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Speaker's Name(s): Len Battifarano

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Alexander & Alexander

Alexander & Alexander Services Inc.
Corporate Communications
1211 Avenue of the Americas
New York, N.Y. 10036
Telephone 212 840-8500

RK-213 - Managing Risk Where They Don't Play By Your Rules
Leonard J. Battifarano

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MANAGING RISK WHERE THEY DON'T PLAY BY YOUR RULES

Good afternoon, ladies and gentlemen. Thank you for the opportunity to share my thoughts and experiences with you on our topic: the challenge of managing risk in parts of the world where they don't play by your rules.

I believe this is an extremely important topic, for several reasons.

First, we are living in a new world. we have become a Global Village. There are of course other cliches: Global Market, Borderless Business World, Transnational Business Community. The simple truth is that more corporations from more countries are doing more business in more places than ever before.

American corporations are no exception. As American risk managers, you must be ready and able to respond quickly and decisively in support of your own corporate strategies to explore new markets. In fact, you should probably have global risk management strategies in place, waiting to be implemented, rather than racing to catch up with yesterday's investment decisions.

Our topic is also related to the recent trend we see in the changing roles being played by risk managers. More and more of you are being invited to participate in the strategic planning sessions your companies' business development initiatives. The reason for this is simple: decision-makers recognize the need to understand the scope and depth of risk in doing business in new markets around the world.

Senior management will increasingly come to rely upon your knowledge of what the rules are in new market places. All the more reason for you to make every possible effort to expand your base of knowledge of our new global business community.

[SLIDE 1,2 THE GLOBAL ASIA PAC; EVR. AFR]

Well, I guess this picture defines the geographic scope of our discussion today; I mean, where else in the world do insurance industries play by your rules? The truth is that virtually all of the world's insurance industries are more similar to each other than any are to the U.S. market. Now certainly, while those of you who do business in Canada, Western Europe an Japan might disagree, even these markets are different and they do play by other rules. It is really your experience, or your brokers', which provides you with a sense of comfort here.

And while it is difficult for American risk managers to understand the rules of other markets, there is another perspective which may surprise some of you. The perspective is that: it may be the U.S. which plays by the rules that are both arcane and unintelligible. Therefore, I hope to conclude my talk with a plot twist more dramatic but hopefully less obscene than the Crying Game.

The U.S. market is also an excellent point of reference from which to begin. And if we define the broad concept of insurance as a kind of a game, then the rules of that game in your market are perhaps the most complicated in the world.

[SLIDE: U.S. MARKET SUMMARY]

The U.S. domestic marketplace is well-organized and highly sophisticated. It is based on competitive pricing, direct or broker-negotiated placements. It is administered by 50-plus jurisdictions that ensure the honesty, integrity, solvency and professionalism of the transaction.

You have a legal system where disputes are resolved through arbitration, judicial process or negotiation. And you operate in a society that is relatively well-informed about both commercial and personal insurance. In short, this industry that you know so well is a market which play by rules that are fair to one and all.

Well that is certainly the myth of American insurance, at least the one I was taught 14 years ago.

Well, let us put aside a look at the reality behind this myth and focus our attention on today's topic.

[SLIDE: FLAGS THEN CHAOS]

And although conducting business around the world can be exciting, I am sure, for many of you the challenge and thrill of managing a global insurance program has at times seemed less like a well-ordered process than a chaotic jumble. Fortunately, there are some basic differences which are easily identifiable. After all, there are only so many industry variations on our insurance theme. It is, however, the application of these differences, the local rules so to speak, with all their subtle nuances that makes the game of global insurance so challenging! Let's take a brief look at some of the basic rules of insurance outside of America.

I would like to review some of the basic differences in global markets and then take a close look at a few specific countries.

A basic point of distinction is the lack of competition in most markets outside the U.S.

[SLIDE: MARKET CHARACTERISTICS]

Many insurance industries are State Monopolies, where there is one or more nationalized carrier responsible for every aspect of the insurance transaction. Iran, Vietnam, India and until recently the People's Republic of China are all classic monopolistic countries. Monopolies also exist in many African countries as well as in the balance of Indo-China and in the Commonwealth of Independent States. In all of these markets, rates; terms and conditions; and claims settlement are normally dictated by government corporations. In most instances, nationalized industries are further restricted by the absence of brokers and agents, the imposition of strict tariffs and severe penalties for the purchase of non-admitted insurance. There is also a distinct absence of broad coverage options, sophisticated risk finance alternatives and sadly, even rudimentary risk management practices. Finally, reinsurance is usually controlled by the state, limiting access to competitive global markets as well as global programs placed back home.

