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GLOBAL INSURANCE: NAVIGATING A COMPLEX WEB OF EXPOSURE AND REGULATION

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Eight years after the start of the Great Recession in 2008, the US economy is beginning to show signs of recovery. Indicators include modest GDP growth, a slight rise in interest rates in 2015 – with more promised for 2016 – and unemployment falling steadily since October 2009 to sit at 4.9 percent in January 2016[1].

Karl Jordan
—Senior Vice President of Global Placement for Allied WorldWide®

That recovery, however, is sluggish compared to that of emerging markets, where long-term growth opportunities are more forthcoming, according to experts.

Investment bank Goldman Sachs predicts global GDP growth in 2016 of 3.5 percent, with just 2 percent growth in developed markets and 4.9 percent in emerging markets.[2]

International business expansion has therefore become a vital strategic pillar for many companies.

Expanding your business internationally can create unlimited opportunities for growth; however with business expansion also comes a unique set of challenges – not least in understanding the unique cultural traits, exposures, legal and regulatory requirements of new territories.

There has been an explosion of regulation around the world in the wake of the 2008 Global Financial Crisis, but very little cross-regional consistency. This has led to an extremely fragmented regulatory environment, and a lack of understanding of the requirements that can create stumbling blocks for businesses looking to expand internationally.

On the surface, the financial implications of non-compliance are easy to understand: fines, penalties and punitive tax assessments can be costly and may not be covered by insurance.

The deeper impact of non-compliance with local regulations is damage to the company's reputation. This is not as easy to recover from – especially in new markets – and is a risk that can be mitigated by investing time and resources to thorough due diligence as part of a robust expansion strategy.

Insurance is a proven enabler for companies to expand – providing cover for fortuitous events and making companies whole again when unknown liabilities occur.

But purchasing insurance on a global basis is not straightforward. It is important for businesses to apply the same level of scrutiny to the purchase of their insurance programme as they do on their due diligence for international expansion.

In order to achieve this, businesses would benefit from partnership with their brokers and carriers – while bringing in external advisors and data points – to inform an appropriate insurance programme.

In this paper, Advisen teamed up with Allied World's Allied WorldWide® multinational insurance team to explore some of the complexities of operating in new territories – from both the risk perspective and also when buying insurance cover.

We will feature an interview with Karl Jordan, Senior Vice President of Global Placement for Allied WorldWide®.

Advisen dug into its extensive loss database to explore some live examples of how global expansion can lead to unintended - and often complex - losses in new territories. We also partnered with insurance business information provider Axco to explore the spiders-web of insurance regulation and compliance when buying P&C and/or professional lines insurance.

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[1] http://data.bls.gov/timeseries/LNS14000000

[2] http://www.goldmansachs.com/our-thinking/pages/outlook-2016/index.html?videoId=139047&cid=PS_01_78_07_00_01_16_01

Faced with this landscape, this paper will discuss how important it is to partner with advisors who can navigate towards a comprehensive solution when buying insurance.

UNINTENDED CONSEQUENCES: HIDDEN RISKS

A ROGUE OFFICIAL: AN ADVISEN CASE STUDY

Walid Hatoum, a former officer of the PBSJ Corporation in Qatar, offered and authorized nearly $1.4 million in bribes, disguised as 'agency fees' to a foreign official who communicated confidential information that helped PBSJ tender winning bids.

Hatoum offered to funnel funds to a local company owned and controlled by a foreign official in order to secure two multi-million Qatari government contracts for PBSJ in 2009.

The foreign official subsequently provided Hatoum and PBSJ's international subsidiary with access to confidential sealed-bid and pricing information that enabled the PBSJ subsidiary to tender winning bids for a hotel resort development project in Morocco and a light rail transit project in Qatar.

Once discovered, PBSJ self-reported the potential Foreign Corrupt Practices Act (FCPA) violations and cooperated substantially.

PBSJ agreed to pay disgorgement and interest of $3,032,875 and a penalty of $375,000.

PBSJ took quick steps to end the misconduct after self-reporting to the Securities and Exchange Commission (SEC), and the company voluntarily made witnesses available for interviews and provided factual chronologies, timelines, internal summaries, and full forensic images to cooperate with the SEC's investigation.

The SEC's order against Hatoum finds that he violated the anti-bribery, internal accounting controls, books and records, and false records provisions of the Securities Exchange Act of 1934. Without admitting or denying the findings, Hatoum agreed to pay a penalty of $50,000.

PBSJ is now known as The Atkins North America Holdings Corporation and no longer offers public stock in the US.

PAY ATTENTION TO DETAIL: AN ADVISEN CASE STUDY

In 2014, the Securities and Exchange Commission (SEC) investigated Hyperdynamics Corporation for possible violations of the Foreign Corrupt Practices Act (FCPA), by failing to accurately record certain payments made by its subsidiary based in the Republic of Guinea.

