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ACE EUROPEAN RISK BRIEFING 2012

Multinational business and export risk

RESPONDENT PROFILES

The research was carried out between 13 April and 3 May 2012. The sample comprised 606 European risk managers, CROs, CFOs, COOs and those responsible for buying insurance.

Interviews were conducted by telephone by Opinion Matters on behalf of ACE Europe. Respondents were chosen at random from a pre-selected database and were screened for eligibility. Respondents were not compensated for their participation and ACE was not identified as the research sponsor.

Respondents by job title

Chief risk officer	**27%**
Chief financial officer	**25%**
Chief operating officer	**24%**
European risk manager	**23%**

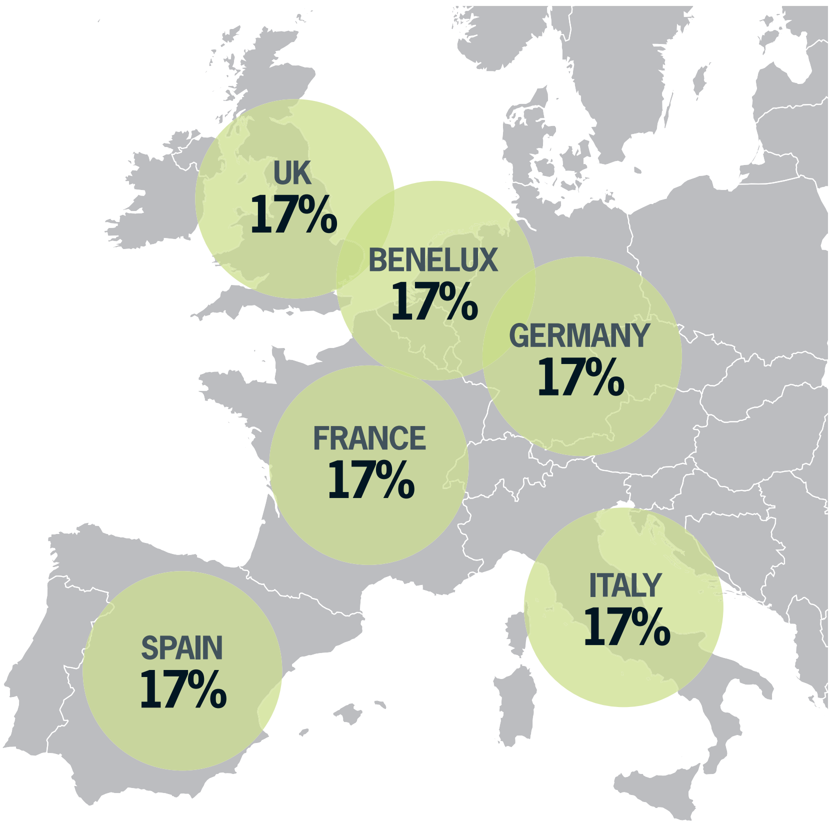
Respondents by size

£500-700m turnover	**51%**
Over £700m turnover	**49%**

Respondents by company sector

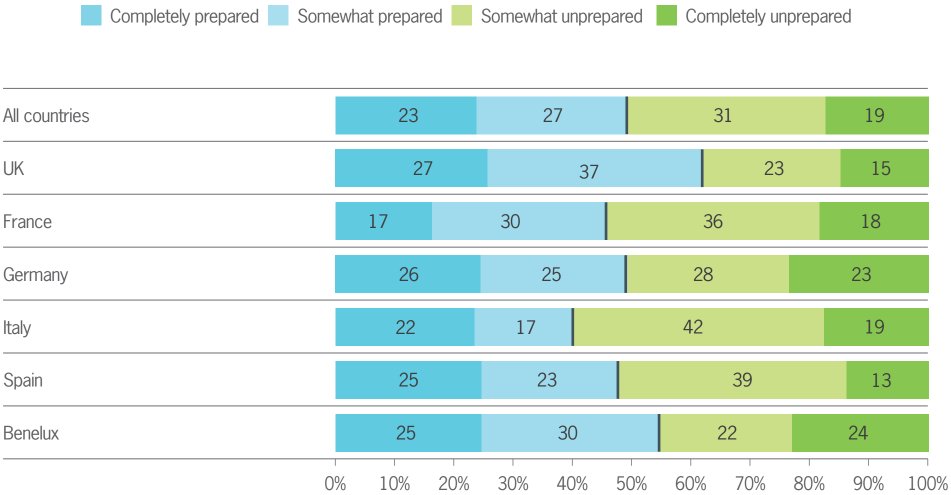
Architecture, engineering and building	**5%**
Retail, catering and leisure	**5%**
Manufacturing and utilities	**6%**
Sales, media and marketing	**6%**
Legal	**7%**
Education	**7%**
Professional services	**7%**
Travel	**8%**
Arts and culture	**9%**
Healthcare	**9%**
IT & telecoms	**9%**
HR	**10%**
Finance	**12%**

Respondents by country



MULTINATIONAL BUSINESS AND EXPORT RISK

How would you rate your company's level of preparedness, in respect of multinational and export risk?



