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WORLD BANK: CONVENTION ESTABLISHING THE MULTILATERAL INVESTMENT GUARANTEE
AGENCY

Done at Seoul, October 11, 1985

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Introductory Note
[FNaal]

FNaal. The Introductory Note was prepared for International Legal Materials by Jürgen Voss, Counsel, The World Bank.

STATUS

On October 11, 1985, the Board of Governors of the International Bank for Reconstruction and Development (the Bank), at its Annual Meeting in Seoul, approved the following Convention for transmittal to member Governments of the Bank and the Government of Switzerland and invited these Governments to sign the Convention. This Convention will establish a new international development institution, the Multilateral Investment Guarantee Agency (MIGA). MIGA is designed to encourage the flow of investments for productive purposes among its member countries, and in particular to its developing member countries. It will serve this objective by issuing guarantees for investments against noncommercial risks and by carrying out a broad array of promotional activities.

The idea of an international investment guarantee facility had been discussed within the Bank and in other international fora since the early 1960's. Suspended in 1973, the discussion was initiated again in 1981 by President Clausen^[FN1]. After extensive consultations with member Governments of the Bank, as well as business and professional associations and international organizations, the Management of the Bank circulated in March 1985 a draft Convention on MIGA to member Governments. This Convention^[FN2] was discussed from June to September 1985 by the Bank's Executive Directors, meeting in a "Committee of the Whole"^[FN3] under the chairmanship of Ibrahim F.I. Shihata, the Bank's Vice President and General Counsel, and assisted by experts from member governments and a drafting team from the Bank's Legal Department. After twenty sessions of vivid discussions, the Committee of the Whole, on September 5, 1985, agreed on a revised draft Convention.

FN1. For more details on the history, see Voss, 24 ILM 688 (May 1985).

FN2. It was published in 24 ILM 692 (May 1985)

FN3. Meetings of the "Committee of the Whole" are less formal than the regular meetings of the Bank's Board of Executive Directors. They serve the purpose of facilitating the frank exchange of views and, when successful, result in an informal agreement which becomes a decision of the Executive Directors by virtue of its confirmation in a formal meeting of the Board. Discussions in such an informal committee also facilitated the formulation of the Convention establishing the International Finance Corporation (IFC) in 1956, the International Development Association (IDA) in 1960, and the International Centre for Settlement of Investment Disputes (ICSID) in 1966.

*1599 On September 12, 1985, this draft Convention was approved by the Bank's Executive Directors in a formal meeting. It was also decided to submit the draft Convention to the Bank's Board of Governors for consideration at its Annual Meeting in Seoul. There the Governors adopted on October 11, 1985 a resolution approving the Convention for transmittal to member Governments of the Bank and the Government of Switzerland, and inviting these Governments to sign the Convention. Ecuador, Korea and Turkey signed on the same day, and Senegal followed a few days later. Further signatures are expected soon.

The Convention will enter into force upon its ratification by at least five Category One countries and fifteen Category Two Countries^[FN4], provided that these countries subscribe to at least one third of MIGA's authorized capital (i.e. to approximately \$360 million). As soon as such a number of countries has signed the Convention, the President of the Bank will convene a committee of the signatory States to prepare for consideration by MIGA's governing bodies the draft policy rules and regulations needed to initiate operations.

FN4. Under the Convention, countries are classified for voting purposes as belonging to either Category One or Category Two. See Schedule A to the Convention for the classification of individual countries.

CONCEPT AND FEATURES

Operations

The Convention, as approved by the Bank's Board of Governors, maintains the basic concept of Management's proposal submitted in March 1985, i.e., the concept of a cooperative institution which (a) is legally and financially independent from the Bank but supplements its operations and maintains some link with it; (b) is designed to operate on a self-sustaining basis; (c) is financed and controlled jointly by developed and developing countries; and (d) in addition to its guarantee operations, will provide a forum for international cooperation among capital-exporting countries, capital-importing countries, and foreign investors.

