

The Multilateral Investment
Guarantee Agency

**COMMENTARY ON THE CONVENTION
ESTABLISHING THE MULTILATERAL
INVESTMENT GUARANTEE AGENCY**

This Commentary refers to the Convention as adopted on October 11, 1985.
The amendments of November 14, 2010 are not addressed.

Commentary on the Convention Establishing The Multilateral Investment Guarantee Agency

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Commentary on the Convention Establishing the Multilateral Investment Guarantee Agency

Introduction

Considerable attention has been focused in recent years on the need to remove barriers impeding the growth of foreign investment in developing countries. Many countries have enacted new laws to promote foreign investment and entered into bilateral investment treaties with capital-exporting countries for this purpose.

The concept of providing foreign investors with financial guarantees against non-commercial risks in developing countries has emerged as a means of improving the investment climate in these countries and, hence, of stimulating investment flows to them. Almost all developed countries and two developing countries have established official schemes to provide guarantees against non-commercial risks to their nations for investments into developing countries. In addition, the Inter-Arab Investment Guarantee Corporation provides guarantees on a regional basis. A private political risk insurance market has also been operating internationally for over a decade. The activities of these entities are subject to several limitations and the perception of political risk remains a significant barrier to investment in developing countries. There is need for a multilateral investment guarantee agency to complement these schemes and improve the investment climate by issuing guarantees and engaging in other investment promotion activities.

The idea of establishing a multilateral investment guarantee agency emerged in the 1950s. It was discussed in the International Bank of Reconstruction and Development

(referred to in the Commentary as the Bank) on several occasions during the 1962-1972 period, but no decision was taken about creating such an agency. President Clausen revived the concept in his first address to the Bank's Annual Meeting in 1981. After detailed studies by the Bank staff and informal discussions with the Bank's Executive Directors, a paper entitled "Main Features of a Proposed Multilateral Investment Guarantee Agency" was distributed to the Executive Directors in May 1984. The paper presented a number of key features distinguishing the proposal from the schemes previously discussed in the Bank. This proposal, with modifications following discussions with the Executive Directors, was subsequently embodied in a "Draft Outline of the Convention Establishing the Multilateral Investment Guarantee Agency," which was circulated in October 1984. On the basis of that document, consultations were held with member governments of the Bank. These consultations resulted in a revised draft of the Convention which was circulated to the member governments in March 1985. Between June and September 1985, the Executive Directors, assisted by experts from member governments, convened in a Committee of the Whole to discuss the draft Convention. In September 1985, the Executive Directors finalized the draft Convention and recommended to the Board of Governors that it adopt a resolution opening the Convention for signature.

The provisions of the Convention are for the most part self-explanatory. This Commentary describes some of its principal features to aid interpretation of its provisions.

I. Status, Establishment and Purposes

1. The Convention establishes the Multilateral Investment Guarantee Agency (referred to in this Commentary as the Agency) as an autonomous international organization with "full juridical personality" under international law and the domestic laws of its members (Article 1) with the main objective of encouraging the flow of investments for productive purposes among its member countries and in particular to its developing member countries (Article 2). The reference to "investments for productive purposes" emphasizes the Agency's concentration on concrete projects and programs in all sectors of the economy. It does not imply a restriction of its operations to the manufacturing sector. In addition to guaranteeing investments in these member countries against non-commercial risks, the Agency is to carry out complementary activities to promote investment flows (Article 2(b)). Article 23 of the Conventions sets out the promotional activities the Agency will provide.

II. Membership and Capital

Membership

2. Membership in the Agency is open to all members of the Bank and to Switzerland (Article 4(a)). There is, however, no obligation for Bank members to join the Agency. The Convention recognizes the importance attached to participation by both capital-exporting and capital-importing members particularly in the provisions for its entry into force (Article 61(b)) and for voting (Article 39).

Capital

3. Earlier Bank proposals envisaged the Agency as having no share capital and conducting its operations on behalf of the member countries which would sponsor investments for guarantee by the Agency. Under the convention the Agency will have a share capital (Article 5) and can issue guarantees in its own right which will be supplemented by guarantees issued for investments sponsored by members; with respect to the latter, the Agency will act only as administrator (Article 24 and Annex I to the Convention). The subscribed capital can be leveraged, allowing for guarantee coverage several times its size (see Article 22).

4. The Convention provides for an authorized capital of one billion Special Drawing Rights, divided into 100,000 shares having a par value of SDR 10,000 each. Members' payment obligations with respect to capital stock will, however, be settled on the basis of the average value of the SDR in terms of U.S. dollars for the period January 1, 1981 to June 30, 1985, i.e. \$1.082, the former date being the date of the introduction of the current basket of currencies of the SDR (Article 5(a)). Once the initially authorized amount is fully subscribed, the authorized capital will be increased automatically to the extent necessary to provide for subscriptions by acceding members (Article 5(b)). The authorized capital may also be increased at any time by the Council of Governors (referred to in their Commentary as the Council) by the special majority of at least two-thirds of the voting power representing at least fifty-five percent of capital subscriptions (Article 5(c) and Article 3(d)).

5. The amount of subscribed capital will determine the Agency's underwriting capacity (see Article 22). It is anticipated that the authorized capital will be subscribed within a reasonable time after the Agency commences

operations and that it will be able to operate successfully on that basis.

6. Every member shall subscribe to the capital stock of the Agency. Article 6 provides for a minimum subscription of 50 shares (SDR 5,000,000). This will give all members a stake in the Agency. Initial subscriptions of original members are set out in Schedule A to the Convention. The subscriptions of acceding members will be determined by the Agency's Council. While shares will be issued at par to original members, the Council is authorized to determine the terms and conditions of acceding members' subscriptions provided that the issue price shall not be less than par. Issue prices above par might be appropriate if the Agency has accumulated reserves at the time of the accession (Article 6).

