ACE Progress Report℠:

Beyond “Non-Admitted”:
A Closer Look at Trends Affecting Today’s Multinational Insurance Programs

Suresh Krishnan

focus on:

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I. Overview:

Congress and The United States Department of the Treasury are considering a reform of the way insurance is regulated in the United Sates. Under consideration is optional federal regulation that would supplant the current state-based insurance regulation.[1] One of the models for this reform is a system of uniform regulation that has been implemented in Europe with decades of European Union (EU) Directives.[2] These Directives created the freedom of establishment and provision of services (also known as “passporting” regimes), which allow insurers to carry on business and insure risks throughout the EU, subject to authorization by the regulator of their domicile. These efforts are also underway to harmonize additional areas of insurance regulation, such as solvency margins and the regulation of control and management. These would facilitate more expansive freedom of trade between and among European Union member countries.[3]

If the principles of the passporting regimes were applied outside the EU, many of the functional costs unknowingly assumed by parties conducting multinational insurance business could be reduced. Currently, though, there is no global regulation of insurance nor a consistent application of insurance laws. But globalization of the economy and corporations demand the globalization of insurance programs, even though global regulatory regimes have traditionally impeded the development of marketable insurance structures that might respond to demands from multinational enterprises. This problem of regulatory impedance is especially acute when it comes to the insurance of large organizations that seek coverage across national borders.

As a result, there are material hurdles to designing and implementing a compliant multinational program. One such hurdle is that multinational enterprises, brokers and insurers using traditional insurance products to conduct multinational business (and pricing such business based on assumptions limited to underwriting and credit risks) assume significantly more risk than is reflected in their premiums.

> “there is no global regulation of insurance nor a consistent application of insurance law.”

This paper begins by identifying the motivations behind purchasing and selling multinational programs and identifies many of the trends, issues, and inconsistencies in today’s environment. Next, it provides an overview of the laws of the major countries in which multinational business is regularly conducted. Finally, insurance products are analyzed in terms of how they are affected by current laws and how regulatory trends may affect those products in the future. This analysis identifies various regulatory and tax risks that may be unknowingly assumed by buyers, producers, and sellers of multinational insurance and that are not generally recognized nor contemplated in insurers’ pricing.

This paper concludes by outlining a clear, rational approach to conducting multinational insurance business – by improving the current master policy arrangement, so that it is flexible and assures seamlessness in an uncertain and complicated regulatory environment. It discusses the imperative of analyzing these global issues as a team effort among the insured, the insurer, and the producer. Each must take an active role in analyzing the needs, designing the product, and acknowledging the risks assumed by each party.

This paper ends with a “toolkit” of questions and issues for each participant to consider when designing and implementing a multinational program.

II. Discussion

A. The Multinational Program: The Motivation Behind the Product

The purpose of utilizing multinational programs is to maximize global capacity and minimize cost while maintaining centralized control over the implementation of a global insurance program. Although risk transfer is offered at a price, many sophisticated buyers will take advantage of both their expertise in monitoring loss development and the predictable nature of their loss profile to design a program that keeps much of the risk within their corporate structure. Therefore, most buyers achieve their corporate risk transfer objectives through the central control of insurance terms and limits, consolidated loss information, consistent loss control procedures, and simplified placement of global insurance coverage.

Most buyers want execution certainty with respect to claims handling and indemnification, whether pursuant to a master policy issued to the parent company or to a local policy issued to its subsidiaries, affiliates, and joint ventures. Consequently, buyers, sellers and intermediaries in the multinational marketplace are not pricing for – and do not intend to assume – regulatory and tax risks. Despite the multiple national regulatory regimes governing insurance, buyers expect a high degree of certainty regarding the risks covered under their global insurance programs. Moreover, insurers, insureds, and producers want the products that they sell, purchase, and produce to be materially compliant under a regulatory and legal microscope.

As a result, risk managers purchasing a multinational program focus on insurance carriers that have the strongest network of local affiliates and non-affiliate partners. And, unless they need local risk transfer, risk managers focus next on reinsuring this exposure with either their captive or a panel of reinsurers. Their goal is to obtain the broadest possible coverage for their exposures under one global program, along with tolerable credit risk to ensure that covered claims will ultimately be paid. However, risk managers need to make sure they put just as much effort into other critical issues affecting their global programs – including the legality and enforceability of the insurance, premium allocation, and payment of applicable taxes and fees. These components represent the risks that are implicitly, and sometimes unknowingly, assumed by various parties in a multinational program.

B. The Current Global Regulatory Landscape

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Nearly every country has laws regulating the business of insurance within its borders. Most industrialized countries, such as the United States, have expansive insurance regulatory regimes that address many of the lines of business conducted by multinational insurance companies.[4] These regulations can cover the licensing of insurers and producers; the regulation of insurance forms and/or rates; the marketing, solicitation, and selling of insurance; the payment of taxes; and other parafiscal charges.[5]

Not surprisingly, most countries prohibit or limit "non-admitted insurance" – the insurance of risks located in their countries by unauthorized or unlicensed insurers. Major countries whose regulatory regimes take a dim view of non-admitted insurance include: Argentina,[6] Brazil,[7] France,[8] India,[9] Italy,[10] the People's Republic of China ("the PRC"),[11] and Russia,[12] as well as many others. However, certain other jurisdictions, including Canada, the United Kingdom, Hong Kong, and Singapore, broadly permit unauthorized insurers to assume local risks.[13] Other jurisdictions have hybrid regulatory regimes that allow some local risks to be assumed by unauthorized insurers, while subjecting such transactions to regulatory oversight and imposing taxes. In the United States, for example, the insurance laws of every state and territory and the District of Columbia prohibit the conduct of an unauthorized insurance business and provide certain exceptions and exemptions to conducting non-admitted business.[14] Similarly, Australia generally prohibits non-admitted insurance, but provides exceptions that include insurance sold to "high-valued insureds" and insurance covering certain "atypical risks."[15]