MIGA will issue guarantees for investments in its developing member countries against four types of non-commercial risk (see Article 11(a) of the Convention): (a) the risk of loss as a result of host government restrictions on currency conversion and transfer (transfer risk); (b) the risk of loss resulting from legislative actions or administrative actions or omissions of the host government which have the effect of depriving the foreign investor of his ownership or control of, or substantial benefits from, his investment (expropriation risk); (c) the risk of a repudiation or breach of a legal commitment by the host government in cases where the investor has no access to a competent judicial or arbitral forum, or faces unreasonable delays in such a forum or is unable to enforce a judicial or arbitral decision issued in his favor (repudiation risk); and (d) the risk of armed conflict and civil disturbance.

In addition to these types of risk, coverage may be extended to other non-commercial risks such as acts of terrorists, except the *1600 risk of currency devaluation or depreciation (Article 11(b))^[FN5]. While coverage is confined to "investments", the Convention purposefully avoids a definition of this term to allow for the extension of cover to newly emerging forms of industrial cooperation. From the outset, eligible investments will encompass equity interests (including portfolio equity investments), equity-type loans (i.e., medium or long-term loans made or guaranteed by owners of equity in the enterprise concerned), and forms of direct investment (see Article 12(a))^[FN6]. Over time, eligibility may be extended "to any other medium or long-term form of investment", provided that loans must

be related to an equity interest or direct investment (Article 12(b)). This will enable MIGA to service new types of investment, especially among developing member countries. To be eligible, investments will furthermore have to be new, i.e., they must involve the transfer of resources from abroad into the host country after the application for cover (Article 12(c)), and they will have to be made in the territory of a developing member country (Article 14)^[FN7].

FN5. Unless stated otherwise, cited Articles refer to the Convention establishing MIGA which is published herein-after.

FN6. The IMF Balance of Payments Manual para 408 at 136 (4th ed. 1977) defines foreign direct investment as "investment which 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". See also OECD, Detailed Benchmark Definition of Foreign Direct Investment (Paris: 1983).

FN7. Developing countries are those listed under Category Two of Schedule A to the Convention. The limitation provided for in Article 14 does not apply to sponsored investments referred to *infra*.

Investors, to be eligible for the Agency's guarantee, must be nationals of a member country or, in the case of corporate investors, must either be incorporated and have their principal place of business in a member country, or the majority of their capital must be owned by nationals of member countries (Article 13(a)). Eligibility may be extended to nationals of the host country if they transfer the assets to be invested from abroad (Article 13(b)). This feature of the Convention will allow MIGA to assist member countries in their efforts to reduce the problem of capital flight. It also emphasizes that MIGA's guarantee protection relates primarily to the transfer of funds into the host country from abroad for development purposes rather than merely to the foreign nationality of the investors.

In addition to its guarantee operations, MIGA will carry out a variety of activities to enhance mutual understanding and confidence between host governments and foreign investors, heighten the awareness of investment opportunities and increase information, knowledge and expertise related to the investment process (see Article 23). Such activities may include research on issues related to foreign investment, the identification of and dissemination of information about investment opportunities, the organization of investment missions as well as the provision of advice and technical assistance to member governments with respect to the design and implementation of their investment policies. Advice and assistance will be given to governments only upon their request.

*1601 MIGA is designed to operate on a self-sustaining basis, paying claims and meeting its operating expenditures from premium income and other revenues such as returns on its investments. It is directed "to carry out its activities in accordance with sound business and prudent financial management practices" (Article 25). In its operational policies, MIGA will thus have to strike a balance between its institutional interest in its financial viability and its promotional mandate^[FN8]. The Convention provides some broad policy guidelines, leaving its implementation to the Board and the Management of the Agency.

FN8. It should be noted that the two aspects are interrelated, as investments that are welcomed by host countries and serve their interests are less vulnerable to adverse host government action.

To ensure host governments' sovereign control over the admission of foreign investment into their territories and MIGA's involvement in such investment, Article 15 provides that the Agency "shall 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." Article 12(d) establishes a number of conditions which an investment must meet in order to qualify for a guarantee. The Agency must be satisfied that the investment is economically sound, complies with the host country's laws and regulations, is consistent with its declared development objectives and priorities, and contributes to its development. MIGA must also be satisfied that the investment to be guaranteed will enjoy fair and equit-

able treatment as well as adequate legal protection in the potential host country. Where, in MIGA's opinion, such conditions do not exist, it would, before initiating guarantee operations in the country concerned, seek to enter into an agreement with it on the treatment of investments guaranteed by it. Such agreements, according to Article 23(b) (ii), "will assure that the Agency . . . has treatment at least as favorable as that agreed by the member concerned for the most favored investment guarantee agency or State in an agreement related to investment".

