

EMERGING MARKETS



How to manage the risks
of global expansion

BUSINESS INSURANCE
WHITE PAPER

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INTRODUCTION

Emerging markets have been big business for U.S. companies in recent years, and that growth — briefly set back in some places by the financial crisis — is likely to continue.

U.S. direct foreign investment in South America nearly doubled to \$148.4 billion in 2011 from \$76.8 billion in 2001, with Brazil and Chile accounting for the lion's share of the growth. Direct investment in the Asia/Pacific region jumped to \$605.2 billion in 2011 from \$227.4 billion in 2001, with developing economies in China, India, Indonesia, Malaysia and Thailand accounting for almost 20% of the totals, according to U.S. Department of Commerce statistics.

Risk managers whose companies are expanding into emerging markets have a lot to contend with, though.

First, they need to understand the culture, customs, regulatory environment and legal systems of the countries in which they will be operating, all of which affect risk management and insurance programs.

Many countries, for instance, require local risks to be insured by local admitted insurers, a potential complication for multinationals with global property/casualty programs.

Property can't always be protected using the same highly protected risk standards followed in the U.S., and owners have to work around problems with older, existing buildings and shortcomings in water and electrical infrastructure and roads.

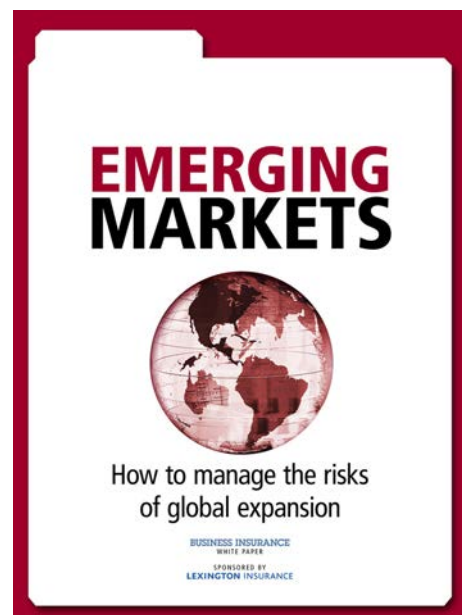
Liability risks, while not historically a huge worry in emerging economies, are becoming a greater concern as the middle class in many countries expands and as health and safety expectations grow with it.

Increasingly sophisticated lawmakers and regulators in emerging markets are taking on environmental risks, passing new laws and rules to limit pollution and assign financial responsibility for cleanups. Enforcement of the rules is tightening.

Directors and officers face a different landscape in many emerging market countries, where private securities lawsuits are rare but regulatory and criminal actions are not. Executives can find themselves personally liable — and even under arrest — for acts that would not be considered criminal and that would be attributed to the corporation in the U.S.

Then there is the array of other exposures to consider, from government confiscation of company property to executive travel and accident risks.

This *Business Insurance* white paper will examine these and other issues companies face in expanding into emerging markets.



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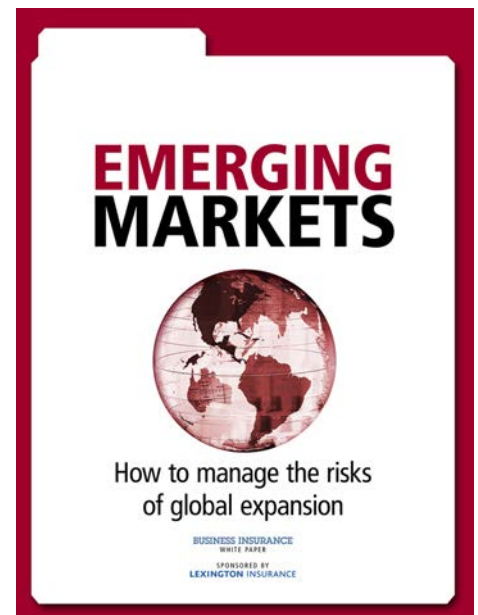
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CHAPTER 1

Risk management in emerging markets

COMPANY EXPOSURES, OVERSEAS TAX REGULATIONS NEED CONSIDERATION

Risk managers grappling with how to structure an insurance program for emerging markets risks have to consider many factors, including the complexity of their own exposures and the regulatory and tax regimes of the countries they're dealing with.

A U.S. multinational, for example, may buy a global property or liability policy written by a U.S. insurer that is intended to cover its worldwide risks. A number of Latin American and Asian countries, though, require local risks to be underwritten by locally admitted insurers and are increasingly intent on collecting taxes attributable to coverage for local risks.

A global policy written by a U.S. insurer, therefore, may not be in compliance with local laws and may subject the policyholder to fines and penalties. Failure to remit premium tax on the portion of a global policy's premium that is attributable to a local foreign risk also may expose the policyholder to penalties.

Emerging market countries that generally prohibit nonadmitted insurance include Argentina, Brazil, China, India, Mexico and Russia.

Claims payments made under a nonadmitted global policy also may raise tax issues. A foreign country's laws may prohibit a nonadmitted insurer from providing claim services or making claim payments to a local entity, noted a 2012 analysis by AIG Property Casualty, formerly known as Chartis. If a claim is paid instead to the parent company — which did not directly suffer the loss — the payment may be considered taxable income to the parent. If the parent then remits an equal amount to the foreign subsidiary to compensate it for the loss, foreign tax authorities may consider it a taxable capital contribution rather than a claim payment, the analysis notes.

Parent companies may opt to avoid these compliance and tax issues simply by buying local admitted policies in the various countries where they have operations. This means the policies will meet local regulatory requirements, follow local industry practices and allow access to local reinsurance pools.



WHERE THE MONEY GOES

Amount invested by U.S. companies in foreign affiliates, 2011, in millions of dollars*

South America

Brazil	\$71,101
Argentina	\$13,309
Chile	\$34,187
Venezuela	\$12,110
Total	\$148,386

Mexico

\$91,402

Asia/Pacific

China	\$54,234
Hong Kong	\$52,542
India	\$24,663
Indonesia	\$11,591
Malaysia	\$13,903
Philippines	\$5,321
Thailand	\$11,308
Total	\$605,202

Russia

\$9,733

All countries

\$4,155,551

*Historical cost basis

Source: U.S. Department of Commerce, Bureau of Economic Analysis

The nature of a company's overseas business also plays into a decision on whether to buy local policies. A U.S. parent may be more inclined to buy local coverage, for example, if it owns a large overseas factory or other real property, operates an auto fleet in a foreign country, or manufactures a dangerous or high-profile product.

Buying locally, though, can cede control of insurance placement and claims management to a company's overseas subsidiaries.

Large multinationals with extensive overseas investments may want to retain that control centrally, and may opt instead for a hybrid type of coverage known as a controlled master program.

In a controlled master program, a global insurer's network of overseas subsidiaries or partners issues local policies wherever a multinational may need them. The insurer also issues a global policy in the parent's home country, either reinsuring the local policy or providing excess difference-in-conditions/difference-in-limits coverage to fill in if the local policy's terms don't cover a loss or if the local policy limits are insufficient.

In cooperation with companies' risk managers and brokers, the insurer normally is responsible for making sure coverage complies with local requirements and is responsible for allocating premium and arranging for local claims adjusting.

Whether a CMP makes sense again depends on a company's size and the nature of its business, said Erik Nikodem, property executive, United States and Canada region at AIG.

If a company owns no property overseas and has stock or machinery in only one or two countries, a CMP is probably unnecessary, and the risk can be handled with local admitted policies or nonadmitted coverage, depending on local requirements, he said.

There are two schools of thought about how to handle a CMP, added Jeff Beauman, vice president of all-risk underwriting with Johnston, R.I.-based FM Global. One seeks to minimize local costs, centralizing insurance buying at the corporate level to control costs; the other focuses on local compliance issues and ensuring local claims payments.

FM Global, which can provide local coverage in 120 countries, advises the latter, Mr. Beauman said.

When a property loss occurs, a policyholder wants money available quickly to start repairs, and that's much easier if the source is local, he said, adding that claim payments from outside a country might trigger scrutiny under anti-money-laundering laws.

"You don't want the delays of trying to import large amounts of cash, particularly in a country that has money-laundering laws and may be quite skeptical of that," he said.

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Jeff Beauman,
FM Global

CHAPTER 2

Overseas property risks pose a challenge

STRIVE TO EXPORT RISK MANAGEMENT CULTURE TO UNITS ABROAD

Property risks in emerging market countries present challenges that risks in developed economies don't, experts agree.

