RECORD OF SOCIETY OF ACTUARIES
1985 VOL. 11 NO. 3

FOREIGN OWNERSHIP OF INSURANCE COMPANIES

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- o Reporting relationship
- o Organizational structure/changes
- o Accounting concerns/techniques
- o "Communication"
- o Personnel impacts

MR. JOHN B. YANKO: When I first saw this topic, my reaction was that it would be about a United States (U.S.) life insurance company, probably owned by a European insurance company, not necessarily a life company and operating under the 334(b)(2) or 338 transaction with the various tax implications. But the topic will cover both directions, with U.S. or Canadian companies as either the owner or the owned.

There are various reasons for companies going into what I will refer to as a foreign market or foreign operations. Diversification is an obvious one and here they are trying to spread their risk or earnings. Growth potential is another reason. Currently many foreign companies see the U.S. as one of the largest growing markets for life insurance sales and they would like to get in on it.

In some operations, companies are concerned about being nationalized and are moving funds from their homeland into another country. Still, the opportunity for profit, either directly or by way of currency fluctuations, is a strong lure. Also, it is an adventure for many people, providing the thrill of learning something new and different. It can represent the mind set of "keeping up with the Joneses." If your primary competitor has a foreign operation, especially a profitable one, why shouldn't you do the same thing?

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PANEL DISCUSSION

The basic reason I am moderating this session is that I work for a company that is owned by a German company. It has 25 percent of the direct market and about 35 percent of the total market including reinsurance; the opportunities for diversifying are very important to it. Products like variable life and universal life and practices like asset-liability matching can be developed in one country and transferred to another; modified where appropriate.

There was a panel discussion yesterday on the topic of management of international operations. I am going to read from material covered there. I think it is helpful. "Reasons for diversifying internationally: alternative management structures; political risks; foreign currency fluctuations; foreign taxes and tax credits; account options for consolidating foreign operations; and cultural considerations."

Again, when a company goes international, you can presume it has adequate capital. Given that, one reason for going international is to buy the management, treat it as an operation, leave it alone and just reap the profits (if you want to call it that). Another reason is consolidation of operations or resources. Call it "economy of scale." It may change and modify the operation as such. It can go into a foreign country, obtain more than one operation and consolidate those. There is also a spinoff opportunity in reinsurance operations and transactions.

Our first speaker today is Mr. Richard P. Burrows. Born and educated in England, he started his actuarial career in 1972. He joined the firm of Tillinghast Nelson & Warren in 1974, where he is currently a Vice President and Principal responsible for the Life Division of the London office. This September, however, he will be moving to New York City to undertake responsibility for the firm's international life insurance operations.

Our second panelist is Mr. William F. McGahan, a Partner in the U.S. firm of Coopers and Lybrand. He is in charge of the firm's U.S. Insurance Management Consulting Practice and is also Vice-Chairman of all U.S. insurance operations including audit, accounting, tax consultation, and life and property and casualty actuarial services. Mr. McGahan's insurance experience spans 25 years. Prior to joining Coopers and Lybrand, he was the chief operating officer of a U.S. life insurance company. He is a member of the International Insurance Seminars and regularly participates in their programs.

MR. RICHARD P. BURROWS: There are at least two ways of looking at the subject of foreign ownership of insurance companies. The first is from the perspective of a European or U.K company owning a North American company, and that is the view I will be presenting. I believe Mr. McGahan will look at it from the opposite angle, that of a North American company owning an overseas organization. In particular, I will divide my comments into three topics: the organization structure, the accounting practices, and the communication channels that are necessary, in foreign ownership situations.

The following items need to be considered when looking at how the U.S. company should be established:

1. Is it a branch of the overseas company?

2. Is it a joint venture?

3. Is it a subsidiary? If so, should there be an offshore or overseas holding company? Without a holding company, what is the world-wide structure of the group?

Many different structures are possible, for all of the companies that are operating in North America. I would be interested in hearing, from people who work for multinationals, about how particular operations are structured. I think you will find those to be highly individual.