The writing of non-admitted insurance is also addressed in the laws of Canada[16] and the United Kingdom,[17] including guidance on the conditions required for carrying on insurance business or assuming risks in those countries by an unauthorized insurer.[18] In these countries, the laws addressing which party is responsible for calculating, collecting, and remitting premium taxes on non-admitted business, as well as how claims may be paid, are well developed.[19] However, in many other countries, insurance laws were designed to regulate domestic and admitted insurers only and do not contemplate the regulation of foreign non-admitted insurers assuming risks located in those countries.[20]

C. Regulatory Trends Affecting Multinational Insurance

Recently, several foreign jurisdictions have begun to take a closer look at their insurance laws and the practices that have developed as the business of insurance, in general, and insuring multinational enterprises, in particular, have matured. Due to the current economic climate and the overall trend in globalization – with the increased marketing of multinational programs by insurers and brokers – laws that have been on the books but ignored for decades are now being revisited. Governments are eager to generate revenue from sources long overlooked, and many historically protectionist measures are being revisited as a reaction to the recent global economic downturn. This revitalized regulatory climate has spawned a number of enforcement activities.

Argentina, for example, has historically prohibited non-admitted insurance. The potential penalties for insuring, issuing, producing, or purchasing policies from an unauthorized insurer may be (i) a fine of up to 25 times premium, payable by the insured and the producer; (ii) a fine of up to US $100,000, payable by the insurance company; (iii) the voidance of the policy; and (iv) individual liability of officers and directors of the insurer and others involved in the transaction.[21]

Recently, Argentine insurance regulatory authorities fined an insured *eight times* premiums paid and a broker *fifteen times* premiums paid for illegally transacting life insurance business with an unauthorized foreign life insurer.[22]

Similarly, Mexican insurance law expressly prohibits a person from entering into an insurance contract with an unauthorized foreign insurer while in Mexico.[23] Mexico's insurance regulator recently publicly reiterated that such transactions violate Mexican insurance laws and constitute a criminal offense, subjecting participants to substantial fines and imprisonment of up to 10 years. This announcement suggests an intention to implement more vigorous enforcement.[24]

D. The Current Product Offering: Challenges and Caveats

Multinational companies demand insurance programs affording coverage of their foreign subsidiaries, affiliates, and joint ventures for several reasons, including, but not limited to: (i) the parent company's ability to assure consistent amounts and types of coverage and risk transfer terms worldwide; (ii) the parent company's ability to control the type and scope of coverage purchased, rather than leaving these decisions to the discretion of managers of their local subsidiaries, affiliates, and joint ventures (who may not be knowledgeable about commercial insurance nor able to assure that the insurance purchased achieves corporate risk management objectives); (iii) the parent company's ability to use its buying power to obtain favorable risk transfer terms and pricing; and (iv) the parent company's ability to obtain consolidated loss information about each of its subsidiaries, affiliates, and joint ventures.

Because of language and regulatory differences, it is generally not possible to ensure that the terms of the local policies are consistent with each other. Additionally, given the significant number of countries and policies often involved in these large programs, the total amount of the limits offered on the local policies can be larger than a single insurer or insurer group would be willing to underwrite (e.g., policies insuring 200 affiliates, with an average limit of US $10 million would result in aggregate exposure of US $2 billion). These large programs may also far exceed the parent company's insurance needs for its worldwide operations and represent a substantial and unnecessary additional cost.

As a result, multinational insurers have typically fulfilled the parent's need for worldwide coverage and consistent limits by offering a master policy to the parent, in addition to local policies. The purpose of the master policy is to fill coverage gaps and to provide consistent limits. For example, assume that a local jurisdiction either does not permit or restricts the amount of insured limits or requires certain conditions for the insurance of certain perils under local policies (e.g., the peril of earthquakes[25]). The master policy may provide expansive earthquake coverage for the property located in such a jurisdiction that is consistent with the needs of the insured. The master policy may also provide limits in excess of the local policies, which frequently do not have the high limits offered under the master policy.

Historically, master policies have generally included the parent and all of its subsidiaries and affiliates around the world as named insureds through a "broad-form" named insured clause.[26] The expectations in this scenario are that one premium will purchase cover for the global exposures of the insured group and that claims not covered by a local policy would be covered by the master policy and paid in the local country.

However, because of increased regulatory and tax scrutiny, the design and implementation of such a master policy may not be defensible in those countries that do not allow non-admitted insurance covering people, properties, or risks located there. Thus, this structure, which is, and has been, the standard insurance practice for at least two decades, may not withstand regulatory scrutiny in many countries, including Argentina and Mexico.

Today, based on recent regulatory actions in Argentina and Mexico and from cases adjudicated in continental Europe[27] and the United Kingdom,[28] assumptions underlying this single "broad-form" master policy have come into question and may now be subject to challenge.

Any sophisticated multinational company seeking comprehensive global coverage – from directors' and officers' liability to environmental risk protection to life sciences – should be aware that a sea change is taking place in the multinational arena. The current "broad-form" master policy implicates greater and broader risks, such as criminal sanctions,[29] than the traditional credit and underwriting risk assumed by the insurers, reinsurers, producers, and insureds participating in the program.

