

Avoiding the Global Compliance Trap

Fuelled by the accelerating pace of technological change and trade liberalisation, the advance of globalisation appears unstoppable. Companies are benefiting from access to new outlet markets, production facilities in countries with cheaper labour costs and fresh capital via the stock market. However, as companies make use of these opportunities they equally need to keep a close eye on new and emerging risks to their business.

As production facilities move to new countries, risk managers find themselves faced with new exposures – at least unknown on this scale - such as typhoons, earthquakes or tsunamis. On the other hand issues such as supply-chain risks, having made headlines in 2007, can cause serious damage to reputation and consumer trust. These new risks can make a comprehensive, and compliant, insurance solution vital to doing global business.

Meeting global compliance needs

Complying with insurance regulation around the world can turn into a headache for risk managers of international companies. Put simply: how can your subsidiaries enjoy integrated and consistent cover worldwide, while at the same time respecting local market practices and regulation and accessing local coverage and claims handling solutions?

Wherever possible and practical, local policies will be issued to clients' local subsidiaries. This has several advantages. The cover will be written on a standard form for the particular country, in language and on terms that the local subsidiary will understand. In the event of a loss, local claims adjusters will be able to assess coverage and quantum issues by reference to familiar policy wording and local market practice.

However, a “local-only approach” may not give clients' risk managers the consistency of cover they need. And issuing local policies everywhere may be neither possible nor practical. To solve these issues, global insurers will often designate one of the local policies (usually, but not strictly necessarily, the policy covering the client's operational headquarters) as a “master policy”. They will then use that policy to cover not only the

“master client” but its subsidiaries worldwide for potential losses that are not covered under local policies, but which would be covered under the master policy. This “infill” cover is known as “difference in conditions/ difference in limits” or DIC/L, and only covers any difference in terms and limits between the local and master policies.

A Global Program with local underlying policies and a central “master” policy covering DIC/L is a powerful tool – because at a stroke, subsidiaries have local coverages in familiar terms and languages which they can show to their regulators or business partners, should they be contractually or legally required to do so; yet also, their global risk manager knows that if it’s a covered loss under the master policy, it’s a covered loss in Manchester, Morocco and Mali.

However, there is a catch: DIC/L coverage is generally provided on an unlicensed basis under the master policy, because the master insurer is generally unlikely to be licensed everywhere the client has subsidiaries. Increasingly, regulators worldwide are turning their attention to insurers providing coverage above or outside the local policy, and tax authorities are wondering whether they should be getting insurance premium tax on the DIC/L coverage offered out of the master policy.

Almost every country in the world that has regulations regarding such matters requires an insurer to hold a license to operate as an insurer within that country. But every country has a different idea of what ‘operating as an insurer’ actually means. An informed and intelligent approach to compliance may mean allow an unlicensed insurer to provide insurance into a country without falling foul of local regulations applicable to insurers within that country. For instance, an insurer unlicensed in the US (a so-called “unauthorized alien insurer”) can provide insurance into every one of the States on the basis of “direct procurement” by the policyholder. Other US States allow larger ‘industrial insureds’ to receive insurance from “unauthorized alien” insurers.

So the question to ask is: “where can insurers provide unlicensed coverage into a country without falling within the relevant jurisdiction’s definition of ‘carrying on insurance’ or

otherwise breaching the applicable licensing law?” To answer that, we compiled a detailed database for over 150 countries worldwide; so we now know where we can legally provide cover into countries on an unlicensed basis. We also know where taxes are payable by the insured or the insurer on such “permissible unlicensed” coverage, and a newly-developed application apportions premium, and calculates any taxes at the appropriate rate.

Of course, there are countries which rule that no risk located within the country in question may be insured other than with a domestically-licensed insurer. In such situations, it won’t be permissible to cover local risks on an unlicensed basis. A different solution is needed.

In these countries we “uninsure” subsidiaries who cannot permissibly receive cover, and instead insure their parent’s economic, strategic and financial interest in, or in respect of, the subsidiary in question. This means that the uninsured subsidiaries are simply not part of the contract of insurance, and the regulator in the home state of the subsidiary has no “unauthorized insurance” to object to. The parent’s loss to its financial interest in respect of that subsidiary will be calculated on precisely the basis that the subsidiary’s loss would have been calculated under the policy, if it were insured; but the loss is that of the parent, and, if covered, is paid to the parent. The parent then has the choice of whether to “repatriate” claims proceeds to its uninsured subsidiary. Repatriation may raise tax issues, which will be unique to each client. While we cannot and will not give tax advice, we have explored the tax situation in general and would say to clients: Do your homework in advance, and the tax effect of repatriating funds may be neutral.

Financial interest coverage to the parent, together with fully-licensed and “permissible unlicensed” solutions, allows global programs that do not only provide significant risk transfer and global servicing capabilities but also address compliance problems inherent in global program structures.

A Pan-European solution

Recent EU legislation has moved towards simplifying compliance and tax requirements within the European Union. The Services directive allows a single insurance policy to be compliant in all 27 EU and three European Economic Area member states. The policy can usually be available in the required local language and has the clear benefit of being one policy with one premium. Typically a locally-issued policy is unnecessary as the master form complies with the legal, tax and regulatory requirements across the region. This cover is not only available for property, but also for casualty, marine and professional lines insurance. It proves a cost-effective solution for global businesses with operations in more than one European country wanting comprehensive cover and centralised control of their risks.

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