It is important, though, to understand the structure. I think the cleanest structure is to have a holding company based in the U.S., with the insurance and other companies in the group reporting to it. The U.S. company would then report back to the overseas company. However, there could be some compelling reasons why this may not be the most efficient structure. Those reasons would have something to do with financial taxations on considerations (that is, how a tax credit is treated in the overseas territory), and/or with accounting considerations, particularly ones involving the use of a specialty basis (that is, a subsidiary reporting directly to another insurance company's subsidiary in the overseas territory without a holding company in-between).

What reporting considerations do we have? Generally speaking, in the U.K. and in other overseas territories, there is no equivalent of U.S. GAAP so reporting will probably be on some statutory basis. I will cover this in more detail under the accounting practices topic. Additionally, would the company be reporting on an equity basis? What is the dividend policy of the group? Other considerations will be of local or foreign management and language problems. I will go into this more later when I discuss communications.

What type of company is the U.S. company reporting to? Is it an insurance company? Is it a mutual insurance company or a stock company? Does it have an upstream holding company? Is that some sort of other company--financial services or industrial? These are very important questions, as it is crucial to the group to know how and to whom it is reporting. Other important aspects of reporting on a more day-to-day basis, are time zone differences and speed of communications. If the U.S. company cannot make decisions without first asking the parent, then there could be considerable problems. In certain locations, for example Australia, there is a huge time difference. It is very difficult to reach people there when they are in their offices and vice versa. A simple decision could take three or four days to enact.

How should the parent company monitor results? One particular company had a report containing some very detailed financial statistics. The object of the report seemed to be to fill in 2,000 holes with numbers. At one extreme, one company in the group had a very strange accounting format. It was so strange that it got its own little box on the report. This box then began to be used by the other companies, as a sort of slush fund. Anytime they could not get figures to balance, they would put a number in the little box which made all the figures balance. So the whole exercise of detailed financial reporting on a monthly basis can actually be self-defeating. It is time consuming; it becomes a form-filling exercise that just gets filed away without any sort of analysis. I think it is important that the results are monitored, but I think they should present key issues to the parent.

The second topic I will talk about is the accounting practices and concerns. This could occupy a whole session, so I am going to limit myself to selected major issues. An interesting paradox was first expounded by Mr. James Anderson. Basically, he maintained that most U.S. insurance companies would be insolvent on a U.K. statutory basis, and vice versa. But then, most progressive insurance companies would be insolvent on a U.K. statutory basis. This is important, but if you think about it, it makes no sense at all. This paradox arose because interest rates were extremely high in the U.S. Most U.S. government bonds are held on an amortized book value basis, and the fact that the market value may have been 30-40 percent below this was not reflected in the statutory statements of the company. Thus it appeared that the assets were greater than the liabilities. In the U.K., however, that company would have been forced to value the assets at market value. On the U.K.'s statutory basis, at certain points in time, liabilities would have exceeded the market value of assets. Although assets are valued on a market value basis, the U.K. had a much more lenient statutory basis in that the true yield coming off the matching assets could be used to value liabilities. When a U.K. company moves into the U.S., valuing its liabilities on the U.S. statutory basis would have given it increased liabilities. If the company was an active trader in the bond market, the amortized value of the bonds would be very similar to their market value. Hence, the U.K. company, on a U.S. statutory basis, would have liabilities appearing to be greater than assets. That was the essential paradox. There is a corollary to this paradox. It appeared that, in Ireland, which has a combination of U.S. and U.K. valuation bases, both the U.S. and U.K. companies would have been solvent.

This example illustrates that, as a practical matter, major issues are involved in reporting on the different statutory bases from one country to the next. You really cannot take anything for granted. You have to look at the statutory basis, and you have to be sure when you set up an operation that your results are not just going to be transferred over to the overseas territory and valued the same way on, say, a German statutory basis, a French statutory basis that you know absolutely nothing about. You could be thinking, from a U.S. perspective, that your company is doing extremely well. You are making GAAP profits; those are increasing, but your parent may be looking at you on a Germany statutory basis, and it thinks you are doing very poorly. So, it is very important to know these differences in accounting practices.