In the future, this sea change will affect the way multinational programs are designed, documented, and implemented. To act prudently and to ensure a level of certainty with respect to the current design of a multinational program and its viability and defensibility in the changing international regulatory forum, considerable thought should be given to obtaining a comprehensive understanding of the regulatory and tax issues that have an impact on multinational programs.

E. Beyond the Question of Admitted vs. Non-admitted Insurance

Today, much of the analysis in the multinational arena focuses on countries that allow or disallow non-admitted insurance. The developments discussed above, however, suggest that the analysis needs to go further to understand and address the roles and responsibilities of each participant in a multinational program and how that participant will be affected.

In the past, insurance and tax regulators in many countries did not have a comprehensive understanding of how their citizens purchased insurance or transferred risk – nor, for that matter, did they actively enforce the existing laws governing such conduct.

The Kvaerner case[30] and reported inquiries subsequently made by tax regulators in Europe and North America highlight the interest in revenue generated from premium taxes and other parafiscal charges. Routine audits of insureds in these countries and other countries and an understanding of how global multi-national programs are currently structured will make the availability of this revenue apparent.

These audits, which follow a fact pattern similar to the *Kvaerner case*, reveal that, although a portion of the total master policy premium was allocated to the subsidiary, neither the subsidiary nor the parent had remitted the appropriate taxes to the revenue authorities of the subsidiary's domicile.[31] The audits uncovered no evidence of the master policy purchased by the parent on behalf of the subsidiaries in the subsidiaries' files.[32] However, the fact that the master policy may not have been delivered in the foreign jurisdiction did not affect the ultimate liability of the subsidiary.

F. Major Countries Where Non-admitted Insurance is Specifically Allowed, and the Conditions to Placement

As noted above, Canada and the United Kingdom generally permit non-admitted insurance. However, the specific regulatory requirements and the obligation to pay the applicable taxes and fees vary between and among the insurer, the insured, and the producer.

In Canada, seven out of ten provinces and all territories do not restrict non-admitted business, while three provinces permit non-admitted insurance only on specific lines.[33] The burden of collecting and remitting the premium tax for such non-admitted coverage initially falls on the Canadian broker.[34] However, depending on the province, the insured is ultimately liable for both the provincial tax on the premium and any tax applied under Canadian federal law for the non-admitted placement. Furthermore, if proper procedures outlined in various Canadian provincial laws are not followed, the Canadian broker may be ultimately responsible for any claims not paid by the non-admitted insurer.[35] In addition, for certain lines of business, the insured is required to use a Canadian-authorized broker to place such risks with an unauthorized insurer, as well as to collect and remit the appropriate provincial and federal taxes and fees. Otherwise, such placement may be unlawful.

In the United Kingdom, however, the law makes it clear that if a non-admitted insurer is not "carrying on" or "effecting" the business of insurance in the UK, local risks may be insured. However, the insurer is liable for the applicable taxes and fees in the UK. The regulation of insurance in the UK focuses on whether the policy is issued in the UK, rather than whether the insured risk is located there.[36]

Thus, even in jurisdictions that permit non-admitted insurance, producers, insureds, and insurers who are not aware of the respective obligations imposed on them by these countries may be exposed to unanticipated regulatory, contractual, and tax liabilities. However, a "broad-form" named insured master policy that does not specifically address the producer's, the insured's, and the insurer's respective obligations in connection with the multinational insurance placement that is effective in these countries may result in such participants assuming the risk that the other participants will not comply with their respective obligations.

G. Cooperation Among International Regulators May Bring Closer Scrutiny

Insurance regulators have recently entered into memoranda of understanding, which formally establish cooperation and information exchange with their international counterparts, to facilitate cross-border enforcement of local insurance laws. The scope of these memoranda of understanding includes an obligation to provide information regarding licensed insurers conducting unauthorized business in another signatory jurisdiction.

In 2007, the International Association of Insurance Supervisors began to promote a Multilateral Memorandum of Understanding among its members.[37] Currently, the insurance regulatory authorities of Australia, Bermuda, France, Germany, the Netherlands, and Taiwan have joined the Memorandum of Understanding, and there are applications pending from a dozen other countries to enter into it, as well.[38]

In the United States, the National Association of Insurance Commissioners has entered into memoranda of understanding and information exchange with the insurance regulatory authorities in Bermuda, Brazil, Egypt, Hong Kong, Iraq, the PRC, Russia, South Korea, Thailand, and Vietnam. In addition, the New York State Insurance Department recently entered into memoranda of understanding with insurance regulatory authorities in El Salvador, Japan, Germany, Macau, the PRC, Taiwan, and the United Kingdom. The Florida Office of Insurance Regulation also entered into memoranda of understanding with insurance regulators in Germany and the United Kingdom.

The overall effect of these memoranda of understanding is to provide regulators with unprecedented access to insurer information through the cooperation of local regulators. Because a foreign regulator may ask the insurer's domiciliary regulator to conduct an investigation on its behalf, multinational insurance purchasers, producers, and insurers must now acknowledge that the inability of a foreign regulator to adequately investigate transactions (and to uncover pertinent information regarding transactions involving non-admitted insurers) may no longer be an obstacle to the vigorous extra-territorial enforcement of foreign insurance laws.

H. Premium Allocation and Reallocation Risk

Another trend calls for additional analysis of today's master policy structure: increased scrutiny by tax authorities to verify and confirm that adequate premium is allocated to local policies and to local risks insured under the master policy and that appropriate taxes have been paid. For example, it has been reported that Belgium, Canada, and France have aggressively pursued tax audits against insureds. Canada has also pursued insurers and insureds with respect to the proper allocation of premiums and commensurate payment of taxes. These audits have focused on the adequacy of allocated premiums and whether the correct amount of taxes, including interest and penalties, has been paid. Some jurisdictions have taken the initiative to reallocate premiums when they believed the allocation was unreasonable for the amount of risk transferred.

