POLITICAL RISK MINIMISATION – A ROADMAP FOR WEALTH AND BUSINESS OWNERS

By Hussein Haeri, Iraj Ispahani and Philip Marcovici

Political risk is one of the most salient concerns of international investors today. Such risks are far from being confined to nationalisations or direct expropriations of international investments. More frequently, international investors in foreign countries can over time face materially different regulations and legal frameworks to those which informed their investments in the first place.

Political risk is also a home country reality for many wealth and business owners and this not only in the developing world. Populist governments, confusion about how best to address income and wealth inequality and many other factors have made political risk something that wealth and business owners internationally need to consider. Often, however, wealth and business owners fail to adequately address political risk in their development of asset ownership and succession structures. However, they should and must.

In simple terms, political risk has to be considered at three levels. First, attention needs to be paid to political uncertainty in the country of the citizenship and/or residence of the wealthy owner. Second, political risk needs to be considered in the location that investment structures are maintained. Third, of course, is the country in which an investment is made. Notably, compared with commercial risks, political risks can be amorphous and hence difficult to predict and manage.

Emerging and frontier markets represent growth opportunities. Diversification, and growing beyond one's borders, is generally recognised as a practical business strategy. Thus, while political risks will shape some investment decisions and flows, such risks cannot easily be bypassed by international investors. Indeed, political risk is now a fact of life across the world; it isn't confined to a select few countries that can be avoided.

History serves as a reminder of the disruption that occurs when revolutions happen, borders may be redrawn and wars can develop. All too frequently, assets including key industrial and commercial assets and land are seized from private citizens by governments. Such takings of private property for supposedly public use is something which wealth owners globally still fear. However, there are more options today to diminish the impact of big geopolitical changes via thoughtful asset protection strategies.

Wealth and business owners can learn from history and pay more attention to what has worked and has not worked in the context of political crises. During the second world war, for example, a number of European companies, including the Philips Electronics group, took steps to isolate their European assets from holdings elsewhere, such as in the U.S. In the 1980s and early 1990s, many businesses in Hong Kong were restructured in view of perceived political risk associated with the return of Hong Kong to China in 1997.

There is moreover a very significant international legal instrument which is all too often overlooked by wealth and business owners: the investment treaty. Investment treaties are international agreements between sovereign states that aim to promote and encourage investments between them. There are over 3,000 investment treaties worldwide.

These investment treaties frequently provide direct rights for international investors which qualify for

protection under their terms. This frequently includes a right to be treated fairly and equitably, a right not to be discriminated against and a right to be compensated for the direct or indirect expropriation of investments.

These investment treaty rights are wide-ranging and afford protection from the actions of governments, legislatures, courts and regulatory authorities. Perhaps the most important aspect of investment treaties is the right for investors to bring direct international arbitration claims against the host country government for breaching investment treaty obligations. Arbitration under investment treaties is often conducted under the auspices of ICSID, a branch of the World Bank.

Given the value of investment treaties to manage political risk, sophisticated international investors increasingly structure their investments through holding companies established in specific jurisdictions to take advantage of particular investment treaties, alongside other considerations.

The importance of dovetailing investment protection with other considerations in investment structures, including taxation, corporate efficacy and disclosure, can be considerable. An investment structure that takes a holistic approach to all factors that are relevant to the specific circumstances is likely to be optimal.

Background on the authors Hussein Haeri is a Partner and Co-Head of International Arbitration at Withers LLP, based in the firm's London office. He is a leading specialist in the field of international investment law and investment treaty arbitration and has served as counsel in over 20 investment treaty arbitrations between international investors and sovereign states. He has drafted model investment treaties and investment legislation for governments. He is a Solicitor-Advocate of the Higher Courts of England and Wales, and previously practiced law in New York and Paris.

Iraj Ispahani is the CEO of Ispahani Advisory Ltd. and is based in London. Iraj serves as a Group Director and Board Member of M.M. Ispahani Ltd, a family business headquartered in Bangladesh which will celebrate 200 years in 2020.

Philip Marcovici is retired from the practice of law and consults with governments, financial institutions and global families in relation to tax, wealth management and other matters. Philip is on the boards of several entities within the wealth management industry, as well as of entities within family succession and philanthropic structures.