Earlier, we touched on ownership structure, and I would like to come back to that. If you are buying an insurance company, is it a stock company or is it a mutual? With a stock company, it is possible to have an upstream holding company. With a mutual, obviously it is not. Therefore the mutual company will have to consolidate your actual returns, unless you have a holding company in-between. But then if that holding company in-between is in the U.S., would overseas legislation require some sort of see-through basis? That is, the ability to look straight through to the holding company and allow the holding of the assets and liabilities on the overseas basis. With other financial services companies, banks, building societies or mutual funds for example, there may be legislation prohibiting ownership of an insurance company. Again, it is important to know whether putting a holding company in place eliminates that problem, whether the group should restructure itself to get over these problems. It could be a major issue for the U.S. company because for the group to restructure, it could take many man hours of work. It could cost a fortune in professional fees. The companies may just think that it is not worth it. But they have to understand that to be successful, eventually they may have to change that attitude. The structure and the way it is accounted for are extremely important issues and should be examined in quite a bit of detail.

One interesting issue is what I call "added value accounting." There are no generally accepted accounting principles (GAAP) for this in the U.S. In other territories, however, many companies have developed a technique which attempts to give management a clearer financial picture of the insurance company that is possible using only the specialty evaluation basis. They use a technique I call "added value" accounting whereby, on a regular basis, maybe once a year, an appraisal of that company is performed. It is carried out by comparing the product lines' stream of future earnings to the statutory valuation basis, discounted at a reasonable rate of interest. Generally speaking, only the in-force business is looked at. Usually, no accounting is taken for the value of good will. It is a particularly useful number for management to focus their attention on, if the only other thing they have is a number from a statutory valuation basis. This is particularly true when companies are new and expanding, which is often the case with North American companies acquired, or about to be acquired, by overseas companies. They are quite interested in growth.

This appraisal value accounting technique is even more powerful if you link it to a stock option scheme for the senior management. In that way, you have a common interest between the shareholders and the management. The managers are very aware that if they do badly, the values of their stock options are likewise reduced. However, if the values of the options increase, the shareholders have a much more relaxed attitude about day-to-day monitoring of the company's money. It is a technique that I am seeing used more and more in the U.K. I think a lot of U.K. companies would like to use it with their overseas insurance companies.

Certain territories have quite rigid and stringent statutory valuation bases, and so additionally have a problem that the defined valuation basis does not truly reflect the earnings progression or potential for the company. Often, when the rules are very rigid and inflexible, it is difficult to market certain types of plans, certain types of products, in those territories. One finds that trying to squeeze the product into the overseas territories reporting system is just impossible. If it is not impossible, it costs you a lot more money in setting up statutory reserves than you otherwise hoped for.

Some tax considerations are particularly crucial on the accounting side. In the U.K. taxes are computed on what is known as an "I - E" (interest less expenses) basis, and this can lead to all sorts of different bases from territory to territory. Still other territories have profit taxes. In certain countries, there are major tax planning opportunities. One concern went through all sorts of contortions to save tax on an insurance company. (It was a general insurance company.) Basically, there was no need to do that because the group as a whole was in a tax loss situation. Upon consolidation, the tax payable on the insurance company would have been more than offset by tax losses in the rest of the group. A lot of time and money was spent on professional fees to get through a major tax planning exercise, in my opinion, for very little result.

Understanding the foreign tax credits is important, and I am sure the new U.S. tax law will bring up a number of important issues about those. For instance, what double tax agreements are in force? I know the U.S. has double tax agreements with both the U.K. and France, and it is rumored that there might be one with the Netherlands sometime in the future. If that double tax agreement does not apply, then tax planning has to be thought through, in much more detail, territory by territory.