I. Claims: Issues to Consider

Many countries do not allow their citizens to purchase insurance from an insurer not authorized to conduct an insurance business in that country. In addition to Mexico and Argentina, France does not allow a non-admitted insurer to cover a French-domiciled person, property, or liability.[39] Sanctions include civil fines and penalties imposed on the purchaser and the threat that the policy will be treated as void. Thus, an insured purchasing a policy from a non-admitted insurer covering a French risk assumes the risk of not having enforceable coverage.[40] In other countries, including Russia[41] and the PRC,[42] there is some doubt regarding the fate of amounts received as claims settlements under unauthorized insurance policies. Claims paid in the normal course of business under a master policy, pursuant to a "broad-form" named insured clause, are subject to confiscation, and criminal penalties may be levied against the recipient of such payments.

Thus, using the current "broad-form" named insured master policy and paying a covered claim under such policy in any one of these countries expose the insurer and the insured to risks that were not generally contemplated when the cover was priced, negotiated, and placed.

> "Many countries do not allow their citizens to purchase insurance from an insurer not authorized to conduct an insurance business in that country."

J. The Recommended Product Offering: Meeting the Needs of Multinationals

In light of the developments outlined in this paper, the use of a master policy with a "broad-form" named insured clause should be carefully scrutinized. Although the "broad-form" master policy was historically designed to eliminate gaps in coverage provided under local policies insuring subsidiaries, affiliates, and joint ventures of multinational companies, this structure appears to no longer satisfy its original objective. Nevertheless, the "broad-form" master policy continues as the primary mechanism for providing insurance coverage to large multinational enterprises. Thus, closer analysis is needed to ensure that risks (other than credit and underwriting insurance risk) are not inadvertently assumed by insureds, producers, and insurers and that the various participants understand their respective obligations to comply with local insurance and tax laws in the various jurisdictions implicated by the program.

Simplifying the master policy and its "broad-form" coverage is an important first step in designing a global program that is defensible and can withstand international regulatory and tax scrutiny. There are no "one-size-fits-all" or "off-the-shelf" solutions for multinational businesses. To address the various regulatory and tax issues and yet provide the buyer with a substantially similar structure and consistent coverage terms, serious consideration should be given to refining the scope of the master policy while providing coverage that is as broad as applicable laws allow.

There are potential solutions that address the insurance demands of multinational enterprises while mitigating the emerging risks to insureds, producers, and insurers implicated by "broad-form" named insured master policies. Removing any of 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 a non-admitted insurer under a master policy will be deemed to be conducting business in those jurisdictions. However, the master policy could insure the parent company's financial interest in such excluded subsidiaries, affiliates, and joint ventures, consistent with laws of the parent company's domicile. This solution may provide coverage and terms that are substantially similar to current "broad-form" master policies while mitigating the risk of being deemed to constitute unauthorized insurance.

Although contrary to current industry practice, based on a comprehensive understanding of the parent company's economic interests in its subsidiaries, affiliates, and joint ventures, and analyzing how such interests may be directly or indirectly insured in Asia, Australia, continental Europe, North America, and the UK, could provide a legally-defensible solution, including coverage and terms that are substantially similar to current "broad-form" master policies.

Adopting this solution addresses many of the challenges outlined in this paper, and promotes the following benefits: (i) premium for insurance under the master policy may now be allocated to one jurisdiction; (ii) applicable taxes and fees under the master policy may now be paid in the jurisdiction in which the master policy is issued; and, (iii) claims covered under the master policy may now be paid to the specific insureds under the master policy. These benefits would effectively eliminate the challenge of allocating master policy premium to countries that disallow non-admitted insurance, and effectively address the challenge of paying a master policy claim in countries that disallow non-admitted insurance.

If designed and administered with compliance in mind, a reformed master policy should withstand legal challenges with respect to providing unauthorized insurance, allocation of premium, and payment of applicable taxes and fees. In addition to directly insuring the parent company and its subsidiaries, affiliates, and joint ventures located in jurisdictions that permit non-admitted insurance under the master policy, local policies issued by locally-admitted insurers would be issued to any subsidiaries, affiliates, and joint ventures in jurisdictions that mandate particular coverages. Such local insurer would underwrite and issue the local policy complying with the local insurance laws and calculate and remit the applicable taxes and fees in connection with such local polices. Claims arising out of such local policies would be adjusted and paid locally.

A solution, which is defensible under English law and a number of other European jurisdictions, is to insure the parent company under a master policy for its financial or economic interest (through its shareholdings or other type of ownership interest) in its subsidiaries, affiliates and joint ventures, rather than to insure those subsidiaries, affiliates and joint ventures directly. The policy would then provide that the parent's loss would be equal to the amount payable, as if the subsidiaries, affiliates and joint ventures were a direct insured. In the United States, a defensible solution is to insure the parent company under a master policy for losses incurred by its subsidiaries, affiliates, and joint ventures. This insurance would cover the parent's ownership interest in such entities or the parent's pre-existing legal or contractual obligation to indemnify such entities and such entities' managers and employees.

