

# Political Risk in Project and Infrastructure Finance

Rising Challenges and Modern Mitigation Strategies

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## KEY POINTS

- Country and geopolitical risk have moved from a background consideration to a central structuring and credit issue, driven by sanctions, resource nationalism, industrial policy and heightened state intervention.
- Traditional contractual protections and political risk insurance remain important, but recent experience shows their limits in practice, particularly where events fall into grey areas between political risk, commercial risk and force majeure.
- Lenders are increasingly responding through pricing, enhanced conditionality, structural protections and tighter control rights, signalling a more selective and differentiated approach to cross-border risk allocation.

## Introduction

Drawing on transaction experience across Europe, the CIS, Asia and Africa, this article examines the most material political risks affecting project finance today and assesses how mitigation strategies have evolved in response.

Project finance has always involved the allocation and management of complex risks across financing, construction, legal, operational and political domains. Among these, political risk has long been recognised as one of the most challenging.

In recent years, however, political risk has become a central constraint on bankability, particularly for large infrastructure, energy and natural resources projects operating across borders.

This shift reflects a broader change in behaviour of states. Governments are more interventionist in sectors viewed as strategic, fiscal pressures are increasing and geopolitical fragmentation has reduced tolerance for long-term private contractual arrangements that limit public policy flexibility. As a result, political risk can no longer be treated as a residual issue addressed through standard documentation; it has become a core structuring consideration for lenders and sponsors. From a lender perspective, this shift has tangible consequences. Political risk is no longer assessed late in the diligence process or treated as residual documentation issue; it increasingly dictates whether a transaction proceeds at all.

Increasingly, these risks are shaped not only by host-state behaviour but by wider geopolitical dynamics, including sanctions regimes, strategic competition over natural resources, and intervention by third states pursuing national or regional interests. As a result, projects may be exposed to political risk even where domestic institutions appear stable and contractual frameworks are robust. This shift marks a move from traditional country risk analysis towards a broader assessment of geopolitical risk, which can evolve rapidly and is often beyond the control of project counterparties.



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## Expropriation, Nationalisation and the Rise of “Creeping” Expropriation

Traditional expropriation and nationalisation remain relevant risks in project finance, particularly in emerging markets and in respect of assets that would historically have been owned or operated by the state or state-owned entity. The distinction between the two lies primarily in compensation: nationalisation typically involves some form of compensation, whereas expropriation does not. In practice, however, compensation rarely reflects fair market value, especially for capital-intensive projects requiring many years to reach economic maturity and to start regenerating revenue and profit.

More problematic in recent transactions is “creeping” or “soft” expropriation. Rather than seizing assets outright, states increasingly apply regulatory or administrative pressure that gradually erodes project value. This may take the form of delays or refusals to renew licences, targeted tax audits, allegations of regulatory non-compliance, or legislative changes that undermine the economic basis of a project without formally transferring ownership.

The Sakhalin-2 LNG project in the far east of Russia provides a well-known illustration. Following significant cost overruns, regulatory pressure was applied through environmental enforcement actions and licence suspensions. This ultimately resulted in foreign sponsors being forced to relinquish majority control to a state-owned entity. More recently, forced renegotiations of power purchase agreements in parts of Sub-Saharan Africa have followed similar patterns, with states alleging contractual or environmental breaches to reduce tariff obligations.

From a lender’s perspective, creeping expropriation is particularly difficult to mitigate. These measures often fall short of the formal thresholds required to trigger political risk insurance or treaty protection, yet their economic impact can be equivalent to outright seizure.

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## Civil Unrest, War and Political Instability

Civil unrest, armed conflict, and political violence remain among the most disruptive political risks in project finance. Their impact is often immediate and severe, affecting not only asset integrity but also the willingness of lenders to remain exposed.

Recent examples include social unrest in 2019 in Chile which disrupted transport and energy infrastructure, as well as unrest in South Africa’s KwaZulu-Natal region in 2021 which affected logistics

and industrial operations. Episodes of geopolitical escalation in recent years in the Middle East and Mozambique have halted construction activity and delayed commissioning of major projects.

A more extreme example includes the conflict between Russia and Ukraine. A large number of cross-border financings linked to natural resources and industrial assets in the region became unbankable following the outbreak of hostilities in 2014, with further disruption after the escalation in 2022. As a result, many projects in the region were abandoned entirely as financiers were unwilling to assume the risk of prolonged instability.