The size of the organization is also quite important in defining accounting procedures. The larger the organization, the more detailed the financial statistics. This can pose serious problems for a small insurance company in North America. It may have to file GAAP returns. It may also be required to produce figures on the overseas territory statutory basis, plus all the other forms that a large organization maintains on a routine basis. I think North American companies need to communicate to their overseas parents just how much additional work they have to do in their normal day-to-day filings in the U.S. Obviously, the bigger the organization, the more at stake. The larger the organization, probably the less rigid it is, the less inflexible it is, the more it will insist that good financial data be communicated back and the less leeway it will give to making the benefits on the product side, for fear of some major disaster happening.

The last topic I will discuss is communications. Even with all of today's high technologies--computer systems, word processing systems, satellites--there is still a need for human communications. Here, language is very important. Even in English speaking countries, the vernaculars are so vastly different that confusion often abounds. Obviously, if a foreign language is involved, then there are even more problems. In foreign operations, it is important to have nationals in fairly senior management positions, if not in all of the senior management positions, who have a firm knowledge of the language and who are natives of that particular territory.

On the financial side, the overseas company would like to have consistent worldwide reporting, but obviously that is very difficult. Some of the accounting results that the overseas parent wants communicated to it bear no relation to the operating territory because the system was developed for an Australian or South American subsidiary. But it is important to communicate back to the parent about particular problems, and not necessarily for there to be a worldwide reporting system.

How is the insurance company treated by the overseas parent? Has it communicated how it would like to see the insurance company operate? Is it treated as an investment? Is it treated as an experiment of some sort? (I think it is unlikely that one would wish to experiment in the U.S., with all the regulations in force. It is probably also very expensive to experiment in the U.S.) Is it treated as a great opportunity? Depending on which one of these is the parent's view, it will have vastly different aspirations. It is important that the parent communicates to the North American company what those aspirations are, what is expected from the company. Does it expect dividends? Does it expect GAAP earnings? Does it expect not to put up any more capital? That is very important.

One other important area in communications is the transfer of concepts from one territory to the next. The products are not transferable, but the concepts are. I think that U.S. companies that are owned by companies in Europe or other overseas countries have opportunities to deliver a wide range of products, and with their own very diverse distribution systems, to contribute to how the group operates on a worldwide basis. This is possible by communicating to the parent just how good these ideas are. It is of no use to talk in esoteric terms about universal life or variable life. One must sit down and explain the concept, how it works and how it might fit in with a particular mode of operations.

In conclusion, I have discussed the fact that there are a great many differences between overseas insurance markets and the North American insurance market with respect to local cultures, customs, regulations and financial reporting systems. This can lead to companies organizing themselves to have completely different operating structures. Company attitudes, dividend payments, accounting and reporting systems, product designs, distribution systems and so forth, will depend on the whole host of considerations. Some companies will have thought about all of these issues, and their structures will reflect that. But the structures of other companies may just be accidental. It is likely in these situations they will not be operating to full efficiency.

Finally, I think that good communications between the parent and the overseas subsidiary are vital, if the group is to succeed. Knowledge of the overseas environment and the ability to communicate conditions in the local environment to the parent are extremely important.

MR. WILLIAM F. MCGAHAN: I would like to discuss a few observations made from a North American perspective. I will address my comments to our overseas friends who have come into the U.S. and taken over companies. Perhaps I will point out some things you may already be aware of, but they are significant.

The first thing that struck me about doing business with people from Europe is they haven't the slightest idea how big this country is. They have a vision of the U.S. which is roughly comparable to that famous New Yorker magazine cover depicting the U.S. as New York City, the Hudson River and then San Francisco with terra incognito in the middle. Some overseas companies locate their U.S. offices by taking a map, pointing to somewhere in the middle and saying: "This should be good because we can get everywhere quickly." So they wind up with offices in St. Louis and Kansas City, which are not bad places, but have no relationship to the market they may be after.

A more specific example is provided by a large European insurer who decided to get into the U.S. marketplace. It wanted to locate in New York City because it was very important to the parent company executives to have access to opera and other amenities that were in New York City. However, the president of the U.S. company did not want to live in New York City. He said he would rather live on the West Coast, so they located the company on the West Coast because, after all, it really was not that far away, and they could get there very quickly. Unfortunately, it was a property and casualty insurer, not involved in the California workers compensation marketplace, and it has been suffering ever since because of a decision that was based on a whim.

