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Structuring Multinational Insurance Programs: Current Challenges in Argentina, Brazil and Mexico

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1. Multinational Programs – an Overview

There is escalating dialogue among risk managers, brokers and insurers in Argentina, Brazil, Mexico and other Latin American countries about how to effectively provide seamless, cost-effective and compliant insurance across national borders to multinational enterprises.

When developing a global insurance program, multinational clients seek outcomes that balance three core elements: maximizing global insurance capacity; minimizing cost; and maintaining centralized control over their insurance programs. Today, sophisticated buyers in Latin America are considering taking advantage of both their internal expertise in monitoring loss development and the predictable nature of their loss profile to structure programs that keep much of the risk under their corporate umbrella, either through reinsurance of such risk to their captives or through internal corporate management accounting. To do so, they leverage companies' central control of insurance terms and limits, consolidated loss information, consistent loss control procedures, use of corporate buying power to obtain favourable risk transfer terms and pricing and simplified placement of global insurance coverage. Accomplishing these tasks in an ever-changing regulatory environment is a major challenge.

This paper introduces many of the regulatory and execution challenges faced in the multinational insurance marketplace, analyzes the laws of Argentina, Brazil and Mexico with respect to the concept of insurable interest, applies that concept to multinational insurance programs, and provides a check list of questions that underwriters, brokers and clients in the region should consider when designing and implementing a materially compliant multinational insurance program.

2. Current Challenges to Multinational Insurance Programs

The ideal solution to cross-border regulatory, tax and execution challenges is to issue a single policy to cover the multinational company's global risks (including those of its worldwide subsidiaries, affiliates and joint ventures), that could be claimed upon in either the country where the multinational's headquarters are located or where the claim occurred. But this approach is neither realistic nor materially compliant – notwithstanding some moves toward international harmonization of insurance legislation (such as the European Union's "passporting" regime). Many countries impose blanket prohibitions on domiciled residents or entities purchasing insurance from anyone except an insurer which is locally established, authorized or licensed ("admitted"). Other countries, while allowing insurance to be purchased from "non-admitted" insurers, impose conditions that must be satisfied before this is permitted and/or impose taxes, penalties or other restrictions on those who elect to do so. Countries with stringent prohibitions on the sale of non-admitted insurance include such major trading jurisdictions as India, China, Japan, Korea, Mexico, Brazil, Switzerland, Argentina and Russia. Countries that permit non-admitted insurance subject to conditions include Australia, Canada, the United States, Germany and Peru.

In addition, the 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 that render it generally impossible to categorically ensure that the terms of each local policy are consistent with the terms of all of the others issued as part of the program. Moreover, given the significant number of countries and policies often involved in multinational programs, aggregate limits offered on the local policies in certain lines, such as property and other infrastructure related insurance products, may be larger than a single insurer or group would be willing to underwrite. For example, policies insuring 100 affiliates with an average limit of R$10 million would result in aggregate exposure of R$1 billion – a sum likely to far exceed the parent company's insurance needs for its worldwide operations, and that would impose unacceptable costs.

A closer analysis of the structure and implementation of multinational programs is necessary in an effort to ensure that regulatory and tax risks are not inadvertently assumed by insureds, producers and insurers.

Multinational insurers have typically fulfilled the parent company's request for worldwide coverage and consistent limits by offering the parent a master "broadform" policy. Such an insurance policy is intended to operate in excess of and in addition to the local policies covering the parent's foreign subsidiaries, affiliates and joint ventures, by filling any coverage gaps of the local policies (Differences in Condition–DIC) and providing 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 may be covered, and where a risk is not covered by a local policy this could be covered by the master DIC-DIL policy and paid in the local country where the claim arose, subject to applicable local laws permitting such a payment.

3. A Changing Regulatory Environment

Recent regulatory developments, as well as a general trend toward increased regulatory and tax scrutiny, have cast doubt on the ability of master DIC-DIL policies with broad-form named insured

clauses to satisfy their original objectives. Since the landmark decision of *Kvaerner plc v Staatssecretaris van Financiën*[1] in Europe, the insurance industry has been left with no doubt that increased interest and scrutiny in revenue generated from premium taxes and other parafiscal charges in the multinational risk arena are 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 programs are currently structured will make the availability of this revenue apparent where it has not been remitted to the revenue authorities of the subsidiary's domicile.

