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MANAGING A GLOBALLY COMPLIANT INSURANCE PROGRAM

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Introduction

For many companies globalization is no longer just an option – it is a necessity. In order to grow and to remain competitive, many companies now find it essential to rely on offshore suppliers, to build manufacturing facilities outside their home country, or to expand into new markets. Engagement in other countries can take any of several forms, including green field projects, mergers or acquisitions, equity investments, or joint ventures.

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Companies that own or lease property outside their home country are faced with many of the same risk management and insurance issues they contend with on their domestic properties, but with added layers of complexity. Some locations may be especially vulnerable to natural catastrophes or political instability. Risk management and loss control activities may be hampered by local customs or business practices. Complex claims will be all the more complex to manage.

FM Global research suggests that one of the largest challenges faced by risk managers is implementing a consistent risk management philosophy across an organization.[1] A global risk management program presents additional complications of extended communication lines, cultural differences, language barriers and time zones. Embedded in the challenge of implementing a global program are two significant tasks: ensuring seamless insurance coverage wherever in the world exposures exist and implementing risk improvement strategies globally.

Insurance and tax authorities throughout the world have increased their scrutiny of insurance-related transactions, potentially subjecting non-compliant companies to regulatory enforcement actions and adverse tax consequences. Failure to comply with local regulations may leave a company without insurance coverage – which may not become apparent until after a loss has occurred – and potentially subject to fines and penalties. A global insurance

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program comprised solely of local, compliant policies, however, runs the risk of becoming a patchwork of uncoordinated, inconsistent coverages that are often poorly understood by the risk manager and not aligned with any cohesive risk management philosophy.

A global property insurance program must be designed to accommodate country-specific regulations where required while still being aligned with an organization's overall risk finance structure and risk management objectives. Companies with subsidiaries, branches, or joint ventures outside their home country need to be certain that their insurance programs are compliant with local regulations, but risk managers also should strive to structure a global property insurance program that provides broad coverage at consistent terms no matter where a loss occurs, and which both facilitates loss control activities across the globe and simplifies the management of complex claims. Fortunately, a growing number of global insurers now offer solutions that help their multinational clients achieve these objectives.

Structuring a global property insurance program.

The global infrastructure necessary to conduct business across borders has improved dramatically over the past decades. Advances in communication, transportation and information technology, as well as trade liberalization in many countries, makes global commerce a reality for even comparatively small companies.

Insurance regulatory and tax structures, however, have not kept pace with these advancements. Insurance is regulated on a country-by-country basis, meaning that a multinational company must have an insurance program that conforms to a wide array of local laws while still providing adequate, uniform protection. The program also must be structured such that companies with exposures elsewhere in the world can receive indemnification from insurers or to finance insurance losses at those locations without incurring significant tax liabilities, which most often happens when claims are paid in a country that is different than the one where the loss occurred.

Admitted versus non-admitted insurance: global master programs

A single master policy providing uniform, broad coverage for a company and its subsidiaries regardless of where a claim is filed has the advantage of simplicity. But a single global policy usually is not a practical solution if foreign subsidiaries, branch offices and manufacturing facilities are to be insured. Many countries require policies to be issued by a local insurer licensed in that country – so-called admitted insurance. If a claim occurs in a country

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requiring admitted insurance, the company may be barred from receiving recoveries from a non-admitted policy. Under some circumstances, companies may also face significant fines for having bought insurance from a carrier not licensed in the country. Nations with the strictest non-admitted rules include Argentina, Brazil, India and China. In Argentina, fines can range as high as 25 times premium for purchasing non-admitted insurance.[2]

Some companies permit subsidiaries and branch offices around the world to purchase their own insurance. While this practice – at least in theory – reduces the burden on the corporate risk management department, and assures that policies are compliant with local regulations and business practices, it can result in a host of issues. Purchasing insurance at the subsidiary level can be inefficient and expensive, it can result in coverage gaps and overlaps, it can expose the company to weak local insurers, and it can leave the company underinsured if adequate capacity is not available from local carriers.

