How to Build a Multinational Program

Global Solutions Customized

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Weighing Worldwide Insurance Options

Much has been said and written about the complexities of multinational insurance programs. For those of us who occupy the multinational space — insureds, carriers and brokers alike — terms such as "compliance," "compulsory," "admitted," and "nonadmitted" are bandied about regularly. But what do these terms really mean, and do they mean the same thing for each stakeholder? More importantly, do these terms actually help us collaboratively structure multinational insurance programs?

The expansion of regulatory regimes governing everything from financial services and taxation, to general business activities and corporate governance — against the backdrop of interconnected world and regional economies — requires a thorough assessment of cross-border risks as well as the options and obstacles inherent in multinational insurance programs.

There is no one right way to structure a program. Rather, each program should reflect a particular multinational's preferences, goal and situation, and be adaptable, year to year, as the organization's needs change and the global business climate inevitably evolves.

This paper sets forth fundamental guidance pertinent to multinationals of any size as they chart a logical, practical approach to insuring multi-country risks.

The Building Blocks

Local Policies. Global Policies. Controlled Master Programs.

A multinational has several options for insuring risks around the globe.

- It may utilize separate, unrelated local insurance policies in each country where it has exposure. These policies are underwritten by carriers licensed in the particular countries to insure the multinational's local offices, operations, subsidiaries, affiliates, assets and/or people. Locally issued policies are tailored to local industry practices and regulatory requirements, provide access to local reinsurance pools, fulfill local contractual obligations, and afford a vehicle for local claim servicing and local payment of claims, premiums and premium taxes.

- A multinational may rely on a single global insurance policy issued in its home country to cover itself and its worldwide exposures. Global policies are generally issued within the multinational's home country by a carrier licensed only in that country. These policies enable the multinational to assess its risks and insurance needs centrally, and provide consistent terms, conditions, limits and umbrella attachment points for the organization's operations worldwide.

- Both local and global policies offer advantages. Fortunately, multinationals do not have to choose one or the other, but rather may combine the best of both in what is commonly referred to as a controlled master program (CMP), which essentially combines multiple local policies issued in various countries with a global policy in the multinational's home country. The global policy is often a "difference in conditions/difference in limits" policy, meaning it serves as a backstop for all of the local policies, providing coverage if a claim is either not covered under a local policy or the local policy limit is exhausted (subject to the global policy's terms, conditions and remaining limits). Because the global policy usually has a worldwide coverage territory, it also covers risks even in countries where there are no local policies. In a CMP the global policy and local policies are linked, often through terms in the global policy. Properly structured, a CMP can provide a multinational and its worldwide operations with the benefits of both local and global insurance protection.

The AIG Philosophy

A Matter of Strategy... and Choice

Notwithstanding the benefits a CMP provides, there may be reasons why a multinational would prefer not to have a local policy in a given country, and instead rely on a global policy to cover its exposures there.

AIG will accommodate its clients' preferences, whether it is a local policy in every country with exposure, local policies only in some countries, or a single global policy. However, in making those determinations we believe our clients should be well-versed on the potential limitations they may encounter should they choose to forgo local policies. In particular, multinationals should be aware of the potential pitfalls a lack of local coverage could create in the areas of compliance, claims, income tax, proof of insurance and coverage.

AIG

How to Build a Multinational Program

Compliance

A Multinational's Regulatory and Premium Tax Requirements

Principles of extraterritoriality and international law dictate that the laws of a particular jurisdiction generally apply to conduct within its borders or by its nationals. Multinationals have offices, operations, subsidiaries, affiliates, assets and people around the world. Because foreign laws generally apply to parties operating in-country, a multinational's presence in a foreign country may subject it to some or all of that country's regulatory requirements. Certain countries have laws and/or regulations that may, with varying degrees of clarity and specificity, indicate that in-country exposures be covered by a carrier that is licensed to conduct business in that country. These mandates may take the form of a prohibition, an affirmative requirement, or both. They may be specific to a particular type(s) of insurance, apply only to compulsory insurance, or apply to all insurance, compulsory or discretionary. Some of these mandates may expressly state the party(ies) to which they apply, i.e., brokers, insureds or carriers resident in the country, whereas others may not. The specific requirements vary country to country.

If a given country clearly requires local operations to be covered by a local policy issued by a locally licensed carrier, then a multinational's local subsidiary — because it is resident in that country and thus subject to local regulation — may be at risk of violating such mandate if it is covered by the parent's global policy, transacted outside the country by its parent, and issued by a foreign carrier. The local subsidiary, as an in-country resident, may also be required to calculate and settle local premium taxes itself, and failure to do so could result in penalties and interest.