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

4. Insurable Interest: a Prudent and Reasonable Solution

What may be an effective solution for multinational companies in one jurisdiction may not work for companies in other jurisdictions. However, removing as additional insureds a parent company's subsidiaries, affiliates, and joint ventures located in jurisdictions that do not allow non-admitted insurance from master DIC-DIL policy coverage will significantly reduce the risk that the insurer under a master DIC-DIL policy will be deemed by the local regulator to be improperly conducting business and directly insuring risks in those jurisdictions. Accordingly, simplifying the master DIC-DIL 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" generally recognized under Argentinean, Brazilian and Mexican law. As described below, the insurable interest approach enables coverage and terms to be provided that are substantially similar to current broadform master DIC-DIL policies, while mitigating the risk of being deemed to constitute transacting unauthorized insurance business.

a. Argentina

Under Argentinean law, the policyholder must have a sufficient insurable interest in the subject matter of the insurance to support a valid and enforceable policy[2], except where expressly prohibited by law, such as coverage of pure financial credit *(crédito financiero puro).*[3]

Although Argentinean law does not recognize a parent company 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. "Although this concept is novel in Argentina and may need to be clarified if challenged, the effect of Argentina's Insurance Law, is that the pecuniary or economic loss is not necessarily limited to the value of a parent's shareholding or dividends", says Martin Arganaraz, a partner in the insurance practice group of Allende and Brea in Buenos Aires. "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 damaged or destroyed property for which the parent is obliged to arrange insurance. In essence, the parent company will receive indemnity for its own loss, not the local loss of its foreign subsidiary. This concept is equally applicable to a liability exposure that takes the form of casualty or professional liability," he notes.

b. Brazil

When Brazil's new Civil Code took effect in 2003, it introduced the concept of legitimate interest — replacing the concept of indemnity — as the essential element of an insurance contract. Thus, the purpose of an insurance contract is to guarantee the insured party's legitimate interest. According to Brazilian doctrine,[4] an individual's or company's interest in a certain asset is legitimately considered *insurable* provided that (i) the potential insured party wants to protect the asset and does not benefit from the occurrence of the risk guaranteed by the insurance contract; (ii) the potential insured party is in a position to endure an economic or pecuniary loss as a result of a claim involving the asset, even though this asset might not be owned by the potential insured party; and (iii) the interest is present not only at the time of the insurer's acceptance of the risk, but also at the time of the claim. In such circumstances, a Brazilian parent company purchasing a master DIC-DIL policy to protect its insurable interests in its subsidiaries, affiliates and joint ventures has the option — if in addition to ownership, internal contracts reflect such an understanding — of paying its subsidiary's loss or not paying such a loss irrespective of whether it purchased insurance to cover such an economic loss.

Although one may take the position that the ultimate loss paid by the parent under the master DIC-DIL policy is attributable to a risk located outside of Brazil — and therefore, it is the risk, not the parent's economic loss, that is covered under the master DIC-DIL policy — such an argument may not be consistent with Brazil's principles of insurable interest. "Even though to precisely define the location of the risk may be very difficult under some circumstances, this challenge, in our view, is not correct because the objective of Brazilian legislation is to prevent individuals and companies residing and domiciled in Brazil from purchasing insurance abroad in order to guarantee risks located in Brazil, and the objective of the master DIC-DIL policy is to insure the Brazilian parent in Brazil for its economic and pecuniary interest in its foreign interests," states Renato Mandaliti, an insurance law practitioner at Mandaliti Advogados in Sao Paulo, Brazil. "To the extent that the Brazilian parent company has an ownership interest of the foreign entity, and in addition, is in a contractual position to sustain an economic loss as a result of a claim not covered or insufficiently covered by the local policy purchased by its foreign entity, it has an interest in protecting the foreign entity's assets, and continues to have this interest both upon insurers acceptance of the insurance contract and at the time of a claim. With these elements in mind, the Brazilian parent company should have an insurable interest in relation to the foreign entity's assets/liabilities, which may be insured in Brazil" Mr. Mandaliti explains.