7. The Convention provides that ten percent of the price of the subscribed shares is to be paid in cash and that an additional ten percent is to be paid in the form of non-negotiable, noninterest bearing promissory notes or similar obligations to be encashed pursuant to a decision of the Board. The cash payment is designed to cover start-up costs, administrative expenditures and possible claims arising out of the Agency's guarantees. The arrangement for additional payment in the form of non-negotiable instruments allows the funds to remain within the members' central banking systems and provides a cushion in the event that a large claim occurs during the Agency's formative years. The purpose of this provision is to strengthen the Agency's standing as a financially sound insurer from the outset. The remaining eighty percent of the subscribed shares is subject to call by the Agency to meet its obligations (Article 7). It should be emphasized that actual recourse to the non-negotiable instruments and the callable capital is not anticipated because the Agency is expected to conduct its activities on a sound business basis and maintain under all circumstances its ability

to meet its financial obligations (see Article 25). Article 8(c) provides that in case of default by a member on a call, the Agency is authorized to make successive calls on unpaid subscriptions.

8. Subject to the limited exception discussed below, payments on the paid in and callable portions of subscriptions must be made in a freely usable currency as defined in the Convention (Articles 3(e) and 8). This is essential to ensure the Agency's financial viability and its recognition as a credible insurer. The Board of Directors (referred to in this Commentary as the Board) has the discretion, after consultation with the International Monetary Fund, to designate as "freely usable" currencies other than those so designated by the International Monetary Fund. The Board can make this decision if it is satisfied that the currency concerned can be readily used for the purposes of the Agency and if the country whose currency is involved agrees (Article 3(e)). In order to reduce the financial burden of developing member countries, the Convention allows developing countries to pay up to twenty-five percent of the paid in cash portion of their subscription in their local currencies. In view of the small amounts likely to be involved, this is not expected to have adverse effects on the Agency's finances.

9. To reduce the financial burden on all members, the Convention provides that under certain circumstances the Agency will refund to members amounts paid on a call on subscribed capital. These refunds would be made in a freely usable currency in proportion to the payments made by members under calls made prior to such refund (Article 10(b)). In the case of recovery of payments from a host country in a currency which is not freely usable, it is envisaged that the Agency would make the refund once it succeeds in converting such payments into usable currencies.

To the extent amounts are refunded, members' callable capital obligations would be re-established so that the situation existing before the respective call is restored (Article 10(c)).

III. Operations

10. The Convention establishes the general framework for the Agency's guarantee operations and enables the Board to define more precisely the scope of these operations by issuing policies, rules and regulations which can be amended from time to time. This provides the Agency with the necessary flexibility to adapt, within this general framework, to changing circumstances and maintain its financial viability. For example, the Agency could limit the scope of its coverage on commencing operations and expand it as it gained experience and built up financial reserves. Moreover, the detail of each guarantee operation and the specific arrangements reached between the Agency and the investor would be incorporated into the contract of guarantee entered into between the Agency and the investor. Article 16 provides that the Agency cannot cover under a contract of guarantee the total loss sustained by an investor. This provision is designed to discourage possible irresponsible conduct by investors relying on total loss cover (commonly referred to as "moral hazard"). In determining the appropriate percentage of possible indemnification, the Agency may find some guidance in the rules of national investment guarantee schemes which typically indemnify between seventy and ninety-five percent of the loss.

11. As stated above, the policies, rules and regulations applicable to guarantee operations will be determined by the Board. Contracts of guarantee, concluded on the basis of these principles, will be approved by the President of the Agency under the direction of the Board.

Scope of Covered Risks and Eligibility

12. The Convention provides for coverage of the three generally accepted categories of non-commercial risks: the currency transfer risk resulting from host government restrictions and delays in converting and transferring local currency earned by an investor, expropriation, and the risk of war and civil disturbance. The Convention adds to these traditionally covered risks the risk of breach or repudiation of a contractual commitment by the host government towards an investor under the limited conditions mentioned in paragraph 15 below (Article 11(a)).

13. The currency transfer risk is broadly defined in Article 11(a)(i). It is intended to encompass all forms of new direct restrictions, including additions to existing restrictions, as well as indirect or disguised restrictions, whether such restrictions are imposed by law or in fact. The restriction must be "attributable to the host government," restrictions imposed by public agencies and other public organs of the host country are intended to be covered by this language. The provision is also intended to include the failure of the host government to act within "a reasonable period of time" on a transfer application. The provision does not define the specific period but it is expected that this will be accomplished in the rules and regulations to be issued by the Board and specifically in the contracts of guarantee. In determining what constitutes a "reasonable period," the Agency will need to reconcile the investors' interest in a speedy transfer with the fact that certain delays in the processing of applications by governments may be justified.

14. Article 11(a)(ii) defines the expropriation risk. It would encompass measures attributable to the host government such as nationalization, confiscation, sequestration, seizure,

attachment and freezing of assets. The phrase "any legislative or administration action" in the provision includes measures by the executive, but not measures taken by judicial bodies in the exercise of their functions. Measures normally taken by governments to regulate their economic activities such as taxation, environmental and labor legislation as well as normal measures for the maintenance of public safety, are not intended to be covered by this provision unless they discriminate against the holder of the guarantee. In defining these measures, the Agency's practice would not be meant to prejudice the rights of a member country or of investors under bilateral investment treaties, other treaties and international law.

15. The breach of contract risk is contained in Article 11(a)(iii). Indemnification is available only when an investor has no forum to pursue the contractual claim against the government or when recourse to such a forum is hampered by an unreasonable delay as defined in the guarantee contract or when, after obtaining a final decision in his favor, the investor is unable to enforce it.

16. Article 11(a)(iv) encompasses the risk of war and civil disturbance. It is intended to include revolutions, insurrections, coups d'état and similar political events which are typically outside the control of the host government. Acts of terrorists and similar activities which are specifically directed against the holder of the guarantee are, however, not intended to be covered by this provision but may be covered under Article 11(b), which is discussed below.

17. The Convention provides additional flexibility by allowing the coverage of other specific non-commercial risks, but only at the joint request of the investor and the host country and with approval of the Board by special majority (Article 11(b)). Such approval may be issued on a case by case

basis or in the form of regulations specifying the cases to be covered under this provision.

18. Events occurring before the conclusion of the contract of guarantee, governmental action to which the holder of the guarantee has agreed or for which he is responsible, and losses resulting from currency devaluation and depreciation are specifically excluded by Article 11(b) and (c).

