Non-Honoring of Financial Obligations by a State-Owned Enterprise

The MIGA Board of Directors has recently approved a new coverage against the risk to be referred to as “Non-Honoring of Financial Obligations by a State-Owned Enterprise” (“NHFO-SOE”).

The new NHFO-SOE coverage protects against losses resulting from the failure of a SOE to make a payment when due under an unconditional financial payment obligation or guarantee given in favor of a project that otherwise meets all of MIGA’s eligibility requirements. It does not require the investor to obtain an arbitral award or judicial decision. This coverage is applicable in situations when a SOE’s financial payment obligation is unconditional and not subject to defenses other than payment of the underlying obligation. Compensation is based on the amount of principal and/or interest that the investor or lender is entitled to receive from the SOE.

The main rationale for the NHFO-SOE coverage is the developmental impact and benefits the new coverage is expected to bring to the host country. In the current risk-averse environment, host countries are seeking credit enhancement instruments to attract long-term financing for priority public sector projects. The NHFO-SOE coverage has the potential to assist host governments leverage private sector financing for projects undertaken by SOEs or public authorities by diversifying the sources of financing available and improving the terms, in particular extending maturities and lowering interest spreads. This coverage also has the potential to redirect resources to under-served segments of the market and to relatively unknown entities that may be entering the market as new borrowers.

The NHFO-SOE coverage is similar to MIGA’s existing NHSFO coverage since neither requires an arbitral award. The main difference is that the NHFO-SOE coverage relates to an unconditional financial obligation or guarantee provided by an SOE, whereas the NHSFO coverage relates to a financial obligation or guarantee provided by a sovereign or sub-sovereign. Furthermore, the NHFO-SOE product complements MIGA’s existing BoC-SOE coverage, which protects against the risk of breach of contract by an SOE with respect to a project agreement that does not constitute an unconditional financial obligation, which breach is subject to an arbitral award rendered against the SOE. This new MIGA coverage complements the suite of instruments used by the World Bank Group in supporting critical projects implemented by SOEs. The new NHFO-SOE coverage has the potential to leverage much-needed private sector financing for projects that have high developmental benefits in countries that need it the most.

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