

Globalisation Challenges for Professional Firms

A Panel Debate:

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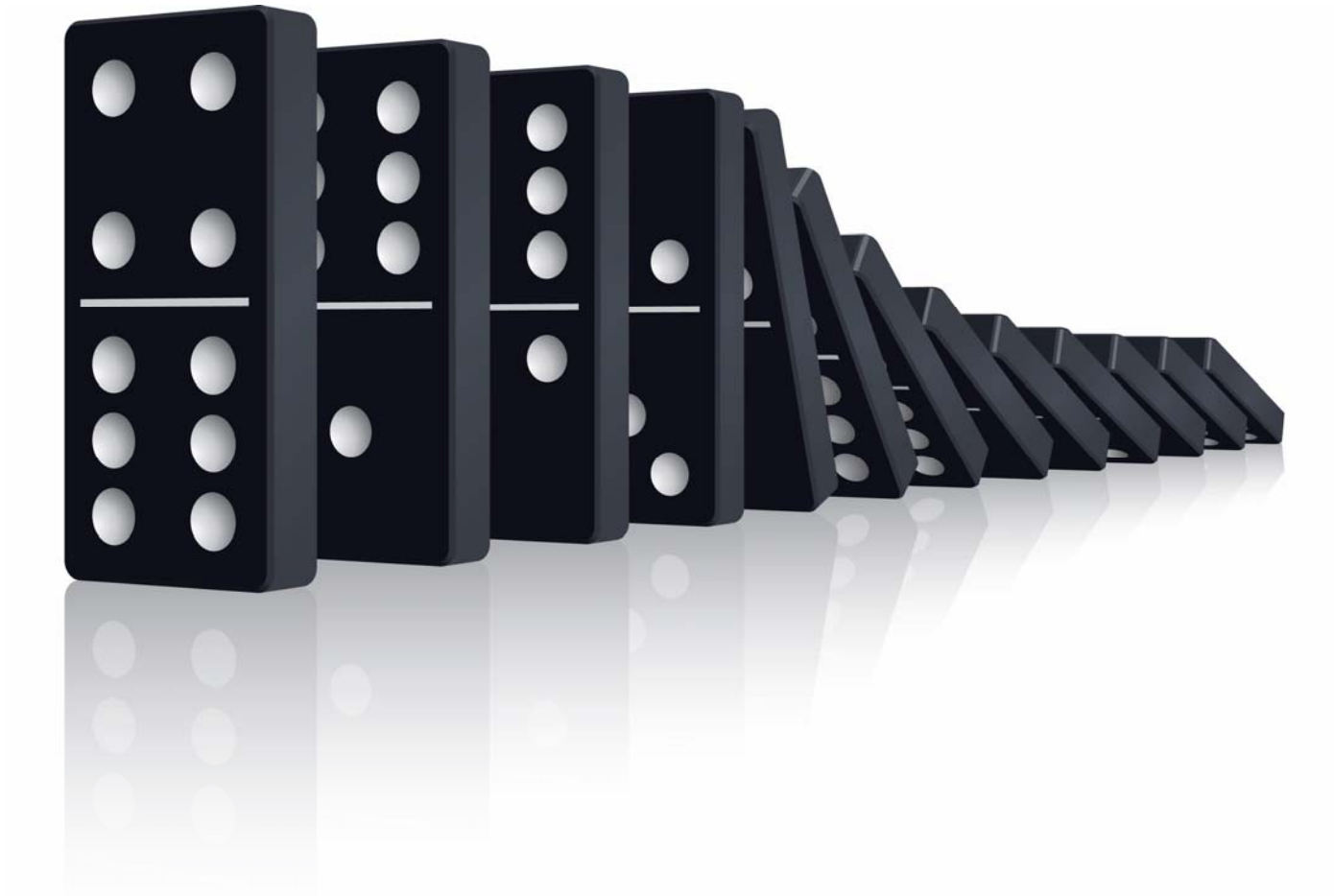




“Globalisation is not something we can hold off or turn off ... it is the economic equivalent of a force of nature - like wind or water.”