19. Article 12 defines the type of investments eligible for cover by the Agency. This provision endeavors to strike a balance between the need to preserve the Agency's scarce capital to promote flows of direct investment and the need to assure future flexibility by allowing the Board to extend coverage to other types of investment. It is envisaged that the Agency will focus on guaranteeing investments eligible under Article 12(a), i.e. equity investment, different forms of direct investment, and medium- to long-term loans made or guaranteed by owners of equity in the enterprise concerned (so-called equity-type or sponsored loans). The term "direct investment" is a generic term whose precise scope will have to be determined by the Board. The Board is expected to be guided by the International Monetary Fund's definition of foreign direct investment as an "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise." The Board may consider as direct investment such new forms of investment as service and management contracts as well as franchising, licensing, leasing, and production-sharing agreements where the investor's return depends on the performance of the enterprise. In any case, it is immaterial whether the investment is made in monetary form or in kind such as the contribution of machinery, service, technical processes and technology.

20. Article 12(b) gives the Board flexibility, in the future, to extend the Agency's coverage to other forms of investment. It authorizes the Board, by special majority, to extend coverage to any medium- or long-term form of investment except loans which are not related to a specific investment covered or to be covered by the Agency. To conserve the Agency's scarce resources, the Agency would not guarantee or reinsure any export credit, regardless of its form, which is provided, guaranteed or reinsured by a government or an official export credit agency. Because the coverage of the Agency is restricted to investments, exports will be covered (within the limits of the preceding sentence) only to the extent that they represent a contribution to a specific investment. An agency or distributorship arrangement, which is designed primarily to promote exports, and in which an investor has an inconsequential equity interest, would not be covered by the Agency. The Agency would function as an investment guarantee agency, and would not function as an export credit agency which could compete with official export credit agencies.

21. To serve its objective without undermining its financial viability, the Agency will limit its guarantees to sound investments. It should satisfy itself that the investment concerned will contribute to the economic and social development of the host country, comply with the laws and regulations of that country, and be consistent with the country's declared development objectives. It should also be satisfied that appropriate investment conditions, including the availability of fair and equitable treatment and legal protection, will apply to the investment concerned (Article 12(d)). In case no such protection is assured under the laws of the host country or under bilateral investment treaties, the Agency will issue the guarantee only after it reaches agreement with the host country pursuant to Article 23(b)(ii) or otherwise on the treatment to be extended to the investments covered by the

Agency. Investments guaranteed by the Agency should also be new, that is implemented subsequent to the registration of the application for the guarantee by the Agency (Article 12(c)). The exclusion of pre-existing investments would not bar the Agency from covering investments made to develop an existing investment or from covering the reinvestment earnings which could otherwise be transferred outside the host country. The term "earnings" in Article 12(c)(ii) is intended to include royalties and license fees.

22. To qualify for a guarantee, investors who are natural persons must be national of members other than the host country. If investors are juridical persons, they must be incorporated and have their principal place of business in a member country other than the host country or have the majority of their capital owned by a member country or its nationals, other than the host country or its nationals. Privately and publicly owned investments are eligible as long as they are operated on a commercial basis (Article 13(a)(iii)). It is expected, however, that the bulk of guaranteed investments will be privately owned.

23. Article 13(c) provides an exception to the requirement that investors may not be linked to the host country in the case of assets transferred from abroad by nationals of the host country or juridical persons incorporated in the host country or owned by host country nationals, provided that the investor and the host country jointly apply for a guarantee and the Board approves it by special majority. This exception is consistent with the Agency's central objective of channelling the flow of investments to developing countries, some of which now have nationals living abroad with considerable off-shore funds. It would also help in the repatriation of capital to developing countries.

24. Article 14 limits the Agency's own guarantee operations to investments made in the territory of a

developing member country. A developing member country is defined in Article 3(c) as a member listed as such in Schedule A to the Convention. During discussions by the Executive Directors, it was understood that the Agency would develop policies on eligibility whereby priority in its operations would be given to lesser developed countries. It was also agreed that, for purposes of Article 14, dependent territories for whose international relations a non-developing country is responsible, should be treated as developing members, if the non-developing member country so requests. However, investments of that member in its dependent territories would be excluded from cover.

Host Country Approval and Subrogation

25. Article 15 provides that the Agency will not conclude any contract of guarantee before "the host government has approved the issuance of the guarantee by the Agency against the risks designated for cover." Any host government may withhold its approval. This enables the host country to evaluate a proposed investment before giving its consent. The Agency is expected to establish procedures for obtaining consents under this provision. These may include requesting approvals on a no objection basis (Article 38(b)). Although the approval of the home country of the investor is not required, it would not be appropriate for the Agency to cover an investment if informed by the investor's home country that it would be financed with funds transferred outside such country in violation of laws.

26. Article 18(a) provides that where the Agency compensates or agrees to compensate an investor under a contract of guarantee, it assumes the rights that the investor acquired against the host country as a result of the event giving rise to the claim against the Agency. Subrogation is an accepted principle of insurance law. It provides for the

assignment of an existing claim from the guaranteed investor to the Agency and the Agency as subrogee acquires the same rights as the investor had. The contracts of guarantee will define the terms and conditions of subrogation. These terms and conditions are of special significance for the investor in view of the fact that the Agency will compensate investors only for part of their losses (Article 16). Article 18(b) provides for the recognition of the Agency's right of subrogation by all members.

27. Under Article 18(c), the Agency has the right to treatment as favorable as would be given the holder of the guarantee with respect to the use and transfer of local currencies of host countries received by the Agency as subrogee. In addition, the Agency is authorized to use these currencies for the payment of its administrative expenditures or other costs and is directed to seek to enter into agreements with host countries on other uses of these currencies if they are not freely usable. Such other uses could include the sale of the currencies to other institutions (such as international lending agencies), foreign investors in these countries or to importers of goods from these countries. The Agency's ability to use effectively, or otherwise dispose of, local currencies may be of significance in its operations in the unlikely case it should acquire substantial amounts of such currencies.