This lack of geographic sense can be illustrated on a more individual level. One executive, who was assigned from an overseas organization to a U.S. company, looked out the window one Friday afternoon and said to a coworker: "It is a lovely day." (They were in New York at the time.) "I think I would like to go to Chicago for the weekend. What is the best way to drive there?" He did not understand that he would be driving the entire weekend, just to get there and back. Distance is important.

I finally came to understand why some Europeans do not get a good idea of the size of the U.S. marketplace. It is a simple reason. We in the U.S. grow up seeing maps of the world on which the U.S. is in the middle, very large and very big. Recently, I picked up a U.K. map of the world, and there was England in the middle with the U.S. way off on the left-hand side, extremely shrunken in size. I would expect that if you grew up in Germany, in Japan, that country would be in the middle of a world map, and the people there would spend all of their lives thinking the U.S. was split into two pieces, and very, very small in size. There is a lot of difference between knowing something and really understanding it.

But there are other things that Europeans do not understand about the U.S. marketplace. There are very significant differences in buyer behavior between the U.S. and Europe. I think it is difficult for European managers, or managers from any other culture, to understand that the U.S. buyers are very different from buyers in their own countries. A lot of studies have been done on the U.S. market.

These are called "psychographics." I am not going to go into them, but if you are in the life insurance business, you know that currently there is very little buyer loyalty in the U.S. There is still some, but very little. If the price goes down by any significant amount, the customer will move quickly to another carrier. Managers from other countries are not used to this. They may get used to it in the future, but, at the moment, they are used to very loyal customers who often have a very strong personal identification with the organization. Those managers also do not understand how buyers in the U.S. are ready to sue at any moment, and what impact that has on losses.

Finally, I think competition is a major issue. Most companies coming into the U.S. are large. They operate in a very small marketplace with something like seven to twelve major competitors. They usually have a good share of the market. Alliance, for example, had 25 percent of the market in Germany, maybe 33 percent if you took reinsurance into account. It is very difficult for executives there to understand that if you come into the U.S. marketplace, you are dealing with 3,000 property and casualty companies and almost 2,000 life insurance companies. Typically, such concerns are coming into the U.S. by buying a company that is not a dominant force in the marketplace. Competition is very, very difficult for them to understand. They come in with a lot of perceptions that need to be overcome.

Generally, as far as organization is concerned, I find that most non-U.S. companies that acquire a U.S subsidiary tend to leave the managers alone until they get into trouble. Then they quickly bring in somebody from the parent company to take over the organization, or maybe to fill several senior slots in the organization. Those people come with all of these biases about the marketplace, about the competition, about the buyers. In the property and casualty field, we have seen a lot of that occurring in the past several years. If you are working in one of those organizations, I think you have to take great care in explaining what is happening in the marketplace, and in explaining to your parent company who your customers are.

If you are in a U.S. company that has been bought by a European, or other foreign, organization, you will find very quickly that several things happen. Delegates from the parent company appear on the premises. These delegates are people who are typically assigned to a unit of the organization, underwriting, claims, investments or so forth. But they really come here to train. It is important not to regard them as spies, because they usually are not. They are here for a valid reason. They typically do not communicate to top management of the company. They deal with somebody who is their patron in that department, and they are here for a specific mission. Thus it is important to find out what that mission is, so you can put them in the right place and you can show them the right things in the organization.

Another thing that will happen after you are acquired is that you will be flooded with requests for information from everybody at the parent company. Everybody wants to know what is going on. It sometimes takes you weeks and weeks to fulfill a request for information. Then after submitting it, you never hear from any of them again. You do not know what they are doing; you have no idea why this is going on, and it can take an enormous amount of time. I think it is very, very important that you set up channels to screen information requests. Then you do not get somebody at a lower level of the parent organization doing a study, having your people run around for four or five weeks gathering information to support this study, which is really not important to the top management of the parent company.