c. Mexico

The general principle under Mexican Law is that parties may agree on the terms and conditions of an insurance contract, except for any provisions that are contrary to law, public policy or affecting the right of a third party, without such party's consent.[5] Therefore, Mexican companies may not be contracting parties on multinational policies issued by insurers unlicensed in Mexico, where such policies refer to the Mexican risks as a covered risk, or where a local Mexican insurance policy refers to a contract not authorized to insure Mexican risks. Furthermore, Mexican residents will breach laws if they remit premiums to unlicensed insurers. Moreover, any premiums they may pay to an unlicensed insurer are not deductible for income tax purposes in Mexico. Consequently, even though such Mexican residents may be named as additional insureds or beneficiaries under a policy issued by an unlicensed insurer, there is an underlying risk that such Mexican residents and the unlicensed insurer are acting in contravention of Mexican law.[6]

Mexican law, however, does not restrict an authorized Mexican insurance company from issuing and implementing a multinational insurance program, and Mexican law does not prevent foreign entities from covering their Mexican financial interest of their foreign subsidiaries, when such financial interests are based on assets or interests located in Mexico. In addition, in order to compliantly implement multinational insurance programs in Mexico, specific authorizations or registrations of contracts should be conducted in advance in order to ensure that the multinational insurance program is not implemented as a bypass to law. In addition to the above, Carlos Ramos Miranda, an insurance law practitioner at the law firm of Barrera, Siqueiros y Torres Landa, S.C. in Mexico City, notes: "For a master DIC-DIL policy issued to a Mexican parent company insuring its interests outside Mexico to be compliant, it is highly important that the actual insured risk is the loss or diminution in value of the financial or economic interest of the parent in the underlying asset or event, that the beneficiary is not in effect the foreign affiliate company and that the parent appropriately considers cost and tax issues associated with any intended cost allocation."

> The outlined approach addresses a multinational corporation's demands for consistent coverage and limits for their worldwide operations, while at the same time placing both insured, broker and insurer in a rational position to safely navigate the waters of increased international regulatory scrutiny

5. The Practical Impact on Global Programs

In Mexico and Argentina, 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. In Brazil, however, although a parent's ownership interest in a foreign entity alone may be sufficient to reflect an insurable interest in such foreign entity, in order to construct a robust and defensible position of insurable interest under Brazilian law, a contractual obligation to either indemnify the foreign entity or arrange for that entity's insurance coverage is recommended.

Therefore, an Argentinean, Mexican or Brazilian master DIC-DIL policy may insure the parent's financial or economic interest — through its contractual obligations, its shareholding or other discernable insurable interest — in its subsidiaries, affiliates and joint ventures, rather than insuring such entities directly. Through inter-company allocations and appropriate transfer pricing documentation, the parent may elect to reimburse its subsidiaries, affiliates and joint ventures for such amounts, since these matters are within its discretion.

6. The "Agreed Value" Policy

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 Argentina, Brazil and Mexico, the principle similar to an "agreed value" policy, (which is recognized under the laws of Australia, France, Spain and England) 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, 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. Also, under this structure, since no direct insurance 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, no premiums would be allocated to those entities and claims would be paid in-country to the parent for its insured losses.

In addition, because this solution 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.

7. Alignment of Interests

The approach outlined above leads to a multinational insurance program that aligns the interest of insureds, brokers and insurers. It also satisfies a multinational corporation's demands for consistent coverage and limits for their worldwide operations, while, at the same time, placing 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 unauthorized insurance in jurisdictions in which it is prohibited.

By insuring the parent company under the master DIC-DIL policy — and not its subsidiaries, affiliates and joint ventures in jurisdictions that prohibit non-admitted insurance — this refined multinational program structure significantly reduces the risks to insureds, producers and insurers associated with non-compliant, 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 innovative solution should lend itself to widespread application throughout the South American region — as it does in the USA and Europe Union — where large multinational groups are located.