Building codes may be underdeveloped or not enforced. Infrastructure, from water and power systems to roads, may not be adequate to protect buildings. Supply chain risks may be murkier than in more developed parts of the world, and catastrophe exposures may not be as well understood.

While highly protected risk, or HPR, standards are followed less frequently in emerging markets, that likely will change as U.S. investment in those markets increases, experts predict. Meanwhile, U.S. companies should strive to apply the same risk management and risk mitigation steps in developing markets as they do at home.

Successful companies should export their risk management culture to affiliates and partners overseas, said Jeff Beauman, vice president of all-risk underwriting with FM Global in Johnston, R.I.

The huge growth in U.S. investment in emerging markets, particularly in Latin America and Asia, has brought a commensurate increase in property risk.

The adequacy of building codes and infrastructure remain problems in many places, though, insurance sources say.

"Building codes unfortunately are nonexistent in many places," while in others they exist but are not enforced, said Erik Nikodem, property executive, United States and Canada region at AIG.

Mr. Beauman pointed to the different experiences of Chile and Haiti during their 2010 earthquakes as evidence of the value of enforcing codes. Chile's quake, one of the most powerful ever recorded, killed 525 people and caused several billion dollars in insured property damage, but the death toll was far lower than it might have been without the country's strict building codes. The smaller quake in Haiti, where codes were not strictly followed, killed more than 300,000 people and destroyed large parts of Port-au-Prince.

"Building codes unfortunately are nonexistent in many places."

**Erik Nikodem,
AIG**

INVESTMENT GROWTH

Growth in the amount invested by U.S. companies in foreign affiliates, in millions of dollars*

Country	2011	2010	2009	2008	2007
Argentina	\$13,309	\$11,241	\$12,310	\$12,197	\$13,692
Brazil	\$71,101	\$64,165	\$53,281	\$43,953	\$48,807
Chile	\$34,187	\$30,507	\$25,385	\$16,286	\$16,337
Mexico	\$91,402	\$84,288	\$82,286	\$87,443	\$91,046
China	\$54,234	\$58,509	\$50,048	\$53,927	\$29,710
India	\$24,663	\$24,822	\$19,166	\$18,354	\$14,622
Malaysia	\$13,903	\$12,030	\$9,061	\$12,243	\$12,140
Thailand	\$11,308	\$10,505	\$9,371	\$9,162	\$10,284
Russia	\$9,733	\$8,347	\$20,070	\$19,777	\$15,029
All countries	\$4,155,551	\$3,790,918	\$3,518,655	\$3,232,493	\$2,993,980

*Historical cost basis

Source: U.S. Department of Commerce, Bureau of Economic Analysis

In underwriting emerging market property risks, FM Global looks at the existing building codes (or the absence thereof), the degree to which they're enforced and the quality of workmanship in a building's construction, Mr. Beauman said.

Infrastructure can be an even bigger challenge in some countries. A given location may lack fire hydrants, for example, or water pressure may be inadequate for fire hoses. Roads might not be wide enough for fire brigades or may be obstructed by low overpasses.

A company may try to follow HPR standards by, for example, installing a sprinkler system in a building, but it may not do much

good if water pressure is too low to operate it, Mr. Nikodem said.

"You may want to have an HPR facility everywhere you go, but you know that's not what you can get in all of these emerging markets," said Christopher Baudouin, CEO of the Aon Global Client Network unit of Aon Risk Solutions in Chicago.

In these cases, property owners should take additional steps to mitigate risks, sources say. If local water pressure is poor, a company may need to install its own pump and tank system, Mr. Beauman said. If the local electrical grid is unreliable, the solution may be to install backup generators to avoid a shutdown during a power outage.

“It’s all about identifying risks and mitigating or eliminating them,” he said.

Companies building new facilities from scratch are more likely to adopt HPR standards than those buying existing buildings, where retrofitting can be problematic, sources say. Thus, high-rise office buildings and hotels in cities and buildings that are part of new office or industrial parks in Latin American and Asia are more likely to be built to developed market standards.

“Those properties are HPR from the beginning,” Mr. Beauman said.

Any company acquiring an emerging market business should inspect its property and estimate the costs of bringing buildings up to HPR standards, he said. Those costs could then be included as part of the capital acquisition budget of the business — meaning that the costs could be amortized over the life of the acquisition — rather than making them part of a later operating budget, which could “slow the progress” of upgrades.

In cases where improvements are difficult or impossible, a company may at least temporarily opt to not cover the buildings in its international property program because the properties could increase the program’s cost, Mr. Baudouin said.

“You will get certain facilities that are better off being insured in local markets” and supported by local reinsurance, at least until the parent company has a better understanding of its exposure, he said.

The proportion of HPR to non-HPR risks continues to be much smaller in emerging markets than in developed economies, Mr. Beauman said. That gap will probably start to close, though, as U.S. companies expand further abroad, he said.

Mr. Nikodem pointed again to the Haiti earthquake as showing the effectiveness of exporting developed market loss prevention measures: the U.S. embassy in Port-au-Prince, built to exacting U.S. standards, suffered little damage despite the devastation around it.

The attitudes of many U.S. businesses about overseas development have changed over the years, Mr. Baudouin said. A decade or more ago, many



AP PHOTO

The 2011 floods in Thailand highlighted how a combination of catastrophe and contingent business interruption risks can cripple a company’s operations in emerging markets.

companies focused mainly on keeping construction and operating costs to a minimum and didn’t see the need to adopt HPR standards. The huge amount of money being generated by these facilities today — and their importance in the supply chain — has made it clear that those attitudes needed to change, he said.

The combination of catastrophe and contingent business interruption risks, meanwhile, also has become a major concern in emerging markets, especially since the 2011 floods in Thailand that shut down several key electronics and auto component manufacturing plants.

"You have to do a better job of investigating and describing your risk for underwriters."

Christopher Baudouin,
Aon Risk Solutions

"The cat exposure itself is already bad enough, but you're much more concerned with downstream" contingent business interruption impacts, Mr. Baudouin said.

In emerging markets, it can be more difficult to follow a company's upstream supply chain, making it tougher to assess the risk, Mr. Nikodem said.

"When you get outside the U.S., the chain starts to get more complex," he said.

The Thai floods showed the risk of a "pinch point" in supply chains, where parts manufacturing is outsourced to a single supplier or group of suppliers concentrated in one area, Mr. Beauman said. This concentration can reduce manufacturing costs, but it also can make a downstream business less resilient when disaster strikes, he said.

Risk managers and their insurers need to weigh their tolerance for this risk and their companies' ability

to weather supply chain disruptions, he said. That examination should then inform companies' outsourcing decisions, he said.

While there is capacity for contingent business interruption coverage in global property programs, capacity from foreign local insurers is "very limited," said Alejandro Marmorek, managing director with Aon's Global Client Network.

"There is a bigger need to understand the risk," Mr. Marmorek said.

"You have to do a better job of investigating and describing your risk for underwriters," Mr. Baudouin said.

The exposure isn't likely to go away: Emerging markets from Chile and Peru to China and Southeast Asia have seen increasingly damaging earthquakes, tsunamis, typhoons and floods in recent years.

CHAPTER 3

Growth seen in liability risks

D&O, ENVIRONMENTAL INSURANCE BECOMING MORE NECESSARY

Property exposures often are the main risk management focus in emerging market insurance programs, but liability risks of various kinds are casting progressively longer shadows.

Liability coverage — apart from mandatory auto liability insurance — has long played a relatively minor role in many foreign local insurance markets.

In China, for example, liability premiums amount to 0.03% of gross domestic product, compared with 0.34% for commercial auto premiums, according to a 2012 Swiss Re Ltd. study. The liability figures for Brazil, India and Russia are similar. In the U.S., by contrast, liability premiums equate to 0.5% of GDP, more than 15 times higher.

U.S. companies with operations in emerging markets typically buy general and auto liability coverage. But as those countries grow and develop, businesses more frequently need to consider other coverages, including directors and officers liability and environmental impairment liability, as well as employers' liability and product liability insurance.

The liability landscape "is changing rapidly" as governments adopt consumer protection and other regulations common to developed markets, said Alejandro Marmorek, managing director of the Aon Global Client Network unit of Aon Risk Solutions in Miami.