Even in markets such as Korea, Taiwan and China where we have seen recent openings to competition and foreign participation, problems remain. Risk managers, playing by local rules here will still find severe tariffs, limited coverage and a distinct lack of local expertise.

For those of you with extensive international experience, a traditional response has been the placement of Non-admitted insurance coupled with DIC and in some instances, security covers.

[SLIDE: ADMITTED VS. NON-ADMITTED]

And while non-admitted insurance has been an accepted solution, it does not always work. Nor is it safe or practical when penalties can include severe fines, imprisonment of local staff, loss of physical assets or loss of local license and commercial registration, as we see in Kuwait, the Philippines, Vietnam and in the emerging markets of Eastern Europe.

Non-admitted insurance becomes even less a realistic alternative when your firm enters into a local Joint Venture and the politically correct and financially prudent alternative is to buy local, regardless of all other considerations.

The challenge of playing by someone else's rules is further complicated by local legal systems and religious or social customs. Sharia Law, practiced throughout the Muslim World is one example of local codes of conduct unfamiliar to most of you. What will you do in countries such as Saudi Arabia, Pakistan, the Sudan and Kuwait where religious law forbids insurance but commercial law requires it? What risk management techniques will you implement to protect staff who will be automatically imprisoned following serious traffic accidents (when I lived in Saudi Arabia, risk management in this regard meant enough cash in the glove box to negotiate out of such situations!) What can you do in these countries where the custom of blood money mandates that cash payments for death are based upon one's sex and religious belief and where expatriate staff can be imprisoned for years, until children of injured parents, reach adulthood and are able to decide upon acceptable compensation?

And although you may be familiar with Napoleonic Civil Code as applied in France, the local application of this set of laws is quite different in Egypt and North Africa. The purchase of Decennial Liability insurance can be extremely difficult and expensive, largely due to a lack of both market capacity and faith in local workmanship and technology.

Other legal systems offer unique challenges as well. In fact, in many countries such as Taiwan, Korea, China and newly established states in Eastern Europe, lawsuits, which we consider to be civil are tried in criminal courts, where the losers are not only obligated to pay all court and legal costs, but can be subjected to criminal proceedings if their case is deemed to be groundless or without merit.

And while some, if not all of you, would relish an opportunity to do away with your broker, there are perhaps some substantive disadvantages to this. Many countries, including China, Korea, India, Vietnam, and Pakistan prohibit any insurance intermediary from representing your interests. In countries such as these, how will your policies be administered; who will provide risk management services; who will negotiate, settle and report on claims? Policy digests, claims summaries and loss prevention scheduling are not provided by carriers, far more interested in cash flow for investment than in satisfied global clients.

[SLIDE: FINANCIAL RULES]

And of course, perhaps the local rules of greatest concern are those related to industry regulation and solvency. In this regard, we find a wide disparity in government supervision of insurance industries around the world. India's industry, administered by the MOF is well-managed. Most of us would find the 4 national carriers following prudent financial policies. Their capital and reserve, premium to surplus ratios and investment policies are all basically sound.

But whereas India's industry plays by British-inspired rules we find many countries that play by questionable rules or worse... no rules at all! Malaysia is just now emerging from a serious financial crisis in the 1980's resulting from virtually no industry oversight. The Bank Negara, Malaysia's central bank has brought order to a chaotic and financially perilous market. The MOF of Taiwan has had to completely re-write the Insurance Company Law regarding investments following serious concerns in the late 1980's. And we have seen the first bankruptcy in Poland's emerging market where a staff of 2,000 company agents/literally underwrote the company to death!

It is important to bear in mind, therefore, that nationalized carriers can, but don't have to pay claims, and competitive markets may want to, but cannot afford it. This is especially true in emerging markets where insurance industries are struggling to keep up with the frenetic pace of new investment.

[SLIDES: 2 POLITICAL RISK]

No discussion of global insurance would be complete without reference to the issue of political risk. Perhaps more than at any time in the last 50 years, political risk in all its manifestations is of serious concern. The globalization of the world's economy; the collapse of the Soviet Union and the resultant chaos in Eastern Europe have combined to create enormous interdependency fraught with uncertainty. This, coupled with continued confrontation in the Middle East; anarchy in parts of Africa, religious war in India and conflict in Indochina and the Korean peninsula, creates a significant risk for global firms, trading in an unstable world. It is quite surprising, astounding perhaps, that with all this occupying our minds, Latin America is considered a relatively safe haven in these troubled times. Political risk is of even greater concern because at a time of increasing global investment we find less capacity and coverage available than for many years. But as with all risk, political uncertainty is a function of local circumstances constantly in flux.

