Non-admitted international insurance coverage is not new. What is new is the growing vigor and energy with which it is being examined by insurance, regulatory and tax authorities around the world. We offer an overview of this increasingly complex topic.

What is Non-Admitted Insurance?

Non-admitted insurance is a policy issued in one country that covers exposures in other countries. In other words, no local policy is issued or specific perils covered locally. Instead, risk transfer is arranged in another country.

The Regulatory Environment

The legal position varies from country to country.

- In some countries non-admitted insurance is permitted.
- In other countries non-admitted insurance is prohibited.
- Some countries permit non-admitted insurance, subject to certain conditions, e.g., Spain permits non-admitted insurance with an EU-registered insurer so long as the policy is issued somewhere in the European Union (EU).
- Other countries permit non-admitted insurance, but require specific registration of the existence of such cover and the payment of insurance premium taxes, e.g., Puerto Rico.
- In still other countries, the law is silent regarding these topics.

It is common business practice in the US to insure overseas assets or operations on a non-admitted basis; however, an important question arises: Will a local subsidiary that is not involved in arranging non-admitted coverage (i.e., no role in the marketing, no local decision to purchase, no local premium contribution) violate local laws? Unfortunately the answer varies on a case-by-case, country-by-country basis, as each situation is assessed by local authorities.

Any Exempt Lines of Coverage?

Once again there is no single answer – the situation varies from country to country. However, as a general rule, limited classes of insurance can be exempt from non-admitted insurance rules and regulations. We have found that, typically, these exempt lines involve risks that by their very nature cross several borders, e.g., Marine Cargo or Business Travel insurance. Additionally, some countries provide exemption for specialist lines of coverage that are not available in their domestic markets, e.g., Professional Indemnity insurance.

The Tax Environment

It’s fair to say that governments everywhere are looking to maximize any available tax revenues. This appears to make subsidiaries of foreign companies attractive targets of potential revenue enhancement. This may mean that foreign subsidiaries have a higher risk of scrutiny by the local tax authorities, who normally look closely at transfer pricing, but also seek any sources of additional tax revenue.

As a result, potential tax liabilities are an important risk for buyers of non-admitted insurance. For example:
• Although in the EU the Kvaerner court decision held that one is permitted to arrange non-admitted insurance (albeit in most countries with the proviso that the insurer is licensed somewhere else in the EU), premium taxes must be filed in each EU country where the coverage applies as if a policy had been issued there. Tax is calculated on that portion of the global premium which relates to the exposure in that country. The EU Freedom of Services Directive enables the use of Euro insurance policies; however, insurance premium tax rates are not yet harmonized and taxes should be filed in separate countries where the risk resides.

• In several countries around the world, non-admitted insurance is permitted, subject to the filing of insurance premium taxes, e.g., Chile, where IPT of 22 percent and VAT of 18 percent are both payable on the local premium.

In the remaining countries the situation is not clear cut because the insurance and tax regulations appear to be silent on the issues of non-admitted insurance and insurance premium tax liability.

Claims Matters

In typical international coverage situations, claims are paid under a local policy with any payments from the “master” policy being channeled through the local policy. Where coverage has been arranged on a non-admitted basis, complications arise due to the absence of any local documentation. The main issues can be summarized as follows:

• Adjusting the Loss – Adjusters can be appointed both on an international or local level to investigate and help mitigate the loss. Such an appointment may be organized prior to the loss occurring in order to better respond to any incident.

• Claims Payments – An insurer may elect to pay a non-admitted claim either directly into the country in question or in the country (i.e., the US) where the master policy is issued. If local payments are detected and the non-admitted insurance was arranged in violation of the law, then the claim payment may be subject to tax assessment, and fines and penalties may be imposed. If a claim payment made in the US relates to an overseas operation, then the IRS may assess the payment as subject to tax and the corporate rate would be applied.

It is therefore important to ensure that appropriate tax liability clauses and limits are included in any master policy wording where non-admitted insurance is anticipated. Since most policies will not pay for fines and penalties, meeting the tax liability on a substantial claim payment may alleviate a lot of suffering on the part of the insurance buyer. When a claim payment is received in the US, getting the funds to the country in question is also challenging. Insureds need to evaluate the most appropriate and effective solution. This may take many forms, from recapitalizing the subsidiary to an inter-company loan.

In Practice

Given the increasing importance of corporate governance, it is crucial that a well-considered strategy be developed for all global program coversages (from D&O to Pollution to Umbrella to Employee Benefits policies). Such a strategy should identify the insured’s international issues and contemplate a solution to as many of these as possible. Such issues may include:

• The cost of having local policies in place around the world, not just the costs involved with fronting policy issuance. Buyers must consider that local premiums are generally tax deductible (some countries also allow non-admitted premiums to be tax deductible subject to insurance taxes being filed, e.g., Australia).

• Does the insured wish to “advertise” full limits purchased, e.g., umbrella programs?

• There is an understanding that transfer pricing rules generally require premiums to be allocated on an arm’s length basis in accordance with the location of the risk. For example, US parent corporations generally can’t deduct premiums allocable to foreign subsidiaries.

• Are the insurances likely to be active on a claims front? (One could expect a GL policy to be reasonably active in an average year, while a Crime policy would be less so.)

• What would be the insured’s position and philosophy toward a partial or total loss in each country?
Given the diverse nature of the topic, no single solution appears to be appropriate for all – other than the obvious: issuing all local policies where necessary and paying all local taxes. What we do see tends to be a patchwork of partial solutions:

- For EU countries, Euro policies are popular. (A Euro policy is issued in one EU country but covers all operations throughout the EU – individual country taxes must still be filed.)
- A direct-writing captive company, normally based in either Dublin or Gibraltar, can issue Euro policies but can also direct-write policies into a number of other territories around the world, e.g., Australia, Hong Kong and Singapore.
- If non-admitted insurance is elected for some or all territories (in cases, for example, where companies choose not to publish details of their D&O program), greater discretion is exercised – premiums are not cross-charged to the local operations, insureds exclude their local management from any of the communication flow relating to the non-admitted coverages and so on.
- Suitable tax liability clauses are negotiated (or at least the option priced) for coverages where non-admitted insurance is likely.

In our discussions with insurers on these issues, it has become apparent that while some degree of awareness exists, limited resources have been dedicated to product development or formation of a preferred approach. The onus remains with the insured to decide the best way forward. Some markets such as Lloyd’s are more advanced in their thinking on this subject (i.e., they insist on paying local IPT amounts when they are aware of a program with foreign risks insured). We believe that as global pressure to comply increases, other carriers are likely to follow suit, but in the short term, little help is available.

In summary, the dual topics of non-admitted insurance and insurance premium tax liability are complex ones without a simple one-size-fits-all solution. Buyers should be wary of entering into non-admitted arrangements without considering all the potential consequences and making suitable plans.

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