Decisions on the payment of claims will be made by the President of MIGA in accordance with the contracts of guarantee (Article 17). Disputes relating to such decisions will be subject to arbitration for final determination (Article 58).

When MIGA pays or agrees to pay a claim, it will succeed to the rights that the indemnified investor may have acquired against the host country as a result of the event giving rise to his claim (Article 18). Subrogation, a generally accepted principle of insurance law, would provide no more than the assignment of an existing claim from the investor to MIGA and would give MIGA no greater substantive rights than the investor had.

Disputes between MIGA and a host country arising from subrogation are expected to be normally settled by negotiation. If negotiations fail, either party may refer the dispute to international arbitration according to the procedures detailed in Annex II to the Convention (Article 57(b)), the parties may agree to try conciliation *1602 before seeking arbitration. MIGA is also authorized to enter with individual host countries into bilateral agreements on the resolution of such disputes using alternative mechanisms, provided that the agreement is approved in each case by the Board by special majority prior to the undertaking by the Agency of operations in the territory of the member concerned.

Organizational, financial and voting structure

MIGA will have full juridical personality and will be both legally and financially separate from the World Bank and any other financial institutions. Membership will be open to all members of the Bank (at present 149) and Switzerland on a voluntary basis (Article 4(a)). Countries which still hesitate to join are free to accede to the Convention at any time in the future. MIGA will have a Council of Governors composed of one representative of each member (and his alternate), a Board of Directors elected by the Council, and a chief executive officer, called the President, selected by the Board and responsible for the recruitment of the staff and the ordinary business of the Agency.

MIGA will be financed by a combination of share capital and "sponsorship" arrangements. It will have a share capital of 1 billion Special Drawing Rights (SDRs). For the purposes of capital subscriptions, the value of the SDR is fixed at the equivalent of U.S. dollar 1.082 per SDR (Article 5(a))^[FN9]. MIGA will become operational when at least one third of its authorized capital (i.e., roughly \$360 million) is actually subscribed. The shares will be subscribed by member countries on the basis of their relative economic strength as measured in accordance with their allocation of shares in the capital of the Bank (see Schedule A to the Convention for the subscriptions of the individual countries). Only ten percent of the subscriptions will be paid in cash. An additional ten percent will be paid in the form of non-negotiable, non-interest-bearing promissory notes to be encashed only if needed by MIGA to meet its financial obligations. The remainder of the subscribed capital will be subject to call. While developed member countries will make payments in freely usable currencies, developing member countries will be able to make up to twenty-five percent of the paid-in cash portion of their subscriptions in their own currencies.

FN9. This is the average value of the SDR in terms of U.S. dollars during the period January 1, 1981 to June 30, 1985. The denomination of the capital in SDR at a fixed equivalent to the U.S. dollar represents a compromise between the countries preferring the denomination of the capital in dollars and those preferring SDRs.

The amount of guarantees which MIGA may issue on the basis of its share capital is subject to a variety of ceilings. To begin with, the total amount of MIGA's contingent liability under all guarantees outstanding may initially not ex-

ceed one and a half times the amount of the subscribed capital plus reserves plus a portion of MIGA's reinsurance coverage; once MIGA accumulates a balanced risk portfolio and gains experience, its Council of Governors, by special majority, may increase this conservative risk-asset ratio up to a maximum of five-to-one (Article 22(a)). To diversify its risk portfolio, MIGA is furthermore directed to prescribe ceilings with respect to individual projects, individual host countries, types of investment, types of risk and other risk determinants (Article 22(b)(ii)). Limits will finally be set for *1603 the total amount of guarantees which may be issued to investors from individual home countries; these limits may be tied to home countries' relative subscriptions to MIGA's capital (Article 22(b)(i)). While the former two types of ceilings serve the purpose of ensuring MIGA's financial credibility and viability, the latter type is intended to ensure an equilibrium between member countries' contributions to MIGA and their benefits from MIGA.