Compliance Questions

When crafting a program for multinational exposures, consider:

– Does local law require the local subsidiary to purchase and/or be covered by insurance from a locally licensed carrier?

– Does local law prohibit the local subsidiary from purchasing and/or being covered by insurance from a carrier not locally licensed?

– Will the parent company charge the local subsidiary for the allocated premium?

–Will the local subsidiary take a tax deduction for the allocated premium?

– Will the local subsidiary need to pay premium tax in-country?

A hypothetical to consider:

An Australian-based multinational has a global professional indemnity policy in its home country that covers the parent company and the worldwide operations of its affiliates. A high profile lawsuit has been brought in Europe against the company's European subsidiary. The local European regulator determines that because the local subsidiary is not covered by a locally licensed carrier, it is violating local regulations, which prohibit entities or residents from purchasing or having coverage for local risks from carriers outside the country. The regulator assesses fines and penalties against the local operation, and renders the company's global insurance policy void in the local jurisdiction, leaving it without coverage for the lawsuit.

In addition, the local tax authority learns that premium tax was not paid in connection with the global policy issued in Australia. Since the subsidiary resides within the tax authority's purview, the tax authority sends it an assessment for back taxes based on the premium it believes should have been charged for local coverage, plus accrued interest. The local tax authority also determines that the subsidiary was charged by its Australian parent company for the portion of the global policy premium attributable to the subsidiary's risks, and took a tax deduction for the premium expense. The deduction is disallowed, and additional fines and penalties are imposed.

Claims

The Need to Respond Locally

The laws of a country generally apply to companies operating within its borders. Global policies are generally transacted entirely within the home country of the carrier and the multinational. During the solicitation, negotiation and binding of the global policy, the carrier does not undertake activities outside the home country. Moreover, the carrier underwriting the policy is generally not licensed or conducting its insurance business outside its home country, and is thus likely entirely outside the purview of foreign regulation. Simply covering potential exposures, such as people or legal liability, in other countries without undertaking activities in those countries does not by itself subject a carrier to regulation in those countries.

While a carrier may be able to consummate a global policy solely from its home country, it may not be able to provide essential insurance-related services locally, because it is neither licensed nor conducting business outside of its home country. It may be prohibited by local law from providing claim services or making claim payments locally. Even if it is not prohibited, a global carrier may refuse to undertake these activities in foreign countries so as to avoid creating a nexus that could subject it to legal or regulatory scrutiny in those countries.

This constraint on localized carrier activity has been recognized and addressed in the U.S. by the Insurance Services Office, Inc. (ISO),[1] which provides standardized policy forms widely used in the U.S. property-casualty insurance industry. ISO forms provide for covering exposures in multiple countries. For example, a standard ISO endorsement entitled *Amendment of Coverage Territory – Worldwide Coverage (CG 2422 10/01)* extends the scope of a general liability policy from U.S.-only to a worldwide territory. By virtue of this extension, the U.S. carrier is able to provide for coverage in multiple countries, including those in which it is neither licensed nor conducting business. In the event foreign law prevents the carrier from defending or paying a claim in that country, the endorsement calls for the carrier to instead reimburse the policyholder. ISO's commentary recognizes that foreign laws, including insurance mandates, may hinder the policy's ability to respond:

A Word About Financial Interest Clauses:

In lieu of wording that covers a multinational's subsidiaries around the world, some global policies incorporate a "financial interest clause," which amends the policy to cover only the multinational's financial interest in these worldwide subsidiaries. The key feature of these clauses is that the parent company is the only legal entity actually covered under the global policy. The purpose of the clause is to avoid the regulatory concerns that can arise when a policy is not issued locally — if the local subsidiaries are not actually covered under the global policy, they are not part of the transaction and arguably not violating regulatory requirements applicable to local entities and residents.

However, financial interest clauses are not a panacea. While technically a multinational's local subsidiaries may not be covered, regulators could potentially view defining financial interest by the amount of subsidiary loss as an attempt to evade local regulatory requirements. Financial interest clauses are untested. We are unaware of any regulators that have opined, officially or unofficially, that a financial interest clause excuses a local subsidiary from local regulatory requirements.

