BFL MAKES A DIFFERENCE

The Cover Note

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EDITORIAL

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With the globalization phenomenon, Canadian companies are spreading their wings more and more, doing business all over the world, building plants overseas, providing services internationally. And as is the case with each new opportunity, this expansion also comes with new challenges.

Multinational companies need to know how to deal with other jurisdictions relative to all aspects of their business.

Insurance is no exception. However, in this respect, not all multinationals receive the professional advice they need to meet regulatory requirements of the various jurisdictions under which they operate. This is also true of foreign companies doing business in Canada (globalization applies both ways).

Regulators around the world, including in Canada, have become very diligent at enforcing rules where just a few years ago non compliance was tolerated and sometimes not really monitored. In addition, many countries have introduced or are considering the introduction of new rules.

The rules set out by local jurisdictions are designed to achieve a variety of objectives including protecting their citizens, controlling the flow of their currency and/or optimizing their tax revenues. And while these objectives are justified or even necessary in many or all instances, the complexities posed by the abundance of regulation is real for multinational clients (Canadian and foreign) who have to deal with them on a daily basis.

In addition, it is not uncommon to hear from such multinational clients that their insurance program is being audited by tax authorities.

The structure of your program, the insurers on risk, the brokers involved and the instructions you provide all contribute to ensuring you are compliant with regulatory requirements. And if you are not, then it should be by choice, not due to lack of information and proper guidance.

And with the level of competition in most fields, you certainly wouldn't want your company to miss out on good business opportunities because of an insurance problem. On several occasions, our firm has met new clients under such circumstances; their insurance brokerage firm was not sufficiently experienced with multinational accounts nor could it rely on a sound international network to implement the solutions their circumstances required.

BFL CANADA has recently nominated a Global Business Leader to work with multinational client accounts to ensure that their programs are structured and managed optimally with respect to regulatory requirements relative to insurance and related tax issues. This new Global Business Leader, Penny Dyte, has been dealing with multinational accounts large and small for many years and will act as a resource to our own brokers placing business internationally, as well as to foreign brokers using our services to place business in Canada.

In our feature article, Penny addresses some of the issues most commonly faced by multinational clients on their insurance portfolio. And on the benefits side, Tom Guay discusses multinational pooling. ♦

GLOBALIZATION, MULTINATIONALS AND INSURANCE

Penny Dyte, Managing Vice President and Global Business Leader
BFL CANADA Insurance Services Inc., Calgary

Business models have evolved with globalization. It is not uncommon for companies to decide that the environment is right for acquiring, starting a new operation or moving into a joint venture arrangement in another country. Or, a Board may decide that they have run out of room to work within their own capitalization and borrowing power and are courting foreign investment in the company or some operations of it here in Canada.

Such transactions are planned thoroughly including analysis and measurement of the **top 10 risks generally known:**

1. **Diversification Risk**
2. **Political Risk**
3. **Legal Environment Risk**
4. **Economic Risk**
5. **Credit Risk**
6. **Interest Rate Risk**
7. **Commodity Pricing Risk**
8. **Foreign Exchange Risk**
9. **Repatriation Risk**
10. **Cultural Risk**

What a tangled web companies must now weave in order to achieve economic advantage.

Insurance products to mitigate some of the foregoing risks are certainly available, and have been for some time: protection against some political risks, confiscation, contract frustration, credit risk and even interest rate fluctuation, currency fluctuation and foreign exchange exposures can find a partial solution in the insurance market place. After all, insurance companies are truly financial institutions with capacity and appetite for balancing risk with reward. They are always willing to consider and weigh risk factors and, ultimately, it is your decision to mitigate internally or externally but the insurance market continues to be a place of creative and sound potential.

However, diversification/globalization has become a much debated issue as we look at whether "going global" is really diversifying risk. More organizations are dependent on outsourcing and international supply chains to get projects completed on schedule and within budgets. Most of this reliance is in China and India, for example, for manufacturing and IT, respectively. Outsourcing, whilst cost effective in concept, has proven to be fraught with hidden costs in the supply chain management of products, goods or services. When something is delayed in production, there can often be an endless chain of suppliers where any one can affect the result. Risk assessments are done but lack execution and an ability to monitor transactional costs: vendor delays, poorly defined contract scope, poor vendor management, a lack of best practices, no accountable overall project manager…and the list goes on. (Source "National Underwriter P&C, September 01, 2010, by Caroline McDonald, Property Casualty 360).