The US investigation was launched after the West African country of Guinea sought help from the G8 countries to track potentially corrupt deals.

The Hyperdynamics investigation focused on whether its activities in obtaining and retaining Concession rights and its relationships with charitable organizations potentially violated the FCPA and anti-money laundering statutes.

The company initially recorded $130,000 of payments as public relations and lobbying expenses to unrelated third parties without evidence that such services were actually performed. The company later determined that a Guinean-based employee controlled the third party entities, but did not record the payments as related party transactions.

Hyperdynamics also failed to implement or maintain a system of adequate internal accounting controls to track the subsidiary's use of funds, as well as to determine whether the company's subsidiary paid related parties. The company's

THE LEVEL "WHEN AN INCIDENT HAPPENS, DEMONSTRATE THAT YOU CAN LEARN FROM THOSE INCIDENTS AND REFORM YOUR PRACTICES."

internal accounting controls also failed to provide reasonable assurances that Hyperdynamics's recording of such expenditures was accurate.

In 2015, Hyperdynamics settled with the SEC to the tune of $75,000 in Civil Money Penalties, in violation of Section 13(b)(2)(A) of the Exchange Act, which requires issuers to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the issuer.

POINTS TO CONSIDER: CREATE A CULTURE OF COMPLIANCE

Commenting on these case studies, Karl Jordan, Senior Vice President of Global Placement for Allied WorldWide, told Advisen: "These examples are very familiar and occur far too frequently as businesses expand internationally.

They emphasise the importance of knowing and understanding the laws of countries in which you operate, while also acknowledging that some laws – such as the FCPA – have power outside their own jurisdiction," Jordan said.

Although the dollar amounts of fines appear relatively low (mainly owing to the corporations self-reporting or collaborating fully with the authorities), it is important to note that the potential reputational damage to companies from such violations could be much more costly.

"There is a need to build faith in the market that, as an insurable risk, you have a culture focused on compliance and self-improvement, and that you are transparent about your business practices" Jordan told Advisen.

"When an incident happens, demonstrate that you can learn from those incidents and reform your practices."

"As situations like the Hyperdynamics situation unfold, there should be red flags that go up at a Head Office level:

- Do you have the controls in place?
- Does your corporate culture demand that those controls are adhered to?
- Are you robust in enforcing those controls in foreign subsidiaries as stringently as at home?"

STRUCTURING AN APPROPRIATE MULTINATIONAL INSURANCE PROGRAM

Part of that culture of compliance and self-improvement involves buying appropriate insurance cover, to act as a back-stop to successful expansion.

Multinational companies purchase insurance to ensure they are protected from ever-growing liabilities and many work with multiple insurance carriers, in multiple jurisdictions, utilizing several brokers to ensure they are protected.

This can be complex, time-consuming and expensive.

Working with one insurance carrier in a multinational program helps to reduce potential gaps in coverage.

The first consideration when looking to buy a global insurance program is whether each country requires a local policy to be issued, or will accept policies issued by foreign insurers.

Focusing on the Asia-Pacific and Latin American regions, Axco data shows that, at first glance, all countries require a local policy to be issued. However, the real picture is more complicated. Some countries, such as Peru,

Chile, Australia and the Philippines allow non-admitted carriers to issue policies under certain circumstances – for example, for certain classes of insurance, or if approached directly by the insurance buyer.

We discussed above how it is important for businesses to partner with external parties to inform an appropriate insurance program for their needs. A mixture of the raw data, along with valued counsel from other experts, will help insurance buyers find a programme that suits their own requirements.

Issuing a non-admitted policy may be allowed, for example, but can claims be paid in the country?

Getting the right experts involved – broker, carrier and insurance buyer – can empower the multinational business to make an informed decision on their insurance needs within their corporate appetite, rather than just meeting minimum regulatory requirements.

DEFENSE COSTS AND LIMITS ADEQUACY

Professional Liability policies offer cover for indemnity (settlement of claims; judgments) and defense costs. The treatment of defense costs in different jurisdictions, however, differs greatly.

Taking the example of Latin America (see map), Axco data shows a patchwork of requirements. Argentina allows for defense costs to be covered outside of the limit of indemnity, while defense costs would erode the limit of liability in Brazil, Chile, Mexico and Peru. Meanwhile, Colombia and Venezuela do not regulate on the coverage of defense costs.

“This is an important issue, when considering the appropriate limit of insurance to buy,” Allied WorldWide’s Karl Jordan says.

“More often than not, a global policy has one aggregate limit of indemnity and it is important to know how doing business in different territories can erode that limit,” he said.

