Why a Global D&O Program is the Right Choice, Right Now

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Redefining Comprehensive and Effective D&O

Conducting business around the world requires carefully planned and structured executive protection insurance programs. In an era of increased global regulatory activity and corporate governance scrutiny, your organization’s directors and officers are in a state of continual risk. For U.S. businesses with subsidiaries abroad, and for all multinational companies with at-risk executives, a comprehensive and responsive global Directors’ and Officers’ Liability (D&O) insurance program has emerged as a leading business issue in today’s market.

A number of factors have led to a growing awareness of and demand for global D&O products, such as increased sophistication of regulatory systems and governance standards, including cross-border collaboration among insurance, tax and securities regulators. Sarbanes-Oxley, J-SOX and similar corporate governance laws and regulations in countries around the world also have sharpened the focus on the efficacy of local and global D&O coverage.

Rising claims frequency has led to increased visibility of D&O risk and exposures, particularly since many countries are now adopting, to some degree, the litigious attitudes so prevalent in the United States, making protections for local country directors and officers a business imperative. In fact, virtually every continent contains one or more countries that have adopted some form of class action litigation.

Disadvantages of Non-Admitted Insurance

Within the global insurance market, there is an evolving understanding of worldwide policy limitations. A country may prohibit a non-admitted insurer from providing payment for loss incurred locally. While D&O is not a compulsory purchase in most countries, if coverage is purchased, local insurance regulations may require the utilization of a locally admitted policy. This increases the potential exposure for companies that choose not to purchase admitted insurance and rely, instead, upon a U.S Master Policy.

Many countries prohibit non-admitted insurance coverage or do not have clear regulatory guidelines regarding the acceptability of non-admitted coverage. Even in cases where the law addresses the requirement for an admitted policy, it is often unclear if the law prohibits payment of a loss into the country from a U.S. Master Policy.

Insurance policies that do not meet the necessary criterion – that is, non-admitted policies – may not be permitted to pay non-indemnifiable claims into that country. Whether a claim is non-indemnifiable by law or via corporate insolvency or bankruptcy, the company may be precluded from protecting the individuals as well, exposing the local directors and officers to personal liability, potentially in the millions of dollars.

Many organizations have encountered increased local concern regarding the extent of protection offered by global non-admitted policies and the extent of indemnification.

1 Except in Romania for Joint Stock Companies, and in Israel where it may be required for provident funds and investment advisors.
protection under the law or from the subsidiary or parent company. Insurers have become more concerned about the consequences, such as financial or business operational penalties, resulting from placing or transacting non-admitted insurance. Additionally, non-compliance with local laws may result in penalties, including fines, taxes, loss of premium, license suspension or termination, and even imprisonment. Local subsidiaries are at operational and reputational risk for non-compliance – resulting sanctions on local operations could include loss of market or license for product or services.

Brazil is an example of a country where a non-admitted policy will not be allowed to provide payment of a locally incurred loss. The law in Brazil permits the government to freeze the assets of the director or officer when a claim arises, until a ruling is issued in favor of the director or officer. Therefore, the only source of funds for payment of defense costs may be an admitted insurance policy.

Finally, non-compliant policies may be declared invalid or void in the local jurisdiction, and if the local subsidiary cannot or may not legally indemnify the individual director or officer, then the individual may be required to pay the loss personally.

Clearly, as this awareness of potential policy limitations has grown, it has led to increased demand for better D&O protection. This interest is quickly spreading to the management teams of U.S.-based corporations’ local subsidiaries.

The Kvaerner Tax Decision

The Kvaerner Tax Decision has had an indelible impact on global D&O purchasing. Kvaerner, a UK company, purchased an umbrella policy from a UK insurer for worldwide professional indemnity cover. The policy covered not only Kvaerner’s parent company, but also its UK and Dutch subsidiaries (the latter was owned by the UK subsidiary). Kvaerner paid the premium and internally invoiced the Dutch subsidiary (through the UK subsidiary) for the portion of the premium reflecting the Dutch risk.

However, the UK parent did not pay the tax related to the premium for the Dutch risk. The Dutch authorities subsequently assessed tax on the premium allocated to the Dutch risk. In 2001, the European Court of Justice, based upon input from France, the Netherlands, England and the German governments, as well as the European Commission, ruled that EU member States may charge premium tax on an insurance premium for a subsidiary established in that State, irrespective of who paid the premium, how the premium was invoiced, or where the premium was paid.