In addition to guarantee operations based on its capital and reserves, MIGA will be able to underwrite investments sponsored by member countries acting in fact as administrator of a separate sponsorship account (see Article 24 and Annex I). Revenues from sponsorship operations will be accumulated in a "Sponsorship Trust Fund" which will be kept apart from the Agency's own accounts. Claims and other expenses resulting from sponsorship operations will be paid out of this fund. Upon its depletion, remaining liabilities will be shared by sponsoring countries, each in the proportion which the guarantees sponsored by it bears to the total amount of guarantees sponsored by all sponsoring countries. Under this "sponsorship window", MIGA's risk-to-assets ratio is one-to-one and its underwriting capacity is infinite, as countries' sponsorship commitments increase automatically with the issuance of every new guarantee. Member countries can be expected to sponsor investments when MIGA cannot cover them on its own account, for example, because one of the above-mentioned underwriting limits is exhausted. In addition, MIGA is authorized to cover investments in developed member countries under the sponsorship window (Article 6 of the Annex) while only investments in developing member countries are eligible for cover on MIGA's own account (Article 14).

MIGA's voting structure is based on the principle that both developed and developing countries have an equal interest in foreign investment and that both groups of countries should, when all eligible countries become members, have voting parity. Article 39 of the Convention provides that each member country will receive 177 membership votes and one additional subscription vote per share^[FN10]. During the first three years of MIGA's existence, each group of countries is assured a minimum of forty percent of the total voting power, by the allocation of supplementary votes if necessary. All decisions during this initial period require a special majority vote of at least two-thirds of the total voting power representing at least fifty-five percent of the subscribed shares of MIGA's capital stock. This arrangement ensures that during the important initial period, decisions will be taken with the support of both developing and developed countries. The supplementary votes and the special majority requirement will be cancelled at the end of the three-year period. MIGA's Council will then reallocate unsubscribed shares to achieve voting parity between the two groups of countries on the basis of membership votes and subscription votes.

FN10. The number of membership votes was computed so that if all members of the World Bank joined MIGA, developing countries as a group would have the same voting power as developed countries as a group.

Relationship with the World Bank Group and other inter-governmental organizations, national investment guarantee agencies, and private political risk insurers.

The Convention directs MIGA to complement the activities of existing operators in the area of investment promotion and investment *1604 insurance and to seek their cooperation. This principle applies foremost to MIGA's relationship with the World Bank Group^[FN11]. Article 2 provides that MIGA shall supplement the activities of the Bank and the International Finance Corporation; Article 35 establishes MIGA's duty to cooperate with the United Nations and other inter-governmental organizations, "including in particular the Bank and the International Finance Corporation"; and Article 23(a)(iii) directs the Agency to "coordinate with other agencies. . . , and in particular the International Finance Corporation" in the performance of its promotional activities. To facilitate this cooperation, the Con-

vention also establishes an institutional link to the Bank: the latter's President shall be ex officio Chairman of MIGA's Board of Directors and shall in this capacity nominate MIGA's President (Articles 32(b) and 33(b)).

FN11. The "World Bank Group" consists of the World Bank, the International Development Association (IDA) and the International Finance Corporation (IFC).

Articles 19 to 21 place MIGA under a duty to complement the operations of national investment guarantee programs of member countries^[FN12], of regional investment guarantee agencies^[FN13], and of private political risk insurers^[FN14] rather than competing with them. MIGA is directed to seek these insurance operators' cooperation and is authorized to enter with them into cooperative arrangements. These may apply to administrative cooperation as well as coinsurance and reinsurance operations.

FN12. At present, 22 countries (practically all OECD countries as well as India and Korea) have national investment guarantee programs.

FN13. At present, only the Inter-Arab Investment Guarantee Corporation in Kuwait, which covers only investments between Arab member countries.

FN14. Political risk coverage is offered by underwriters of Lloyd's of London and of some U.S. insurance companies.