Let me talk about the U.S. perspective on going into the international markets. That is largely a property and casualty perspective, not a life perspective. There are not many life insurance companies who have gone into overseas marketplaces. I do not know what the reason is. It may be related to the fact that in World War I a lot of big mutual companies lost properties overseas. But whatever the reason, they have not done it.

It is important to understand how they have gone into the overseas marketplaces. Usually, the large property and casualty companies got involved because they had to serve large multinational clients with overseas locations. They needed to provide insurance on a worldwide basis to corporations like Exxon, Firestone or Ford. Their typical first arrangement was a service one: "Let's find out who is writing insurance business in Indonesia, the local company. We will arrange something with it so that it will provide coverage." Very quickly, companies got into other arrangements where they established a local presence. Around the world, there are a number of different alternatives for how they establish that presence. They become admitted in countries where admission as an insurance company is required. In some countries, they operate as non-admitted carriers; not recognized by any of the licensing authorities. Here, they just write business, either on a direct basis or as a reinsurer--they might write business through a primary company and then assume it all into their own organizations. Some of them actually form subsidiaries or buy companies. Some of them set up branches. So, the property and casualty company structures around the world are very different. Some of those structures are dictated by local law. Some companies are lucky that they got in early, before the countries realized that this was indeed a money-making activity and decided to keep out anybody else. So you find interesting patterns around the world where companies actually own organizations, or are doing business through other carriers because they did not get there early enough.

In that latter environment, they typically bring every transaction back to the U.S. Huge volumes of information then flow back to the U.S.--every premium, every loss, every claim settlement. That information is fit into systems in the U.S. That is particularly true with a branch operation, where the company writes through an agent in the foreign country. Often, that volume of information gets so big it is difficult to deal with, but the company is forced to because of an accounting regulation that went into effect in the 1970s called FASB-8 (Federal Accounting Standards Board - 8). This said you have to recognize foreign currency exposure on a transaction-by-transaction basis. That has changed somewhat in the last couple of years because of a couple of things--inflation and because of foreign currency exposure. Foreign currency was not a problem until ten years ago, and then not a critical one until four or five years ago when the U.S. dollar became extremely strong against foreign currencies. Now it is a significant problem. In 1982, the U.S. accounting profession adopted FASB-52 which eliminated FASB-8 and said that a number of alternatives are available to account for foreign business. However, all of that business has to be translated into U.S. dollars in one form or another.

Let me tell you a little bit more about FASB-52. Essentially it says: "Let's look at what is really happening. Are you guys just doing a couple of transactions in that country or are you there to stay? Where is the money going? Are you leaving the money or are you bringing it back?" If you are leaving the money there, paying the expenses there and are there on a permanent basis, FASB-52 says, in effect: "I do not care what your organizational structure is, whether you have a branch, a subsidiary or an agency, you can treat that entity as a reporting entity on a balance sheet and income basis and you can treat that currency as what we call a functional currency for your reporting."

What impact does that have? It means that in translating the balance sheet and income statement from that operation, you revalue it as an asset and do not deal on a transaction-by-transaction basis. You are essentially taking the impact of that into your surplus, and not through your income statement. It is a very significant change. But there are still income statement implications because in that local environment, you may be doing business in several foreign currencies and you are going to have to translate those into the functional currency you are dealing with. But, you are not taking every transaction and measuring its impact in terms of dollars. This has led to structural changes in some of the companies. At my firm, we are now seeing much more emphasis on decentralized management, much more emphasis on profit centers.