While such risks are traditionally associated with emerging markets, recent political risk assessments increasingly highlight exposure in developed economies as well. Civil disturbance and politically motivated disruption are no longer confined to a narrow group of jurisdictions.

For project finance structures, these risks translate into physical damage to assets, interruption of supply chains, evacuation of personnel and delays that jeopardise long-stop dates and financing timelines. Even temporary instability can undermine lender confidence at critical stages of a project's lifecycle.

In practice, the difficulty is often less the availability of force majeure or political violence protections, and more the timing and optics of their deployment. Lenders are frequently reluctant to rely on remedies that crystallise losses or trigger defaults in volatile political environments, in particular where long term exposure to the jurisdiction remains unavoidable.

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## Changes in Law and Regulation

Given the long tenor of project finance transactions, stability of the legal and regulatory framework is essential.

Changes in tax regimes, environmental standards, energy policy or sector-specific regulation can materially affect project economics. Such changes may be general in nature, affecting an entire sector, or discriminatory, targeting a specific project or category of investors. This distinction is important for risk allocation. General changes are often treated as commercial risks borne by the project company, whereas discriminatory measures are more readily characterised as political risk.

Examples over the past decade include retrospective changes to renewable subsidy regimes in parts of Europe and the introduction of new taxes on renewable energy revenues in Spain in 2012, which materially affected photovoltaic and wind projects. In other regions, amendments to mining codes and energy legislation in recent years have sought to increase state participation in existing projects (recent examples include a new Mining Act which gave the state a free equity stake in all existing mining projects and required a minimum 5% local company shareholding in Tanzania in 2017 and Mexico's 2022 Mining Law reform, enacted April 2022, which declared lithium a strategic mineral for national development, placing its exploration, extraction and use under exclusive state control through a new public entity). Similarly, the offshore wind sector in the US is seeing shifts in regulation and government policy leaving investors exposed.

Many projects, particularly in the developed countries, have no specific protection against changes in law or government policy. Where a project benefits from contractual mechanisms such as stabilisation clauses and change-in-law protections, their effectiveness ultimately depends on the host state's willingness to honour them as well as investor's willingness to commence dispute resolution proceedings against a government, which often makes doing any business in that country next to impossible in practice.

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## Foreign Exchange Controls and Transfer Restrictions

Foreign exchange controls represent one of the most acute political risks in cross-border project finance. These measures prevent project companies from converting local currency revenues into hard currency required to service external debt.

Ukraine provides a clear example. Following the escalation of conflict in 2022, strict currency controls and moratoria on foreign currency payments were imposed. Even prior to that, guarantees and cross-border payments often required licensing from the National Bank of Ukraine, creating delays that threatened debt service.

Similar dynamics have been observed in other jurisdictions, including FX liquidity shortages affecting power sector projects in Nigeria, recurring capital controls in Argentina and prolonged FX backlogs in Ethiopia impacting industrial developments.

In practice, lenders may be unable to recover funds despite continued project performance. For financiers, FX controls represent one of the few political risks capable of defeating an otherwise well-structured transaction.

From a financing perspective this is one of the few political risks capable of defeating an otherwise well performing project with lenders being unable to access cash flows from a viable project.

Taken together, the risks of expropriation, political instability, regulatory change, and currency controls represent a complex and dynamic threat matrix. These risks are no longer discrete, low-probability events but are increasingly interconnected – a seemingly minor regulatory change can be a precursor to creeping expropriation, while civil unrest may trigger emergency currency controls. This modern risk environment therefore demands more than a singular contractual safeguard. It requires a sophisticated, multi-layered mitigation framework that integrates contractual protections, specialised insurance, and structural financing solutions, the components of which are analysed below.

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## From Country Risk to Geopolitical Risk: Project Finance in an Era of Strategic Tensions

Recent developments underline that political risk in project finance can no longer be analysed solely through the traditional lens of instability of a host state or regulatory unpredictability. Instead, projects are increasingly exposed to broader geopolitical dynamics, including great-power competition, sanctions

regimes, strategic resource nationalism and even military or quasi-military intervention. Certain resource-rich jurisdictions have in recent years become effectively unfinanceable for many international lenders and sponsors, not because of technical or commodity-price risk, but due to regime volatility, sanctions exposure, disputed sovereign authority and the fragility of contractual and arbitral enforcement. In such environments the risk profile of an entire jurisdiction can change abruptly, with direct consequences for concession stability, revenue flows, insurance availability and the enforceability of lender protections.