The days when companies could be purely nationalistic in their business strategies are almost over. Even many of the smallest companies now operate across multiple jurisdictions. Indeed, some companies are today 'born global' and derive a high proportion of their revenues from overseas customers from their inception.

Rather than slowing down globalisation, the financial crisis appears to have encouraged it. In 2011, global flows of foreign direct investment surpassed the pre-crisis average between 2005 and 2007[1]. Many companies increasingly see multinational business as a way of securing growth and diversifying risk at a time of considerable uncertainty.

More specifically, another result of the crisis and ensuing recessions has been to accelerate the shift in the centre of gravity of the global economy towards the East and South – something that was already well underway prior to 2007. With so-called emerging market regions projected to provide the lion's share of GDP growth for the foreseeable future[2], the trend now seems irreversible.

Opportunities and risks from multinational expansion

Greater international exposure presents companies with powerful opportunities. For most European businesses, local opportunities for revenue growth will likely be constrained for some years. As a result, many companies across the region – both in Europe's better-performing and 'deep crisis' economies – are directing their exports and capital investments beyond the EU. Greater specialisation and supply chain complexity can also cause companies to look overseas, because the best – and often the cheapest – services, such as manufacturing or business process outsourcing, may be found many thousands of miles away from corporate headquarters.

But a more diverse international footprint also exposes companies to higher levels of risk. As value chains become more extended and complex, companies must be able to identify, assess and mitigate risks across multiple and less familiar jurisdictions. This requires a highly robust risk management and insurance framework, and an alertness and adaptability that depends on the right local knowledge and global capability to deal with highly divergent political, economic and regulatory environments.

As a result, over half of European companies (52%) believe that doing international business has become more risky over the last five years. A similar proportion feels either underprepared or completely unprepared to deal with multinational and export risk. There is some regional variation within this overall finding; companies in the UK feel most prepared, while those in Italy feel least prepared.

[1] UNCTAD *Global Investment Trends Monitor*, No. 8, 24 January 2012
[2] HSBC, *The World in 2050*, January 2011

"OVER HALF OF EUROPEAN BUSINESSES BELIEVE THAT DOING INTERNATIONAL BUSINESS HAS BECOME MORE RISKY"

> "95% OF RESPONDENTS HAVE CHANGED THEIR APPROACH TO MULTINATIONAL AND EXPORT RISK"

Catastrophes and crises raise multinational risk perceptions

The vast majority of respondents, 95%, indicate that they have changed their approach to multinational and export risk over the past five years. They also identify a number of specific drivers behind the change.

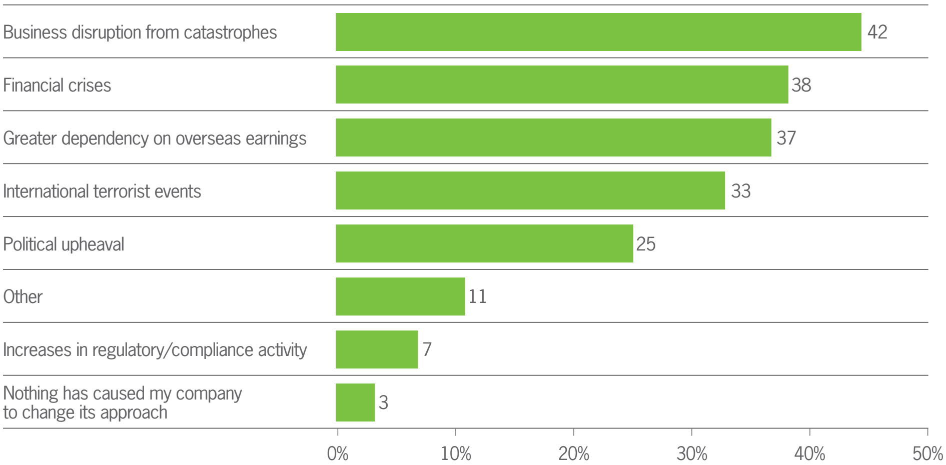
One of the top factors, unsurprisingly, is their company's increasing dependence on overseas earnings. As noted above, the global economy has entered a new phase in which emerging markets will be tomorrow's engines of growth, and this is driving many European businesses towards newer and less familiar markets.