Employers' liability, for instance, has become a bigger issue in Brazil with the tough enforcement of wage-and-hour regulations, he said.

Hong Kong and Indonesia also are becoming bigger markets for employers' liability coverage, added Claude Gallelo, managing director with Willis Risk Solutions International in New York.

While products liability coverage isn't new to developed Asian markets like Japan, it has only recently become more common as a liability line in emerging markets. For example, Chinese manufacturers — the world's largest exporters — have become much bigger buyers of product liability insurance in recent years, driven largely by demands of overseas vendors, according to John Stabelos, Asia/Pacific zone manager, loss control services, with Chubb Group of Insurance Cos. in Melbourne, Australia.



Overseas buyers require Chinese companies to have products liability coverage with limits comparable to a U.S. company's, often naming the U.S. buyer as an additional insured.

These overseas buyers require Chinese companies to have products liability coverage with limits comparable to a U.S. company's, often naming the U.S. buyer as an additional insured, market sources say.

People and companies in China, Vietnam and other developing economies are gradually becoming more aware of their legal rights, especially as they do more and more business internationally, Mr. Stabelos said. As that happens, the understanding of liability exposures and the need for risk management will increase.

"As these countries emerge and grow, so will their legal systems," said Joan Rugar, division president for foreign casualty with AIG in Philadelphia. Several Southeast Asian countries have strengthened financial responsibility laws, she said.

U.S. and European companies involved in large-scale projects like infrastructure or energy development have generally been careful to follow the same liability risk management practices abroad as they would at home, Mr. Marmorek said.

U.S. INVESTMENT ABROAD

Amount invested by U.S. companies in foreign affiliates by industry, 2011, in millions of dollars*

Country	Mining	Manufacturing	Wholesale trade	Information	Finance**	Professional, scientific & technical services
Argentina	\$1,762	\$3,968	\$817	\$1,297	\$1,090	\$121
Brazil	\$5,784	\$31,848	\$2,929	\$5,715	\$10,513	\$1,265
Chile	N/A	\$3,724	\$749	\$439	\$3,925	\$420
Mexico	\$6,346	\$30,400	\$2,375	\$2,220	\$11,328	(\$317)
China	\$2,846	\$26,710	\$4,819	\$3,018	\$2,482	\$1,338
India	N/A	\$3,639	\$2,681	\$3,704	\$3,713	\$6,899
Malaysia	\$4,417	\$6,245	\$655	\$150	\$516	\$301
Thailand	\$144	\$6,340	\$1,144	\$27	\$415	\$325
Russia	\$1,493	\$3,456	\$656	\$105	\$204	\$627
All	\$188,003	\$588,736	\$193,767	\$127,170	\$777,152	\$90,109

*Historical cost basis

**Excludes depository institutions and insurance

Source: U.S. Department of Commerce, Bureau of Economic Analysis

Risk management failures, especially by a high-profile U.S. company, could cause not only liability claims but reputational damage, industry sources agree.

U.S. companies expanding into emerging markets need to be aware of each country's legal and regulatory system and its culture, Ms. Rupar said. Controlling liability risk, she added, also entails putting the company on a good footing with local authorities and local people. For example, energy and mining companies — which already might be viewed by some as exploitative — may make things worse by bringing in large numbers of foreign workers rather than hiring locals, "isolating themselves from the community instead of joining

it," she said.

This can make dealing with an accident or other situation giving rise to liabilities that much harder, she said.

The good news for risk managers is that liability coverage for emerging market risks remains plentiful and relatively inexpensive. General liability programs typically consist of a primary policy written by an admitted local insurer with a limit of \$1 million to \$2 million per occurrence and annual aggregate, and umbrella coverage provided through a global or controlled master program, market sources say.

"It's relatively easy, and there's plenty of capacity," Mr. Marmorek said.

CHAPTER 4

D&O liabilities subject to laws of the land

INDEMNIFICATION ISSUES MAKE SIDE A COVERAGE NECESSARY

Emerging market directors and officers liability risks can be very different from risks in developed nations, and companies investing abroad need to understand the differing laws and customs of each country to build effective D&O programs.

While most U.S. D&O claims stem from securities lawsuits from private individuals, for instance, actions against executives in developing countries tend to be regulatory or even criminal in nature. Unlike the U.S., many countries' laws prohibit — or are silent on — indemnification of executives by their companies.

A worldwide D&O policy written in the U.S. may also trigger tax and legal problems in countries that require admitted local insurance, meaning that local policies are a must, experts say.

Risk managers thus have to grapple not only with the corporate governance and executive liability rules of each country but also those countries' insurance and tax laws, said Dave Williams, vice president and worldwide manager of the multinational solutions group of Chubb Specialty Insurance in Boston.

Regulation in emerging economies has developed quickly in recent years, with governments updating their companies' laws to spell out the duties of officers and directors and foreign stock exchanges revamping rules and regulations for listed companies.

For example, the Hong Kong stock exchange last year required that listed companies carry an "appropriate" level of D&O insurance or explain why they are not complying, said Ziad Kubursi, head of global financial lines-growth economies with AIG in New York.

Turkey enacted a new commercial code in 2011 that expanded financial disclosure requirements and enumerated director responsibilities and liabilities, he said.

China in 2006 enacted a new company law that requires directors and managers to act with "loyalty and diligence" toward the company.

The move to tighten governance rules has been especially pronounced in already heavily regulated industries such as financial services and health care,



The Hong Kong stock exchange last year required that listed companies carry an "appropriate" level of D&O insurance or explain why they are not complying.

Mr. Williams said.

"That's been probably the most significant development in the last five years," he said. "You could say regulation of finance went on steroids after 2008."

"As these rules come into play, the awareness of the potential liability of these directors and officers is increasing," Mr. Kubursi said.

Regulators and law enforcement authorities have undertaken most actions against company executives in emerging markets, creating problems that U.S. risk managers might not be accustomed to, sources say.

One of these, rare in the U.S., is criminal liability for corporate actions. "For many areas of the world, that is already the status quo," said Ann Longmore, executive vice president with Willis North America Inc. in New York.

Outside the U.S., the corporate veil that protects individual executives from personal liability "is tissue thin, to the extent it exists at all," Ms. Longmore said.

Legal systems in some countries assume a person is guilty until proven innocent, and some have not adopted the practices of bail or plea bargaining, she added. This means a company official could be arrested for the company's failure to pay taxes, and the company would have to move quickly to defend the case because the official might stay in jail until it is resolved, she said.

Civil regulatory actions against executives, meanwhile, most often are triggered by whistle-blowers inside a company or by the company's competitors or creditors reporting it to the government, said Mr. Kubursi.

Shareholder lawsuits are rare. Some countries — including Argentina, Brazil, Chile, Columbia and China — allow some form of “collective action.” But in many others, “class actions are not allowed per se,” he said.

This is likely to change as laws in emerging markets evolve, sources agree. In addition, the U.S. Supreme Court's 2010 ruling in *Morrison v. National Australia Bank* — that a non-U.S. shareholder of a foreign company traded on a foreign exchange may not bring a securities fraud lawsuit in the U.S. — could lead institutional investors to push for the ability to pursue such cases in overseas jurisdictions that don't currently allow them, Mr. Kubursi said.

“Inevitably, there will be more securities class actions (in developing countries), more class actions generally,” he said.

Another problem for companies is that corporate indemnification of executives is either prohibited or uncertain in many jurisdictions; some laws bar the practice while others don't mention it, and the issue has never been tested in courts.

In the latter cases, “there will always be some uncertainty until courts opine on when indemnification is acceptable and when it's not acceptable,” Mr. Williams said.

Where indemnification is untested and an executive has been charged criminally, a company also will want to think about whether indemnification would make it appear the company is supporting a criminal — “not a great idea,” Ms. Longmore said.

The indemnification issue increases the importance of having adequate Side A D&O protection covering directors and officers individually, sources say.

U.S. companies operating overseas typically have “ABC” D&O policies covering foreign subsidiaries' executives, company indemnification liabilities and



The indemnification issue increases the importance of having adequate Side A D&O protection covering directors and officers individually.

claims against the subsidiary itself.

A decade ago, corporations may have supplied this coverage simply by buying a U.S.-issued global D&O policy insuring worldwide operations. More recently, though, companies have become more convinced of the need to comply with foreign insurance and tax laws, including requirements in multiple countries to place coverage with admitted local insurers and pay local premium taxes. Argentina, Brazil, China, India, Mexico and Russia are among the countries generally requiring admitted coverage.