A financial interest clause may also give rise to uncertainty in quantifying a loss. While it is intended to cover the parent for an amount identical to that which the subsidiary would have been covered for had it been an insured under the policy, if not carefully defined, and the actual loss sustained by the subsidiary arguably does not equal the actual post-loss reduction in the subsidiary's value to the parent, then recovery may be uncertain. Lastly, even if the financial interest clause solves any regulatory issues, it may trigger undesirable or unforeseen tax consequences, regardless of whether the financial interest clause effectively removes the subsidiary as an insured.

1 ISO is a leading source for actuarial, underwriting and claim information as well as policy forms in the U.S. property-casualty insurance industry. See www.iso.com.

> "Because the laws of foreign countries can sometimes interfere with or complicate recovery of insured losses … if local laws prevent the CGL insurer from providing the insured with a defense, then defense costs incurred by the insured will be reimbursed … If the insurer is prevented for any reason from paying covered damages on behalf of the insured, the amount of those damages will be reimbursed … If the laws of the country in which the insured is conducting operations require the purchase of specific insurance (e.g., from an insurer domiciled in the foreign country), then the CGL policy will function as excess insurance over that foreign insurance..."

While this ISO endorsement and commentary is specific to the U.S. marketplace and to general liability insurance, the fact that a carrier on a global policy may be unwilling or unable in some cases to adjust or pay claims locally is a universal concern for many types of insurance.

Consider how this might play out:

A multinational's Southeast Asian subsidiary owns a factory that manufactures widgets. A chemical explosion causes significant damage to the facility, destroying inventory. While it is too soon to quantify the extent of the loss, a bevy of loss control experts, engineers, and investigators will be needed to conduct forensic analyses and facilitate the release of insurance proceeds vital to the local operation's financial survival.

The factory does not have a local property policy in place. Rather, coverage for the loss is being sought under a global property policy that was negotiated and purchased by the parent company in Mexico and issued by a carrier licensed and operating only in Mexico. Because the carrier's license and operations are confined to Mexico, it may not be able to undertake any claims-related activities in Southeast Asia or retain a third-party to do so either. The subsidiary may be left to service the claim itself — locating and engaging all necessary engineers, adjusters and experts, in-country or elsewhere, to investigate, analyze and adjust the property damage and time element aspects of its loss.

Claims Questions

When crafting a program for multinational exposures, consider:

– If a loss occurs locally, can the local subsidiary retain local counsel and other litigation experts to defend a lawsuit?

– Will the subsidiary be able to retain loss control experts, engineers, medical providers and other vendors to assist in the claim adjusting process?

– Will the subsidiary be able to retain investigators, search for beneficiaries, assist in gathering documentation, or arrange for housing or other accommodations in the wake of a loss?

– Will the subsidiary be able to arrange for immediate medical treatment and evacuation?

Additionally, as a result of the explosion 25 individuals sustain bodily injuries, many of them severe. They are suing the subsidiary, alleging negligence in maintaining the factory in a reasonably safe manner.

Here again, the factory does not have a local policy in place to respond to these allegations. Instead, coverage will be sought under the parent company's global liability policy, also negotiated and purchased in Mexico and issued by the same carrier.

Once again, the carrier may not be able to undertake any local claims-related activities or retain a third-party to do so. The subsidiary may need to retain local counsel to defend these claims. Moreover, because of the country's underdeveloped legal system, the subsidiary is likely to have difficulty identifying and retaining appropriate counsel. Due to conflicts of interest and other legal considerations, multiple law firms may need to be retained.

In sum, due to limitations on the ability of a global carrier to respond locally, a multinational and its subsidiaries may be in the unenviable position of responding to claims on their own. The best way to ensure that a carrier will manage losses and claims locally is to have local policies issued by a global carrier's local affiliates as part of a CMP.

Income Tax

Tax Liability and Capital

Not only does the absence of a local policy potentially impact the ability of a multinational to obtain claim services in-country, but if a claim payment cannot be made locally there may be tax ramifications as well.

Consider:

A company's European subsidiary suffers a $30 million property loss. The loss is covered by a global policy negotiated and purchased in the U.S. by the U.S. parent company. As no local policy was purchased the carrier may be unable to remit claim payment directly to the subsidiary in Europe, and may instead pay the parent company in the U.S. — a move that has material tax ramifications.

Since the parent company did not actually sustain the loss, the proceeds could be taxable income to the parent company. The highest U.S. corporate income tax rate is 35 percent, which translates to a potential $10.5 million tax liability. In addition, if the subsidiary is not sufficiently capitalized to absorb the loss on its own, necessitating that funds be contributed by the parent to the subsidiary, the funds could be considered taxable income to the subsidiary as well. For example, if the subsidiary is subject to a 25 percent income tax rate under local law, the parent company may need to provide the subsidiary with $40 million to fully compensate it for the loss after tax. As a result, the total organizational tax liability in this example would be $20.5 million ($10.5 million for the parent and $10 million for the subsidiary).