Perhaps it will be helpful at this point to explore specific countries which are currently in various stages of change or evolution and by doing so, illustrate the range of different rules that you face outside the U.S. For today's discussion, I have tried to identify countries which either play by different rules, new rules, or in the extreme, no rules at all.

Let's begin with China, a country of great interest to many American business people, yet one which remains an enigma to even the most ardent Sino-philes. China's insurance industry was, until just recently, a monopolistic one, in which the People's Insurance Company was the only carrier, and its 50,000 staff the only conduit for domestic and international insurance placements.

However, beginning in 1988, we saw a hint of change, as the MOF began considering a slight market opening for alternatives to the PICC. Of course all hopes abruptly ended with the **[SLIDE: TIANEMMEN SQUARE]** tragic events at Tianemmen Square and the consequent crackdown on economic liberalization. During the last two years of the 1980's we **[SLIDE: TERRA COTTA SOLDIERS]** saw a steady outflow of people, assets and opportunity from both China and Hong Kong as safe havens were sought in S.E. Asia and Canada.

But during the last 3 years we have seen yet another abrupt change in China's economic policy. No fewer than three new insurance companies are now operating in the PRC. The Shanghai-based Bank of Communications was first with the Pacific Insurance Company, followed by the Shen-zen based Ping An insurance company, both of which are locally-owned, quasi-private sector insurers. Finally, the A.I.U. received a limited license on 1 October last year to insure foreign firms and foreign-Chinese joint ventures in Shanghai as well as Chinese lives on a national basis.

While this has meant a true opening of the market and an end to the monopoly of PICC it has not necessarily meant an improvement in the rules.

Certainly rates are now competitive, policy forms have been liberalized and international reinsurance can be negotiated instead of mandated. But simply because you may now have insurance alternatives does not mean you will want to use them.

I recently visited China on behalf of 2 clients interested in pursuing alternatives to the PICC. We met with one of the new companies and were very impressed with their professionalism, technical proficiency and serious approach to underwriting. However, our meeting with the other was truly amazing. Their building is ostentatious, even garish, by Chinese standards of modesty; their staff were conspicuously well-dressed and insisted on entertaining us at a lavish private restaurant. But most astounding of all was the response given by the Director of Underwriting when asked if she enjoyed her new responsibilities. She was disappointed, depressed because the investment staff were the most important to the group; her job was to merely generate enough premium to allow the investment wizards to do what they wanted. When pressed about the efficacy of this underwriting philosophy she said she hoped one day to be promoted to the investment department.

An opening market in China? Yes. New more liberal rules to play by? Yes. Safe, prudent market alternatives? Not exactly. When you consider the frenzied growth and investment in Southern China along with the attitude of at least some of the new insurance carriers you get a sense of a market on the edge of chaos. Overlay the continuous political risk many believe still exists in China and you have, not an improvement in local rules but a rapidly evolving situation where the rules are variable and market oversight appears to be minimal. As an aside; by the time we returned to Hong Kong, our host at lunch had prepared a draft agreement to establish a Joint Venture brokerage company in China to be prepared for the day when brokers too could add to the investment pie. We politely declined the offer.

If China is a market when rule changes are not necessarily for the better let's look at a country where the old rules remain solidly in place despite strong pressure from the outside for change.

[SLIDE: INDIA]

India's insurance industry has been a monopoly of the state since 1953 when the General Insurance Corporation nationalized all existing carriers. The resultant organization of one life and four non-life companies provides an efficient, if somewhat out-dated network from which to purchase insurance. Rates are essentially set by the GIC, although some relief from the tariff is possible; policies are based on standard British wording and are adequate for most purposes; domestic capacity is quite large, supported internationally by a cartel of British brokers arranging virtually all Treaty and Facultative reinsurance; and solvency is not an issue in India where the GIC enjoys profits under strict government control, while operating in an underinsured, non-litigious society.

For all this, India's insurers do not provide professional service, and in the absence of a brokerage community, there is no mechanism in place to serve the needs of global corporations with sophisticated risk management philosophies and practices. Although insurance consultants are permitted by law, the few currently in business offer little except for fire loss adjusting and marine cargo surveys. While insurance education is stressed it is rudimentary in nature viewing risk transfer as the basis of all "quasi" risk management systems.