The Results

Insurance premium tax (IPT) must now be paid where the risk is located, and IPT must be based upon a just and reasonable method of premium allocation.
Understanding the Global Environment

Making optimal decisions about a global D&O program begins with understanding the current global environment. Aon’s financial services experts have developed a database of more than 175 countries – *Aon Financial Services Group’s Country Purchasing Guide* for D&O insurance and other management liability products. This comprehensive database contains such country-by-country information as whether or not non-admitted insurance is problematic; general information regarding taxes due; and penalties that can be imposed on the purchaser and insurer of non-admitted insurance. It also outlines the risks of D&O claims in specific countries and contains information on insurer capability of placing D&O insurance policy within those countries.

Furthermore, Aon has compiled research on the specific indemnification laws of more than 120 countries. Our findings have been edifying. For example, more than 50 percent of these countries do not have laws that address indemnification. In the countries that do have indemnification laws, the protections are typically much more narrow than those in the United States. In approximately 7 percent of the countries researched, the law does not permit indemnification.

Additionally, we have tracked the purchasing habits of our U.S. clients in with regard to local country D&O policies used to supplement their global D&O purchasing programs. Regionally, the majority of foreign policies placed abroad are being placed in Europe. More specifically, policies were purchased in 25 European countries, with the greatest number of policies being purchased in Germany followed closely by France and Italy. In Asia, the most numerous local policy purchases have occurred in China, with Japan second, followed third by India. Of the policies purchased in Latin America, Brazil was the clear leader with a significant number of policies also purchased in Mexico and Argentina.

*D&O Policies Purchased for International Subsidiaries in Regions of the World*

*Note: 0% does not equal zero policies purchased*
Seven Steps to a Successful Global D&O Program

Aon has made a significant financial and human capital investment to understand the international D&O placement exposures of our clients. As the international legal and regulatory framework continues to evolve, we remain the best positioned global broker to help our clients mitigate risk. Through our research initiatives and practically tested brokerage process, we have developed a best practices guide for our clients to evaluate and address their potential global D&O risk. We recommend taking the following steps to implementing a comprehensive and effective global D&O purchasing approach:

1. Evaluate the nature and scope of your global operations and exposures (i.e. evaluate local subsidiaries based on size, strategic importance, nature of operations, visibility of local board, revenues, etc.)

2. Determine the countries to address, along with the desired Limit, using the Aon Financial Services Group’s Country Purchasing Guide, which will help you prioritize exposures and local policy purchasing.

3. Review the problematic countries against your U.S. Master program primary insurer’s global capabilities.

4. If the match is significant, obtain tied-in policies where possible and buy stand-alone policies where they may be required, whether because of law in that country or because the insurer does not offer admitted paper in the country and has no partner to do so.

5. If the match is not significant or your U.S. Master program primary insurer is not global, explore alternative options, including, but not limited to:
   - Consideration of changing your U.S. Master primary insurer to an insurer with more comprehensive global capabilities
   - Purchase of standalone/separate Limits in all countries where your U.S. Master primary insurer cannot extend coverage

6. Work with your broker to estimate the probable additional cost: Premium, tax, broker fees and commissions.

7. Obtain all additional submission/due diligence information not produced in Step 1 above (e.g. legal names of all applicable international subsidiaries and a local contact for each country).
Why Aon?

Aon’s dedicated global D&O and E&O practice, pioneered by the Financial Services Group (FSG), has the experience, knowledge and insight to design effective global programs that will protect your leadership against potentially devastating losses. For nearly 20 years, Aon has led the evolution of D&O liability insurance. An innovator in this field, Aon was the first broker to develop a wide range of D&O products that are industry standards today. FSG currently places more than $2.3 billion in management liability premium worldwide and are the leading broker in placing local D&O and financial services policies on behalf of our clients.

The group’s widely known publications include Executive Liability Advisor, which addresses timely issues including changes in laws and cases of interest affecting executives around the world, and Global Alerts on significant insurance-related changes in the marketplace, regulatory environment or applicable laws in various countries. Additionally, the FSG team maintains a compendium of information on local country penalties for non-compliance (by both the buyer and the insurer) of local country insurance laws, as well as information regarding average limits purchased in local country jurisdictions, and up-to-date information on each of the market’s capabilities to place D&O policies in various countries.

Aon’s FSG experts proactively participate in information sharing throughout our offices in more than 100 countries. This ongoing knowledge exchange focuses on the financial products marketplace, local insurers, coverage terms, pricing, claims and regulation. Finally, we coordinate internationally through Aon’s Global Client Network, a multi-lingual, multi-cultural internal group with expertise in international insurance.

For more information:

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