

Insurance Times Investigates Corruption in emerging markets

By Saxon East and Lauren Gow

- It is difficult to do business in Russia and China without breaking the law, as corruption is so endemic
- The new Bribery Act will mean directors face up to 10 years' imprisonment if staff are caught in breach of the rules
- It will be a challenge for Lloyd's to operate strictly within the act when it opens its Moscow office this year

Bribery abroad exposed

Insurers and brokers wanting to expand in emerging countries are facing a stark choice: break the Bribery Act or walk away from business.

Despite tough management talk that they have the proper checks and controls in place, the reality of working abroad is very different, we can reveal.

Nobody would talk on record to *Insurance Times*, but sources speaking anonymously say it is "impossible" to do business abroad without breaking the law. India, Russia and China are said to be plagued by corruption, and paying off people in these countries is a way of life.

The revelations will serve as a sharp warning to insurance management, who face up to 10 years in jail if staff are caught breaching the new act, which comes into force in July.

One source with extensive insurance experience in Russia, says:

'Lloyd's has decided to go into Russia, so it must have decided it can live with the consequences of UK legislation'

Anonymous source

"When the Bribery Act comes into force, and we don't know the effect of it yet, it is going to make it very difficult for anyone to do business with countries like Russia.

"From the top down, the whole structure is utterly corrupt. It's difficult to explain to people why we should accept that, but if you know anything about Russian history, you have to just accept it. That's the way it has always been."

So-called 'facilitation payments' – paying off government officials or politicians – are illegal according to

the Bribery Act but are unavoidable in emerging countries. Officials are paid off directly, or more typically a middle man is employed to do the dirty work.

The source says: "If you want to function there as a business, you have to find a way to get round this. Say you open an office in Russia and want the telephones connected – who is going to do that? Somebody sitting in an office with power? You have to pay to get that done.

"But below this government level, businesses function in a normal commercial way. And that is something people in the UK cannot understand. People think the whole place is the 'Wild East' but it's not like that at all."

The source continues: "Insurance companies, for example, have no intention of destroying their balance sheets by paying claims corruptly. Loss adjusters and courts are used. It is a professional system for everything from telephone companies to petrol stations – once you have paid off the politicians."

Break the law or walk away?

The revelations show how challenging it will be for Lloyd's – which plans to open an office in Moscow in the middle of this year – to operate strictly within the structure of the Bribery Act. The source says: "Lloyd's has decided to go in, so it must have decided it can live with the consequences of UK legislation."

A Lloyd's spokesman said: "Lloyd's is not new to the Russian market. We have been doing business in the country from London for years. Opening an office in Moscow is just the next step, and we always operate transparently and to the highest ethical standards."

One insurance director with experience of emerging markets admits that some firms will break the act and win business. But he prefers to walk away and not take the risk.

"That's what is so difficult for a broker to understand," he says. "They see a business and that they could get that nice account if they could only do this. But you've got to be tough and explain that you can't do that."

A £5.25m wake-up call

- The FSA's £5.25m fine of Aon in January 2009 was a wake-up call for brokers to improve their safeguards in relation to bribery and corruption.
- The FSA never accused Aon of directly being involved in bribes, but stated that "suspicious payments" of around \$7m (£4.6m) were paid to both businesses and individuals in six countries, including Bangladesh, Burma and Vietnam – payments that could have been used for bribes, says the FSA.
- The "suspicious payments" have always remained a mystery, but certainly there was a feeling in the market at the time that Aon was particularly generous on its corporate hospitality.
- An insurance director said: "I think the FSA have made it so difficult now, nobody is going near it [excessive corporate hospitality]. The old days, when the client came to London and the broker picked him up at the airport with a chauffeur-driven car, and paid for him and his wife to share a nice hotel in London, have gone."
- Aon has improved its systems and controls in the wake of the fine, along with the rest of the market.
- The director continues: "I think everybody was cleaning their act up anyhow, and you know how the FSA work – they like to find one company or person and use that as a reason to encourage others to sort out their dubious cases and to improve them."
- He adds: "That FSA has made a big improvement to the industry. It's by targeting one company to improve the others that the FSA has made a big difference."



Scale of corruption

Which countries treat dirty money in business as a way of life, and which are trying to clean up their acts?

Russia

Corruption rating: ●●●●●

Described by sources as "utterly corrupt", paying off officials is par for the course. Facilitation payments are unavoidable here.

India

Corruption rating: ●●●●●

Corruption is so bad that it threatens to deter foreign investors and derail the country's growth, a report from KPMG revealed last month. Forking out petty bribes is standard practice.

Brazil

Corruption rating: ●●●●●

Insurance businessmen used to be "dreadful" but the country is now at last beginning to "clean up its act". It is just about possible to operate there within the confines of the Bribery Act.

Costa Rica

Corruption rating: ●●●●●

The former chief executive of reinsurance broker PWS Holdings, Julian Messent, was jailed for 21 months after funnelling third-party payments of \$2m (£1.23m) in Costa Rica. Despite the high-profile case, Costa Rica is one of the less risky emerging countries, with a mid-tier ranking in the 2010 Corruption Perceptions Index.

UK

Corruption rating: ●●●●●

Brokers have cleaned up their act since the FSA made an example of Aon with a £5.25m fine, and business conducted within the country is fairly clean. Big questions remain over how UK business will expand into emerging countries without paying off government officials, politicians and even gangsters.

Talking points ...

- Does the Ministry of Justice understand that it is almost inevitable that brokers will have to break the strict terms of the Bribery Act if they wish to build business in certain countries?
- Will the legislation put UK-based brokers at a competitive disadvantage?
- How will the new guidelines affect corporate hospitality, in this country and overseas?

The route of facilitation payments



A broker may need a range of services: a licence to operate, work visas for staff, or even just office utilities to be connected.



An agent, typically sourced via word-of-mouth recommendation, is paid to 'fix' all the problems.



The agent will frequently contact yet more middle men, who will pay off government officials or politicians.



All obstacles removed: a licence to operate the office is granted, visas granted, and utilities switched on.