Let's look back at management and business reporting in the foreign entities. Again I think most companies start by looking at them as U.S. operations. There are regulatory requirements in a lot of countries. Some do not have those, but many do require the filing of financial statements with local regulatory authorities. The DLT in England, I think, is perhaps the best known, but there are regulations in France, Japan and many other countries. They are very complex. They are not U.S. statutory. They are not U.S. GAAP. They are usually something else. The books of the entity have to be set up to comply with the local requirements, and those can be rather strenuous. In Japan, for example, there is a manual on how to calculate incurred but not reported (IBNR) losses for property and casualty companies. My understanding is that most property and casualty companies in Japan follow that manual, report the results to the local authorities, and then do their own calculations of IBNR because the manual calculations have no bearing on reality. They are in the statutory requirement for filing. You have to understand that you are going to keep a couple of sets of books when you are operating overseas.

Another thing you may have to understand is that when you get statements from overseas, things may not be as they appear. Premium does not always mean premium the way you understand it. In some cases, premium means collected premium. In some cases, it means written premium. In other cases, it means earned premium. You have to understand what is reported when somebody says: "My premium was..." It is the same with losses, there are all kinds of variations from country to country, and some within countries depending on the local customs and standards. If you are doing business over there, make sure whoever is reporting to you is using your definition, the one you require.

Another thing that is becoming very important for a U.S. company operating overseas is investments. If a company has significant overseas holdings, it could have a big problem balancing currency exposures. That may not be obvious from the financial statement because the subsidiary may have translated everything into the local currency and reported that. But in fact, if it is a company operating in Italy, it may be writing half of its business in Austria in shillings and that may not be apparent in the financial statement. So there is an underlying currency exposure that you have to be aware of.

There are other hidden exposures in the currency/investment area. For instance, a Greek contractor you insure may decide to put up a building in Italy. A special policy must be issued for a large U.S. corporation to cover anything that is not covered in its eighteen subsidiaries in different countries. Premiums can be paid in U.S. dollars, but the losses incurred in other currencies.

Last, there are the "traveling" risks, as I call them. A ship insured in Greece winds up being repaired in Brazil. The losses and the repair costs are very different from one place to another. Not all of these risks can be identified in advance, but you should be aware of the fact that they exist.

Another important issue is personnel. When non-U.S. companies come into the U.S., they are shocked at how U.S. personnel think nothing of quitting and going someplace else, particularly data processing personnel. Loyalty is not to the company, but to occupation. Perhaps that may even be true of the personnel professionals themselves. They move around within their field and do not stay with one company. Foreign companies find this very difficult to deal with.

Similar considerations apply when a U.S. company goes overseas. You have to recognize that you cannot go in and fire somebody with the expectation that he will easily find another position somewhere else. You may find that when you fire him, half of the staff leaves with him in outrage, and you may find that you now have a very serious problem trying to hire anybody else into that organization. You will also find that personnel policies with respect to vacation, leave time and so on vary dramatically around the world. There are hidden costs in all of these aspects. In West Germany, it is not atypical for people to have six weeks holiday, and for them to be encouraged to take at least four weeks of that holiday time in one solid block so that they get adequate rest and recuperation to come back to the job feeling good. There is a lot of cost in that. You will also find that employee benefit plans are structured very differently from one country to another. You have to understand those differences.

I want to talk now about the movement of information and money. You will find that certain countries do not frequently talk to each other, so that telephone lines do not go the way you logically think they would. Italian telephone lines, for some strange reason, all go through Germany, but do not go into France. So information travels in circular paths around the world. Likewise, money cannot be transferred directly between certain countries. So, there are very elaborate means of moving money around the world. For example, from Brazil to Peru to someplace else and then finally into the U.S. Reinsurance plays a significant role in the movement of that money. As you begin to operate in an international environment, and try to set up systems in it, you may find that, in some countries, you cannot use certain kinds of equipment. There are some countries in the world where it is impossible to buy an IBM computer. IBM does not do business in certain countries, largely because they insist that majority ownership be held by a resident with only a minority interest held by the company. So you are going to find places where there are no IBM computers, and you are never going to get them. There are lots of interesting patterns around the world that you must be very, very sensitive to.