Payment of Claims

28. In order to ensure prompt payment of claims, decisions will be taken by the President in accordance with the contracts of guarantee and such policies as the Board may adopt (Article 17) and, in cases of dispute, final determination may depend on the outcome of arbitration between the Agency and the investor concerned (Article 58). It is envisaged that these policies will require the holder to seek such administrative remedies as may be appropriate under the

circumstances, if they are readily available under the laws of the host country, and may provide for reasonable periods of time to elapse so as to maximize the prospects for amicable settlement of claims between investors and host countries (Article 17). It is expected that the specific time limits, to be included in the guarantee contracts, would be consistent with the practice of other political risk insurers. This provision reflects established practices of national investment guarantee schemes and should not impose an undue burden on investors since they are not required to exhaust all local remedies before obtaining compensation from the Agency. The time limits would depend on the type of risk involved and the complexity of the particular case. The above time limits must be distinguished from the maximum periods allowed between the filing of a claim and the Agency's decision on the claim. These time limits are not specified in the Convention because of the difficulty in determining specific periods which would be appropriate in all situations. However, the Agency may establish such time limits in its rules and regulations and may incorporate them into the contracts of guarantee in order to increase the attractiveness of its services.

Relationship to National and Regional Entities as well as Private Political Risk Insurers

29. The Agency will complement national and regional programs rather than compete with them (Article 19). It is therefore expected to focus on guaranteeing investments from members without a national program (chiefly capital-exporting developing member countries), co-guaranteeing investments with national and regional agencies, providing reinsurance for national and regional agencies, guaranteeing investments which fail eligibility tests of the national and regional program concerned despite their soundness and developmental character, and guaranteeing investments financed by investors from different member countries. To contain its overhead and

enhance its efficiency, the Agency may avail itself of the administrative support of national or regional entities and may enter into appropriate cooperative agreements with them (Article 19). For example, national administrative agencies might assist in processing applications of local investors for multilateral guarantees and any resulting claims. This would reduce the possible need for the Agency to establish offices away from its headquarters. It is clear, however, that the Agency would have to rely on its own risk assessments and reserve to itself decisions on issuance of guarantees and on payment of claims.

30. Article 19 defines the institutions the Agency may cooperate with in this respect as "national entities of members and regional entities the majority of whose capital is owned by members, which carry out activities similar to those of the Agency." This includes any agency that issues investment guarantees against non-commercial risks or that promotes private investment to developing countries. As a result, the Agency might cooperate with more than one institution in the same country. It should be noted that cooperation between a national entity and the Agency does not result in the entity automatically becoming the channel of communication between the member country and the Agency under Article 38. This provision requires each member to designate an appropriate authority for communication on all matters arising under the Convention.

31. The Agency may cooperate with private political risk insurers to enhance its own operations and to encourage those insurers to provide political risk insurance in developing members of the Agency on conditions similar to those of the Agency (Article 21 (a)). For example, with respect to the former objective, private insurance companies might assist the Agency in marketing its program. With respect to the latter objective, the Agency is expected to play a catalytic role in

mobilizing private underwriting capacity, for example, by entering with private underwriters into coinsurance arrangements. The Agency will in particular seek to guarantee investments for which comparable coverage on reasonable terms is not available from private insurers.

32. The purpose of Articles 19 to 21 is to establish the Agency as a facility designed to cooperate with and increase the efficiency and effectiveness of both public and private political risk insurers. How cooperation will be achieved will depend on the administrative structure and the situation of the insurance market in the country concerned. In some countries governments play a role in coordinating public and private insurance activities, and Article 38(a) requires the Agency to consult with member governments, at their request, on the matters set out in Articles 19 to 21. These include the Agency's complementary role in the design of its own guarantee operations, coinsurance, reinsurance, sponsorship operations and administrative cooperation. Where appropriate, the Agency may enter into an "umbrella agreement" with a government providing the framework for the Agency's cooperation with the public and private insurers of that member.

Reinsurance

33. The Agency is authorized under Articles 20 and 21(a) to provide reinsurance to institutions of members issuing investment guarantees, to regional investment guarantee agencies (of which the sole example at present is the Inter-Arab Investment Guarantee Corporation), and to private insurers in member countries. As stated in paragraph 31 of this Commentary, the Agency's arrangements with private insurers, including arrangements for reinsurance, are intended to encourage them to offer investors guarantees on conditions similar to those offered by the Agency. Reinsurance is

intended to diversify the Agency's own risk portfolio as well as that of the reinsured entity. It should also allow the reinsured entity to expand its operations.

34. It should be noted that reinsurance provided by the Agency must always relate to "specific investment." The intention here is to exclude the reinsurance of portions of primary underwriters' risk portfolios (commonly referred to as treaty reinsurance). It should also be noted that reinsurance operations are intended to comprise only a predetermined part of the Agency's overall operations. Article 20(a) therefore provides that maximum amounts shall be set from time to time by the Board by special majority. In the case of investments completed more than one year prior to receipt of the application for reinsurance by the Agency, the Convention establishes an initial limit of ten percent of the total coverage which the Agency may provide on its own account, i.e. without resort to sponsorship. These limits apply to the reinsurance of both public entities and private insurers. They may be changed by the Board by special majority whenever deemed appropriate.

35. The conditions determining eligibility with respect to risks, investment, investor and host country applicable to Agency guarantees will apply to reinsured investments; for technical reasons, reinsured investments need not be implemented subsequent to the application for reinsurance (Article 20(a)).

36. Article 20(c) provides that, to the extent possible, reinsurance arrangements will be structured so that the Agency or the reinsured entity will have equivalent rights of subrogation and arbitration to those the Agency would have if it were primary guarantor. However, the Agency's rights as subrogee will not be effective without the host country's prior approval of the reinsurance by the Agency (Article 20(c)). In

some cases, it might be impracticable for the Agency to be subrogated to the rights of the reinsured entity. In other cases, it might be expedient for the Agency to let the reinsured entity enforce the subrogated rights acquired by the Agency as its agent. Article 20(c) requires contracts of reinsurance to provide that the reinsured entity will pursue recovery remedies with due diligence.

37. Under Article 21(b), the Agency may reinsure any guarantees issued by it with public or private insurers. Such reinsurance would allow it further to diversify its risk portfolio. It is expected to use this authority only where it can obtain reinsurance cover at appropriate terms and reasonable cost.