D&O coverage for many large U.S. multinationals is provided under controlled master programs, in which local admitted insurers — often affiliates or partners of global insurers — issue underlying policies to a multinational's foreign subsidiaries. The global insurer then either reinsures the local policy or, where not blocked by an admitted insurance mandate, provides excess difference-in-conditions/difference-in-limits coverage above it.

Terms of local policies vary by country but can be made to match a U.S. policy's terms. A Chinese partner of Zurich Insurance Co. Ltd., for example, uses a translated U.S. form for local coverage of Zurich clients, said Jennifer O'Neill, global head of product development-specialty lines in New York.

Limits for Side A coverage also typically are lower in emerging markets than in the U.S., Ms. O'Neill said.

Apart from complying with insurance laws, having local coverage means simpler and faster payouts when claims arise, sources agree.

A multinational with a global program and no local underlying coverage would face the problem of getting money into the country where it's needed, though "I'd rather have the challenge of how to get money in than not have the money at all," Ms. Longmore said.

Local coverage is sometimes broader than what is typically available in the U.S., Mr. Williams said. Policies, for instance, may not have the "insured versus insured" exclusion typical in the U.S., or may have a broader definition of insured persons, since managers of foreign affiliates may have different roles than they might in the U.S.

Local coverage also can be tailored to fit local conditions, Mr. Kubursi said. If a country has a "loser pays" litigation system — in which the loser covers all court costs — the policy could be written so that recoveries in a win replenish D&O policy limits, he said.

The market for emerging markets D&O, meanwhile, continues to be soft, in part because loss experience has been better than that in developed markets, sources say.

Notices of claim under emerging market policies have been rising in recent years, but actual paid losses are manageable, Mr. Williams said.

"It's still a relatively benign environment, for local policies especially," he said.

That also may change as these economies grow and legal and regulatory systems evolve.

"It's just a matter of time before claims catch up with pricing," Mr. Kubursi said.

CHAPTER 5

Focus on environment growing stronger

MULTINATIONALS MANAGING RISKS THE SAME AS IN HOME COUNTRIES

Environmental laws have not historically been stringent in emerging economies, but that's changing.

Growing numbers of Latin American, Asian and Eastern European countries are adding environmental laws to their books and stepping up enforcement activity. And U.S. companies are increasingly applying U.S. risk management standards in these countries, wary of fines, civil and criminal penalties and reputational damage that could come with pollution incidents.

The increased regulation "is being driven by societal as well as economic issues," including a growing middle class in many emerging economies that is demanding better environmental conditions, said Steven Piatkowski, vice president with ACE Environmental Risk in Philadelphia.

The number of environmental laws and regulations adopted by countries in Latin America, Asia-Pacific, Africa and the Middle East has more than doubled since 2006, with emerging economies in Asia showing a 250% increase, according to Enhesa, an environmental health and safety consulting firm based in Brussels.

China, for example, is working with the U.S. Environmental Protection Agency to develop regulations governing air, water and soil pollution and hazardous waste disposal, Mr. Piatkowski said.

Indonesia last year adopted new rules requiring polluters to pay for cleanups and compensate people damaged by air and water pollution or mismanagement of hazardous waste, according to Enhesa.

Enforcement also is picking up. Chile, for example, has established an environmental regulatory agency and two new courts to hear appeals of fines that can reach \$10 million for violations of environmental laws, Enhesa reports. The U.S. EPA also has advised Chilean regulators and courts on enforcement procedures.

After a 3,600-barrel oil spill in 2011, Brazilian authorities halted Chevron Corp.'s offshore drilling operations; filed criminal charges against the company, drilling contractor Transocean Inc. and 17 of the companies' executives and employees; and



AP PHOTO

Brazilian authorities halted Chevron Corp.'s offshore drilling operations after 3,600-barrel oil spill in 2011, highlighting stronger environmental enforcement in emerging markets nations.

brought civil lawsuits against both for environmental damages.

Chevron was nearing a \$144 million settlement in December 2012 after previously agreeing to beef up its safety procedures, Reuters reported. Brazil's oil industry regulator found Transocean bore no responsibility for the spill.

Unlike U.S. laws, emerging market environmental regulations typically focus on current pollution incidents and legal violations rather than remediation of past pollution at closed sites, experts say.

"They are going to learn from our regulations, but aren't going to take it to an extreme," Mr. Piatkowski said.

Even so, compliance can be complicated, said Christopher Baudouin, CEO of the Aon Global Client Network unit of Aon Risk Solutions in Chicago.

In China, for example, companies may be dealing with different city, regional and national

government entities on environmental issues, and they may get three different answers to a single question, he said.

Most U.S. and European multinationals apply the same environmental awareness and risk management practices to emerging market operations as they do at home, he added, concerned not just with compliance but also with potential damage to their brands.

"They are probably more prone to being targets of negative press coverage if something happens," Mr. Baudouin said.

"The reputation risk is a concern," said Craig Richardson, senior vice president with ACE Environmental Risk in Atlanta. "If you're not in the news, that's a great thing."

General liability policies issued by some local emerging market insurers include sudden and accidental pollution coverage, typically not available in the U.S., said Claude Gallelo, managing director with Willis Risk Solutions International in New York.

The limits available under these policies usually aren't sufficient, though, and many U.S. companies buy standalone environmental impairment liability coverage, Mr. Richardson said. These programs often are structured as controlled master programs, with local policies issued in countries that require admitted coverage and a global policy providing coverage elsewhere, Mr. Richardson said.

Limits typically range from \$10 million to \$20 million per occurrence, though they can climb as high as \$50 million, he said.

ACE last year expanded its coverage of catastrophe management services for environmental risks, including such things as crisis communications, third-party medical costs, funeral expenses and psychological counseling costs.

CHAPTER 6

Specialized insurance coverages needed

POLITICAL RISK, TRAVEL, FOREIGN VOLUNTARY WORKERS COMP ALL KEY

While taking care of their broader property and casualty insurance needs, companies expanding into emerging markets also need to consider specialized coverages that could include political risk, travel and accident and foreign voluntary workers compensation insurance.

Political risk policies cover confiscation, expropriation and nationalization of a company's foreign assets, as well as currency inconvertibility and damage done by politically motivated violence. Business interruption caused by covered property damage also can be included.

While outright government seizures continue to pose a serious threat of financial loss to many multinational companies, certain direct government actions and political events such as currency inconvertibility or inability to transfer funds can lead to substantial losses as well. For instance, a local government may suddenly find itself in a financial crisis and react by banning all cross-border transfers of hard currency in an effort to maintain sufficient reserves of hard currency. Similarly, local banks and exchange houses could simply lose their ability to convert local deposits into hard currency if a country's currency reserves fall to critically low levels. These types of situations are commonly referred to as currency inconvertibility or transfer risk, and they can prevent a multinational company from receiving important intercompany payments from a local subsidiary, such as scheduled dividends or intercompany loans and trade receivables, said Francisco Cuevas, vice president and senior underwriter with AIG's political risk group in New York.

Policyholders range from equity investors with stakes in overseas companies to multinationals with fixed assets overseas or contractors — such as oil and gas companies — with equipment that moves from country to country.

Interest in emerging markets political risk coverage has grown over the past five years, driven in part by rising overseas merger and acquisition activity, said Corina Muller Monaghan, senior vice president for financial solutions with Willis Group Holdings P.L.C. in New York. Venezuela's



Business travel and accident policies provide various coverages for employees making trips abroad, including out-of-country medical coverage.

nationalization of industries ranging from oil and steel to cement, starting in 2008, also has spurred interest, she added.

A political risk policy might cover a dozen or so emerging market nations with separate country limits, among them Angola, Brazil, China, Colombia, India, Indonesia, Mexico, Morocco, Nigeria, Peru, Russia, South Africa and Vietnam, AIG's Mr. Cuevas said.

Policies are generally written to cover the parent company in its home country. A company would need to have at least \$3 million to \$5 million in overseas assets to make the insurance worthwhile, "because it's not inexpensive coverage," Ms. Monaghan said.

Confiscation, expropriation and nationalization policies can provide as much as \$1 billion in coverage when syndicated among several insurers, Mr. Cuevas said. AIG insurers write up to \$120 million per country and in the aggregate, he said.