Doing business according to local rules in India is cumbersome but not onerous. India's market could benefit from enhanced insurance and risk management training but its industry does not need to be de-nationalized or opened to foreign competition to make it better.

If India can withstand the virulent religious and civil strife occurring throughout much of the country investment could flow once again and you as foreign risk managers can feel secure dealing with a professional marketplace, despite its local rules.

While India's market has not yet been seriously affected by the civil strife in-country, I suppose, given increased violence that it could. What happens to an insurance industry in a country destroyed by war? Well, compliments of **[SLIDE: HUSSEIN]**, the Mother of all Warriors, we had an opportunity to explore this issue first hand.

I was part of an A&A team on the ground in Kuwait in the days immediately after its liberation until the end of the 1991 when the situation returned to normal, normal for Kuwait of course.

[SLIDE: WAR]

We found an industry in chaos. Not destroyed, but in chaos. The 4 government insurers which dominate Kuwait's industry were closed, their offices and records damaged or destroyed and their staff killed, having fled abroad or recovering from the tremendous shock of invasion, occupation and liberation. Only the Bahrain-Kuwait Insurance Co., domiciled in Bahrain, was spared the terrible destruction visited on the 4 larger Kuwaiti insurers (Warba, Gulf, Al Alheia, the Kuwait Insurance Co.).

But what amazed us was how quickly the industry recovered. Within 2 months, international treaties were renewed, with greater capacity; offices were re-opened; staff returned or was replaced; and policies, premiums and files were largely accounted for or restructured. The anticipated crisis was over, massive claims adjustments and loss payouts were averted because so little in Kuwait is actually insured (it is against the Koran to circumvent the will of Allah) and that which was is currently being administered by the United Nations.

There are, however, some interesting points to make. The Kuwait MOF, responsible for the insurance industry was, in August of 1990, considering significant liberalizations to Kuwait's strict insurance laws. This effort came to an abrupt halt when Iraq invaded, and was permanently shelved after Kuwait's liberation. Today, Kuwait's industry remains a highly regulated, financially sound but strictly administered industry where insurance for governmental contracts (virtually all of Kuwait's business) must be placed with a government carrier and where non-admitted insurance is severely punished through fines, imprisonment and potential loss of local license and assets.

And second, because so many of Kuwait's insurance professionals were either Palestinian or Jordanian, the industry suffered a huge man-power loss when the Emir evicted these 2 nationalities. In fact, the leading national company was nearly closed because its Director was a Jordanian; a sinister figure in Kuwait who we met shortly after his return from Baghdad, where he allegedly sat out the war at Saddam's knee, bearing gifts of Kuwaiti dinars from his company vaults. Yet even this crisis passed without serious incident although the Kuwait Insurance Co. did lose its position as the government lead for all energy sector business.

And as the much anticipated boom in business opportunity faded, and I finally got to go home, we left an industry fully recovered from Iraq's invasion, with its rules virtually unaffected by the events of the previous year.

For our final analysis, let's look at a newly emerging country, one which is rising out of the rubble of the collapsed Soviet Empire, throwing off the shackles of a monopolistic insurance industry, and establishing an entirely new set of rules by which to play.

[SLIDE: VILNIUS]

The Ukraine is an impressive new state, the size of France, with an economy the size of Italy's; and with 57 million people capable of feeding themselves and maintaining what was the Soviet Union's industrial might in Aviation, communications, Steel-making and of course defense.

This emerging market currently has 70 insurance companies, apparently none of which are properly funded, all utilizing rates set by the Soviet carrier the Ingostrakh, which was believed by many to be unprofessional to begin with. Historically, insurance was merely a vehicle used to raise revenue for the government, largely through crop insurance, where claims were rarely paid.

If you had to purchase insurance for operations in the Ukraine today, you would be wise to do so via a non-admitted program. However, in as little as six months time, Ukraine's parliament could issue entirely new insurance regulations and associated common law through which the insurance industry can be regulated and insureds can have legal recourse.

Our firm is actually playing a role in this effort, as consultant to the Ukrainian government. The overall effort is to enact a set of laws to administer the industry and allow for the oversight of a more financially sound market, including the Ukerderzstrakh, the Ukraine's bankrupt state company. The Ukraine's insurance law will be a similar to common law, with various codes borrowed from the UK, France, Italy and Germany. It is noteworthy to point out that non-admitted insurance will be treated as it is in Kuwait, as a criminal offense punishable by fines, loss of license and loss of assets.