III. Conclusion and Toolkit

While there are some efforts within governments to harmonize insurance laws, the European "passport" regime is the only regulatory regime in place that facilitates multinational insurance. In the United States, even if the contemplated national insurance regulation eventually becomes law, it would only harmonize insurance laws within U.S. borders. In fact, the only truly international harmonization has been the agreements among various insurance regulators to cooperate in enforcing their respective insurance laws. Thus, global harmonization of insurance and insurance-related tax laws is not a realistic short-term solution to the problems encountered today in insuring multinational enterprises.

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Because of increased international regulatory scrutiny over cross-border insurance, the use of "broad-form" named insured clauses in master policies implicate nascent risks borne by insurers, producers, and insureds that outweigh the benefits. Therefore, in the evolving regulatory climate, the insurance community must reconsider the traditional multinational policy structure. As discussed in this paper, a multinational policy program can be structured that satisfies clients' demands for consistent coverage, as well as limits for their worldwide operations, while withstanding tax and regulatory scrutiny with respect to unauthorized insurance.

With sufficient knowledge and experience to navigate the regulatory minefield of multinational insurance, a "toolkit" of the relevant questions to ask when structuring and implementing a multinational policy program will result in a more effective and legally sound program – one that is consistent with the participants' needs and expectations. The following is a general list of questions that should be asked in connection with any multinational policy program:

1. Do the countries in which the risk is located allow a non-admitted insurer to underwrite that risk? If the answer is yes, then what are the conditions under which a non-admitted insurer may conduct the business of insurance in that country? In addition, if the country permits risk to be insured by a non-admitted insurer, who is responsible for any applicable premium taxes and other parafiscal charges?
2. The information resulting from that analysis will provide the route to explore whether: (a) obligations are placed on a broker (local or international broker) and (b) whether premium allocated to the risk in such country is subject to an insurance premium tax and other parafiscal charges. If there are such taxes or charges, whether they are to be calculated, collected, and remitted to the applicable local authorities by the insured, the insurer, or the broker needs to be determined.

3. Next, questions concerning the place of payment of premium and issuance of the master policy should be analyzed. Should certain subsidiaries be included as named insureds under the policy, or should the parent or the purchaser of the policy be the only named insured under the master policy? Consequently, where should premiums be calculated and paid? Ultimately, how may claims be adjusted and paid? In countries that strictly prohibit non-admitted insurance, should claims under the master policy relating to a loss in that country be handled by employees of the non-admitted insurer issuing the master policy? Is it more prudent to use a third party administrator, retained by the insured, to work on behalf of the non-admitted insurer to adjust such a claim?
4. Finally, where may claims be paid? Many countries define the conduct of insurance to include the payment of claims, while others are either unclear on the issue or silent. If a claim is paid to the parent under the master policy, will the claim amount attract any taxes if the parent pays such amount to the covered subsidiary or affiliate? If taxes are applicable, further questions about the capital and tax structure of the insured organization may need to be thoroughly examined to clearly understand any potential tax liability of the insured, its subsidiaries, and joint ventures, and how that potential tax liability affects the insurer and the claim amount.

Risk managers and buyers of multinational programs and producers should work with a global insurer that maintains a local presence in the major jurisdictions where multinational enterprises have interests. The insurer should possess the expertise and acumen to understand the issues that affect today's multinational programs. The insurer should also provide buyers with a level of comfort and confidence that their interests are aligned with that of the insurer to ensure that the concerns outlined in this paper will be thoroughly analyzed with superior judgment, and disparate issues will be addressed in a sophisticated and transparent manner.

About the Author:

Suresh Krishnan is General Counsel for the ACE Group's Multinational Client Group, where he has global legal oversight for matters connected with the company's multinational products and services. With more than 18 years of experience in the insurance industry, Mr. Krishnan most recently served as General Counsel of ACE USA. He joined ACE in 1999 and subsequently served as General Counsel of ACE Financial Solutions. Prior to his tenure with ACE, he held various legal positions with the Gerling Group and the Swiss Re Group. Mr. Krishnan received his Bachelor of Arts degree from Colgate University and a Juris Doctor degree from the University of Richmond School of Law.

[1] See Nat'l Ins. Consumer Protection Act of 2009, H.R. 1880, 111th Cong. § 101 (2009). See also U.S. Dep't of the Treasury, Financial Regulatory Reform—A New Foundation: Rebuilding Financial Supervision and Regulation (Jun. 17, 2009) available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/testimony_-_treasury.pdf (last visited April 16, 2010).

[2] See Council Directive 2005/68/EC, 2005 O.J. (L 323) 1 (concerning reinsurance); Council Directive 2002/13/EC, 2002 O.J. (L 77) 17 (concerning solvency margin requirements for non-life insurance undertakings); Council Directive 2002/83/EC, 2002 O.J. (L 345) 1 (concerning life assurance); Council Directive 2002/13/EC, 2002 O.J. (L 77) 17 (concerning solvency margin requirements for non-life insurance undertakings); Council Directive 2001/17/EC, 2001 O.J. (L 110) 17 (concerning the reorganization and winding-up of insurance undertakings); Council Directive 91/674, 1991 O.J. (L 374) 7 (concerning the annual accounts and consolidated accounts of insurance undertakings); Council Directive 73/239/EEC, 1973 O.J. (L 228) 3 (concerning the taking-up and pursuit of the business of direct insurance other than life assurance); Council Directive 73/240/EEC, 1973 O.J. (L 228) 20 (abolishing restrictions on freedom of establishment in the business of direct insurance other than life assurance).

[3] Amended Commission Proposal for a Directive of the European Parliament and of the Council on the Taking-up and Pursuit of the Business of Insurance and Reinsurance, 2008 O.J. (COM) 119 available at http://ec.europa.eu/internal_market/insurance/docs/solvency/proposal_en.pdf (last visited Feb. 12, 2010).