Insurers can't legally cover countries on the U.S. Office of Foreign Assets Control trade sanctions list. Capacity also is limited in volatile areas of the

world, including much of the Middle East after the Arab Spring revolts, Mr. Cuevas said.

While political risks often are uncontrollable, companies still can take mitigation steps. Having a local joint venture partner — something some countries require — could make dealing with government authorities easier, Ms. Monaghan said.

Understanding a country's society, laws and customs can similarly help executives avoid antagonizing local governments, Mr. Cuevas said.

Another set of risks arises from overseas business travel. Business travel and accident policies provide various coverages for employees making trips abroad, including out-of-country medical coverage, emergency evacuation for medical care and travel inconvenience coverage for trip cancellations and lost personal property, said James Walloga, vice president with ACE USA Global Travel Risk Management in New York.

Insurers may pay claims directly to covered employees or may reimburse employers for expenses the employers have covered.

As they would with other property/casualty coverages, companies need to be aware of countries that require local admitted insurance if claims are to be paid in those countries, Mr. Walloga said. Overseas travel and accident

insurance — like other types of policies — can be structured as a controlled master program, with local policies issued where needed and a global master policy providing difference-in-conditions/difference-in-limits coverage.

Controlled master programs can eliminate the duplicate coverage and costs that result from having unrelated global and local travel policies, he said. Companies that already are using controlled master programs for property or liability lines are the most likely to adopt the structure for travel accident coverage, he added.

"From that perspective, it's not that heavy a lift," Mr. Walloga said.

Foreign voluntary workers compensation is another coverage designed to protect company employees working abroad. The policies do not provide statutory workers comp coverage but are designed to provide similar benefits in cases where statutory workers comp wouldn't respond — for example, if an employee was not hired in the U.S. or if injuries fall outside time limits on out-of-state work imposed by some state laws.

The policies also cover employees for endemic diseases — such as malaria or typhus — that they may contract while working abroad.

CHAPTER 1

Risk management in emerging markets

COMPANY EXPOSURES, OVERSEAS TAX REGULATIONS NEED CONSIDERATION

Risk managers grappling with how to structure an insurance program for emerging markets risks have to consider many factors, including the complexity of their own exposures and the regulatory and tax regimes of the countries they're dealing with.

A U.S. multinational, for example, may buy a global property or liability policy written by a U.S. insurer that is intended to cover its worldwide risks. A number of Latin American and Asian countries, though, require local risks to be underwritten by locally admitted insurers and are increasingly intent on collecting taxes attributable to coverage for local risks.

A global policy written by a U.S. insurer, therefore, may not be in compliance with local laws and may subject the policyholder to fines and penalties. Failure to remit premium tax on the portion of a global policy's premium that is attributable to a local foreign risk also may expose the policyholder to penalties.

Emerging market countries that generally prohibit nonadmitted insurance include Argentina, Brazil, China, India, Mexico and Russia.

Claims payments made under a nonadmitted global policy also may raise tax issues. A foreign country's laws may prohibit a nonadmitted insurer from providing claim services or making claim payments to a local entity, noted a 2012 analysis by AIG Property Casualty, formerly known as Chartis. If a claim is paid instead to the parent company — which did not directly suffer the loss — the payment may be considered taxable income to the parent. If the parent then remits an equal amount to the foreign subsidiary to compensate it for the loss, foreign tax authorities may consider it a taxable capital contribution rather than a claim payment, the analysis notes.

Parent companies may opt to avoid these compliance and tax issues simply by buying local admitted policies in the various countries where they have operations. This means the policies will meet local regulatory requirements, follow local industry practices and allow access to local reinsurance pools.



WHERE THE MONEY GOES

Amount invested by U.S. companies in foreign affiliates, 2011, in millions of dollars*

South America

Brazil	\$71,101
Argentina	\$13,309
Chile	\$34,187
Venezuela	\$12,110
Total	\$148,386

Mexico

\$91,402

Asia/Pacific

China	\$54,234
Hong Kong	\$52,542
India	\$24,663
Indonesia	\$11,591
Malaysia	\$13,903
Philippines	\$5,321
Thailand	\$11,308
Total	\$605,202

Russia

\$9,733

All countries

\$4,155,551

*Historical cost basis

Source: U.S. Department of Commerce, Bureau of Economic Analysis

The nature of a company's overseas business also plays into a decision on whether to buy local policies. A U.S. parent may be more inclined to buy local coverage, for example, if it owns a large overseas factory or other real property, operates an auto fleet in a foreign country, or manufactures a dangerous or high-profile product.

Buying locally, though, can cede control of insurance placement and claims management to a company's overseas subsidiaries.

Large multinationals with extensive overseas investments may want to retain that control centrally, and may opt instead for a hybrid type of coverage known as a controlled master program.

In a controlled master program, a global insurer's network of overseas subsidiaries or partners issues local policies wherever a multinational may need them. The insurer also issues a global policy in the parent's home country, either reinsuring the local policy or providing excess difference-in-conditions/difference-in-limits coverage to fill in if the local policy's terms don't cover a loss or if the local policy limits are insufficient.

In cooperation with companies' risk managers and brokers, the insurer normally is responsible for making sure coverage complies with local requirements and is responsible for allocating premium and arranging for local claims adjusting.

Whether a CMP makes sense again depends on a company's size and the nature of its business, said Erik Nikodem, property executive, United States and Canada region at AIG.

If a company owns no property overseas and has stock or machinery in only one or two countries, a CMP is probably unnecessary, and the risk can be handled with local admitted policies or nonadmitted coverage, depending on local requirements, he said.

There are two schools of thought about how to handle a CMP, added Jeff Beauman, vice president of all-risk underwriting with Johnston, R.I.-based FM Global. One seeks to minimize local costs, centralizing insurance buying at the corporate level to control costs; the other focuses on local compliance issues and ensuring local claims payments.

FM Global, which can provide local coverage in 120 countries, advises the latter, Mr. Beauman said.

When a property loss occurs, a policyholder wants money available quickly to start repairs, and that's much easier if the source is local, he said, adding that claim payments from outside a country might trigger scrutiny under anti-money-laundering laws.

"You don't want the delays of trying to import large amounts of cash, particularly in a country that has money-laundering laws and may be quite skeptical of that," he said.

"You don't want the delays of trying to import large amounts of cash, particularly in a country that has money-laundering laws and may be quite skeptical of that,"

Jeff Beauman,
FM Global

CHAPTER 2

Overseas property risks pose a challenge

STRIVE TO EXPORT RISK MANAGEMENT CULTURE TO UNITS ABROAD

Property risks in emerging market countries present challenges that risks in developed economies don't, experts agree.

Building codes may be underdeveloped or not enforced. Infrastructure, from water and power systems to roads, may not be adequate to protect buildings. Supply chain risks may be murkier than in more developed parts of the world, and catastrophe exposures may not be as well understood.

While highly protected risk, or HPR, standards are followed less frequently in emerging markets, that likely will change as U.S. investment in those markets increases, experts predict. Meanwhile, U.S. companies should strive to apply the same risk management and risk mitigation steps in developing markets as they do at home.

Successful companies should export their risk management culture to affiliates and partners overseas, said Jeff Beauman, vice president of all-risk underwriting with FM Global in Johnston, R.I.

The huge growth in U.S. investment in emerging markets, particularly in Latin America and Asia, has brought a commensurate increase in property risk.

The adequacy of building codes and infrastructure remain problems in many places, though, insurance sources say.

"Building codes unfortunately are nonexistent in many places," while in others they exist but are not enforced, said Erik Nikodem, property executive, United States and Canada region at AIG.

Mr. Beauman pointed to the different experiences of Chile and Haiti during their 2010 earthquakes as evidence of the value of enforcing codes. Chile's quake, one of the most powerful ever recorded, killed 525 people and caused several billion dollars in insured property damage, but the death toll was far lower than it might have been without the country's strict building codes. The smaller quake in Haiti, where codes were not strictly followed, killed more than 300,000 people and destroyed large parts of Port-au-Prince.

"Building codes unfortunately are nonexistent in many places."