Alternatively, risk managers can attempt to stitch together local policies purchased at the corporate level into a cohesive program. Policies typically are in local languages, however, making it difficult to ensure that appropriate coverage is in place. Local policies may vary widely from country to country, and from insurer to insurer. The definition of common terms also varies widely depending on location.[3] Efforts to achieve consistency, certainty and clarity in coverage can be further undermined by inconsistent and ambiguous national regulatory and fiscal systems.

The most effective way for a multinational company to insure their property exposures worldwide is often a controlled master program – a combination of local policies and a global master policy issued in the company's home country. Under this approach, local admitted policies – issued by either locally-licensed members of a global insurance group or independent local insurance partners – are supplemented by a global master policy purchased at the corporate level that provides Difference in Conditions [DIC]/Difference in Limits [DIL] coverage.

DIC/DIL coverage wraps around a local admitted policy when the coverage in the master policy is broader in terms of coverage or limits. If certain risks are not covered by a local policy, the master policy may provide coverage. Where no local policies exist, the master policy provides primary coverage. According to risk managers surveyed by Aon, the most significant benefits of this type of program are "Certainty of Coverage — knowledge of what coverage is included in the program," followed by "Cost" and "Statutory Compliance."[4]

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In many countries, admitted coverage is not required. In those countries coverage provided through a global master policy is acceptable from an insurance regulatory perspective, and reducing the number of policies on a program lessens the risk manager's administrative burden. Insurance buyers nonetheless should evaluate the benefits of purchasing a local policy even if not required by law. Local policies are more likely to be tailored to local laws and practices. Additionally, buying local policies may help avoid certain tax issues associated with multinational policies, which will be discussed later.

Beyond compliance and tax issues, an integrated global program tends to be cost effective – a comprehensive program through one insurer and its local partners often is less expensive than buying local policies individually. Additionally, a global program through a leading insurer can provide policyholders with access to world-class expertise and can facilitate engagement by claims, loss control and underwriting personnel to help clients get a better understanding of their risk. It also can assure a uniform approach to claims and help simplify the management of complex claims.

Claims management

Complex property claims benefit from the technical expertise available from large global insurance companies. At the same time, the claims management process often relies on claims adjusters with experience in their local market. When buying global property insurance, risk managers should ensure that they will get the benefits of the institutional knowledge of a large, sophisticated insurer as well as local presence and knowledge of local conditions and issues.

Having admitted local policies where required by law may become a critical factor when a claim arises. With only non-admitted coverage provided in a country where locally admitted insurance is required, direct interaction between the foreign subsidiary and the insurer's claims department will not be possible, adding complexity and uncertainty to the claim process. Additionally, if the claim occurs in a jurisdiction requiring a local policy, the global insurer will most likely be barred from conducting some claim management activities locally, leaving the local subsidiary with little assistance at a critical time.

Local claims representatives can quickly conduct a direct evaluation and quantification of the loss. A local adjuster may be able to more promptly make a determination, and a payment can be made in a timely manner. In addition to insurance regulatory compliance issues, first-hand knowledge of local business practices and legal and regulatory issues can be invaluable.

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Loss prevention

Insurers can provide valuable engineering and loss control services, and risk managers need to ensure that these services are available wherever properties are located. Risk engineering and loss prevention capabilities should be available within a global platform that balances centralized expertise with local knowledge of regulatory and business environments. Implementing best practices and a consistent loss prevention philosophy must take place within the context of local conditions and respect the requirements of local jurisdictions.

From a practical perspective, risk managers should acknowledge that risk management and loss control objectives will be more difficult to achieve in some countries. They are likely to find that, in some emerging economies, the prevailing standards of protection and construction differ significantly from what they may be used to at home. Fire and natural hazard risks may not be as well understood as in developed economies.