Even in jurisdictions with relatively stable institutions and established rule-of-law frameworks, projects linked to critical minerals, strategic infrastructure or energy transition assets are increasingly shaped by broader geopolitical considerations. External geopolitical pressure (and strategic competition) can affect permitting timelines, community consent, sovereign decision-making and ultimately investor confidence.



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For project finance stakeholders, this reinforces a critical point: political risk today is not confined to fragile or emerging markets. Strategic importance alone can elevate a project into the geopolitical sphere, with consequences that may not be fully mitigated by conventional contractual protections or political risk insurance.

Lenders and sponsors must therefore assess not only host-country fundamentals, but also how a project fits within wider geopolitical fault lines that may evolve over the life of the financing.

Recent developments around critical minerals, energy transition supply chains and industrial policy further illustrate this shift. The introduction of the EU Critical Raw Materials Act, the EU Net-Zero Industry Act and similar strategic frameworks in other jurisdictions are reshaping the political risk landscape for infrastructure and mining projects. These regimes increasingly combine subsidies, local content requirements, export controls and national security screening, with direct implications for project economics, financing structures and lender appetite. Projects that are technically sound and commercially viable may become unbankable not because of host-country instability, but because of policy alignment risk: the risk that a project falls on the wrong side of strategic priorities of one or more powerful states.

Therefore, modern political risk increasingly has extraterritorial character. In such cases, the traditional allocation of political risk between host state and project company becomes less effective. Contractual protections, stabilisation clauses and government support agreements (discussed later on in this article) are typically calibrated to address host-state interference, not losses arising from geopolitical escalation or shifts in strategic alliances.

For lenders, this evolution has material implications. Sanctions-linked illegality events, drawstop triggers and mandatory prepayment provisions are now increasingly central to political risk analysis, while the

availability and continuity of insurance and Export Credit Agency (ECA) cover may be affected mid-life by geopolitical developments entirely outside the control of project counterparties.

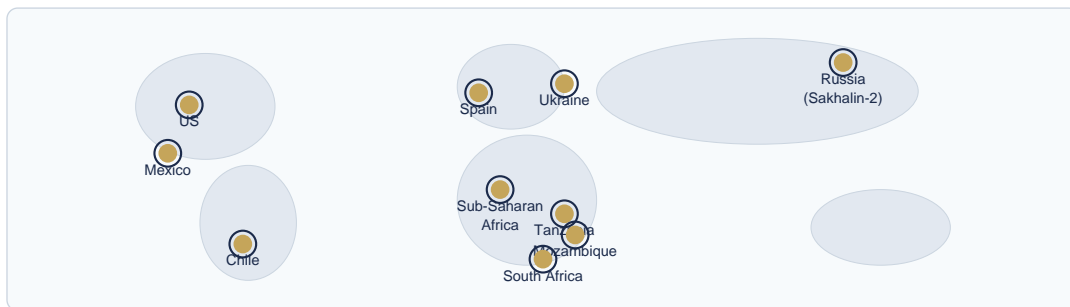
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## Measuring Political Risk

Political risk assessment has become increasingly sophisticated. Insurers, brokers, and multilateral institutions now employ modelling frameworks incorporating hundreds of variables, including fiscal stability, regulatory intervention, conflict intensity and public unrest indicators.

These assessments feed directly into lender credit committees and influence pricing, tenor, reserve requirements and the availability of uncovered tranches. Political risk is no longer treated as a binary overlay; it is embedded in deal economics from the outset.

### Case Study Locations: Global Political Risk Exposure



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## Mitigation Strategies: What Works in Practice

Political risk cannot be eliminated, but it can be managed through a combination of insurance, contractual protections, structural measures and strategic alignment.

## Political Risk Mitigation Framework

Integrated multi-layered approach to managing political risk in project finance



Insurance and guarantees remain important tools. Political risk insurance and ECA or DFI (Development Finance Institutions) cover may protect against expropriation, political violence and currency inconvertibility. Similarly private political risk insurance is widely provided by various private insurance companies. However, such covers are often costly, consuming a substantial proportion of lender margin and claims may be difficult to pursue in cases of creeping expropriation.