**Erik Nikodem,
AIG**

INVESTMENT GROWTH

Growth in the amount invested by U.S. companies in foreign affiliates, in millions of dollars*

Country	2011	2010	2009	2008	2007
Argentina	\$13,309	\$11,241	\$12,310	\$12,197	\$13,692
Brazil	\$71,101	\$64,165	\$53,281	\$43,953	\$48,807
Chile	\$34,187	\$30,507	\$25,385	\$16,286	\$16,337
Mexico	\$91,402	\$84,288	\$82,286	\$87,443	\$91,046
China	\$54,234	\$58,509	\$50,048	\$53,927	\$29,710
India	\$24,663	\$24,822	\$19,166	\$18,354	\$14,622
Malaysia	\$13,903	\$12,030	\$9,061	\$12,243	\$12,140
Thailand	\$11,308	\$10,505	\$9,371	\$9,162	\$10,284
Russia	\$9,733	\$8,347	\$20,070	\$19,777	\$15,029
All countries	\$4,155,551	\$3,790,918	\$3,518,655	\$3,232,493	\$2,993,980

*Historical cost basis

Source: U.S. Department of Commerce, Bureau of Economic Analysis

In underwriting emerging market property risks, FM Global looks at the existing building codes (or the absence thereof), the degree to which they're enforced and the quality of workmanship in a building's construction, Mr. Beauman said.

Infrastructure can be an even bigger challenge in some countries. A given location may lack fire hydrants, for example, or water pressure may be inadequate for fire hoses. Roads might not be wide enough for fire brigades or may be obstructed by low overpasses.

A company may try to follow HPR standards by, for example, installing a sprinkler system in a building, but it may not do much

good if water pressure is too low to operate it, Mr. Nikodem said.

"You may want to have an HPR facility everywhere you go, but you know that's not what you can get in all of these emerging markets," said Christopher Baudouin, CEO of the Aon Global Client Network unit of Aon Risk Solutions in Chicago.

In these cases, property owners should take additional steps to mitigate risks, sources say. If local water pressure is poor, a company may need to install its own pump and tank system, Mr. Beauman said. If the local electrical grid is unreliable, the solution may be to install backup generators to avoid a shutdown during a power outage.

“It’s all about identifying risks and mitigating or eliminating them,” he said.

Companies building new facilities from scratch are more likely to adopt HPR standards than those buying existing buildings, where retrofitting can be problematic, sources say. Thus, high-rise office buildings and hotels in cities and buildings that are part of new office or industrial parks in Latin American and Asia are more likely to be built to developed market standards.

“Those properties are HPR from the beginning,” Mr. Beauman said.

Any company acquiring an emerging market business should inspect its property and estimate the costs of bringing buildings up to HPR standards, he said. Those costs could then be included as part of the capital acquisition budget of the business — meaning that the costs could be amortized over the life of the acquisition — rather than making them part of a later operating budget, which could “slow the progress” of upgrades.

In cases where improvements are difficult or impossible, a company may at least temporarily opt to not cover the buildings in its international property program because the properties could increase the program’s cost, Mr. Baudouin said.

“You will get certain facilities that are better off being insured in local markets” and supported by local reinsurance, at least until the parent company has a better understanding of its exposure, he said.

The proportion of HPR to non-HPR risks continues to be much smaller in emerging markets than in developed economies, Mr. Beauman said. That gap will probably start to close, though, as U.S. companies expand further abroad, he said.

Mr. Nikodem pointed again to the Haiti earthquake as showing the effectiveness of exporting developed market loss prevention measures: the U.S. embassy in Port-au-Prince, built to exacting U.S. standards, suffered little damage despite the devastation around it.

The attitudes of many U.S. businesses about overseas development have changed over the years, Mr. Baudouin said. A decade or more ago, many



AP PHOTO

The 2011 floods in Thailand highlighted how a combination of catastrophe and contingent business interruption risks can cripple a company’s operations in emerging markets.

companies focused mainly on keeping construction and operating costs to a minimum and didn’t see the need to adopt HPR standards. The huge amount of money being generated by these facilities today — and their importance in the supply chain — has made it clear that those attitudes needed to change, he said.

The combination of catastrophe and contingent business interruption risks, meanwhile, also has become a major concern in emerging markets, especially since the 2011 floods in Thailand that shut down several key electronics and auto component manufacturing plants.

"You have to do a better job of investigating and describing your risk for underwriters."

Christopher Baudouin,
Aon Risk Solutions

"The cat exposure itself is already bad enough, but you're much more concerned with downstream" contingent business interruption impacts, Mr. Baudouin said.

In emerging markets, it can be more difficult to follow a company's upstream supply chain, making it tougher to assess the risk, Mr. Nikodem said.

"When you get outside the U.S., the chain starts to get more complex," he said.

The Thai floods showed the risk of a "pinch point" in supply chains, where parts manufacturing is outsourced to a single supplier or group of suppliers concentrated in one area, Mr. Beauman said. This concentration can reduce manufacturing costs, but it also can make a downstream business less resilient when disaster strikes, he said.

Risk managers and their insurers need to weigh their tolerance for this risk and their companies' ability

to weather supply chain disruptions, he said. That examination should then inform companies' outsourcing decisions, he said.

While there is capacity for contingent business interruption coverage in global property programs, capacity from foreign local insurers is "very limited," said Alejandro Marmorek, managing director with Aon's Global Client Network.

"There is a bigger need to understand the risk," Mr. Marmorek said.

"You have to do a better job of investigating and describing your risk for underwriters," Mr. Baudouin said.

The exposure isn't likely to go away: Emerging markets from Chile and Peru to China and Southeast Asia have seen increasingly damaging earthquakes, tsunamis, typhoons and floods in recent years.

CHAPTER 3

Growth seen in liability risks

D&O, ENVIRONMENTAL INSURANCE BECOMING MORE NECESSARY

Property exposures often are the main risk management focus in emerging market insurance programs, but liability risks of various kinds are casting progressively longer shadows.

Liability coverage — apart from mandatory auto liability insurance — has long played a relatively minor role in many foreign local insurance markets.

In China, for example, liability premiums amount to 0.03% of gross domestic product, compared with 0.34% for commercial auto premiums, according to a 2012 Swiss Re Ltd. study. The liability figures for Brazil, India and Russia are similar. In the U.S., by contrast, liability premiums equate to 0.5% of GDP, more than 15 times higher.

U.S. companies with operations in emerging markets typically buy general and auto liability coverage. But as those countries grow and develop, businesses more frequently need to consider other coverages, including directors and officers liability and environmental impairment liability, as well as employers' liability and product liability insurance.

The liability landscape "is changing rapidly" as governments adopt consumer protection and other regulations common to developed markets, said Alejandro Marmorek, managing director of the Aon Global Client Network unit of Aon Risk Solutions in Miami.

Employers' liability, for instance, has become a bigger issue in Brazil with the tough enforcement of wage-and-hour regulations, he said.

Hong Kong and Indonesia also are becoming bigger markets for employers' liability coverage, added Claude Gallelo, managing director with Willis Risk Solutions International in New York.

While products liability coverage isn't new to developed Asian markets like Japan, it has only recently become more common as a liability line in emerging markets. For example, Chinese manufacturers — the world's largest exporters — have become much bigger buyers of product liability insurance in recent years, driven largely by demands of overseas vendors, according to John Stabelos, Asia/Pacific zone manager, loss control services, with Chubb Group of Insurance Cos. in Melbourne, Australia.



Overseas buyers require Chinese companies to have products liability coverage with limits comparable to a U.S. company's, often naming the U.S. buyer as an additional insured.

These overseas buyers require Chinese companies to have products liability coverage with limits comparable to a U.S. company's, often naming the U.S. buyer as an additional insured, market sources say.

People and companies in China, Vietnam and other developing economies are gradually becoming more aware of their legal rights, especially as they do more and more business internationally, Mr. Stabelos said. As that happens, the understanding of liability exposures and the need for risk management will increase.

"As these countries emerge and grow, so will their legal systems," said Joan Rugar, division president for foreign casualty with AIG in Philadelphia. Several Southeast Asian countries have strengthened financial responsibility laws, she said.

U.S. and European companies involved in large-scale projects like infrastructure or energy development have generally been careful to follow the same liability risk management practices abroad as they would at home, Mr. Marmorek said.