[4] In the United States, the McCarran-Ferguson Act requires that the "business of insurance" be primarily regulated at the state and territorial level. 15 U.S.C. §§ 1011-1015. See, e.g., N.Y. C.L.S. Ins. Law § 1113; Cal. Ins. Code §§ 100-124.5.

[5] See, e.g., Cal. Ins. Code § 700 (license requirement to transact insurance business); Cal. Ins. Code § 1861.05 (regulation of rates); Cal. Ins. Code § 381 (required content of policies); Cal. Ins. Code § 1631, et seq. (licensing of agents and brokers); Cal. Ins. Code § 790.03 (prohibition on unfair methods of competition or unfair and deceptive practices); Cal. Const. art. XIII § 28 (authority to tax insurance premiums); Cal. Ins. Code § 995.5 (authority to tax insurance premiums); Cal. Rev. & Tax. Code § 12201, et seq. (authority to tax insurance premiums); N.Y. Ins. Law § 1113(a) (license requirement to transact insurance business); N.Y. C.L.S. Ins. § 2305 (regulation of rates); N.Y. C.L.S. Ins. § 2301 (regulation of policy forms); N.Y. C.L.S. Ins. §§ 2102 - 2106 (licensing of agents and brokers); N.Y. C.L.S. Ins. § 1313 (regulation of contents of advertisements and other public announcements concerning financial condition of insurers); N.Y. C.L.S. Ins. § 2403 (prohibition on unfair methods of competition or unfair and deceptive practices); N.Y. Tax Law § 1501, et seq. (authority to tax insurance premiums).

[6] Argentina—Section 2 of Law No. 12,9888 and Section 23 of Law No. 20,091 provides that only insurance companies approved by the Superintendent of Insurance of Argentina may insure risks in Argentina.

[7] Brazil—Coverage of risks located in Brazil is regulated under Article 6 of Decree-law No. 73/66, which only permits placement of insurance and reinsurance abroad when coverage is not available in Brazil or coverage thereof is not convenient to the national interests. When insurance is placed with non-admitted insurers, according to articles 44, I, "d", and 81, of Decree-law no. 73/66, the Brazilian Reinsurance Institute (IRB) is responsible for intermediating and promoting placement abroad of insurance and reinsurance where such insurance is not available in the domestic market. An insured may not turn to the non-admitted market until after it has obtained either 10 declinations or, if there are not 10 domestic carriers in that line of business, a declination from each local insurer in that business.

[8] France—Art. L. 310-10 of the French Insurance Code generally prohibits foreign insurers from issuing contracts (souscrire) of direct insurance covering the "risk" of any person, property or liability located in France other that those foreign insurers permitted to insure such risks pursuant to Article L.310-2 of the Code. Permitted foreign firms include companies headquartered in France or in another EU member state or companies located outside of the EU that engage in authorized insurance activities through their permitted establishments in France. Consequently, a US insurer without a duly-authorized establishment in France would not be permitted to insure French risks.

[9] India—Proviso 3 of Section 2C (1) of the Insurance Act of 1938 provides that no insurer other than and Indian insurance company can carry on any class of insurance business in India on or after the commencement of the Insurance Regulatory and Development Authority Act of 1999. Furthermore, there is a requirement of registration under Section 3 of the Insurance Act of 1938, which provides that no person can carry on the business of insurance in India unless it has obtained from the Insurance Regulatory and Development Authority a certificate of registration. Regulation 3(i) of the Foreign Exchange Management (Insurance) Regulations of 2000 provides that (a) a person resident in India may take or continue to hold a general insurance policy issued by an insurer outside India; provided, that the policy is held, under a specific or general permission of the Central Government or (b) a person resident in India may continue to hold any general insurance policy issued by an insurer outside of India when such person was resident outside India. Furthermore, Regulation 5 of the Memorandum of Exchange Control Regulations, relating to the General Insurance in India (issued by the Reserve Bank of India vide AP (DIR Series) Circular No. 18) (Sept. 12, 2002) provides that persons, firms, companies and others resident in India cannot take insurance cover of any kind with insurance companies in foreign countries without the prior permission of the Reserve Bank of India. Further, permission of Government of India under General Insurance Business (Nationalisation) Act of 1972 is also required to be taken in such cases.

[10] Italy—Non-EU insurers may not operate in Italy under the freedom of services regime and may only underwrite risks in Italy if they have an establishment authorised by the Italian Regulatory Authority - ISVAP (Section 28 of the Legislative Decree 7th September 2005 N. 209.). Unlike EU insurers operating under the freedom of establishment regime, such establishment must meet capital requirements and have assets located in Italy.

[11] The restrictions are derived from Article 7 of the PRC Insurance Law, which requires all the entities and organizations in China to obtain the insurance from insurance companies that are established in the PRC. Moreover, the similar restrictions are imposed on foreign-invested companies by Article 9 of the PRC Sino-Foreign Equity Joint Venture Law, Article 16 of the PRC Wholly Foreign Owned Enterprise Law and Article 18 of the PRC Sino-Foreign Cooperative Joint Venture Law.

[12] Russian Federation—Article 4.1(2) of Federal Law No. 4015-I of 27 November 1992 on the Organization of Insurance Business in the Russian Federation provides that only insurers and, in most circumstances, reinsurers that are licensed to conduct an insurance business in Russia are permitted to insure any risks located in the Russian Federation. See also Article 6(2) of Federal Law No. 4015-I. In addition, Article 4(5) of the Insurance Law of the Russian Federation also provides that insurance (other than certain reinsurance under certain circumstances) covering legal entities and individuals that are domiciliaries or residents, as the case may be, of the Russian Federation may be only issued by duly licensed insurers.