PREPARATORY COMMITTEE

As noted above, the Board of Governors has authorized the Bank to convene a Preparatory Committee of Government experts from signatory States as soon as the Convention is signed by member countries whose ratification is required for its effectiveness. This Committee will be charged with formulating the rules and regulations determining MIGA's operational and financial policies. The drafts agreed upon by the Preparatory Committee will then be submitted to the Agency's Council of Governors or Board of Directors, as the case may be, for adoption.

This approach is intended to enable the Agency to assume operations promptly upon the effectiveness of the Convention. It will furthermore give countries the opportunity to take the results of the preparatory work into account in their decision on the ratification of the MIGA Convention; and it will finally ensure that MIGA's initial policies reflect the consensus of its original members.

*1605 As outlined above, the Convention is coached in broad terms to give MIGA sufficient flexibility for the continuous adjustment of its program. The Convention must therefore be translated into precise operational and financial policies on the basis of which actual operations will take place. Also, the Convention governs only the institutional relationships between MIGA and its members as well as among MIGA's members; it does not directly affect insured investors. The mutual rights and obligations of MIGA and insured investors will be determined by the contracts of guarantee which MIGA will conclude with investors. For these reasons, the work of the Preparatory Committee is of immediate interest to the business community - MIGA's potential clientele - as well as to existing political risk insurers (public and private ones) as it will determine the modalities of MIGA's cooperation with them.

CONVENTION ESTABLISHING THE MULTILATERAL INVESTMENT GUARANTEE AGENCY

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***1607 CONVENTION ESTABLISHING THE MULTILATERAL INVESTMENT GUARANTEE AGENCY**

PREAMBLE

The Contracting States

Considering the need to strengthen international cooperation for economic development and to foster the contribution to such development of foreign investment in general and private foreign investment in particular;

Recognizing that the flow of foreign investment to developing countries would be facilitated and further encouraged by alleviating concerns related to non-commercial risks;

Desiring to enhance the flow to developing countries of capital and technology for productive purposes under conditions consistent with their development needs, policies and objectives, on the basis of fair and stable standards for the treatment of foreign investment;

***1608** Convinced that the Multilateral Investment Guarantee Agency can play an important role in the encouragement of foreign investment complementing national and regional investment guarantee programs and private insurers of non-commercial risk; and

Realizing that such Agency should, to the extent possible, meet its obligations without resort to its callable capital and that such an objective would be served by continued improvement in investment conditions,

Have Agreed as follows:

CHAPTER

Establishment, Status, Purposes and Definitions

Article 1. Establishment and Status of the Agency

(a) There is hereby established the Multilateral Investment Guarantee Agency (hereinafter called the Agency).

(b) The Agency shall possess full juridical personality and, in particular, the capacity to:

- (i) contract;
- (ii) acquire and dispose of movable and immovable property; and
- (iii) institute legal proceedings.

Article 2. Objective and Purposes

The objective of the Agency shall be to encourage the flow of investments for productive purposes among member countries, and in particular to developing member countries, thus supplementing the activities of the International Bank for Reconstruction and Development (hereinafter referred to as the Bank), the International Finance Corporation and other international development finance institutions.

To serve its objective, the Agency shall:

- (a) issue guarantees, including coinsurance and reinsurance, against non-commercial risks in respect of investments in a member country which flow from other member countries;
- (b) carry out appropriate complementary activities to promote the flow of investments to and among developing member countries; and
- (c) exercise such other incidental powers as shall be necessary or desirable in the furtherance of its objective.

The Agency shall be guided in all its decisions by the provisions of this Article.

***1609** Article 3. Definitions

For the purposes of this Convention:

- (a) "Member" means a State with respect to which this Convention has entered into force in accordance with Article 61.
- (b) "Host country" or "host government" means a member, its government, or any public authority of a member in whose territories, as defined in Article 66, an investment which has been guaranteed or reinsured, or is considered for guarantee or reinsurance, by the Agency is to be located.
- (c) A "developing member country" means a member which is listed as such in Schedule A hereto as this Schedule may be amended from time to time by the Council of Governors referred to in Article 30 (hereinafter called