U.S. INVESTMENT ABROAD

Amount invested by U.S. companies in foreign affiliates by industry, 2011, in millions of dollars*

Country	Mining	Manufacturing	Wholesale trade	Information	Finance**	Professional, scientific & technical services
Argentina	\$1,762	\$3,968	\$817	\$1,297	\$1,090	\$121
Brazil	\$5,784	\$31,848	\$2,929	\$5,715	\$10,513	\$1,265
Chile	N/A	\$3,724	\$749	\$439	\$3,925	\$420
Mexico	\$6,346	\$30,400	\$2,375	\$2,220	\$11,328	(\$317)
China	\$2,846	\$26,710	\$4,819	\$3,018	\$2,482	\$1,338
India	N/A	\$3,639	\$2,681	\$3,704	\$3,713	\$6,899
Malaysia	\$4,417	\$6,245	\$655	\$150	\$516	\$301
Thailand	\$144	\$6,340	\$1,144	\$27	\$415	\$325
Russia	\$1,493	\$3,456	\$656	\$105	\$204	\$627
All	\$188,003	\$588,736	\$193,767	\$127,170	\$777,152	\$90,109

*Historical cost basis

**Excludes depository institutions and insurance

Source: U.S. Department of Commerce, Bureau of Economic Analysis

Risk management failures, especially by a high-profile U.S. company, could cause not only liability claims but reputational damage, industry sources agree.

U.S. companies expanding into emerging markets need to be aware of each country's legal and regulatory system and its culture, Ms. Rupar said. Controlling liability risk, she added, also entails putting the company on a good footing with local authorities and local people. For example, energy and mining companies — which already might be viewed by some as exploitative — may make things worse by bringing in large numbers of foreign workers rather than hiring locals, "isolating themselves from the community instead of joining

it," she said.

This can make dealing with an accident or other situation giving rise to liabilities that much harder, she said.

The good news for risk managers is that liability coverage for emerging market risks remains plentiful and relatively inexpensive. General liability programs typically consist of a primary policy written by an admitted local insurer with a limit of \$1 million to \$2 million per occurrence and annual aggregate, and umbrella coverage provided through a global or controlled master program, market sources say.

"It's relatively easy, and there's plenty of capacity," Mr. Marmorek said.

CHAPTER 4

D&O liabilities subject to laws of the land

INDEMNIFICATION ISSUES MAKE SIDE A COVERAGE NECESSARY

Emerging market directors and officers liability risks can be very different from risks in developed nations, and companies investing abroad need to understand the differing laws and customs of each country to build effective D&O programs.

While most U.S. D&O claims stem from securities lawsuits from private individuals, for instance, actions against executives in developing countries tend to be regulatory or even criminal in nature. Unlike the U.S., many countries' laws prohibit — or are silent on — indemnification of executives by their companies.

A worldwide D&O policy written in the U.S. may also trigger tax and legal problems in countries that require admitted local insurance, meaning that local policies are a must, experts say.

Risk managers thus have to grapple not only with the corporate governance and executive liability rules of each country but also those countries' insurance and tax laws, said Dave Williams, vice president and worldwide manager of the multinational solutions group of Chubb Specialty Insurance in Boston.

Regulation in emerging economies has developed quickly in recent years, with governments updating their companies' laws to spell out the duties of officers and directors and foreign stock exchanges revamping rules and regulations for listed companies.

For example, the Hong Kong stock exchange last year required that listed companies carry an "appropriate" level of D&O insurance or explain why they are not complying, said Ziad Kubursi, head of global financial lines-growth economies with AIG in New York.

Turkey enacted a new commercial code in 2011 that expanded financial disclosure requirements and enumerated director responsibilities and liabilities, he said.

China in 2006 enacted a new company law that requires directors and managers to act with "loyalty and diligence" toward the company.

The move to tighten governance rules has been especially pronounced in already heavily regulated industries such as financial services and health care,



The Hong Kong stock exchange last year required that listed companies carry an "appropriate" level of D&O insurance or explain why they are not complying.

Mr. Williams said.

"That's been probably the most significant development in the last five years," he said. "You could say regulation of finance went on steroids after 2008."

"As these rules come into play, the awareness of the potential liability of these directors and officers is increasing," Mr. Kubursi said.

Regulators and law enforcement authorities have undertaken most actions against company executives in emerging markets, creating problems that U.S. risk managers might not be accustomed to, sources say.

One of these, rare in the U.S., is criminal liability for corporate actions. "For many areas of the world, that is already the status quo," said Ann Longmore, executive vice president with Willis North America Inc. in New York.

Outside the U.S., the corporate veil that protects individual executives from personal liability "is tissue thin, to the extent it exists at all," Ms. Longmore said.

Legal systems in some countries assume a person is guilty until proven innocent, and some have not adopted the practices of bail or plea bargaining, she added. This means a company official could be arrested for the company's failure to pay taxes, and the company would have to move quickly to defend the case because the official might stay in jail until it is resolved, she said.

Civil regulatory actions against executives, meanwhile, most often are triggered by whistle-blowers inside a company or by the company's competitors or creditors reporting it to the government, said Mr. Kubursi.

Shareholder lawsuits are rare. Some countries — including Argentina, Brazil, Chile, Columbia and China — allow some form of “collective action.” But in many others, “class actions are not allowed per se,” he said.

This is likely to change as laws in emerging markets evolve, sources agree. In addition, the U.S. Supreme Court's 2010 ruling in *Morrison v. National Australia Bank* — that a non-U.S. shareholder of a foreign company traded on a foreign exchange may not bring a securities fraud lawsuit in the U.S. — could lead institutional investors to push for the ability to pursue such cases in overseas jurisdictions that don't currently allow them, Mr. Kubursi said.

“Inevitably, there will be more securities class actions (in developing countries), more class actions generally,” he said.

Another problem for companies is that corporate indemnification of executives is either prohibited or uncertain in many jurisdictions; some laws bar the practice while others don't mention it, and the issue has never been tested in courts.

In the latter cases, “there will always be some uncertainty until courts opine on when indemnification is acceptable and when it's not acceptable,” Mr. Williams said.

Where indemnification is untested and an executive has been charged criminally, a company also will want to think about whether indemnification would make it appear the company is supporting a criminal — “not a great idea,” Ms. Longmore said.

The indemnification issue increases the importance of having adequate Side A D&O protection covering directors and officers individually, sources say.

U.S. companies operating overseas typically have “ABC” D&O policies covering foreign subsidiaries' executives, company indemnification liabilities and



The indemnification issue increases the importance of having adequate Side A D&O protection covering directors and officers individually.

claims against the subsidiary itself.

A decade ago, corporations may have supplied this coverage simply by buying a U.S.-issued global D&O policy insuring worldwide operations. More recently, though, companies have become more convinced of the need to comply with foreign insurance and tax laws, including requirements in multiple countries to place coverage with admitted local insurers and pay local premium taxes. Argentina, Brazil, China, India, Mexico and Russia are among the countries generally requiring admitted coverage.

D&O coverage for many large U.S. multinationals is provided under controlled master programs, in which local admitted insurers — often affiliates or partners of global insurers — issue underlying policies to a multinational's foreign subsidiaries. The global insurer then either reinsures the local policy or, where not blocked by an admitted insurance mandate, provides excess difference-in-conditions/difference-in-limits coverage above it.

Terms of local policies vary by country but can be made to match a U.S. policy's terms. A Chinese partner of Zurich Insurance Co. Ltd., for example, uses a translated U.S. form for local coverage of Zurich clients, said Jennifer O'Neill, global head of product development-specialty lines in New York.

Limits for Side A coverage also typically are lower in emerging markets than in the U.S., Ms. O'Neill said.

Apart from complying with insurance laws, having local coverage means simpler and faster payouts when claims arise, sources agree.

A multinational with a global program and no local underlying coverage would face the problem of getting money into the country where it's needed, though "I'd rather have the challenge of how to get money in than not have the money at all," Ms. Longmore said.

Local coverage is sometimes broader than what is typically available in the U.S., Mr. Williams said. Policies, for instance, may not have the "insured versus insured" exclusion typical in the U.S., or may have a broader definition of insured persons, since managers of foreign affiliates may have different roles than they might in the U.S.

Local coverage also can be tailored to fit local conditions, Mr. Kubursi said. If a country has a "loser pays" litigation system — in which the loser covers all court costs — the policy could be written so that recoveries in a win replenish D&O policy limits, he said.

The market for emerging markets D&O, meanwhile, continues to be soft, in part because loss experience has been better than that in developed markets, sources say.

Notices of claim under emerging market policies have been rising in recent years, but actual paid losses are manageable, Mr. Williams said.

"It's still a relatively benign environment, for local policies especially," he said.