“One solution a company may agree on with their carrier is to issue excess policies in local jurisdictions that respond when the primary global layer is eroded by the cost of defending claims.”

MAPPING BUSINESS NEEDS TO REGULATORY COMPLIANCE

Services – especially financial services – are an important contributor to global wealth. According to the CIA’s World Fact Book[3], the Service Sector contributed more than 63 percent of Global GDP in 2014.

With its increasing importance in the global economy, it is important to ensure service businesses have adequate insurance cover.

Axco data shows a fragmented approach to compulsory professional services insurance across the Asia-Pacific and Latin American regions (see maps).

Advisen asked Allied WorldWide’s Karl Jordan what repercussions there may be for businesses in not knowing these rules when they buy cover.

“It is fairly simple to get the raw information on compulsory insurance cover, but it is important to not just meet the minimum requirements, but to consider whether the insurance meets the buyer’s real exposures and provides meaningful cover for them,” Jordan said.

[3] https://www.cia.gov/library/publications/resources/the-world-factbook/

ARE DEFENSE COSTS WITHIN OR OUTSIDE LIMITS?

Source – AXCO

"Looking 3-5 years down the line, there are likely to be many more compulsory professions, as regulatory bodies continue to build and enhance their regulatory frameworks. Multinational firms face challenges in keeping pace with global regulatory change and communicating best practices and compliance across their global network."

Insurance carriers and other advisors often have relationships locally with regulators and access to a more complete regulatory picture in the regions.

COMPULSORY PROFESSIONAL LIABILITY COVER

Source – AXCO

Source – AXCO

BEYOND BOX-TICKING

Global expansion is an exciting and - simultaneously - terrifying period in a business lifecycle. The opportunities are abundant, but the risks and additional business complexity can be daunting.

This paper looked at some of the complexities of operating in new territories - from both the risk perspective and also when buying insurance cover.

The world is becoming smaller, as faster routes to international trade open up. However, multinational companies

need to ensure they are applying a global culture of compliance and best practice in order to expand successfully.

"It is important that businesses align their global guiding principles around compliance and ethical business practices with the goal of profit and revenue generation. A culture of compliance should be on the same footing and have equal priority to revenue generation," Allied Worldwide's Jordan said.

Unforeseen circumstances will occur, and in those cases companies will be judged not just on the incident, but how they reacted to that incident and used it as an improvement tool.

Faced with this landscape, it is increasingly important for businesses to partner with advisors who can navigate towards a comprehensive solution when buying a global insurance program.

Multinational companies purchase insurance to ensure they are protected from ever-growing liabilities and many work with multiple insurance carriers, in multiple jurisdictions, utilizing several brokers to ensure they are protected. This can be complex, time-consuming and expensive. Working with one insurance carrier in a multinational program helps to reduce potential gaps in coverage.

In order to achieve this, businesses would benefit from partnership with their brokers and carriers – while bringing in external advisors and data points – to inform an appropriate insurance programme.

"The triumvirate of experience and knowledge – broker, carrier and buyer – can empower the insurance buyer to make an informed decision on their insurance needs within their corporate appetite, rather than just meeting minimum regulatory requirements," Jordan said.

ABOUT THIS RESEARCH

ABOUT ALLIED WORLDWIDE®

Allied World Assurance Company Holdings, AG, through its subsidiaries and brand known as Allied World, is a global provider of innovative property, casualty and specialty insurance and reinsurance solutions. Allied World offers superior client service through a global network of offices and branches. All of Allied World's rated insurance and reinsurance subsidiaries are rated "A" by A.M. Best Company, "A" by Standard & Poor's, and "A2" by Moody's, and our Lloyd's Syndicate 2232 is rated "A" by A.M. Best Company, "A+" by Standard & Poor's and "AA-" by Fitch Ratings.

Coverage includes:

- Directors & Officers (D&O)
- Employment Practices Liability (EPL)
- Excess Casualty
- Primary Foreign Casualty
- Environmental Liability
  - Site Specific (Scheduled) Pollution Legal Liability
  - Contractors Pollution Liability

ABOUT AXCO

Axco is the leading supplier of global insurance market information with over 50 years' experience in researching and publishing industry intelligence on insurance and employee benefits. Its unique business model and methods of

research have enabled the development of an extensive suite of products comprising in-depth reports, focused profiles, Q&A databases, intelligent questioning tools, and email services which are delivered to every corner of the globe.

ABOUT ADVISEN

Advisen is leading the way to smarter and more efficient risk and insurance communities. Through its information, analytics, ACORD messaging gateway, news, research, and events, Advisen reaches more than 150,000 commercial insurance and risk professionals at 8,000 organizations worldwide. The company was founded in 2000 and is headquartered in New York City, with offices in the US and the UK.