Bill Clinton





In which of the following countries do you have wholly-owned offices?				
	Top 10		Top 25	
	2007	2006	2007	2006
	%	%	%*	%
France	100	89	83	74
Germany	78	78	56	58
Belgium	100	100	78	79
Netherlands	78	78	44	37
Italy	78	78	44	53
Spain	78	67	44	47
Portugal	22	11	11	5
Other W. Europe	56	56	33	39
E. Europe	67	89	56	58
Russia	78	N/A	56	N/A
Singapore	67	89	50	53
Hong Kong	78	89	67	63
Japan	89	78	44	42
China	100	100	83	73
India	-	N/A	-	N/A
Gulf States	89	N/A	61	N/A
Other Asia	44	89	28	47
Australia	-	N/A	-	N/A
N. America	67	23	39	42
S. America	22	22	17	16
Other non-UK	-	56	6	42

(Source: PwC The Law Firm's Survey 2007)



Global Firms: Ring-fenced Legal Risk?

James Roberts

Partner

Barlow Lyde & Gilbert LLP



RING-FENCING LEGAL RISK

- ring-fencing legal liability – as part of managing legal risk
- common structure = network of “independent” firms,
with “umbrella” entity tying it together
- claimant attacks on the structure are common – why?
 - perceived deeper pockets in the case of the UK and US entities
 - take advantage of more favourable US litigation environment
 - greater (perceived) reputational impact / commercial pressure
- Globalisation + US litigation culture = an increasing problem...



RING-FENCING – THE US EXPERIENCE

- for UK firms → extra-territorial US jurisdiction
+ a taste of what's to come?
- the US legal theories involved are familiar to UK lawyers:
 - principal / agency – Firm A was acting as the agent of Firm B or the umbrella entity
 - alter ego – Firm A was so dominated by Firm B or the network as a whole that no distinction should be drawn between them
 - single partnership / holding out – network as a whole carrying on business together such that they were, or were holding that they were, a single partnership
- real problem = the US litigation environment, especially jury decisions



RING-FENCING – THE US EXPERIENCE (2)

- US Courts historically required some actual involvement by another part of the network in the particular problem – e.g.:
 - conduct of engagement and relationship between involved entities
 - warnings and “red flag” incidents during / after engagement
 - outward representation of individual firms and staff
 - sharing of personnel / secondments
 - “enforcement” role after the event
- but “involvement” need not be substantive / extensive – e.g.:
 - The Manhattan Investment Fund (2001) – The Deloitte Bermudan audit partner held out as “global practice leader”, and member of the umbrella entity’s committee.
 - Parmalat (2005) – The GT umbrella entity disciplined individual partners of GT Italy in connection with their Parmalat audits and ultimately expelled the Italian firm.



RING-FENCING – THE US EXPERIENCE (3)

- March 2008 US appeal decision – Banco ESI v. BDO International:
 - BDO International “*la[id] down accounting, auditing, investigation and other standards and practices to be adhered to by the Member Firm*” including the BDO Technical Manuals for auditing
 - therefore, “*BDO International did control the means – the management, audit manuals, and software – used by BDO Seidman to conduct its work for the Banco Plaintiffs*”
 - and therefore, arguably, BDO Seidman carried out that work as agent for BDO International
- A significant widening? Compare earlier US decisions – e.g.:
 - Nuevo Mundo Holdings v. PwC (2004) – not sufficient for the Claimant to rely on the fact that, across the network, “*there is overall training and supervision of all affiliates and peer review meetings held to assure compliance with the accepted professional standards and ethical requirements of what each affiliate is doing*”
 - The Royal Ahold case in 2004 – “*member firms in an international accounting association are not part of a single firm and are neither agents nor partners of other member firms simply by using the same brand name*”

RING-FENCING – COULD IT HAPPEN IN THE UK?