[13] Such countries include Canada and the United Kingdom, which are discussed in Section II(F) of this memorandum. In addition, Singapore broadly permits unauthorized insurance. See Part IIA of the Singapore Insurance Act (Chap. 142). In Hong Kong, there is no explicit provision which prohibits an unauthorized insurance company which underwrites multinational policies from assuming Hong Kong risks. However, a company that wishes to carry on insurance business in or from Hong Kong must still be authorised under Section 8 of the Insurance Companies Ordinance (Chap. 41).

[14] See, e.g., Fla. Stat. §§ 626.901 - 626.903; 215 Ill. Comp. Stat. 5/121 - 5/121-19; N.Y. Comp. Codes R. & Regs. tit. 11, §§ 27.0 - 27.23; Pa. Stat. §§ 40-15-101 - 40-15-125; Tex. Ins. Code Ann. arts. 101.001 - 101.301.

[15] See the Insurance Act 1973 (Cth), as amended by the Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007. A "high-value insured" is a corporation, partnership or trust (either as a single entity or a group of related entities) that has (i) total group gross operating revenue in Australia of AU$200 million or more, (ii) total group gross assets in Australia of AU$200 million or more or (iii) total group employees in Australia of 500 or more: regulation 4B Insurance Regulations 2002 (Cth). An "atypical risk" is a risk coving loss or liability arising from the hazardous properties of nuclear material, war, terrorism, satellite or space, biological risk, medical clinical trials, aviation liability, ship owners' protection and indemnity (other than for pleasure crafts), equine mortality or fertility and any loss or liability incidental to any of those risks. Id. at 4C.

[16] Canada – Section 4(1) of the Excise Tax Act, R.S.C. 1985, c. E-15 contemplates the purchase of insurance with an insurer not incorporated under the laws of Canada or of any province subject to the payment of a tax on net premiums paid.

[17] United Kingdom - Section 19(1) of the Financial Services and Markets Act 2000 contains a general prohibition against carrying on regulated activities in the UK without authorisation. The regulated activities, as set forth in Regulated Activities Order 2001, include effecting "and carrying out" contracts of insurance.

[18] See, e.g., note 17 supra.

[19] For example, in British Columbia, Canada, Section 76 of the Financial Institutions Act, R.S.B.C. 1996, c. 141, outlines the respective roles of the insured and the broker.

[20] For example, Section 17 of the Thai Non-Life Insurance Act B.E. 2535 (1992) provides that "no person shall act as insurer by entering into a non-life insurance contract with any other person unless he has obtained a license to engage in non-life insurance business under this Act." There is no provision under Thai law prohibiting a Thai insured from entering into an insurance contract with a foreign insurance company or an unlicensed insurance company. However, a person who would like to carry on an insurance business in Thailand is required to obtain a license; otherwise such person will not be allowed to engage in insurance business in Thailand. This is because the focus of the Act is only applicable to Thai insurance companies or foreign insurance companies having a branch office in Thailand. See also Hong Kong, note 13 supra.

[21] See Section 2 of Law No. 12, 9888 and Section 23 of Law No. 20,091 (only insurance companies approved by the Argentine Superintendent of Insurance may insure persons or assets domiciled in Argentina.)

[22] Decree No. 560/2009, Argentine Ministry of the Economy and Public Finance (May 15, 2009).

[23] In Mexico, Article 1, General Law of Insurance Institutions and Mutual Companies published in the Federal Gazette (Diario Oficial de la Federación) on August 31, 1935 with the later amendment on July 18, 2006 provides that only approved insurance institutions may engage in insurance-related activities.

[24] "Evite Comprar Seguros Foraneos; Podria Ir a Prision," economia.terra.com (Sept. 9, 2009).

[25] In Japan, for example, earthquake insurance coverage is not permitted as a stand-alone policy, and is only permitted as part of fire coverage. Item 3 of Paragraph 2 of Article 2 of the Act on Earthquake Insurance (Act No. 73 of 1966); Paragraph 2 of Article 1 of the Ordinance for Enforcement of the Act on Earthquake Insurance (Ordinance of the Ministry of Finance of Japan No. 35 of 1966).

[26] A "broad-form" named insured clause generally includes a parent company's current and future subsidiaries, affiliates and joint ventures and named insureds, subject to certain threshold limitations, unless insurance is otherwise specifically provided for such entities.

[27] Case C-191/99, Kvaerner plc v Staatssecretaris van Financiën, 2001 E.C.R. I-4447, [2001] STC 1007. In this case, Kvaerner plc, a UK company, purchased professional indemnity insurance, worldwide umbrella insurance and worldwide catastrophe insurance from a UK insurer. The insurance policies provided that the named insured is "Kvaerner plc and/or its subsidiaries and/or associated companies as instructed by the policyholder" and Kvaerner plc included its Dutch subsidiary in the cover. The Netherlands tax authorities brought an action against Kvaerner plc to collect premium taxes in connection with the coverage. The European Court of Justice ruled that a European member state may charge insurance premium tax on a premium relating to the insurance of a subsidiary company established in that state. The court concluded that the tax is owed regardless of whether an intra-company payment of pro-rated premium is made.