Limits of Guarantee

38. Under accepted principles of insurance and banking, the incurring of aggregate liabilities in excess of the insurer's or bank's equity is permitted. The basis for this principle is that it cannot reasonably be expected that all guaranteed or insured risks will become losses. Under the Convention, this principle is applied to the Agency. Article 22(a) provides that the maximum aggregate amount of contingent liability which may be assumed by the Agency may not exceed one hundred and fifty percent of its subscribed capital and reserves as well as, possibly, a portion of reinsurance cover, unless the Council determines otherwise by special majority. Since the Agency is expected to build up its portfolio over time, the Board is called upon to review from time to time the actual spread of risks and the loss potential with a view to determining whether a higher risk-asset ratio should be recommended to the Council. However, any decision to increase the ratio is, as stated above, subject to a special majority vote and the maximum risk-asset ratio may not exceed one-to-five.

39. Article 22(b)(i) provides that the Board may prescribe the maximum amount of contingent liability for all guarantees issued to investors of individual members. The objective of this provision is to maintain equilibrium between the relative contributions of a member to the Agency and the benefits from the Agency accruing to its investors. In setting limits, the Board is required to give "due consideration" to a member's capital subscription; however, "due consideration" is also to be given to the need of applying these limits more liberally to developing member countries when they or their nationals invest in other developing members.

40. A third category of limits may be established by the Board in order to achieve a viable overall spread of risk and to avoid undue concentrations of risk. Thus limits may be placed on the Agency's exposure with respect to the size of individual projects, total investments in individual host countries, types of investment or risk or other factors (Article 22(b)(ii)). Since these limits serve solely to diversify risk, any limit on investments in individual host countries is not to be affected by such countries' relative capital subscriptions.

Investment Promotion

41. One of the features that distinguish the Agency from earlier proposals is its obligation to carry out activities complementary to issuing guarantees to promote the flow of investments to and among member countries (Article 2(b)). The Agency has a responsibility under Article 23(a) to conduct research and disseminate information on investment opportunities in developing member countries, as well as to undertake other activities to promote foreign investment. In addition, the Agency, at the request of a member, may provide technical assistance and advice with the objective of improving investment conditions. This could include advice on such matters as the drafting of investment codes and reviewing

investment incentive programs. Such complementary services may be provided against appropriate fees or may be extended at no cost to the beneficiary countries when warranted.

42. In carrying out its promotional activities, the Agency will be guided by the relevant investment agreements among its members and will seek to remove impediments among its members to investment flows. In addition, the Agency has a duty to coordinate with other agencies concerned with the promotion of foreign investment, particularly the International Finance Corporation (Article 23(a)). This would help to avoid duplication in the Agency's activities.

43. Article 23(b)(i) places a duty on the Agency to encourage the amicable settlement of disputes between investors and host countries. It may also provide information on available dispute settlement and conciliation mechanisms. The agency is also directed to promote and facilitate the conclusion of investment protection treaties among its members. For example, it could undertake studies on existing agreements and assist member governments in the analysis of the implications of and benefits from such agreements.

44. Under Article 23(b)(ii), the Agency will endeavor to enter into bilateral and multilateral agreements with its members in order to assure that the investments guaranteed by it will receive treatment at least as favorable as that accorded by the member concerned to the most favored investment guarantee agency or State. In determining the most favored agency or State, the Agency will consider agreements as a whole, and not their individual provisions. Agreements under Article 23(b)(ii) require the Board's approval by special majority. It is anticipated that these agreements would be concluded when the investments covered by the Agency would not otherwise benefit from

existing bilateral treaties or when the standards provided in such treaties are deemed by the Agency to be inadequate.

Guarantees of Sponsored Investments

45. Earlier Bank proposals to establish an international investment insurance agency contemplated that the Agency would have conducted its operations solely on behalf of sponsoring member countries. Under the Convention, Guarantees of sponsored investments play a supplemental but important role to operations conducted by the Agency on its own behalf. In addition to the latter operations, the Agency may, under Article 24, guarantee other investments, and provide additional reinsurance, if a member or members agree to sponsor these investments. The specific provisions relating to sponsorship operations are set out in Annex I, which is an integral part of the Convention. It must be emphasized that the assets held and administered by the Agency in the Sponsorship Trust Fund mentioned below are required under Article 2(c) of Annex I to be kept separate and apart from the assets of the Agency and that the Agency cannot incur any liability with respect to its own assets under the sponsorship operations (Article 6 of Annex I).

46. The mechanics of sponsorship are as follows: A member proposing to the Agency the guarantee of an investment will incur a loss-sharing contingent obligation in the amount of the guarantee sponsored by it. Premiums and other revenues attributable to sponsored guarantees will be accumulated in a separate trust fund called the Sponsorship Trust Fund. The administrative expenses and payments on claims related to sponsored investments would be paid out of this Fund. After depletion of the Fund, any loss incurred on a sponsored guarantee would be shared by all sponsoring members, each in the proportion which the total amount of guarantees sponsored by it bears to the total amount of

guarantees sponsored by all members. Each sponsor's maximum liability is, however, limited to the total maximum contingent liability under all guarantees sponsored from time to time by that member. Articles 1 and 3 of Annex I provide limitations on a members obligation to share in losses under the sponsorship arrangement.

47. Sponsorship enables members to provide investment insurance protection in several instances. Members which do not have a national scheme may use this system to provide coverage to their investors. For other members, sponsorship might be used as a risk diversification device since it would allow them to substitute the pro rata share in all contingent liabilities of the Sponsorship Trust Fund for the entire contingent liability for the investments if insured by their national scheme.

48. In general, the provisions of the Convention relating to guarantee operations and financial management which are applicable to the Agency's own operations will also apply to sponsored guarantees (Article 6 of Annex I). In particular, the eligibility requirements under Articles 11 and 12 of the Convention also govern sponsored investments. However, guarantees relating to sponsored investments are not limited to nationals of member countries. Article 1(a) of Annex I provides that such investments may be made "by an investor of any nationality or by investors of any or several nationalities." The host country may co-sponsor an investment. Co-sponsorship indicates a strong developmental interest by the host country in the investment, and an intention to improve its risk profile. Article 1(c) of Annex I places a duty on the Agency to give priority treatment to the coverage of investments co-sponsored by the host country.

