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Life Assurance in Dublin's IFSC

by Colm Fagan

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"*In Dublin's fair city, where the girls are so pretty*" run the opening lines of the city's anthem, "Molly Malone." But is it just the pretty girls that are enticing major financial services groups to establish cross-border life assurance operations from Dublin's International Financial Services Center (IFSC)?

The latest "Blue Book" from Ireland's Enterprise Ministry records business transacted in 1995. It shows a total of 12 companies authorized to transact cross-border business from Ireland under the EU's Third Life Directive. This Directive—also called the Framework Directive—established the framework for Europe's single market in life insurance.

Total premium income in 1995 was IR£161m ($240m), a 50% increase on the previous year. Industry estimates indicate that premium income more than doubled to IR£343 million in 1996 (Figure 1).

While growth rates in the three years prior to 1996 have been exceptional, activity during 1997 indicates that life assurance in the IFSC is moving to an even higher plane. Major changes are also taking place in the nature of operations being launched from Dublin.

Most of the companies named in the 1995 Blue Book were subsidiaries of U.K. parents. Their initial *raison d'être* was to sell policies back into the U.K.

Of course, tax is still an important attraction for companies thinking of establishing in the IFSC. Investment income and capital gains on policyholders' funds are completely exempt from Irish tax. Also, shareholder's profits are subject to a specially low tax rate of 10% until the year 2005. Thereafter, tax on shareholders' profits increases—but only to 12.5%. The Irish Government has guaranteed the 12.5% rate until at least the year 2025.

A major attraction for newer entrants, however, is Ireland's regulatory regime for life assurance and the country's long experience in the design and delivery of both unit-linked and traditional policies.

The Department of Enterprise, Trade, and Employment (DETE) is the regulator for the insurance industry. Traditionally, it has adopted a "hands-off" approach to supervision and has placed considerable reliance on the professional judgment of the insurer's Appointed Actuary. This approach has continued following the implementation of the Third Life Directive. Its effect has been to facilitate product innovation without compromising solvency. In the last 60 years, not a single life insurer supervised from Ireland has gone into administration or receivership.

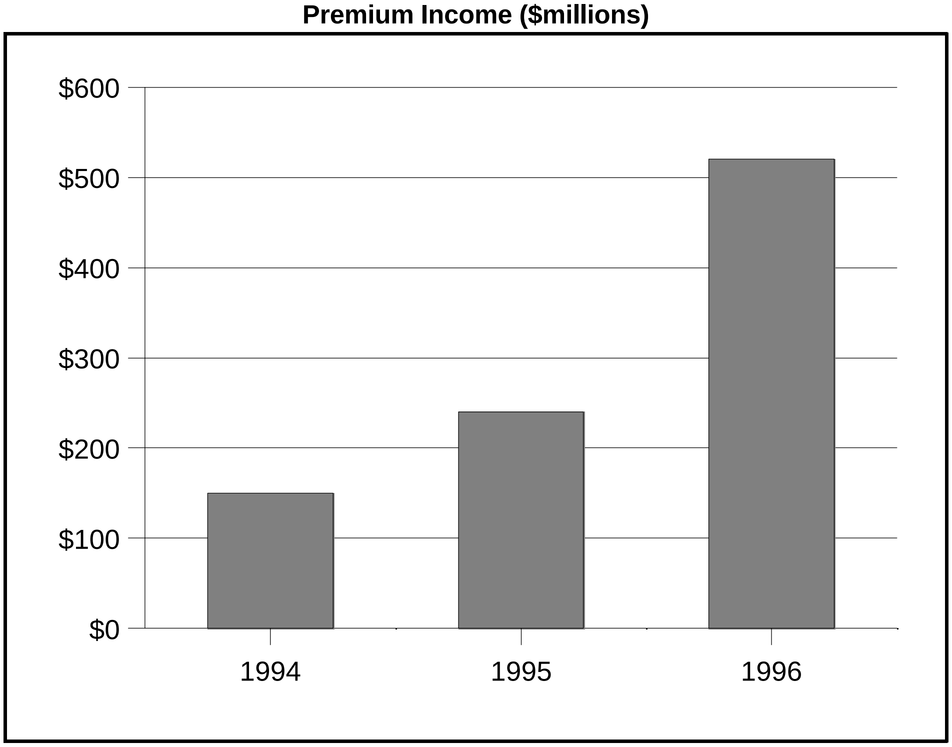
As long ago as the early 1970s, unit-linked business already accounted for more than 50% of all new insurance policies sold in Ireland. The flexible whole of life product design was commonplace by the early 1980s as well as for Critical Illness Insurance. This contrasts with the experience in many European countries where unit-linked policies were only introduced within the last five to 10 years.