Further, Political Risk Insurance (PRI) policies are often subject to material limitations and exclusions that are not always fully appreciated at transaction outset. Coverage is typically tightly defined, with exclusions for foreseeable events, gradual regulatory change, macroeconomic measures of general application, or losses arising from the insured's own acts or omissions. Seemingly technical distinctions (for example between discriminatory and non-discriminatory regulatory measures, or between outright expropriation and creeping interference) can often determine the outcome in practice. As a result, insured parties may find that losses arising from politically driven measures fall into grey areas that trigger disputes over scope, causation or valuation, rather than clean indemnification.

Operational compliance is a further, and often underestimated, challenge. PRI policies impose ongoing information, notification and co-operation obligations, requiring insureds to keep insurers promptly informed of material developments, potential claims and changes to the risk profile. In complex projects (particularly where issues emerge gradually or across multiple workstreams) insureds may unintentionally fall short of these requirements, for example by failing to notify regulatory signals at early stages, informal government actions or emerging disputes. Insurers have increasingly relied on such failures as grounds to reduce or deny coverage, even where the underlying political event is otherwise within scope.

These risks are heightened where no specialist broker is involved to manage communications, interpret policy triggers and co-ordinate engagement with insurers, leaving sponsors or lenders to navigate highly technical policy mechanics alongside live project stress.

From a lender and sponsor perspective, this underscores that PRI is not a substitute for active risk management, but a contingent tool whose effectiveness depends on disciplined internal processes and

alignment across legal, commercial and operational teams. Without clear ownership of insurer engagement and robust escalation protocols, PRI can introduce a different category of execution risk at precisely the moment it is expected to provide protection. In that sense, PRI should be assessed not only on headline coverage, but on its practical usability under stress – including claims behaviour, information thresholds and the capacity of project parties to comply with policy conditions in volatile political environments.

These challenges are amplified in a geopolitical context. Political risk insurance is generally calibrated to address actions of the host state, rather than losses arising from third-state measures, multilateral sanctions, or shifts in international relations that render projects unviable or unfinanceable. As geopolitical tensions increasingly intersect with strategic sectors such as energy, critical minerals and infrastructure, insured parties may find that the most material risks fall outside traditional coverage assumptions, reinforcing the need for cautious reliance on PRI as a primary mitigant.

Contractual protections continue to play a central role. Project finance documentation sometimes requires government support agreements which commonly include political force majeure events, change-in-law provisions, stabilisation clauses, arbitration in neutral forums and waivers of sovereign immunity. Similarly, project finance loan agreements often include events of default linked to expropriation, foreign exchange controls or civil unrest events.

These protections are necessary but often insufficient on their own.

Firstly, many of these mechanisms are inherently reactive rather than preventative and their effectiveness depends on the political and institutional context in which they are deployed. Change-in-law and stabilisation provisions, for example, can provide economic rebalancing where regulatory or fiscal measures adversely affect a project, but they rarely insulate lenders from short-term cash flow disruption, prolonged disputes or delayed remedies. Recent regulatory interventions in the energy and infrastructure sectors (including windfall taxes, tariff freezes and retroactive subsidy changes) have demonstrated that even well-drafted clauses may offer limited protection where governments act under political or fiscal pressure. In practice, the commercial reality is that lenders often face a choice between accommodating temporary breaches through waivers or restructuring or triggering enforcement in circumstances where political optics and local sensitivities make enforcement legally and reputationally complex.

Secondly, reliance on dispute resolution and sovereign immunity waivers can give a false sense of security. While arbitration in neutral forums remains a cornerstone of cross-border project finance, enforcement risk has come under renewed scrutiny, particularly where host states invoke public policy, emergency legislation or national interest arguments to resist or delay compliance with arbitral awards. High profile investor-state disputes in recent years have highlighted the gap between obtaining an award and successfully monetising it, especially where key project assets are immovable or politically sensitive. Moreover, government support agreements (often viewed as a critical credit enhancement) may themselves be exposed to political change, budgetary constraints or challenges to authority and enforceability, underscoring the importance of diligence not only on contractual drafting, but also on counterparty capacity, institutional robustness and the broader political economy in which the project operates.

These limitations are particularly acute where adverse outcomes arise not from a discrete action of a host state, but from geopolitical escalation, such as the imposition of international sanctions,

co-ordinated policy responses by multiple states, or strategic intervention driven by resource or security considerations. In such scenarios, contractual remedies may exist in theory but prove difficult to exercise in practice.