49. The limitation provided in Article 14 of the Convention restricting coverage to investments in developing countries

applies to operations on the Agency's own account and does not extend to sponsorship operations. Members may sponsor investments in any member country, but a special emphasis is placed on operations in developing member countries. The rationale for allowing sponsorship operations in developed countries is that guarantees for sponsored investments in developed countries, which are of particular interest to some capital-exporting developing countries, do not absorb scarce underwriting capacity and would not therefore reduce the Agency's capacity to guarantee investments in developing countries. In some circumstances, an investment in a developed country corporation may facilitate joint ventures with that corporation or its subsidiary in developing countries. Investments in developed countries also have the advantage of improving the risk profile of the Sponsorship Trust Fund's portfolio and enabling it to achieve a greater measure of diversification.

50. Article 5(a) of Annex I authorizes the Agency to issue reinsurance to members and their agencies, regional agencies of members and private insurers in member countries on the basis of sponsorship. These reinsurance operations are subject to the same conditions as reinsurance operations on the Agency's own account. Reinsurance on the basis of sponsorship diversifies risk. The sponsorship of privately insured investment for reinsurance can be used by members as a substitute for the reinsurance of these investments on their own account. All sponsoring members would share pro rata in any loss under the reinsurance policies, irrespective of whether the loss arises from a sponsored guarantee or a sponsored reinsurance policy.

51. Article 6 of Annex I provides that sponsorship operations will be carried out in accordance with the same sound business and financial practices governing the Agency's guarantee operations based on its own capital and reserves.

As in the case of underwriting for its own account, the Agency would not be expected to cover sponsored investment involving unacceptably high risks or that would unbalance its risk portfolio. Sponsorship operations would also benefit from the credit of the sponsoring members which, it is assumed, would be among the most creditworthy members. Article 1(c) of Annex I specifically directs the Agency to "pay due regard to the prospects that the sponsoring member will be in a position to meet its sponsorship obligations." Moreover, sponsorship operations are expected to be financially as sound as the Agency's own guarantee operations.

52. Article 1(d) of Annex I requires the Agency to consult periodically with sponsoring member countries on matters related to sponsorship operations. Moreover, voting allocations will be modified for the purpose of decisions on sponsored investment in that each sponsoring member and each member hosting a sponsored investment will be allocated an additional vote for each SDR 10,000 of any investment sponsored or hosted by it (Article 7 of Annex I). Theoretically, therefore, there is a possibility that the terms and conditions adopted by the Board for sponsorship operations may not be identical to those concerning operations on the Agency's own account.

IV. Financial Provisions

53. Article 25 directs the Agency to "carry out its activities in accordance with sound business and prudent financial management practices with a view to maintaining under all circumstances its ability to meet its financial obligations." It is anticipated that the Agency would become financially self-sufficient. Management is expected to endeavor to avoid calls on member's subscribed capital. The experience of national investment guarantee agencies and the private insurance market indicates that this is a realistic objective.

54. The Agency will need to charge adequate premiums, fees and other charges under Article 26 in order to become financially viable and self-sufficient. The convention does not prescribe how premiums and fees are to be determined and the rates applicable to each type of risk will need to be established and periodically reviewed by the Agency. It has considerable discretion to decide on the level and structure of its premiums and fees including charges for its promotional activities.

55. The Agency's financial standing is enhanced by the requirement in Article 27(a) that all net income is to be retained as reserves until they amount to five times the subscribed capital of the Agency. An exception to this provision is that the Council, by special majority, may decide to use part of its revenues to return to members amounts paid on calls on subscribed capital if the financial position of the Agency would so permit (Article 10(a)(iii)). After these reserves have reached the above-mentioned limit, the Council can determine under Article 27(b) whether to allocate any excess net income to reserves, make a distribution to the members or otherwise dispose of such income.

V. Organization and Management

56. The basic structure of the Agency follows that of other international financial institutions, especially the Bank and the International Finance Corporation. The Agency has a three-tiered structure, consisting of a Council of Governors, a Board of Directors and a President and staff (Article 30).

57. The Council is composed of one Governor from each member and his Alternate (Article 31). The Convention does not place any restriction on members in the appointment of their Governors and Alternates. The Council meets at least annually and can be convened at any other time by the Council or the Board. The Council is vested with all the powers of the Agency, except those specifically conferred by the Convention on another organ of the Agency. However, the Council may delegate to the Board the exercise of any of its powers except the specific powers listed in Article 31(a) reserved to the Council, such as admission and suspension of members, classification of members for voting purposes or as developing member countries, changes in capitalization, increases of the ratio provided in Article 22(a), determination of Directors' compensation, amendments to the Convention, cessation of operations and liquidation of the Agency, and distribution of assets to members upon liquidation.

58. The Board is elected in accordance with Article 41(a) and Schedule B and is responsible for the general operations of the Agency (Article 32(a)), a responsibility which covers all matters related to the Agency's policies and regulations but not its day-to-day management which is the responsibility of the President and staff. The Board may take any action required or permitted under the Convention. The Council determines the term of office of Directors under Article 32(c). The Board will consist of not less than twelve Directors. The Council will determine the number of Directors, which it may adjust to take into account changes in membership. Of the total number of Directors, one-fourth would be elected separately, one by each of the members having the largest number of shares. The remaining Directors would be elected by the other members (Schedule B). Each Director may appoint an Alternate (Article 32(b)). The Board will meet at the initiative of the Chairman or at the request of three Directors (Article 32(d)). It is anticipated that during the

formative years of the Agency, the volume of business might not justify a Board sitting in continuous session. This would reduce administrative costs since, under those circumstances, the Directors and Alternates would receive compensation only for attendance at the meetings and the discharge of other specific official functions (Article 32(e)).

59. The President of the Agency is appointed by the Board. The Board would decide on this appointment on the Chairman's nomination (Article 33(b)). The President is responsible for conducting the ordinary business of the Agency under the general control of the board and for the appointment, organization and dismissal of staff (Article 33(a)). It is intended that the number of staff would be kept small to increase the Agency's effectiveness and viability. The salary and terms of the contract of the President are to be determined by the Council (Article 33(b)). This follows the practice of the Bank.

60. Article 34 is based on similar provisions in the Articles of Agreement of the Bank and the International Finance Corporation, and prohibits any interference by the Agency and its President and staff in the "political affairs" of any member. This does not prevent the Agency, however, from taking into consideration all circumstances relevant to its underwriting decisions and its promotional activities.

