# ACE Progress Report℠

## *Structuring Multinational Insurance Programmes: Current Challenges in Australia, New Zealand and the Asia-Pacific Region*

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## Structuring Multinational Insurance Programmes: Current Challenges in Australia, New Zealand and the Asia-Pacific Region

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### 1. Multinational Programmes – an Overview

There is a continuing debate in the Australian, New Zealand and Asian insurance and reinsurance industry about how to effectively provide seamless, cost-effective and compliant insurance across national borders to multinational enterprises.

When developing a global insurance programme, multinational clients seek outcomes that balance three core factors: maximise global insurance capacity, minimise cost, and maintain centralised control over the programme. Sophisticated buyers take advantage of both their expertise in monitoring loss development and the predictable nature of their loss profile to structure multinational insurance programmes that keep much of the risk within the corporate umbrella structure. To do so, they leverage their company's central control of insurance terms, limits and retentions. This outcome is influenced by access to consolidated loss information, consistent loss control procedures, use of corporate buying power to obtain favourable risk transfer terms and pricing, and the simplified, centralised placement of global insurance coverage.

This article introduces and provides an overview of many of the regulatory and execution challenges faced by multinational companies purchasing globally coordinated insurance programmes; analyses the laws of Australia, Singapore, Hong Kong, Malaysia and New Zealand with respect to the concept of insurable interest; applies that concept to multinational insurance programmes originating there; and provides a checklist of questions that underwriters, brokers and clients in the region should consider when designing and implementing a measurably compliant multinational insurance programme.

### 2. Current Challenges to Multinational Insurance Programmes

The ideal solution to cross-border regulatory, tax and execution challenges would be to issue a single policy to cover the multinational company's risks (including those of its worldwide subsidiaries, affiliates and joint ventures) around the world which could be claimed upon in either the country where the multinational's headquarters is located or where the claim occurred. Yet this is neither realistic nor materially compliant – notwithstanding some moves towards international harmonization of insurance legislation (such as the European Union's 'passporting' regime).

Many countries impose blanket prohibitions on domiciled residents or entities from purchasing insurance from anyone except an insurer which is locally established, authorised or licensed ('admitted'). Other countries (including Australia), whilst allowing insurance to be purchased from 'non-admitted' insurers, impose conditions that must be satisfied before this is permitted and yet others impose tax penalties or other restrictions on those who elect to do so. Countries that are most restrictive about sales of non-admitted insurance include Argentina, Brazil, India, China, Japan, Korea, Mexico, Switzerland and Russia. Countries that are more permissive about non-admitted insurance, subject to conditions, include Canada, the United States, Germany, the United Kingdom, Chile and Peru.

The multinational parent company's ability to obtain worldwide consistency of coverage type, amount and risk transfer terms is affected by a variety of factors including language and regulatory differences which will render it generally impossible to categorically ensure that the terms of each local policy are consistent with the terms of all of the other policies, including the master policy issued as part of the programme. Additionally, given the significant number of countries and policies often involved in multinational programmes, limits offered on the local policies may aggregate to an amount larger than a single insurer or group would be willing to underwrite. For example, policies insuring 100 affiliates with an average limit of AU$10 million would result in aggregate exposure of AU$1 billion – a sum which is likely to far exceed the parent company's insurance needs for its worldwide operations and which may impose unacceptable costs.

Multinational insurers have typically fulfilled the parent company's request for worldwide coverage and consistent limits by offering the parent a master 'broadform' policy. These policies are intended to operate excess of and in addition to the local policies insuring the parent's foreign subsidiaries, affiliates and joint ventures by filling any coverage gaps of the local policies (Differences in Condition–DIC) and to provide consistent limits (Differences in Limit–DIL). However, the underlying expectation within this framework is that, in exchange for a single premium, the global exposures of the whole multinational enterprise will be covered and, where the risk is not covered by a local policy, this would be covered by the local insured's claim against the master policy and paid in the local country where the claim arose.

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## 3. A Changing Regulatory Environment

Recent specific regulatory developments, as well as a general trend towards increased regulatory and tax scrutiny, have cast serious doubt on the ability of master policies with broadform named insured clauses to satisfy their original objectives.

Since the landmark decision of *Kvaerner plc v Staatssecretaris van Financiën*,[1] the insurance industry has been left in no doubt that increased interest and scrutiny in revenue generated from premium taxes and other parafiscal charges in the multinational risk arena is likely to become more commonplace, even in those countries where insurance arrangements had not been the subject of tight regulation. Routine audits of insureds in many countries and an understanding of how global multinational programmes are currently structured will make the availability of this revenue apparent where it has not been remitted to revenue authorities.