Obtaining a favourable arbitral award is often only the midpoint of the dispute. Enforcing that award against a recalcitrant sovereign state presents a formidable legal and practical challenge. Host state resistance strategies are multi-faceted and begin long before enforcement. During the arbitration itself, a state may engage in procedural attrition by challenging the tribunal's jurisdiction, objecting to arbitrator appointments to cause delay, or initiating parallel litigation in its domestic courts to create conflicting judgments. Once an award is issued, the states often seek its annulment in the courts of the arbitral seat, arguing procedural irregularities and claiming immunity from execution. While the grounds for annulment under the New York Convention are narrow, such proceedings can delay enforcement for years.

In higher-risk jurisdictions, structuring is frequently more effective than documentation. Offshore account structures help by keeping all funds offshore and allowing only the necessary remittances onshore to cover costs and robust cash waterfall mechanisms can go a long way by insulating lenders from local interference. In jurisdictions with FX restrictions, techniques such as intra-group borrower structures, down streaming of proceeds, and registration of intra-group loans may significantly reduce enforcement risk. Commodity-linked projects may rely on barter arrangements, supported by hedging strategies, to mitigate currency exposure.

The involvement of DFIs and multilaterals often functions as a form of "soft insurance". Their political influence and reputational weight can deter aggressive state action in ways that contractual remedies cannot.



## Mitigants: What No Longer Works in Practice

Recent experience highlights several mitigation strategies that are increasingly insufficient when deployed in isolation. It is not right to assume that broadly drafted MAE clauses can effectively operate as a backstop for political risk or to think that arbitration awards will translate into timely and effective recovery. Similarly, overreliance on political risk insurance without active management of notification and compliance obligations is problematic. It is also wrong to assume that political risk is confined to emerging or institutionally weak jurisdictions.

These limitations reinforce the need for an integrated approach combining structuring, governance, insurance discipline and ongoing political risk monitoring.



## Conclusion

Political risk has always been inherent to project finance, but its nature, drivers and consequences are changing. Governments are more interventionist in strategic sectors, geopolitical fragmentation is accelerating, and the boundary between domestic policy risk and international geopolitical risk is

increasingly blurred. As a result, political risk can no longer be addressed solely through standard documentation or treated as a residual legal issue.

For lenders and sponsors, political risk must now be approached as a core structuring discipline, requiring early identification, realistic allocation and continuous monitoring over the life of a project. While insurance, contractual protections and government support agreements remain important tools, their limitations are increasingly evident in scenarios involving sanctions, creeping interference or geopolitical escalation.

In this environment, structural protections, disciplined cash flow controls, careful counterparty analysis and the involvement of DFIs or multilaterals often provide more effective resilience than legal remedies alone.



*There is no single solution. Successful mitigation depends on an integrated approach that combines legal, commercial, operational and geopolitical analysis, together with an acceptance that certain political risks cannot be eliminated but must instead be priced, structured and actively managed.*

Ultimately, there is no single solution. Successful mitigation depends on an integrated approach that combines legal, commercial, operational and geopolitical analysis, together with an acceptance that certain political risks cannot be eliminated but must instead be priced, structured and actively managed. As geopolitical considerations continue to shape investment outcomes, the ability to anticipate and adapt to political risk will remain a defining factor in the bankability of complex project finance transactions.

*The views expressed in this article are personal and do not necessarily reflect the views of any financial institution or organisation with which the author is affiliated.*

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Kirill Lebedyanskiy is a senior finance lawyer at HSBC. Prior to his current role, he worked at ABN AMRO Bank as a Co-Head of Lending Legal UK for several years, where he supported various businesses within its investment banking division including Project and Leverage Finance as well as leading ESG and regulatory related projects.

Prior to moving in-house, Kirill worked as a finance lawyer at Linklaters, where he gained substantial experience in a variety of financing transactions, including, among others, debt capital markets, hedging, insurance, project finance, trade finance, leveraged finance, emerging markets, real estate finance, as well as restructuring. He also worked in business and legal teams of RBS, Citibank and Deutsche Bank where he was on secondments.

Kirill is a solicitor of England and Wales and is familiar with civil law jurisdictions as well and has an LLM degree from Queen Mary University of London.

### Further Reading

- Political risk insurance: safeguarding global supply chains amidst geopolitical tensions? (2025) 5 JIBFL 331.
- Managing currency risk in emerging Asia investment: towards diversification (2025) 10 JIBFL 698.
- Lexis+® UK: LexisPSL Commercial Practical Guidance: Practice Note: Securing a resilient supply chain.

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