61. The principal office of the Agency will be located in Washington, D.C., unless the Council, by special majority, decides to establish it in another location (Article 36(a)). In addition, the Agency may, under Article 36(b), establish such other offices as may be necessary for its work.

62. While previous proposals envisaged a number of organizational links between the Bank and the Agency, the Convention establishes only a minimal organizational link between the two institutions. The President of the Bank would

serve *ex officio* as Chairman of the Agency's Board (Article 32(b)). It is intended that this relationship would promote the role of the Agency as an international developmental institution and assist it to gain recognition without affecting the different roles of the two institutions. The Agency might find it advisable to enter into a cooperative agreement with the Bank or the International Finance Corporation or both to take advantage of their technical and administrative services and facilities as required (see Article 35).

VI. Voting, Adjustment of Subscriptions and Representation

63. The voting structure of the Agency reflects the view that Category One and Category Two countries have an equal stake in foreign investment, that cooperation between them is essential, and that both groups of countries should, when all eligible countries become members, have equal voting power (50/50). It is also recognized that a member's voting power should reflect its relative capital subscription. The Convention, therefore, provides that each member is to have 177 membership votes plus one subscription vote for each share of stock held by it (Article 39(a)). The number of membership votes is computed so as to ensure that if all Bank members joined the Agency, developing countries as a group would have the same voting power as developed countries as a group. In order to protect the minority group before such equality is reached, this group would receive, during the three years after entry into force of the Convention, supplementary votes which should allow it to have as a group 40 percent of the total voting power. These supplementary votes would be distributed among the members of the group concerned in proportion to their relative subscription votes and would be automatically increased or decreased, as the case may be so as

to maintain the 40 percent voting power of the group (Article 39(b)). Even during the transition period, such supplementary votes would be cancelled whenever the group reached 40 percent of the total voting power through subscription and membership votes. In any case, supplementary votes would be cancelled at the end of the three-year period. During this three-year period, all decisions of the Council and the Board would be taken by a special majority of at least two-thirds of the total voting power representing at least fifty-five percent of total subscriptions, except if a specific decision was subject to a higher majority under the Convention, in which case, the higher majority would be controlling (Article 39(d)). An example of the latter would be certain amendments to the Convention (Article 59(a)).

64. During the third year after entry into force of the Convention, the Council is required under Article 39(c) to review the allocation of shares and to be guided in its decisions by three principles: (a) the voting power of members is to reflect actual subscriptions and membership votes; (b) the shares originally allocated to countries which have not signed the Convention at the time of the review are to be made available for reallocation so as to make possible voting parity between developing and developed members; and (c) the Council will take appropriate measures to facilitate the members' subscriptions to the shares allocated to them. The purpose of the reallocation is in time to achieve voting parity between both groups on the basis of relative subscription and membership votes.

65. To protect members' voting rights against erosion as a result of a general increase in capital, Article 39(e) entitles each member to new subscriptions of the increase in proportion to its relative subscription to the Agency's capital before the increase.

66. The voting procedures applicable to the Council and the Board under Articles 40 to 42 generally correspond to those of other international financial institutions, notably the Bank. One distinguishing feature is the provision that allows the Executive Directors to take decisions without a meeting (Article 42(c)). This is provided in view of the possibility that the Agency would initially have a non-resident Board.

VII. Privileges and Immunities

67. The provisions on the privileges and immunities of the Agency are patterned closely on those of the International Finance Corporation. The necessary differences from the privileges and immunities of the Corporation reflect special features of the Agency's operations.

68. The Convention provides that actions (other than actions arising in relation to disputes between parties to a contract of guarantee or reinsurance which are subject to arbitration under Article 58 and disputes between the Agency and a member concerning a guaranteed or reinsured investment, which are subject to arbitration or agreement on alternative procedures under articles 59), may be brought against the Agency only in a court of competent jurisdiction in the territories of members where that Agency has certain specified ties (Article 44). It is specifically provided that no action may be brought by members or those deriving claims from members or in respect of personnel matters. The latter exclusion represents a codification of existing practice applicable to international organizations. Article 45(a) provides that the assets of the Agency, which for purposes of this Chapter are defined as including Sponsorship Trust Fund assets, are immune from search, requisition, confiscation, expropriation, or any other form of seizure by executive or

legislative action; this immunity does not, however, extend to judicial action.

69. As a general rule, the Agency's property and assets are free from restrictions, regulations, controls, and moratoria. It should be noted, however, that assets acquired by the Agency exercising its rights as successor to or subrogee of an investor are free from applicable controls of the host country only to the extent that the investor whose rights the Agency acquired through subrogation was entitled to such treatment (Article 45(b)).

70. Article 46 provides that the Agency's archives are to be inviolable and that its official communications are to be accorded the same treatment as is accorded to those of the Bank. As in the Articles of Agreement of the Bank and IFC, no mention is made of the status of the Agency's premises. It is understood, however, that the Agency's premises will receive the same treatment that is accorded to the premises of other international organizations.

71. Article 47 exempts the Agency, its assets, property and income, as well as its operations and transactions from taxes and customs duties. This is not meant to provide for an exemption from taxes or duties which are in fact no more than charges for services rendered. With respect to assets acquired by the Agency from an investor through subrogation, it should be noted that these assets are acquired by the Agency net taxes and duties owed by the investor. Once such assets become the property of the Agency, they shall be exempted from taxes and customs duties. The Agency is not expected to acquire non-cash assets through subrogation, as it would claim compensation from the host country only for amounts paid to the investor. In the exceptional case that the Agency does acquire such assets, the expectation is that the Agency would convert these into cash expeditiously.

72. It should be noted that privileges and immunities are bestowed on the Agency for the purpose of enabling it to carry out its functions (Article 43), and that the Agency may waive these immunities where such a waiver would not prejudice its interests. Moreover, the Agency is directed to waive the immunities of its staff where in its view the immunity would impede the course of justice and the waiver would not prejudice the interests of the Agency (Article 50).