[28] DSG Int'l Ins. Services Ltd. v HMRC (2007) IPT 0013 (DSG). In this case, DSG International Insurance Services ("DSG"), an Isle of Man company, provided insurance to another Isle of Man company, ASL Serviceplan Limited ("ASL"), which in turn sold service contracts to a UK retailer's customers covering products that the customers purchased. The policy indemnified ASL against claims being made by the UK retailer's customers in the UK. HM Revenue and Customs attempted to collect premium taxes from DSG. The UK's VAT and Duties Tribunal applied the precedent established by Kvaerner regarding the location of the risk and held that it would be necessary to ascertain the location of the activities covered by the policy.

[29] See note 24 supra and notes 40, 41 and 42 infra.

[30] See note 27 supra.

[31] See note 27 supra. In the Netherlands, non-admitted insurance is not permitted and if a non-admitted insurer assumes Dutch risks, the premium tax payable on premium allocated to that risk is to be paid by the Dutch insured, not the non-admitted insurer. Article 2:27 of the Act on Financial Supervision prohibits any party having its seat in the Netherlands to perform the business of a life or non-life insurance company in the Netherlands without a license from the Dutch Central Bank. Moreover, Article 2:75 of the Act on Financial Supervision prohibits any party to advise on financial products, including insurance, in the Netherlands without a license from the Dutch Authority for Financial Markets. In addition, Article 2:80 of the Act on Financial Supervision prohibits any party from performing intermediary activities in the Netherlands without a license of the Dutch Authority for Financial Markets and Article 2:92 prohibits any party from acting as an authorized agent or delegated authorized agent in the Netherlands without a license of the Dutch Authority for Financial Markets.

[32] One reason for the subsidiary not having the master policy in its files is because the policy was issued in the parent's domicile, with a "broad-form" named insured that included the subsidiary as an additional insured. It was, and is, customary for the foreign named insured not to receive copies of the master policy, because the insurer underwriting the master policy will typically not be licensed in the country of the foreign named insured.

[33] The Provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec and Newfoundland and Labrador, and the Yukon, North West and Nunavut Territories do not restrict non-admitted business. The Provinces of New Brunswick, Nova Scotia, and Prince Edward Island permit non-admitted insurers to only insure certain lines of business.

[34] As examples, in Ontario, Section 10(1) R.R.O. 1990, Regulation 991 of the Registered Insurance Brokers Act and in New Brunswick, Section 355(1)-(4) Insurance Act, R.S.N.B. 1973, c. I-12Insurance Act, R.S.N.B. 1973, c. I-12 both place the onus of the collection and remittance of premium tax for non-admitted coverage on the insurance broker.

[35] As an example, Section 396 of the Ontario Insurance Act provides that a broker is personally liable to insureds on all contracts of insurance unlawfully made by or through the broker with a non-admitted insurer in the same manner as if the agent or broker were the insurer. Similar provisions are found throughout the various provincial insurance acts.

[36] Section 19 FSMA 2000 prohibits any person from carrying on a regulated activity in the UK unless they are authorised or exempt. Article 10(1) of the Regulated Activities Order includes effecting and carrying out a contract of insurance.

[37] Int'l Assn. of Ins. Supervisors, Multilateral Memorandum of Understanding on Cooperation and Information Exchange (Feb. 2007) available at *http://www.iaisweb.org/__temp/IAIS_MMoU.pdf* (last visited April 16, 2010).

[38] Int'l Assn. of Ins. Supervisors, website available at http://www.iaisweb.org/index.cfm?pageID=605 (last visited April 16, 2010).

[39] See footnote 8 supra.

[40] The French Insurance Code does not specifically prohibit a non-admitted insurer from paying a claim on a French policy. However, the making of such payment (a principal element of an insurance policy) risks being deemed by French regulatory authorities and courts to constitute the unauthorized practice of regulated insurance activities in France (Art. L. 310-2 III). Moreover, the violation of Art. L. 310-10 and L. 310-2 of the Code may constitute criminal offenses. However, insurance policies issued by non-admitted insurers are enforceable in France to the extent that the insured acquires the policy in good faith. Consequently, according to Art. L. 113-5 of the Code, the insurer may, nevertheless, be held responsible for performance under the policy. However, an insured that knowingly purchases a policy from a non-admitted insurer covering a French risk assumes the risk of not having enforceable coverage and the insurer assumes the risk of incurring criminal and civil penalties.

[41] Under Article 14.1 of the Administrative Code of the Russian Federation, the conduct of an insurance business in the Russian Federation without the necessary licence may expose the insurer to administrative sanctions in the form of monetary fines (up to RUB 50,000) or the "confiscation of the manufactured product, equipment and raw materials." Moreover, pursuant to Article 171 of the Criminal Code of the Russian Federation, the individuals involved in the conduct of such unlicensed activity may be subject to criminal sanctions. In addition, the policy may be invalidated by a court upon the claim of the insurer itself, a shareholder of the insurer or the Federal Service for Insurance Supervision; provided, that it is proved that the insured knew or should have known that the insurer was conducting such business without a licence. The effect of such voidance is that the insurer will be ordered to return to the insured any premiums paid in respect of the policy and the insured will be ordered to return to the insurer any claims payments made by the insurer.

[42] Where a policy is in fact issued by a non-admitted overseas insurer and it is held to constitute the illegal transaction of insurance in the PRC, based on the particular facts and circumstances, pursuant to Article 159 and Article 181 of the PRC Insurance Law, the following sanctions may be imposed: (a) confiscation of illegal income; (b) a fine equivalent to more than one time but less than five times the illegal income; or a fine ranging from RMB 200,000 to RMB 1,000,000 if no illegal income is generated or if the illegal income is less that RMB 200,000; and (c) criminal liability (if any).

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