It is certainly exciting to see the creation of new insurance industries throughout Eastern Europe, not without a few bumps and bruises but certainly a step in the right direction for professional risk managers asked to protect corporate assets in these countries.

Thus far our discussion has been largely from your perspective, an American risk manager looking out upon an uncertain, alien and indeed perhaps a hostile world where they certainly do not seem to play by your rules, if indeed by any rules at all.

There is obviously another perspective; the view from the other side, of your new playing partner. Local rules unfamiliar and uncomfortable to you may derive from important local considerations which when better understood, can at the least be appreciated and perhaps incorporated into effective global risk management strategies.

While my colleague Ms. Gallis-quendnau (will/has not doubt already) spoken eloquently of insurance in developing countries, it maybe helpful to make some useful observations regarding local rules which you may find troublesome. **[SLIDE: GROWTH DEVELOPMENT PROTECTION, ASSET RETENTION]** Monopoly, state-regulated tariff markets are essentially efforts to control an industry capable of supporting local growth and development. Nationalized insurance companies and their state controlled private sector relatives are engines for domestic investment; tariffs, a market tool to assist in the profitable underwriting so necessary to that development. Limited foreign participation and controlled reinsurance are additional tools utilized to keep premium in-country and limit participants not part of the domestic development agenda, who may be more intent on remitting profit than in local investment.

While we may not enjoy, nor profit from our dealings with the GIC of India, the Bao Viet of Vietnam or the Bimeh of Iran, we must try to appreciate their role in the local economy.

Similarly, the lack of a serious network of brokers may limit the delivery of necessary risk management services, but from the local perspective in Korea, China, and India, it eliminates unnecessary, and often unprofessional service, as well as wasteful commission taken from the more proper direct transaction between insured and insurer.

At this point, I expect you might agree that there are many insurance markets which do not play by your rules. But regardless of the diversity and complexity of those rules it is important for each of you to understand them, or if you don't, have someone who does, translate on your behalf.

Compliance with local insurance laws is important for you and your respective firms. It is an indication of your sensitivity, appreciation and commitment to those countries in which you operate.

As risk management input continues to grow in importance as a criteria for overseas investment, your knowledge of and expertise in the world's insurance market will allow you to play a vital role in your firm's global expansion.

The challenge to do and the resultant opportunity are part of your future.

Now, about that plot twist I promised you. If we took a global survey of risk managers, most would be reasonably comfortable in doing business in many of the countries that I have mentioned today with the exception of one:

[SLIDE: U.S. FLAG]

I am afraid to tell you that the most frightening country in the world, the one which has a truly distinctive and difficult set of rules is the United States. Perhaps a bit of introspection is called for, not unlike when leaving the Bronx Zoo in NY, you pass by a cage over which is the sign, The World's Most Deadly Animal; naturally you rush to the exhibit only to be confronted by your mirrored reflection. Or in the immortal of Pogo, "I have seen the enemy, and he is me."

Having spoken at similar RIMS sessions in Singapore, Korea and Australia, I can personally attest to the fear that most risk managers have about doing business here.

They see America as a society driven to violence; suffering from a complicated and costly legal system, burdened by even more expensive health care and workers' compensation benefits; losing its competitive advantage due to products liability settlements gone haywire; having to sort out an administrative nightmare of more than 50 insurance regulators; confronted with insurer insolvency and an environmental movement capable of bankrupting American industry. Very few global risk managers envy you and your positions and most lose sleep wondering how they will, if ever, learn to abide by your unintelligible local rules.

There is no doubt that many countries have insurance industries which are difficult to understand, expensive to do business in, devoid of sophisticated insurance products and professionals and which often present serious financial and political challenges. Some, if not all of this is the unavoidable assumption of risk we face in our new world order.

But you can be creative in your response to this challenge. Explore all potential coverage options and service providers. As your firm develops global expansion strategies, learn about local insurance industries, legal environments, and social customs in China, India, Vietnam and Khazakhstan. Do the obvious; talk with your global broker, talk to their competitors (we are always willing to give free advice!). Spend the time, money and energy to attend RIMS conferences elsewhere; the Asian RIMS Conference, held every second year, is a good starting point. You cannot do it from your office; I believe you must live and breathe in those markets where your firm transacts business. If not you, then your broker.

If managing risk where they play by different rules is analogous to a game, it is most certainly a serious game for you. Know all the rules and exceptions, know the players and arbiters and know what you can and cannot do to play fairly.

Quite frankly, I believe it is not so much that you must learn new rules than it is accepting many new players with diverse skills into an expansive game in which you are all quite capable of winning!