VIII. Withdrawal, Suspension of Membership and Cessation of Operations

73. The provisions of the Convention on withdrawal from the Agency, suspension of membership and cessation of operations are generally patterned on those of the Bank. Any member may withdraw from the Agency at any time by notifying the Agency in accordance with Article 51. However, to ensure the Agency's continuity, especially in its formative years, a member may not withdraw within the first three years of its membership. The Council has power under Article 52(a) to suspend a member which has failed to fulfill any of its obligations under the Convention. A suspended member has no rights and privileges under the Convention other than procedural rights and the right of withdrawal and remains subject to all of its obligations (Article 52(b)). Every former member remains liable for its existing or contingent obligations towards the Agency incurred before the cessation of its membership, unless other arrangements have been made with the Agency (Article 53).

74. Article 54 enables the Board to suspend the Agency's guarantee operations and other activities. Under Article 55 the council, by special majority, may decide to place the Agency into liquidation. No assets can be distributed to members

after liquidation until all liabilities of the Agency have been discharged or otherwise settled (Article 55(b)).

75. Article 55(c) provides that any distribution of the Agency's remaining assets to members are to be made in proportion to each member's share in the subscribed capital. Similarly, any distribution of remaining assets of the Sponsorship Trust Fund must be made to sponsoring members in proportion to the relative amounts of investment sponsored by them. Members still having obligations towards the Agency would be entitled to their share in the assets only after settlement of these obligations. In practice, the Agency's claim against the member concerned could be offset against its claim to the share in the Agency's assets so that the agency would be required to pay out only the balance. This Article also authorizes the Agency to distribute assets "in such manner as the Council shall deem fair and equitable." This provision is intended to provide for the most economical disposition of assets. It is intended that accepted corporate practice would be followed so that the value of assets given to an individual member in kind would be assessed by independent appraisers and credited against that member's share in the distribution.

IX. Settlement of Disputes

76. The Convention establishes procedures for four different types of disputes:

a) following the example of the Bank and other international financial institutions, questions of interpretation or application of the Convention arising between any member and the Agency or among any members will be decided by the Board subject to the possibility of appeal to the Council (Article 56);

b) disputes arising under a contract of guarantee or reinsurance between the Agency and the other party will, if not solved amicably, be submitted to arbitration in accordance with the rules contained or referred to in the contracts of guarantee or reinsurance (Article 58);

c) disputes between the Agency as subrogee of an investor and a member shall be settled either in accordance with Annex II to the Convention or in accordance with an agreement to be entered into between the Agency and that member on alternative dispute settlement mechanisms (Article 57(b)). Such an agreement (which must be approved by the Board by special majority before the Agency undertakes operations in the territory of the member concerned) would be negotiated between the parties taking Annex II as a basis. To the extent that such arrangements are satisfactory to the Agency, the agreement could, for example, provide that the Agency first seek remedies available to it under the domestic laws of the host country and seek recourse to arbitration only if it has not obtained relief under such remedies within a specified period of time. Such an agreement should assure that the Agency is treated at least as favorably, with respect to rights to proceed to arbitration, as in the arrangements which the member concerned has agreed for the most favored investment guarantee agency or any State party to an agreement related to investment. The agreement may also provide for alternative methods to arbitration such as seeking an advisory opinion from the International Court of Justice; and

d) disputes other than those under (a), (b) or (c), which arise between the Agency and any member or agency thereof as well as all disputes between the Agency and a former member will be settled in accordance with Annex II, i.e., through negotiations and failing this, according to conciliation and arbitration (Article 57(a)).

77. The Convention does not provide specific procedures to govern arbitration between the Agency and holders of a guarantee or a reinsurance policy. It is anticipated that the contracts of guarantee and reinsurance would normally refer to an internationally recognized body of rules for commercial arbitration, such as the ICSID rules, the rules developed by the United Nations Commission on International Trade Law (UNCITRAL) or the rules of the International Chamber of Commerce.

78. Annex II, which like annex I is an integral part of the Convention, requires that the parties first attempt to negotiate a settlement before resorting to arbitration (Article 2 of Annex II). In fact, it is anticipated that all such disputes would be settled amicably through negotiations as is the case in the practice of other international financial institutions. Failing negotiation, the parties have the option of attempting a settlement through conciliation or proceeding to arbitration. Where the parties agree to use conciliation, they may proceed to arbitration only when conciliation fails (Article 3 of Annex II). Article 4(g) of Annex II provides that the arbitral tribunal (the Tribunal) shall "apply the provisions of this Convention, any relevant agreement between the parties to the dispute, the Agency's by-laws and regulations, the applicable rules of international law, the domestic law of the member concerned as well as the applicable provisions of the investment contract, if any." The reference to domestic law includes the member's conflict of laws rules. In case of a conflict between rules of international law and rules unilaterally issued by either of the parties to the dispute, international tribunals apply rules of international law. Arbitral awards are final and binding upon the parties (Article 4(h) of Annex II) and they are enforceable within the territories of every member as if they were final judgments of a court of the member concerned; however, they can be executed only according to the laws of the country where execution is sought

(Article 4(j) of Annex II). This arrangement reflects the common interest of all members in the Agency's financial viability.

X. Amendments

79. The provisions of the Convention relating to amendments (Articles 59 and 60) strike the necessary balance between allowing modifications to the Convention that might be desirable or necessary for the operation of the Agency while protecting the members from increased obligations and dilution of their rights against their will. Thus, amendments may generally be approved by three-fifths of the Governors having four-fifths of the total voting power, while certain amendments require unanimous approval and others require and approval of those members whose liability would be increased. Amendments to Schedules A and B require a special majority.

XI. Final Provisions

Entry into Force

80. The Convention provides for its entry into force when it is ratified, accepted or approved by five States classified in Category One and fifteen States classified in Category Two if the total subscription of these countries amounts to not less than one-third of the authorized capital (Article 61(b)). This threshold constitutes only the minimum requirement for the effectiveness of the Convention, based on a judgment that it will be possible to begin operations on a modest scale and that an early start of operations is desirable. It is expected that the Agency will exceed these minimum requirements in a reasonably short period of time.

Territorial Application

81. The Convention applies to all territories "under the jurisdiction of a member." This includes territories which, though not necessarily part of a member's territory in the strict legal sense, are subject to a country's jurisdiction for economic purposes under international law.