- established exposures areas under UK law
- surely not a claim like the Banco v. BDO? Compare:
 - *Duke v. Pilmer* (1999; Australia) – combined partnership for certain, limited purposes only (promotion and standardisation) not a partnership for carrying out of the client engagements
 - *Brostoff v. Clark Kenneth Leventhal* (1996; England) – association of firms under same banner not trading with a view to its profit, rather supporting (not replacing) profitable efforts of individual firms
- BUT we do see extravagant and unfounded claims in the UK alleging worldwide partnerships of network firms...



RING-FENCING - CONCLUSION

- threats to ring-fencing steadily increasing:
 - as globalisation continues to exert its influence on professional firms
 - as UK firms get dragged before the US Courts
 - as the broader US claims culture is increasingly exported here
- the balance between managing legal risk and the commercial drivers...



Insurance Purchasers' Considerations

Thomas Sheffield
Technical Director
Aon Global



WHAT SHOULD INSURANCE PURCHASERS CONSIDER WHEN ANALYSING INTERNATIONAL EXPOSURES?

- Ask Questions about themselves
- Ask Questions about the jurisdictions in which they operate



QUESTIONS ABOUT OURSELVES

- In which countries do we operate?
- Do we have multiple subsidiary holding companies in the country?
- Our business structure (Partnership, LLP, Corporation)
- What is our turnover in that country?
- How many employees do we have there?
- Is our operation there for back-office support, client-facing?



QUESTIONS ABOUT THE JURISDICTIONS

- What is the claim and litigation environment in country?
- What is the claim and litigation environment for industry/regulatory oversight in the country?
- Of the countries in which we operate, which are considered “problematic” jurisdictions for non-admitted insurance?
- Of the problematic countries, which are of greatest financial or strategic importance?
- In those countries that are problematic, what are the penalties for not complying with the requirement for admitted insurance?
- Of the problematic countries, where do we have local national Partners or Managers in the professional services firm.
- In the problematic countries, what indemnification protection is permissible or available, if any?
- Complicating factors of purchasing locally admitted policies: contract language, local claims handling, additional costs, lack of clarity in the local laws, etc.



WHAT ARE THE POTENTIAL INSURANCE SOLUTIONS IN THOSE COUNTRIES WHERE YOU WISH TO PURSUE ADMITTED POLICIES?

- Purchase a separate Limit, locally admitted policy in each of those jurisdictions, or
- Work with your “Master” policy primary insurer (or prospective primary or actual or prospective low excess) insurer to purchase locally admitted policies in each of those jurisdictions and tie-in the Limits where permissible. Where separate Limits are required, purchase a separate Limit, locally admitted policy; and/or
- Where the Freedom of Services Directive applies (EU/EEA), purchase one policy to address those jurisdictions, if your “Master” policy primary insurer offers a FoS policy.



WHAT ARE THE RISKS AND EXPOSURES OF PURCHASING NON-ADMITTED INSURANCE IN YOUR INTERNATIONAL JURISDICTIONS?

- Some countries require locally admitted insurance policies
- Some countries are unclear or silent on the acceptability of non- admitted policies
- Increased sophistication of international regulatory bodies and systems
- Tax implications
 - *On premium payments – For Insurers*
 - *On payment of claims – Insureds*
 - *Accounting implications*
- Indemnification protections are limited or even non-existent

Global Coverage – Insurance considerations arising from globalisation.

John Latter

Head of MIP (Multinational Insurance Proposition)

Zurich Financial Services Group



THE INSURANCE CONSEQUENCES AND CONSIDERATIONS ARISING FROM GLOBALIZATION/ EXPANSION.