In some countries, concepts of insurance and risk management may seem new and foreign. Some cultures view insurance with suspicion, and some individuals may even view it as a violation of religious principles. Even within cultures where insurance is comparatively common, "evolving from a predominantly risk transfer culture to a risk management culture is a lengthy process," warns broker Marsh in a report on the multinational insurance market.[5] Cultural and language barriers can make communicating and obtaining buy-in extremely difficult. The assistance of an experienced multinational insurer with knowledge of local culture and business practices can be tremendously helpful in this process.

Tax considerations

Risk managers should consult with tax counsel to understand the tax-related issues of multinational insurance programs and the options available to manage the exposure. The crux of the issue is that tax laws in the United States and elsewhere can make it difficult for companies with multinational insurance programs to receive indemnification from insurers or to finance insurance losses at foreign locations without incurring unanticipated tax liabilities unless programs are carefully structured.

Claims payments from non-admitted international policies are typically paid in the location where the policies are issued as opposed to the country where the loss occurred. According to tax experts, in the case of the United States, the IRS may treat claim payments for losses that occurred in a foreign country as income, taxed at the corporate tax rate.[6] Furthermore, local tax authorities may view a remittance by a foreign parent to a local company as a

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taxable transaction.[7] Local authorities also may require certain regulatory approvals from other government agencies, such as the securities regulator.

In addition to assessing the tax consequences for insurance claims proceeds, companies also should keep in mind the tax treatment of premiums for non-admitted insurance. Even though a policy may be issued in a company's home country, the company still may be responsible for paying premium taxes in each country in which it has operations. Since the highly influential Kvaerner case in 2001, in which a Scandinavian company that bought a global policy in London was found to owe premium tax to Dutch authorities for its operations in the Netherlands, it is accepted that premium tax may be due in every jurisdiction where a company has operations. Failure to properly calculate and pay premium taxes can result in significant fines and penalties.[8]

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Captives

A captive can help manage retentions, reduce volatility and lower costs. A captive also can be used to implement loss control measures and incentive structures throughout a global organization. Ideally, a company's captives are seamlessly integrated with its global insurance program. To achieve this objective, however, numerous challenges must first be addressed. Not the least is the need for licensed fronting insurers. Lining up and managing global fronting arrangements is time consuming, and the collateral requirements of fronting arrangements can be a burden. To add further complexity, some regulators limit offshore reinsurance cessions and have increased the capital impact to both insurers and reinsurers, thereby potentially making fronting arrangements both more complex and more expensive.[9]

While creating and maintaining a global captive can be challenging, the benefits can be substantial. One use of a captive within a global program is to structure a program such that the predictable layer of claims is retained within a self-insured retention or ceded to the captive. The global insurer then provides coverage above the captive's participation for potential high severity claims.

Choosing an insurer

The number of insurers that claim to have a truly global risk management and insurance offering is limited, and within that small group there are substantial differences in scope and

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in the breadth and quality of services. When choosing an insurer, risk managers should assess the following criteria:

- A global network of local policy-issuing companies.
- Broad coverage that is closely matched between local policies and the global master policy.
- Local know-how and presence, while still having access to the expertise of a sophisticated global insurer.
- Centralized services that are available to the corporate client combined with localized, on-the-ground services delivered to local subsidiaries and locations.
- Qualified claims professionals with on-the-spot authority in close proximity to insured locations.
- The flexibility to structure a program to reflect a company's business model, risk management strategy, and financial and tax objectives.

Conclusion

Risk managers of companies owning or leasing property outside their home countries are challenged to assemble the best property insurance program structure to address their firm's risk management objectives while complying with local insurance regulations. They need to ensure that their program provides consistent, secure coverage wherever risks are located, and access to world-class loss control and claims management expertise that also is knowledgeable of local conditions, standards and practices.

For many companies, a controlled master program from a large global insurance company is the best answer. Global programs offer the benefits of control, cost, and continuity of coverage and services. With the right partner, risk managers will find an optimal blend of global and local insurance coverage to both ensure compliance with local regulations and to achieve risk management, financial and tax goals. ■

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