In light of these matters, a closer analysis of the structure and implementation of multinational programmes is necessary in an effort to ensure that regulatory and tax risks are not inadvertently assumed by insureds, insurance brokers and insurers and so that the various participants understand their respective obligations to comply with local insurance and tax laws in the various jurisdictions applicable to the program.

## 4. Insurable Interest: a Prudent and Reasonable Solution

What might be an effective solution for multinational companies that are headquartered in one jurisdiction may not work for companies in other jurisdictions. However, removing from master policy coverage a parent company's subsidiaries, affiliates, and joint ventures located in jurisdictions that do not allow non-admitted insurance as additional insureds will significantly reduce the risk that the insurer under a master policy will be deemed by the local regulator to be improperly conducting business and directly insuring risks in those jurisdictions. Accordingly, simplifying the master policy and its broadform coverage is an important and prudent first step in designing a global program that may withstand international regulatory and tax scrutiny.

An important element of this approach is to rely upon the basic legal concepts of 'insurable interest' (or 'economic and pecuniary interest' under Australian, Singaporean and Hong Kong law). As described below, the insurable interest approach enables coverage and terms to be provided that are substantially similar to current broadform master policies while mitigating the risk to insureds, brokers and insurers of being deemed to be participating in 'unauthorized' insurance business.

**a. Australia**

Under Australian law, the policyholder must have a sufficient pecuniary or economic interest in the subject matter of the insurance to support a valid and enforceable policy. Although Australian law does not recognise a parent as holding such an interest in the physical assets of its subsidiaries, affiliates and joint ventures, it is generally accepted that a parent company does have an insurable interest in its financial interest in those entities. "The effect of Australia's Insurance Contracts Act" according to Dean Carrigan, a partner in the insurance practice group of Allens Arthur Robinson in Sydney, "is that the pecuniary or economic loss is not necessarily limited to the value of a parent's shareholding or dividends. For example, where a parent is a shareholder in its subsidiary but also has an obligation to arrange insurance for that subsidiary's property, the parent's pecuniary or economic loss as a result of the property being damaged or destroyed can be made referable to the value of the loss to the damaged or destroyed property for which the parent is obliged to arrange insurance. This concept is equally applicable to a liability exposure that takes the form of casualty or professional liability."

**b. Singapore, Hong Kong, Malaysia and New Zealand**

In Singapore and in Hong Kong, although there is no settled legal insurable interest requirement for non-life or non-marine policies, insurable interest is deemed to exist if the policyholder (a) has legal or equitable title to the subject matter, (b) is in possession of the subject matter, or (c) is not in possession of the subject matter but may be either responsible for, or suffer loss in the event of, any damage to the subject matter.[2] Under both Singapore and Hong Kong law, according to Simon McConnell, an insurance law partner at Allens Arthur Robinson's Hong Kong office, "legal obligations include any legal or contractual indemnity from the parent to its subsidiary. Both Singapore and Hong Kong law look to English law for precedent and on that basis it is settled that, where a person has assumed a legal obligation to indemnify another against loss of or damage to property, he has an insurable interest therein to the extent of his possible liability."

Malaysian law follows a similar approach. According to Sagadevan Thangavelu, an insurance partner in the Kuala Lumpur law firm of Shearn Delamore & Co, "offshore insurance is defined under the Income Tax Act of 1967 and consistent with that Act, if an insurance policy is issued to a resident of Malaysia to insure the pecuniary or economic loss of the insured in Malaysia and such loss is indirectly attributable to a foreign subsidiary or affiliate of the insured, such foreign entity loss may be indemnified in Malaysia and would not be characterised as insurance of a foreign loss."

New Zealand also recognizes the concept of insurable interest. According to Mark Todd, an insurance partner at Bell Gully in Auckland "even though the insured in New Zealand is not required to have an insurable interest in the subject matter of the insurance policy the insured must be able to show that the policy provides cover against a pecuniary or economic loss in order for the policy to be classed as a 'contract of indemnity against loss'."

## 5. The Practical Impact on Global Programs

In all these countries, the parent's insurable interest need not be reflected merely in a full ownership interest in the foreign entity – it may arise by having partial ownership interest coupled with a contractual obligation either to indemnify the foreign entity or to arrange for that entity's insurance coverage. Therefore, an Australian master policy may cover the parent's financial or economic interest (through its shareholding or other discernable insurable interest) in its subsidiaries, affiliates and joint ventures, rather than insuring such entities directly.[3] The parent may elect to reimburse its subsidiaries, affiliates and joint ventures for such amounts, although the matter is within its discretion.