So, let's add another evolving risk to our list of 10, above:

11. Supply Chain Management Risk

Insurance-wise, for 2011, the spotlight is going to be on two areas of international insurance regulation. Whether entering the physical business environment in a foreign jurisdiction or simply designing a risk management program that entails the use of international insurance capacity, it will be important to watch the repercussions of a tough economic transition in the insurance industry. The two areas to which I refer are; Solvency II, which holds an industry-wide agenda for 2011, as it moves to implementation at the end of 2012 [FSA's website states that the EU directive is due to be implemented on 1 November 2012] and, secondly, the struggle of insurers with the revised industry accounting standard expected in July of this year.

With respect to the former, the rationale for European Union insurance legislation is to facilitate the development of a Single Market in insurance services in Europe, whilst at the same time securing an adequate level of consumer protection. Many Member States have concluded that the current EU minimum requirements are not sufficient and have implemented their own reforms, thus leading to a situation where there is a patchwork of regulatory requirements across the EU. This hampers the functioning of the Single Market and makes financial supervision of the Market unmanageable.

While the Solvency I Directive was aimed at revising and updating the current EU Solvency regime, Solvency II has a much wider scope. A solvency capital requirement may have the following purposes:

- To reduce the risk that an insurer would be unable to meet claims;
- To reduce the losses suffered by policyholders in the event that a firm is unable to meet all claims fully;
- To provide early warning to supervisors so that they can intervene promptly if capital falls below the required level; and
- To promote confidence in the financial stability of the insurance sector.

The proposed Solvency II framework has three main areas (pillars):

Pillar 1 consists of the quantitative requirements (for example, the amount of capital an insurer should hold).

Pillar 2 sets out requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers.

Pillar 3 focuses on disclosure and transparency requirements.

This is not just the case in the EU. In fact there are reforms taking place around the World, In fact, here in Canada, we saw the Office of the Superintendent of Financial Institutions Canada (OSFI) come out with an edict on January 1, 2010, which changed the way that insurers were to operate in Canada. This has led to a heightened discussion at the Canadian Revenue Agency (CRA) on how unlicensed insurance is dealt with in Canada. OSFI has felt, and continues to be concerned about, weaknesses in regulation and supervision in the insurance industry, where there is a general mistrust by regulators, worldwide, that the global financial crisis may have introduced more risk into the system with insurers faring better than banks.

Now, more reform is expected. In August of 2010, OSFI released a DRAFT guideline on “Guidance for Reinsurance Security Agreements”, wherein OSFI will require ceding companies to negotiate and enter into suitable arrangements and to take all necessary practical and operational measures to create and maintain a valid and enforceable first-ranking security interest. At the core is the desire of OSFI to bring more transparency, create fairness between domestic and foreign reinsurance entities, provide more similarity for capital credits charges between life reinsurance and that of the P&C reinsurance sector and lead to Canada making further changes in line with other jurisdictions.

The Canadian Underwriter magazine announced on January 5, 2011, “OSFI publishes final Guideline B-3 on reinsurance practices”, which sets out four principles that should be incorporated into an insurer’s overall reinsurance risk management policy. The risk principle, approving a reinsurance risk management policy, is required by July 1, 2011 with the remaining three principles to be compliant by July 1, 2012:

1. "The level of a FRI's due diligence on any reinsurance counterparty should be commensurate with its level of exposure to that counterparty."];
2. The terms and conditions of the reinsurance contract should provide clarity and certainty on reinsurance coverage; and
3. A ceding federally regulated insurer (FRI) should not be adversely affected by the terms and conditions of a reinsurance contract.

In other words, you do not have to worry only about risks abroad, there are some here at home as well. Is your program compliant? Fortunately OSFI does an excellent job.