Ireland was ahead of the U.K. in embracing the unit-linked concept, mainly because Irish Life, the market leader, was an early convert to the unit-linked cause. It introduced its first unit-linked policy in 1964 and its "Property Modules" range of funds, introduced in 1969, captured the imagination of an investing public eager to share in the benefits of a booming real estate market.

The Irish insurance industry's early love affair with unit linking contrasts with the U.K. where the market leaders (Prudential, Standard Life, etc.) viewed the concept with suspicion and, as a consequence, were slower in adding unit-linked products to their portfolios.

This long experience with unit linking means that there is now in Dublin a strong cadre of professionals with the necessary skills in dealing with sophisticated life insurance products. The market is also responding quickly to the growing demand for outsourced professional and administrative services—actuarial advice, Third Party

FIGURE 1
Premium Income ($millions)



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This combination of a favorable regulatory regime, no tax on policyholders' funds, low tax on shareholders' profits, a strong skills base, and membership of the EU is attracting an increasing number of major financial services groups to establish life assurance companies ("head office undertakings" is the official terminology) in Dublin to sell life assurance and pension products to customers both within and outside the EU.

The vision of the original promoters of the European single market is at last being realized. It is now almost as easy for a company based in Dublin to sell business in Lombardy as it is for one based in Milan or Rome.

This is precisely what is happening in the case of the Lombardy-based Gruppo Area, a broadly based financial services group whose activities include a bank, Area Banca, established in 1995.

Sales of life insurance and annuity products are central to the group's operations. Up to now, the Gruppo Area sales network has distributed the products of other Italian life assurance companies. This will change in the future, however.

A wholly-owned subsidiary, Area Life International, has now been authorized to transact cross-border business from Dublin's IFSC and, in the future, the group's Italian sales network will distribute the products of Area Life. At a later stage, Area Life International plans to sell policies in other EU member states.

A number of other European and American companies are taking a similar route. At least two major American groups have decided to base their planned European life assurance companies in Dublin, selling into other countries on either a "Freedom of Services" or "Freedom of Establishment" basis.

The procedures for obtaining authorization to establish a new life assurance company in Ireland or to transact cross-border business from an Irish head office using either the Freedom of Establishment or Freedom of Services provisions of the EU's Third Life Directive are relatively straightforward.

An application to the DETE for authorization to establish a head office undertaking in Ireland must be accompanied by a comprehensive business plan. The Department has specified the required content of the plan in general terms. In reality, it is looking for a little more than the type of planning document which the sponsoring institution will want prepared in any event to satisfy itself of the undertaking's viability.

The plan must be accompanied by optimistic and pessimistic financial projections based on alternative sales and expense assumptions. The capital requirement for the undertaking is derived from these projections.

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The undertaking's Appointed Actuary must certify that the initial capital base will be sufficient to cover mathematical reserves and the required minimum solvency margin under EU regulations for the first three to five years of operations.

The capital requirement depends on a variety of factors including product design, sales volumes, distribution costs, etc. The minimum solvency margin required under EU Regulations is 800,000 ECUs. This equates to approximately IR£640,000 at current exchange rates. The DETE likes the projections to show free capital exceeding the minimum by a comfortable margin throughout the plan period. Furthermore, even the simplest business plan will include some start-up costs that cannot be recovered immediately from margins in policies sold.

Taking all these factors in account, total shareholder funds of at least IR£1M ($1.5m) will be required for the simplest of business proposals. The capital requirement could be much higher for a proposal involving significant capital strains in the early years.

While the DETE approves the application for authorization to establish a new life assurance company in Ireland, the Industrial Development Agency (IDA), whose primary function is to promote inward investment into Ireland, is charged with recommending to the Department of Finance whether the undertaking qualifies for the special tax exemptions associated with the IFSC. The IDA's primary concern is that the undertaking is not a "brass plate" operation and that it generates employment in Ireland, either directly or indirectly through the medium of a Third Party Administrator. The target is that it should generate 20 jobs—either direct or outsourced—within three to five years of commencement of operations.

An application to the DETE for approval to establish a branch in another EU member state follows a similar but more streamlined procedure. The normal time limit for branch authorization is three months, compared with six months for a head office undertaking.