Income Tax Questions

When crafting a program for multinational exposures, consider:

- Will the claim need to be paid in-country?
- If the global policy cannot respond by paying the claim locally and must instead pay the parent company, will the parent incur tax liability in its home country?
- Will the parent need to make a capital contribution to the local subsidiary; if so, will the local subsidiary incur tax liability?
- Can the local operation survive if the parent does not infuse capital to make it whole for a loss?

Proof of Insurance

Satisfying Local Authorities

Depending on the nature of a multinational's local operations, a local policy issued by a locally licensed carrier may be needed to fulfill contractual and/or other obligations.

Consider:

A large South American-based pharmaceutical company and its subsidiaries sponsor clinical trials around the world. Following one clinical trial sponsored by the parent company in Europe, 50 individuals sustain bodily injury and are on the verge of litigation.

The local subsidiary, which sponsors most of the clinical trials in this same country, has a local insurance policy that expressly provides clinical trials coverage. The parent company (and sponsor of this trial) only has a global policy issued in South America.

Proof of Insurance Questions

When crafting a program for multinational exposures, consider:

- Are local operations required to obtain insurance from locally licensed carriers?
- Does a contractual counterparty, government entity or other party need to be shown evidence that coverage has been obtained locally?
- Will failure to provide evidence of locally obtained insurance breach contractual covenants or trigger any commercial, contractual or reputational consequences?

The Ethics Committee responsible for approving the clinical trial requires that, as a condition precedent to approval, the trial sponsor be insured by a carrier licensed in the country where the trial is conducted. The parent company did not obtain this requisite local policy, and now faces potential regulatory consequences in addition to the individual lawsuits. Additionally, there may be ramifications for conducting a clinical trial without proper approval. On top of the financial exposure, both the parent company and the local subsidiary may face reputational risk.

Coverage

A Global Policy for Local Risks

Without a local policy in place, a multinational could be left without coverage for certain losses.

An example:

An organization faces a potential directors and officers (D&O) lawsuit in Europe. All of its D&O exposures worldwide were insured under a single global policy, which was issued on a non-European D&O coverage form.

The potential losses from this oncoming lawsuit may not be adequately covered under the global policy because the facts giving rise to the legal action are particular to European companies, and not expressly contemplated in the non-European form. The standard D&O form in Europe would have covered this potential lawsuit.

Coverage Questions

When crafting a program for multinational exposures, consider:

– Are there particular insurance terms and conditions local operations need to be adequately protected?

– Are the necessary terms and conditions available only under a local policy?

Evaluating the Risks

The Greater the Exposures, the Greater the Need for Local Insurance Protection

The fundamental question facing every multinational is whether or not to utilize a local insurance policy in a given country for a particular line of business, either on a stand-alone basis or as part of a CMP. While posed as a yes or no question, the complexities in answering it are multi-faceted, and involve the same analytical skills, judgment and risk assessment that risk managers deploy on a daily basis.

The more significant the risks, the greater the need for local insurance protection. A multinational should undertake a comprehensive risk assessment annually to determine whether a local policy is prudent in a given country for a given line of business.

A thorough evaluation should encompass the multinational's products and services, physical presence, corporate structure/capital position, lines of insurance and contractual counterparties.

Ultimately, the risk manager must consider the local assets, exposures and individuals at risk.

Products and Services

Whether or not a risk manager wants a local policy in a given country may depend on the products and services its operation provides in that country. If the local operation manufactures an inherently volatile or dangerous product, the risk may be heightened and a local policy may be wise. A consumer-oriented product or a high profile product that attracts media attention also indicates higher risk and is more likely to merit a local policy. The risk manager should also review if and how products or services are regulated, what regulatory bodies are involved and whether prior approval is a prerequisite for conducting business. Lastly, the types of claims and allegations that have historically arisen in connection with the local operation are a key consideration.

Physical Presence

The nature and size of the local operation has bearing on program structure. For example, does the multinational have only a small in-country sales office, or does it have a large factory or an extensive auto fleet on the ground, which heightens exposure? Whether the local subsidiary rents space or owns real property could implicate different liability considerations, and may also be important in assessing the risk.

Company Structure/Capital Position

A subsidiary's legal structure and local capital position could portend whether a local policy is warranted. Different types of liabilities and considerations come into play depending on whether the parent company has a locally incorporated subsidiary or a locally authorized branch. When it is the later, the risk manager may be especially reluctant to expose the parent company to the foreign risks of not having a local policy.

