Risk Identification and Allocation in Asset Recycling

Full Description

The Relevant Authority should identify and allocate risks for the concession or lease arrangement as part of the transaction preparation. The objective is to ensure that specific risks are transferred to the party best able to control or mitigate those risks, thus improving the bankability and ensuring long term quality service.

Risks should be:

- retained by the Relevant Authority.
- transferred to the private sector; or
- shared between the Relevant Authority and the private sector.

Risk identification

As a first step, the Relevant Authority should put together a comprehensive list of relevant risks associated with the project in the form of a risk register. Although the risks may vary from transaction to transaction, there will be certain risks that are common to all or most transactions.

The Relevant Authority should group these risks into risk categories associated with respective functions or with respective phases as shown below:

Box 6: Common Risk Categories

- Operations — the risks related to successful operations of the asset, including the risk of interruption in service or asset availability, or the risk that the cost of operating and maintaining the asset is different than projected.
- Demand — the risk that the usage of the service (or demand) is different than projected, or that revenues are not collected as expected.
- Regulatory risks — risk of regulatory changes that adversely affect the project. For example, changes to tariff setting mechanisms impacting revenue streams.
- Change in law — the risk that a change in general law adversely affects the project, such as changes in general corporate taxation.

- Financial — risk that changes in interest rates, exchange rates or inflation adversely affect the project outcomes.

- Default — the risk that the private party to the project contract turns out not to be financially or technically capable to implement the project.

- Force Majeure — risk that external events beyond the control of the parties to the contract, such as uninsurable natural disasters affect the project.

- Climate-related risks –such as risks related to the physical impacts of climate change (Climate Change Physical Risks) and risks related to the transition to a lower-carbon economy (Climate Change Transition Risks).

Risk allocation

After identifying the asset-specific risks, the Relevant Authority should consider the following three principles in allocating risks:

- Which party is best able to control the likelihood of the risk occurring?
  - For example, if the private party will oversee the asset operations because it has the most expertise in that area; this also means bearing the cost of operating and maintenance expenses.
- Which party is best able to control the impact of the risk?
  - For example, the private party may be responsible for the demand/ usage of the asset if it has expertise in introducing measures to boost the demand/ usage of the asset.
- Which party is best able to absorb the risk at the lowest cost, if the likelihood and impact of risks cannot be controlled?

Template for risk matrix

The risk matrices for specific sectors are provided in Modules 1 to 4: Airport Module, Power Generation Module, Toll Roads Module, Ports Module.

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The Guidelines have not been prepared with any specific transaction in mind and are meant to serve only as general guidance. It is therefore critical that the Guidelines be reviewed and adapted for specific transactions To find more, visit the Guidelines to Implementing Asset Recycling Transactions [Section Overview] and [Content Outline], or [Download the Full Report].

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