It is essential to clearly define the parent's financial interest and the mechanism by which its subsidiaries', affiliates' and joint ventures' property damage and liabilities will be determined. In Australia, New Zealand, Singapore, Hong Kong and Malaysia, we consider that a viable solution to the challenges identified above is to adopt the principle of an

'agreed value' policy whereby the parent agrees in advance to the basis on which the value of the parent's financial interest in its subsidiaries', affiliates' and joint ventures' losses is to be calculated. This principle is a prudent and reasonable approach to indemnifying the parent for an amount equal to the loss suffered by a subsidiary, affiliate or joint venture. Under this structure, since no direct cover is provided to those subsidiaries, affiliates and joint ventures located in countries that do not allow non-admitted insurance or where the conditions by which non-admitted cover may be provided are not satisfied, master policy premiums would be paid by the parent and claims would be paid in-country to the parent for its insured losses.

In addition, because this approach clearly identifies the jurisdictions in which the insurance is being provided, the amount and allocation of premium taxes and other parafiscal charges among the insurer, the producer and the insured is readily identified.

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## 6. Alignment of Interests

The outlined approach leads to a multinational insurance program which aligns the interest of insureds, brokers and insurers. It addresses a multinational corporation's demands for consistent coverage and limits for its worldwide operations, whilst at the same time placing the insured, broker and insurer in a rational position to safely navigate the waters of increased international regulatory scrutiny over cross-border insurance including those which arise from issuing, selling or purchasing unauthorised insurance in highly restrictive jurisdictions.

By insuring the parent company under the master policy and not its subsidiaries, affiliates and joint ventures in jurisdictions that are highly restrictive about non-admitted insurance, this structure significantly reduces the risks that insureds, producers and insurers may be found non-compliant with respect to unlicensed insurance. Although any assumptions attributing 100 percent of all losses suffered by a subsidiary, affiliate or joint venture to the indemnity provided to the parent for such losses should be carefully evaluated on a country-by-country basis, this multinational solution lends itself to widespread application in the Asia-Pacific region (as well as in the USA and Europe in accordance with applicable insurance regulations) where large multinational groups are concentrated.

## 7. Checklist and Conclusion

Before underwriting and binding a multinational insurance program, participants in the program should consider the following checklist, which recommends designing and implementing a measurably compliant multinational insurance program from a 'bottom-up' perspective – requirements for local policies as well as a 'top-down' perspective – ensuring potential gaps in those local policies are covered by a master DIC and/or DIL excess policy.

1) Is local coverage required and if so, is it adequate? Is a Difference in Conditions (DIC) excess policy needed?
2) Is the local limit adequate? Is a Difference in Limit (DIL) excess policy needed?
3) If DIC/DIL is needed, may it be compliantly (policy, premium, claims, tax) issued by an insurer unlicensed in the local country?
4) If yes, must DIC/DIL premium be allocated to countries where risk is located?
5) If yes, are premium taxes due on such DIC/DIL premium allocation and who will calculate, collect and remit payment?
6) If no, how may a master DIC/DIL excess policy be compliantly issued to meet expectations?
    a) What risks are covered?
    b) How is premium allocated and paid?
    c) Where will premium taxes and/or other applicable fees and surcharges be remitted?
    d) How will claims be adjusted and paid?

Clearly, multinational policies are crucial for international groups – a way to ensure group-wide coverage where the group is operating in many jurisdictions. Yet for the insured, broker and insurer, the jurisdictional spread embedded in these programmes introduces increased regulatory and fiscal risk. The proposed solution keeps multinational policies straightforward, transparent and marketable while ensuring that the parties are not inadvertently brought onshore in a country that disallows non-admitted insurance for tax and regulatory purposes.

"If designed and administered with the issues outlined in this paper," Mr. Carrigan adds, "this reformed master policy provides a reasonable and prudent approach to purchasing and selling multinational insurance and should withstand legal challenges under Australian Law and under the laws of a number of Asian countries with respect to providing unauthorised insurance, allocation of premium, and payment of applicable taxes and fees."

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Endnotes

1 Case C-191/99, Kvaerner plc v Staatssecretaris van Financiën, 2001 E.C.R. I-4447, [2001] STC 1007.

2 Sharpe v Sphere Drake Insurance, the Moonacre [1992] 2 Lloyds Rep 501; National Oilwell (UK) Ltd v Davy Offshore Ltd [1993] 2 Lloyds Rep 582; Feasey v Sun Life Assurance Co of Canada [2003] EWCA Civ 885.

3 Wilson v Jones (1867), L.R.2 Ex. 139 at 144; Macaura v Northern Assurance Co Ltd [1925] AC 619.

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