Last, I want to talk about local cultural and market issues. I will tell you a story that Mr. Victor Kiam told the other day. He is the guy who bought the electric razor company. He decided to market his product in Japan and set up a mechanism to get clearance from the government. It said he could market all of the electric razors he wanted to. So he went over there and the first thing he realized was that there is no retail space in Japan. Typically, when he went into a retailor to sell him something, he had no place to put inventory. Whatever inventory he had was on the shelves. Mr. Kiam then had to set up a new distribution system. Instead of delivering the razors once a month, he had to deliver them two or three times a week because the retailor had no place to put them. The distribution system was one where a truck came around every two or three days, filled the empty space on the shelf and left. It was a very expensive proposition, but that was the only way he could do business.

Something you have to realize is that you do not contact people the way you do in the U.S. Mr. Kiam told another story about visiting a distributor in order to get a feel for the market. He introduced himself and spent hours with the distributor. The distributor asked him how long he had been in Japan, talked to him about his family, talked to him about local customs, the weather and then left. Mr. Kiam asked his Japanese contact about what happens next. The contact said: "Well, you go back to your hotel room and if he liked you, he will give you a call." He waited there for several days and did not receive a telephone call. So, he felt that there had to be a better way to do this, and the Japanese contact said: "Have you talked to his banker?" He said: "No, I haven't." The Japanese friend said: "Go talk to his banker. I will introduce you to him." He talked to the banker. The banker introduced him to the president of the company. The president then made the call down the chain of command to this retailer, and

Mr. Kiam went back in to talk to the retailer as if he had never met him before. The retailer asked him what his name was, when he came to Japan, how long he had been there, because he wanted to save face. He did not want to let the president know that he had turned him down on an earlier occasion.

Their culture and the way they do business is very different. If you are going to do business overseas, you have to learn how other people do business in order to sell your product in their marketplace.

MR. DAVID J. CONGRAM: I am vice president--Life Division, Aetna Canada. Mr. Burrows, you mentioned the term "appraisal value." I wonder if you could give us a little bit more of an explanation of what you mean by that.

MR. BURROWS: Essentially, it is similar to the appraisal-value calculations that are carried out in North America for the valuation for purchase of a life insurance company. The way that it is done in the U.K. is to divide the value up into three components: the net worth, the value of the in-force block of business, and the value of the plan (or the value of any expected future new business.) What the companies look at, on a consistent basis, year by year, for example is how the value of the in-force block of business is moving. If it has increased in value by $10 million since the last time the valuation was made, then you will think the management performed pretty well. If it has gone down by $10 million, then you will think management did pretty badly. Essentially, it gives an indication of the progress of a company which does its accounting on a statutory basis. Remember, there are very few adjustments to accounts on a statutory basis in most territories apart from the U.S. It gives you an indication of the progress which you would not normally get out of statutory accounts. Do you want further explanation?

MR. CONGRAM: On what basis is that, gross premiums? Can you relate that to what we look at when we talk about return on equity (ROE)? Is it similar to that? I am just trying to get a good measure.

MR. BURROWS: You could not relate it to ROE as such. But, the methodology would be to project all future earnings of the company by looking at cash flows on an after-tax basis, allowing for the way the statutory reserve basis moves. So you do look at all future cash flows and discount those at a required rate of interest.

MR. CONGRAM: So it really is a sales basis.

MR. BURROWS: Yes, a sales basis without the element of goodwill.

MR. YANKO: Are there any more questions?

MR. M. SCOTT MACAULAY: I'm an actuarial assistant at the Citadel. I was wondering, with regard to reporting, how you handle things like year-end requirements where the data you need to complete is in a reverse order to the way you would normally need to do it. With deadlines like January or February, what is the best way to handle that?

MR. MCGAHAN: There is usually a lag in reporting when you are dealing with an overseas entity. You very often will be reporting three or four months after the fact, so you may have a quarter lag or you may have a two-month lag or the books on the overseas company may close before your's close. Typically, U.S. companies do not ask the overseas entities to go through all the conversions to GAAP, because they just do not have properly trained personnel in all of those locations. They ask for information, usually a balance sheet, an income statement and then supporting statements which provide enough information to the head office to make the adjustments when the report comes in.