That also may change as these economies grow and legal and regulatory systems evolve.

"It's just a matter of time before claims catch up with pricing," Mr. Kubursi said.

CHAPTER 5

Focus on environment growing stronger

MULTINATIONALS MANAGING RISKS THE SAME AS IN HOME COUNTRIES

Environmental laws have not historically been stringent in emerging economies, but that's changing.

Growing numbers of Latin American, Asian and Eastern European countries are adding environmental laws to their books and stepping up enforcement activity. And U.S. companies are increasingly applying U.S. risk management standards in these countries, wary of fines, civil and criminal penalties and reputational damage that could come with pollution incidents.

The increased regulation "is being driven by societal as well as economic issues," including a growing middle class in many emerging economies that is demanding better environmental conditions, said Steven Piatkowski, vice president with ACE Environmental Risk in Philadelphia.

The number of environmental laws and regulations adopted by countries in Latin America, Asia-Pacific, Africa and the Middle East has more than doubled since 2006, with emerging economies in Asia showing a 250% increase, according to Enhesa, an environmental health and safety consulting firm based in Brussels.

China, for example, is working with the U.S. Environmental Protection Agency to develop regulations governing air, water and soil pollution and hazardous waste disposal, Mr. Piatkowski said.

Indonesia last year adopted new rules requiring polluters to pay for cleanups and compensate people damaged by air and water pollution or mismanagement of hazardous waste, according to Enhesa.

Enforcement also is picking up. Chile, for example, has established an environmental regulatory agency and two new courts to hear appeals of fines that can reach \$10 million for violations of environmental laws, Enhesa reports. The U.S. EPA also has advised Chilean regulators and courts on enforcement procedures.

After a 3,600-barrel oil spill in 2011, Brazilian authorities halted Chevron Corp.'s offshore drilling operations; filed criminal charges against the company, drilling contractor Transocean Inc. and 17 of the companies' executives and employees; and



AP PHOTO

Brazilian authorities halted Chevron Corp.'s offshore drilling operations after 3,600-barrel oil spill in 2011, highlighting stronger environmental enforcement in emerging markets nations.

brought civil lawsuits against both for environmental damages.

Chevron was nearing a \$144 million settlement in December 2012 after previously agreeing to beef up its safety procedures, Reuters reported. Brazil's oil industry regulator found Transocean bore no responsibility for the spill.

Unlike U.S. laws, emerging market environmental regulations typically focus on current pollution incidents and legal violations rather than remediation of past pollution at closed sites, experts say.

"They are going to learn from our regulations, but aren't going to take it to an extreme," Mr. Piatkowski said.

Even so, compliance can be complicated, said Christopher Baudouin, CEO of the Aon Global Client Network unit of Aon Risk Solutions in Chicago.

In China, for example, companies may be dealing with different city, regional and national

government entities on environmental issues, and they may get three different answers to a single question, he said.

Most U.S. and European multinationals apply the same environmental awareness and risk management practices to emerging market operations as they do at home, he added, concerned not just with compliance but also with potential damage to their brands.

"They are probably more prone to being targets of negative press coverage if something happens," Mr. Baudouin said.

"The reputation risk is a concern," said Craig Richardson, senior vice president with ACE Environmental Risk in Atlanta. "If you're not in the news, that's a great thing."

General liability policies issued by some local emerging market insurers include sudden and accidental pollution coverage, typically not available in the U.S., said Claude Gallelo, managing director with Willis Risk Solutions International in New York.

The limits available under these policies usually aren't sufficient, though, and many U.S. companies buy standalone environmental impairment liability coverage, Mr. Richardson said. These programs often are structured as controlled master programs, with local policies issued in countries that require admitted coverage and a global policy providing coverage elsewhere, Mr. Richardson said.

Limits typically range from \$10 million to \$20 million per occurrence, though they can climb as high as \$50 million, he said.

ACE last year expanded its coverage of catastrophe management services for environmental risks, including such things as crisis communications, third-party medical costs, funeral expenses and psychological counseling costs.

CHAPTER 6

Specialized insurance coverages needed

POLITICAL RISK, TRAVEL, FOREIGN VOLUNTARY WORKERS COMP ALL KEY

While taking care of their broader property and casualty insurance needs, companies expanding into emerging markets also need to consider specialized coverages that could include political risk, travel and accident and foreign voluntary workers compensation insurance.

Political risk policies cover confiscation, expropriation and nationalization of a company's foreign assets, as well as currency inconvertibility and damage done by politically motivated violence. Business interruption caused by covered property damage also can be included.

While outright government seizures continue to pose a serious threat of financial loss to many multinational companies, certain direct government actions and political events such as currency inconvertibility or inability to transfer funds can lead to substantial losses as well. For instance, a local government may suddenly find itself in a financial crisis and react by banning all cross-border transfers of hard currency in an effort to maintain sufficient reserves of hard currency. Similarly, local banks and exchange houses could simply lose their ability to convert local deposits into hard currency if a country's currency reserves fall to critically low levels. These types of situations are commonly referred to as currency inconvertibility or transfer risk, and they can prevent a multinational company from receiving important intercompany payments from a local subsidiary, such as scheduled dividends or intercompany loans and trade receivables, said Francisco Cuevas, vice president and senior underwriter with AIG's political risk group in New York.

Policyholders range from equity investors with stakes in overseas companies to multinationals with fixed assets overseas or contractors — such as oil and gas companies — with equipment that moves from country to country.

Interest in emerging markets political risk coverage has grown over the past five years, driven in part by rising overseas merger and acquisition activity, said Corina Muller Monaghan, senior vice president for financial solutions with Willis Group Holdings P.L.C. in New York. Venezuela's



Business travel and accident policies provide various coverages for employees making trips abroad, including out-of-country medical coverage.

nationalization of industries ranging from oil and steel to cement, starting in 2008, also has spurred interest, she added.

A political risk policy might cover a dozen or so emerging market nations with separate country limits, among them Angola, Brazil, China, Colombia, India, Indonesia, Mexico, Morocco, Nigeria, Peru, Russia, South Africa and Vietnam, AIG's Mr. Cuevas said.

Policies are generally written to cover the parent company in its home country. A company would need to have at least \$3 million to \$5 million in overseas assets to make the insurance worthwhile, "because it's not inexpensive coverage," Ms. Monaghan said.

Confiscation, expropriation and nationalization policies can provide as much as \$1 billion in coverage when syndicated among several insurers, Mr. Cuevas said. AIG insurers write up to \$120 million per country and in the aggregate, he said.

Insurers can't legally cover countries on the U.S. Office of Foreign Assets Control trade sanctions list. Capacity also is limited in volatile areas of the

world, including much of the Middle East after the Arab Spring revolts, Mr. Cuevas said.

While political risks often are uncontrollable, companies still can take mitigation steps. Having a local joint venture partner — something some countries require — could make dealing with government authorities easier, Ms. Monaghan said.

Understanding a country's society, laws and customs can similarly help executives avoid antagonizing local governments, Mr. Cuevas said.

Another set of risks arises from overseas business travel. Business travel and accident policies provide various coverages for employees making trips abroad, including out-of-country medical coverage, emergency evacuation for medical care and travel inconvenience coverage for trip cancellations and lost personal property, said James Walloga, vice president with ACE USA Global Travel Risk Management in New York.

Insurers may pay claims directly to covered employees or may reimburse employers for expenses the employers have covered.

As they would with other property/casualty coverages, companies need to be aware of countries that require local admitted insurance if claims are to be paid in those countries, Mr. Walloga said. Overseas travel and accident

insurance — like other types of policies — can be structured as a controlled master program, with local policies issued where needed and a global master policy providing difference-in-conditions/difference-in-limits coverage.

Controlled master programs can eliminate the duplicate coverage and costs that result from having unrelated global and local travel policies, he said. Companies that already are using controlled master programs for property or liability lines are the most likely to adopt the structure for travel accident coverage, he added.

"From that perspective, it's not that heavy a lift," Mr. Walloga said.

Foreign voluntary workers compensation is another coverage designed to protect company employees working abroad. The policies do not provide statutory workers comp coverage but are designed to provide similar benefits in cases where statutory workers comp wouldn't respond — for example, if an employee was not hired in the U.S. or if injuries fall outside time limits on out-of-state work imposed by some state laws.

The policies also cover employees for endemic diseases — such as malaria or typhus — that they may contract while working abroad.