Moving outside of Canada and the EU, there is more: Columbia – instituted the Financial Reform Bill under Law No 1328, Democratic Republic of the Congo - is awaiting new insurance legislation and the new Code des Assurances has been drafted but is awaiting approval and Guatemala – brought in new law that requires the Banking Superintendency (Superintendencia de Bancos – SIB) to issue some 25 regulations and procedures – to name a few and to give you a sense of the emergence of yet another risk under the heading of “Going Global”:

12. Regulation, Tax, Fines, Penalties and Compliance.

Where does it begin and when does it end?

Now, more than ever, you need an independent insurance broker who can be flexible and knowledgeable. Not just to present product offerings toward the mitigation of the top 12 risks, but now also one that can manage your interests with dedicated attention and concern for compliance. If you simply rely on your insurance company for this guidance, it may be the thing of the past for, as you can now see.... they are just a little busy getting their houses in order for the onslaught of regulation procedures and compliance for which they, themselves, need to prepare. ♦

Multinational Pooling

Thomas Guay, President
BFL CANADA Consulting Services Inc., Montreal

The development of global business has led to new challenges for multinational corporations in designing Employee Benefit plans that meet local regulations, are competitive in both cost and design and meet the differences in expectations from country to country.

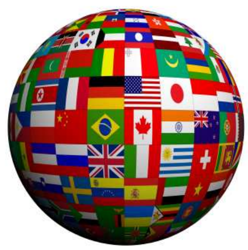
Global businesses have turned to multi-national pooling arrangements to reduce their overall benefit cost. Multinational pooling is a system under which the group insurance plans of local subsidiaries of a single company operating in various countries are pooled together for the purpose of reducing their risk charges on a world-wide basis. This is accomplished through the process of experience rating the pool, under which the local benefit plans are assessed as a single group for underwriting purposes.

A multinational pooling account is essentially a second stage accounting of insured employee benefit plans at the international level. Such a process introduces the application of administration and risk charge retentions which are based on an accurate assessment of costs incurred in insuring a given group of employee benefit risks internationally. This approach means that ingoing premium levels do not necessarily represent the cost of a given plan. In many cases the real or net cost will be much less, depending on the level of insured claims experience.

This type of arrangement brings together insured benefits (Life Insurance, Accidental Death & Dismemberment, Long Term Disability and Excess Medical Benefits) which have been set up locally. Premiums are paid by the subsidiaries on a purely local basis, and claims are settled by the local insurers on a purely local basis. At the end of each experience year the local insurers involved in a given multinational pooling account will submit the results of the local plans to the international underwriter showing amounts held, received and paid in respect of those plans.

Then, a multinational account is drawn up showing premiums paid minus claims, minus the insurer's risk retention and administration charge. This account also takes into consideration other items such as reserves, interest, non-rated premiums, local taxes, local dividends and commissions.

If the experience of the pool is favourable, then there will be a surplus in the multinational account, payable to the client. By combining the local benefit plans into one pool, a multinational employer can take advantage of combining the global experience of its local plans for experience rating purposes. This allows for a reduction in the multinational employer's risk charges as the employer is able to spread the risk of adverse experience over a larger group.



Estimates by advisors on multinational pooling suggest that over a period of 5 years, an 8% to 15% reduction of local premium costs can be achieved. In years of good experience, dividend percentages can be substantial, even reaching 80% to 90% of risk premiums paid. In addition, such pools help Multinational employers achieve a reduction in the overall cost of their local benefit plans without reducing the benefit levels.

With these structures, multinational employers will receive enhanced reporting regarding the overall costs and performance of their global plans, thus allowing for more effective management of the plans.

In addition, by receiving detailed financial reports on a regular basis regarding the operation of the pool, a multinational employer will be able to identify any problem areas, such as cost escalation or claims incidence in a local benefit plan, which will allow for steps to be taken to remedy the situation.

As for coverages that do not form part of a pooling arrangement, several insurance companies offer program reporting, which is information on local benefit plans, including non-insured retirement plans and funds, premiums and claims for risk and medical plans and details on other non-pooled arrangements.

Most network providers require a minimum of 250 employees insured in at least two countries for underwriting a multinational pool. ♦

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