How the local subsidiary or branch is capitalized and what tax liabilities may be incurred if a claim payment were received from the parent company could be factors. A strong capital position may afford the local subsidiary the flexibility to forgo a contribution from the parent. Conversely, a weak capital position could jeopardize the solvency of the local operation, necessitating capital from the parent and possibly triggering significant tax liability.

Lines of Insurance

Type of insurance is another determinant. If the line of insurance is compulsory, such as auto insurance, the decision to buy local is easy. However, most lines are not compulsory, in which case the decision may be swayed by whether the line is third-party liability or first-party, and/or whether it is a high frequency or high severity line. Moreover, if crucial terms and conditions are available only in the local marketplace, purchasing a local policy will be particularly important.

Contractual Counterparties

Whether or not a local policy would be advantageous (or necessary) could also depend on local contracts and contractual counterparties. If the local counterparty is a private sector company and the contractual obligations are innocuous, the risk of not having local insurance may be minimal. However, if the contract is with a local government entity that imposes obligations to carry insurance from a locally licensed carrier, the need to purchase local may be clear.

The European Paradigm

Freedom of Services Policies

Companies in Europe may have yet another option to weigh: Freedom of Services (FOS) policies. These essentially enable a carrier licensed in one member state of the European Union to cover risks across the European Economic Area (EEA).[2]

At first blush, FOS policies may appear to be a complete solution for a multinational's European risks. A multinational could obtain a single policy covering all of its European risks, and the policy would be deemed admitted throughout Europe by virtue of the carrier's FOS rights. However, nothing is that simple; the use of a one-size-fits-all FOS policy raises its own set of concerns.

While a FOS policy is indeed considered admitted throughout the EEA, local requirements in each covered country must still be addressed. For example, the FOS policy may need to incorporate specific provisions unique to each covered country and/or may need to be translated into various languages. Also, as with local policies, premium taxes will still need to be calculated and remitted by the carrier in each covered country. Claim handling may need to be localized as well. So while FOS policies distinguish European-based risk programs from those produced elsewhere and may have some appeal, they must be carefully considered and smartly executed.

A Final Note

The debate and discussion over structuring multinational programs will continue. What really matters, however, is what the various options mean to each particular stakeholder — and the implications they have for a particular multinational's insurance program. We believe that the best protection will always be the risk manager's ability to make well-informed decisions in covering his or her company's unique exposures, at home and in every jurisdiction in which it operates.

Biography

David Halperin is Deputy General Counsel, Global Commercial Insurance, AIG. In this capacity, he oversees a team of lawyers dedicated to building protocols for information exchange and substantive interaction with regional and country counsel. Additionally, he works on multinational matters and other key initiatives integral to the mission of the Global Commercial Insurance organization.

Prior to assuming this role, Dave was Associate General Counsel of AIG for the U.S., responsible for overseeing the WorldSource, Aviation and Warranty Divisions of the company.

He joined AIG in 2001 as Assistant General Counsel of Risk Management.

David earned a B.A. from Colgate University and a J.D. from Rutgers School of Law.

2 The EEA consists of Iceland, Liechtenstein and Norway plus the 27 countries that comprise the European Union (Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Finland, Estonia, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom).

The AIG Network

At AIG, our ability to provide local policies and service the needs of our multinational clients is virtually boundless. We have licensed carriers worldwide, both in large commercial hubs such as London, Paris, Tokyo, Hong Kong, Singapore and Sao Paolo, and smaller locales like Papua New Guinea, Kenya and Azerbaijan.

Even more important than the geographical reach of our companies are the experience and servicing capabilities that come with it. We have more than 800 professionals dedicated to underwriting and servicing multinational programs, and can draw on more than 13,000 claims professionals across more than 300 offices around the globe to serve our clients wherever they operate. Our member companies issue more than 30,000 local policies annually in connection with controlled master programs.

We know the markets in which our clients operate very well. AIG companies have been licensed in nearly 30 percent of their markets for more than 50 years, and in 70 percent of their markets for more than 25 years.

Our multinational clients and brokers reap the benefits of in-country underwriting, claims expertise and resources accumulated over decades. A knowledge of local practices and customs is ingrained in our operations. We have forged long-standing relationships with local professionals, such as law firms, engineers, adjusters and regulatory bodies, to serve our clients' local needs. Our local policies provide access to our network, and all of the capabilities that come with it.

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