8. Checklist and Conclusion

Before structuring and underwriting a multinational insurance program, participants in the program should consider the following checklist, which

recommends designing and implementing a materially 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 adequate? Is a Difference in Conditions (DIC) excess policy needed?
2) Is local limit adequate? Is a Difference in Limit (DIL) excess policy needed?
3) If DIC/DIL is needed, can it be compliantly (policy, registration or filing with regulator, premium, claims, tax) provided from outside the local country?
4) If yes, are premium taxes due, and who will pay?
5) If no, how may DIC/DIL be compliantly structured to meet expectations?

a) What risks are covered?
b) Have the local regulators approved the form, or is there an exemption to approval?
c) How is premium allocated and paid?
d) How will claims be adjusted and paid?

Multinational program structures are crucial for international groups as a way to ensure group-wide coverage where the group is operating in multiple jurisdictions. Yet for the insured, broker and insurer, the jurisdictional spread embedded in these programs introduces increased regulatory and fiscal risk. The proposed solution keeps multinational policies straight-forward, 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 multinational insurance programs are underwritten, executed and administered with the issues outlined in this paper, this new program structure will provide a reasonable and prudent approach to purchasing and selling multinational insurance and should withstand any legal challenge under Argentinean, Brazilian and Mexican Law, as well as under the laws of a number of other South American countries.

When designing and implementing a multinational program, clients, brokers and insurers should be aware of the issues and ambiguities introduced and analyzed in this paper and the importance of an independent third party's documented assessment of their multinational program. Risk managers and buyers of multinational programs and producers should work with a global insurer and an independent financial and tax advisor to address many of the issues addressed in this paper. Working with experienced accounting, tax, legal, and financial specialists to design a comprehensive global insurance program — with appropriate documentation and supporting contractual arrangements fitting the specific needs and goals of multinational enterprises — should result in a materially compliant international insurance program and should assure that the program ultimately satisfies the collective objectives of the multinational enterprise, insurance broker and insurance carrier.

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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] Article 2 of Law 17,418.

[3] Article 24 of Law 20,091. There is no clear definition of "pure financial credit." It is generally understood that operations involving financial loans are not a permitted insurable interest. It has also been interpreted that coverage of risks associated with investment in securities is also included in this prohibition. On the other hand, coverage of the risk of a buyer defaulting in the payment of the acquisition of goods or services (due to commercial or political circumstances) is permissible. Therefore, it is not the risk of default of a payment that would make the coverage prohibited, but the underlying cause of the payment that is objectionable.

[4] Tzirulnik, Ernesto et al, "O contrato de seguro : de acordo com o novo código civil brasileiro", 2nd ed., São Paulo, Editora Revista dos Tribunais, p. 32-36, 103-104, 111-113.

[5] The General Law of Insurance Companies and Mutual Institutions – (the "Insurance Law" or "IL") regulates the establishment and operation of insurance companies. According to the Insurance Law, only companies specifically authorized by Mexican authorities are allowed to engage in insurance activities in Mexico. All insurance transactions entered within Mexican territory are intended to be subject to Mexican laws (See Article 4 of the Insurance Law). An insurance activity is considered to be that where, a person (insurer) is paid an amount of money (premium) to bind itself to, in case that a future and uncertain event materializes, it indemnifies for, or restores, either directly or indirectly, another person's suffered damage, (article 3 of the Insurance Law). Further, under article 1 of the Insurance Contract Law ("ICL"), through an insurance contract the insurance company is bound, in exchange for a premium, to restore damage or to pay a sum of money in the case a specific event materializes.

[6] In accordance with article 36-D of the IL, insurance companies are only allowed to offer the operations and services authorized by it to the public, prior registration of their products before the National Insurance and Bonds Commission. The requirements to secure such registration are set under general rules issued by the Commission. These requirements basically refer to the filing before the Commission of the description of the coverage to be offered, including technical notes with the financing of premiums, tariffs and contract models, or clauses, as well as other related information. Only authorized Mexican insurance companies may offer insurance in Mexico. The IL further prohibits Mexican individuals or entities to contract insurance with foreign insurance companies when the risk may occur in Mexican territory (See Article 3 of the IL). Mexico's insurance regulator publicly iterated that such transactions violate Mexican insurance laws and constitute criminal offences, subjecting participants to substantial fines and imprisonment of up to 10 years. This announcement suggests an intention to implement more vigorous enforcement. (See"Evite Comprar Seguros Foraneos; Podria Ir a Prision," economia.terra.com (Sept. 9, 2009))

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