On approving an application to establish a branch in another member state, the Irish supervisory authority informs the supervisory authority of the "host" member state and provides it with information of the proposed constitution and operation of the branch, as required under the Framework Directive. Within two months of receiving this information, the host country supervisor must notify DETE of its "general good" requirements. General good requirements include regulations to protect consumers from unscrupulous sales practices, e.g., rules on the wording and content of sales illustrations.

The procedures for carrying on "Freedom of Services" business are much simpler. The applicant is only required to send a notification to the DETE stating the nature of the commitments that it proposed to cover. The DETE in turn notifies the supervisory authority of the other member state. It is worth noting that no approvals are required, provided that the company satisfies normal Irish solvency margin requirements. Naturally, it is also necessary to comply with the general good requirements of the host member state.

The most important point to note about the Irish regulatory process has more to do with style than substance. Both the DETE and the IDA see their primary job as helping *bona fide* applicants to secure authorization, not hindering them.

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There is much debate about the relative advantages of "Freedom of Services" and "Freedom of Establishment" under the Third Life Directive. In practice, the right answer depends on a variety of factors. These include:

- The scale of the operation in a particular country
- The distribution channels being used
- The products being sold
- The host country's tax and regulatory structure.

Essentially, the question should be answered by reference to business considerations. Too often it has been answered incorrectly by referring purely to legal and tax considerations, without considering wider business issues.

In summary, Dublin's emergence as a leading location-to-market cross-border life assurance in Europe is due to a combination of:

- Zero tax on policyholders' funds
- 10% tax on shareholders' profits (increasing to 12.5% for the 20 years from 2005)
- A regulatory regime that facilitates product innovation
- A sophisticated support structure that includes ready availability of people with strong product knowledge and technical expertise.

With all these advantages, who cares about the prettiness of the girls in Dublin's fair city?

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Minutes of the International Section Conference Call

Monday, July 20, 1998

Participating: Michelle Chong Tai- Bell (Chairperson), Josh Bank, Mike Gabon, Ric Geisler, Kevin Law, Bruce Moore, Angelica Michail (International Section Council); Bob Collett (Committee on International Issues); Chelle Brody, Lois Chinnock, and Lela Long (SOA Staff).

The minutes from the March 3, 1998, conference call were approved.

SPRING MEETINGS REVIEW. Mike Gabon reported that he believed that the Maui sessions were successful and well attended.

Mike Gabon will be the Section's Spring Meetings representatives for 1999.

ANNUAL MEETING UPDATE. Mike Gabon reported that the Annual Meeting sessions are fairly well set, with some recruiting left to do. The Section will sponsor five sessions (including the field trip to the United Nations and the Section breakfast) and co-sponsor three other sessions. The attending Ambassadors will be asked to speak briefly at the breakfast. The Council decided to have a hospitality suite after the field trip on Tuesday, October 20. Mike will handle the arrangements. Lois Chinnock reminded the Council that the deadline for putting speaker names into the final program is August 3.

Bob Lyle will be the Section's 1999 Annual Meeting representatives.

AMBASSADOR PROGRAM. The Council members discussed Lela Long's memo of recommendations to improve the Ambassador Program and agreed to all recommendations for better use of resources. The Council asked for a written procedure for the appointment of Ambassadors. The members saw a need for more information about the candidates before appointing them. The Council also agreed to the recommendations for improved communications and suggested the list of Ambassadors and their addresses be placed on the SOA web site as well as be published in every issue of the *International Section News*. Lela will format her memo into an article for the next issue.

Josh and Lela will work on the list of ambassadors to bring it up to date.

REPORT ON THE MEETING OF COUNCIL OF SECTION CHAIRPERSONS

- ***E&E REDESIGN:*** There is a potential problem internationally. For example, on the Continuing Education segment, how much credit is needed and how do you obtain it if you are overseas? Bruce Moore will submit a newsletter article by August 15, 1998, describing the international issues, with a request for feedback from the members. Ambassadors will also be contacted to see whether they can get involved.
- ***SOA STRUCTURE:*** Lois Chinnock described the new SOA Staff Structure. Linden Cole is retiring this year. Chelle Brody is the new Manager of International Affairs. Lela and Patrick Cichy will provide support. The rationale for the restructure is to induce Sections, practice areas, and the Board of Governors to work together.
- ***ANNIVERSARY ACTIVITIES***. There are several 50th anniversary activities and commemorative events planned for 1999 in San Francisco. The International Section was asked to be involved in the following anniversary projects planned:

  a. *Monograph of classic papers*. The International Section was

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