However, this isn't the only factor. The past few years have seen a higher-than-average frequency of natural and man-made catastrophes, ranging from the tsunami and earthquake in Northern Japan and the floods in Thailand, to the explosion at the Deepwater Horizon rig off the Gulf of Mexico. Indeed, 2011 was a record year for economic losses from natural catastrophes worldwide[3].

Not surprisingly, these events remain front of mind for executives who must manage risk right across a company's global operations. These events, after all, have had high visibility in the media and some may even have had a direct impact on their own company's supply chain resilience. So, when respondents were asked what has caused their company to change its approach to multinational business and export risk, they point to disruption from catastrophes as the number one factor.

Perhaps unsurprisingly, European companies list financial crises as the

What has caused your company to change its approach to multinational insurance risk management during the last five years?



number two driver of change. With the key causes and geographical origins of the last financial crisis firmly rooted in the developed world, it suggested that the West was far from immune to the kind of crippling collapse that the Asian economy, for example, had suffered during its own crisis in the late 1990s. Today, financial crises can strike anywhere and, in our increasingly connected economy, their effects are likely to be more wide-reaching than ever before.

Interestingly, international terrorist events are also cited by over 30% of companies as a driver. This ties in with other findings from our research, which we published in July 2012, showing that terrorism and political violence is the number one emerging risk concern for European businesses overall. After a decade of high-profile terrorist activity during which terrorist attacks have reached a new level of audacity and intensity, this concern is perhaps inevitable.

[3] Munich Re, 12 July 2011

“COMPANIES HAVE WOKEN UP TO THE NEED FOR WELL-STRUCTURED AND CLEARLY COMPLIANT D&O COVER”

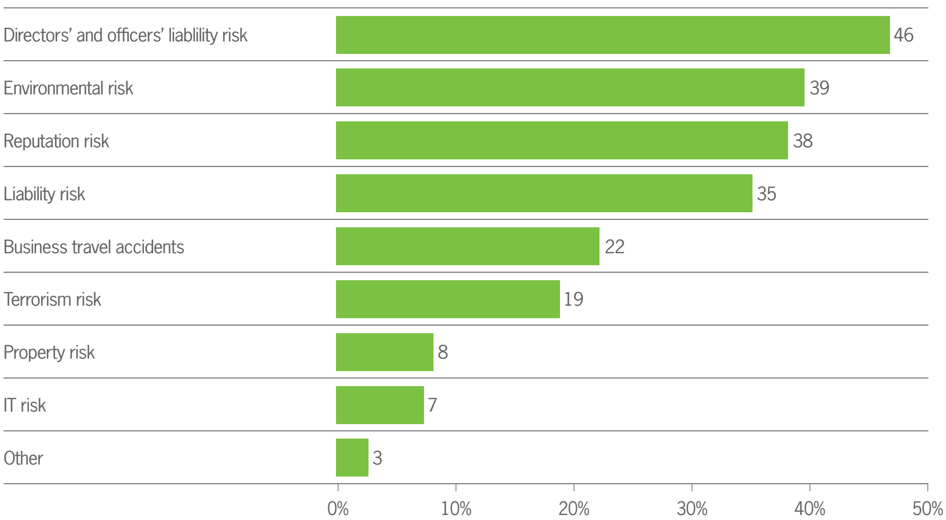
D&O risk tops the list of specific risk concerns

Asked about the specific risk areas to which their multinational operations are most exposed today, respondents point to directors’ and officers’ (D&O) liability as the number one exposure.

This is a belief supported by recent regulatory and legal developments. It is now a year since the UK Bribery Act came into force, for example. Significantly, while the Act made it a criminal offence to give or receive a bribe, it also introduced a corporate offence of failing to prevent bribery. The potential for culpability to reach beyond a director’s or officer’s own actions to those of others is also under the spotlight. Recent allegations against a large global retailer headquartered in the USA, have focused on whether its managers in Mexico made ‘improper payments’ to secure the company’s presence in the country and have led to accusations of a ‘cover up’ implicating the company’s own Board of Directors.

Traditionally, while multinational insurance programmes have been commonplace for general property and casualty risks, companies have tended to purchase one global D&O insurance policy to cover worldwide exposures. However, with increasing regulatory risk (and regulators more likely to take action against individuals), an overhaul of governance arrangements (with more non-executive directors on boards) and a growing likelihood for D&O claims to be incurred outside a company’s home country thanks to globalisation, many companies have woken up to the need for a well-structured and clearly compliant multinational D&O insurance programme.

Which risks are your multinational operations most exposed to today?



