Beware Overseas Risk

Chinese companies are embarking on an ambitious path to become leading multinational corporations. With great opportunities come great risks, especially in Western markets full of unexpected liabilities.

In reviewing the facts and figures that dominated a remarkable year, 2016 is likely to be remembered in the markets as the year Chinese buyers became global powerhouses. Over a relatively short period of time, private Chinese companies have flourished domestically and begun expanding overseas. These Chinese corporations are economically competitive, designed to reach a massive scale of consumers with the ability to integrate rapidly-developing and efficiency-generating technologies.

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This trend is evident in the volume of mergers & acquisitions in the region. According to *Mergermarket*, Asia-Pacific is on track to surpass Europe as the world's second largest region for M&A dealmaking. In 2016, over US$720 billion was transacted in Asia-Pacific including Japan, representing nearly a quarter of global deals, and 258 of these deals were Chinese outbound transactions valued at over US$185 billion.

Expectations for Chinese M&A in 2017 are muted as a result of guidance from Chinese regulators that outbound M&A deals valued at over US$10 billion will be subject to heightened scrutiny. Nonetheless, the role of Chinese and Asian corporations in global business is set only to continue growing.

CHALLENGES WHEN GOING ABROAD

When expanding overseas, it's easy to forget that companies will face unique risks and liabilities in every market they enter. This is particularly the case in markets outside of Asia, where shareholder claims and class action lawsuits can cost companies millions of dollars in defense and settlement costs.

This is not a phenomenon restricted to the United States, where companies are generally aware that corporations face a generally more litigious environment. Australia has since 2004 seen investor or shareholder class action suits rise by over 50 per cent – today, Australia is the jurisdiction where corporations are most at risk of facing a class action outside of the US.

Employment practices are another oft-overlooked area of liability for expanding Asian and Chinese corporates. Anti-discrimination legislation in developed markets can expose corporations to suits from employees claiming sexual harassment, discrimination, wrongful termination and breach of contract, among a range of other potential accusations.

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Meanwhile, expanding corporations must also begin re-evaluating their liabilities in Asia, where regulators are taking an increasingly active role in overseeing corporate governance. These dynamics have already led Asian regulatory bodies to take a more active role in addressing market misconduct and corporate malfeasance, particularly evident in Hong Kong where the city's Securities & Futures Commission has heightened its focus on corporate investigations.

The nature of liability can change rapidly, and having a corporate presence in multiple countries multiplies this uncertainty. Insurance can help address and mitigate these risks, but a comprehensive solution to risk doesn't come from a "one size fits all" approach.

INSURANCE CONSIDERATIONS

Companies building an overseas presence should carefully consider the governance requirements for each market in which they will operate. Indeed, liability risks arising for potential shareholder actions or regulatory investigations should be a top priority when evaluating M&A targets in overseas markets.

Directors & Officers insurance, a relative rarity for Chinese corporations in their home market, is a critical element of risk mitigation for boards and officers of Chinese companies that wish to operate in Western markets. Many of today's best directorial talent won't even serve on a board without the backing of a D&O insurance policy.

As Chinese corporations reach scale that may match or exceed global competitors, a broad global policy becomes an increasingly important option for managing unknown liability risks. In addition, executing a comprehensive global policy alongside locally admitted policies is becoming a priority to comply with local insurance regulations to insure the ability to deliver funds for claims in overseas territories. Locally admitted policies may also have enhanced coverage developed over many years to address the unique exposure of that country.

Many insurers offer global cover from a single contact point in say London or New York; unfortunately, this setup can rapidly break down when claims are filed. It is one thing to have a claims professional sitting in London assessing a case in Vietnam for a Chinese company – it's quite another to have local contacts and execution capability in each market to see a claim through the process. These cases, increasingly frequent in a globally-connected business environment, require local knowledge and expertise across a number of unique jurisdictions.

Local expertise and operational capabilities should thus be a key consideration for Chinese corporations of any size as they move ahead with global expansion plans, both organically and through acquisitions.

Beyond D&O insurance, Chinese corporations may find themselves best served by a more comprehensive *multinational approach* that covers a broader range of liabilities across multiple jurisdictions. A multinational program includes a broader suite of products tailored to meet the demands of the business, which could range from property and casualty to professional indemnity or cyber liability.

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Global growth is the natural evolution of business in Asia. But it is also an endeavor fraught with uncertainty. By taking a clear-eyed view of the potential risks and rewards, and how to mitigate them on a market by market basis, corporations will set the platform for global success.