive to maintain a multi-year average of issuance of $1.8-2.2 billion.
- *Investment Flows to IDA countries*. MIGA will strive to maintain a portfolio composition weighted towards IDA countries. In assessing its performance, MIGA will also look at total FDI flows to IDA countries as a percentage of total FDI flows, during the FY09-11 period.
- *Financial Measurement*. Return on Operating Capital before Provisions (ROOC) with the goal of achieving a return of 7-10% by the end of the FY09-11 period.

Annex. Overview of the PricewaterhouseCoopers' Political Risk Insurance Market Study

(prepared for MIGA March 2008)

Background. As an input to the MIGA FY09-11 Operational Directions paper, the agency commissioned PricewaterhouseCoopers (PwC) to undertake a study of the political risk insurance (PRI) market. The purpose was to provide a qualitative and quantitative analysis of core market trends, and to assist MIGA in assessing its role relative to identified market conditions.

The Report's Key Observations

- The report's notes that the PRI market has evolved significantly in the past twenty years, experiencing ebbs and flows in exposure and premium growth, development of new products, and the entrance of new market participants.
- The market for traditional PRI products – which MIGA occupies – has become a relatively small subset of a larger market of political risk mitigation instruments. MIGA remains an influential but niche player, with diminishing market presence in the context of expanding overall political risk mitigation market.
- However, PwC sees opportunity for MIGA to play a larger role. Market participants value MIGA's financial strength, ability to work with difficult projects in difficult countries, large capacity and long-term coverage periods, the relationships with governments and the excellent claims history. A strong desire is expressed for MIGA to expand its product offerings.

Identified Trends

Based on surveys and meetings with industry participants, PwC suggests that decisive action by MIGA would position it to take advantage of the facts that significant amounts of FDI and debt flow to developing countries go "uncovered", and significant numbers of investment opportunities are foregone each year due to inability to adequately protect against political risk. There is an expectation among many survey participants that political risks will increase worldwide over the next five years, and market participants expect demand for political risk mitigation instruments in the developing world to continue to increase.

Recommendations for MIGA

PwC suggests significant opportunities exist for MIGA to leverage its core strengths and respond to market demands by:

- *Defining, testing, and launching new products*. Such new products could include: Sovereign non-honoring coverage; Comprehensive non-payment coverage; Stand-alone debt coverage; Existing equity and acquisitions coverage; Qualifying MIGA's PRI Coverage for favorable regulatory capital treatment; Portfolio coverage; Intellectual Property Coverage; Coverage for carbon credit and other environmental requirements; Local currency loan financing political risk coverage; and, Consulting services.
- *Improving operational efficiency*. Opportunities include: Improving and accelerating application and approval processes; Enhancing flexibility in policies and guidelines terms and conditions; Strengthening engagement with the broker community; Conducting periodic benchmarking analysis of broker commissions and insurance company ceding commissions.

- *Creating transparency, confidence and efficiency in the market by spearheading the collection of accurate and complete data*. Achieving consensus regarding standard product terms and conditions; Working with the Berne Union to promote expanded and consistent gathering of market data.