In terms of other specific risk categories, environmental risk is next on the list. We will explore this risk in detail in another report in this series, but it is clear that a combination of stakeholder pressure, concern about climate change and resource scarcity are placing an ever-greater burden on companies to manage their environmental exposures appropriately. This is particularly relevant for a multinational business, because companies that invest in overseas markets want to be seen to be responsible corporate citizens, working with the communities in which they operate.

Notably, multinational exposure to reputation risk, general liability risk and business travel risk are also concerns for more than 20% of respondents in each case.

The compliance challenges of multinational insurance

Despite these concerns, only half of European businesses currently have a multinational insurance programme in place to cover their global risks.

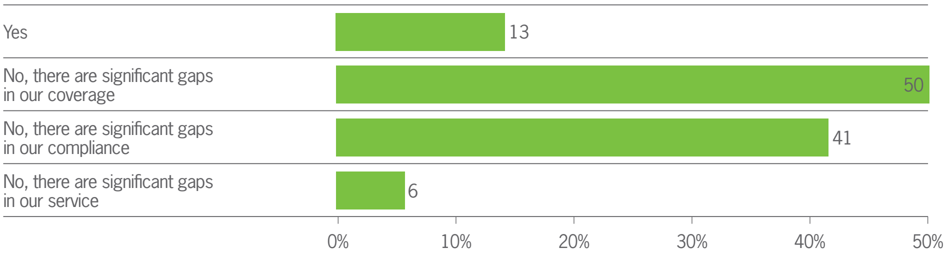
Indeed, overall, just 13% of companies believe they have an insurance programme that is well constructed for their multinational needs. 50% of companies believe there are significant gaps in coverage and 41% say there are significant gaps in respect of compliance.

When asked which areas of compliance concern them most, respondents identify local policy compliance (48%), claims settlements (40%) and consistency of coverage (36%) as the top three issues.

These may not be the most exotic of topics for a management team to debate. But the fact that only 3% of companies have no concerns about compliance highlights the importance of clients and their insurance partners developing solutions that actually work as intended across multiple markets.

In particular, as continued globalisation drives the likelihood of more insurance losses outside a company's home country, we expect issues around claims compliance to gain greater prominence. This is, in our view, an important area that is sometimes overlooked.

Do you believe your multinational insurance programme is well constructed for your needs?

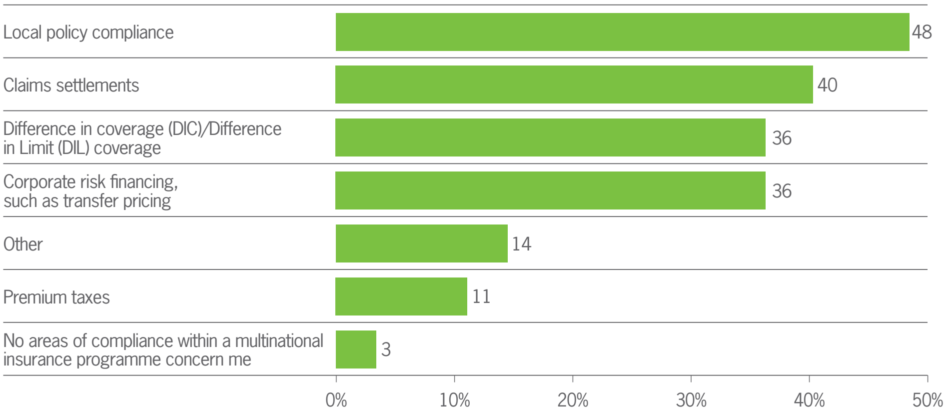


> "ONLY 3% OF COMPANIES HAVE NO CONCERNS ABOUT COMPLIANCE"

Of course, by its very nature, developing a multinational insurance programme that is both compliant and meets business needs is not a simple exercise. The fact is that multinational programmes do raise significant compliance issues, not least in respect of where a valid policy can be issued, where and how a claim may be paid, and how clients address inter-group allocations in any multinational risk-financing arrangement.

Although the challenges can initially appear daunting, they can be overcome with forethought, consultation and expertise. When designing and implementing a multinational programme, clients and their insurance partners should therefore work closely together, should give the necessary attention to developing appropriate documentation. They should also take full advantage of the technical expertise available to them, both internally and externally. Ultimately, by working with experienced accounting, tax and financial specialists to design a multinational insurance programme, European risk managers should be able to benefit from a solution that satisfies both business and regulatory requirements.

Which areas of compliance within a multinational insurance programme concern you the most?



> **“THE CHALLENGES SEEM DAUNTING BUT CAN BE OVERCOME WITH FORETHOUGHT, CONSULTATION AND EXPERTISE”**