- The insured's risk profile will move from being purely domestic in nature to covering risks in one or more overseas locations or it will incorporate new overseas risk locations.
- Existing insurance arrangements may need to be morphed into a Global insurance solution.
- The insured and the insurer must establish the licensing requirements of either the captive and / or the commercial insurer to ensure that they can cover the new international exposures.
- Who is responsible for the collection and disbursement of insurance premium taxes and how will this actually operate?
- How is coverage going to be provided into territories that explicitly prohibit non admitted insurance by foreign insurers?



A WORKING EXAMPLE

- A UK law firm merges with one or a number of major international law firms forming an organisation with fee earning offices in:
 - UK
 - EEA
 - US
 - Japan
 - Switzerland



A WORKING EXAMPLE CONTINUED

To even begin building a solution the insurers (including captives) must:

- understand where the insured risks are located.
- be permitted to provide coverage into each and every country, state, province, canton etc. where a risk is located. Global coverage from a single country **is not** acceptable, you must fully understand the licensing and regulatory landscape and apply this to each risk profile on a case by case basis.
- allocate the appropriate premium to the risk on a country by country basis.
- ensure that where coverage abroad **is permissible** under insurance regulation, that the correct insurer taxes are calculated and remitted in accordance with the tax regulations of each and every country of risk. This will vary also by line of business in many cases.
- be ready to provide solutions to cover the potential coverage gaps where non admitted coverage is not permissible.



FOCUSSING ON TERRITORIAL SCOPE

- **1.2 TERRITORIAL LIMITS**

Worldwide excluding any country or territory where it has been declared unlawful to trade by the United States government or its agencies and/or where such trade is otherwise prohibited by the United States government or its agencies.

This is not the answer.....



A REAL LIFE EXAMPLE

INSURANCE BUSINESS LAW (effective 1 April 1996)

XIII. Foreign Insurers (Articles 185 to 240)

- A foreign insurer **shall not be allowed to carry on insurance business unless it establishes its branch office in Country 2** and obtains the license from the Minister of Finance. **A foreign insurer shall also be required to conduct the insurance business only within the scope of its license and through its branch office.** For the purpose of licensing foreign insurers, the same provisions as apply to domestic insurers shall be instituted.



SO WHOSE ISSUE IS THIS AND WHAT ARE THE POSSIBLE CONSEQUENCES?

- An insurer risks having licenses revoked or fines imposed.
- Insured and insurers could face calls for the payment of unpaid taxes plus interest accruing as well as tax fines.
- Insurance contracts could be deemed unenforceable by a regulator and therefore leave the insured with the potential of an unpaid claim.
- Brokers risk E&O exposures by not advising their clients correctly on the requirements of the international insurance environment they are operating in.

Praveen Sharma, Marsh - "**Marsh's Tax And Regulatory Unit Responds To Evolving Global Environment**"

Best's Insurance News

June 23, 2008

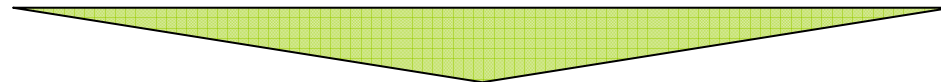
Such arrangements can create tax and even **criminal exposures**, Sharma said. The rules in some countries are very clear: local risks cannot be covered by an overseas insurer that is not licensed in the jurisdiction. A multinational corporation that is judged not to have paid its taxes in a particular country could face potentially severe financial penalties.



IN CONCLUSION

To navigate our way through the challenges we (insured / insurer / broker / captive) need to:

1. Understand the customers risk profile.
2. Establish the regulatory position in every country where an insured has a risk.
3. Determine that the appropriate licenses are available to the insurer.
4. Understand what the tax obligations are for the foreign insurer on a country by country and line of business basis.
5. Ensure that the tax obligations are recorded to satisfy tax audit requirements.
6. Ensure that all oversea insurance premium taxes are collected and disbursed.
7. Maintain the licensing, tax, legal and regulatory data on an ongoing basis.



The solutions we offer need to be transparent, flexible
and respond to customer needs





Cover for Umbrella Organisations

