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International Life Insurance from Ireland

by Andrew Kay

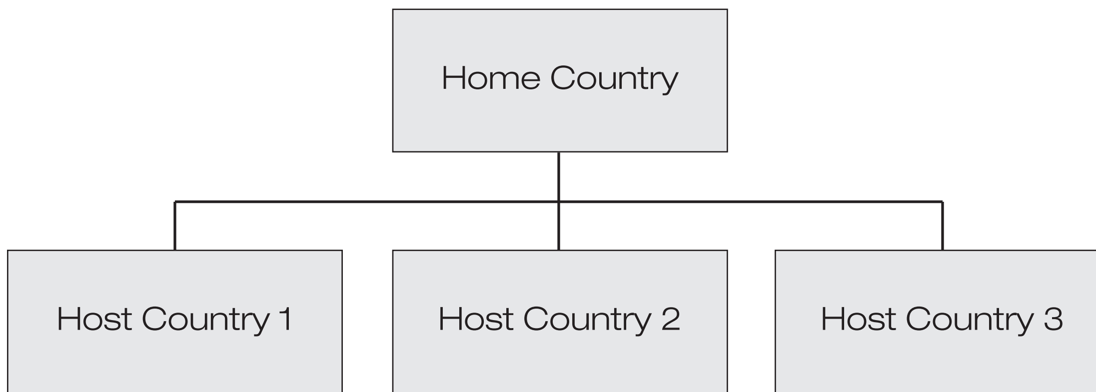
With economic growth forecast to exceed 5 percent in 2005, Ireland is enjoying something of a mini-boom at present, reminiscent of the Celtic Tiger experience of the late 1990s, when the country's economic growth rate averaged almost 10 percent per annum. Ireland, the only English-speaking member of the Euro zone, boasts a record of high economic growth over the last decade or more that stands in sharp contrast to the sclerotic growth experienced by other members of the Euro zone in that period.

The country's superior economic performance can be attributed in large measure to the firmly pro-business stance of successive Irish governments. A significant contributor to Ireland's economic strength has been the success of its international life insurance industry. In fact, the international, or cross-border, life insurance market has thrived in recent years to the point where it now exceeds the domestic market in terms of new business premium income (€6.4bn in 2003 for the cross-border market compared with €4.0bn for the domestic market). Industry figures are not yet available for 2004, but while both domestic and cross-border business written from Ireland experienced strong growth in 2004, the cross-border market again outperformed, thereby extending its lead over the domestic market.

We are seeing increasing numbers of both U.S. and European insurers establishing themselves in Ireland to enable them to efficiently target the trillion dollar European savings and investment market.

Access to a Single European Market

The growth in Ireland's international insurance market is a result of various European Union Directives aimed at building an integrated European financial services market. The first EU Life Directive (1979) set the minimum solvency requirements for insurers operating in the EU. Provided these solvency requirements are satisfied, the third Life Directive (1992) allows companies with their head office authorized in one EU country (the "home"country) to sell into another EU country



(the "host" country) without having to seek additional authorization.

Once a company can demonstrate its ability to satisfy the solvency requirements of the home country, all that is required is for it to abide by the consumer protection requirements of the host country. This effectively means that the home country regulator is the primary regulator with full responsibility for solvency supervision, while the host country takes responsibility for consumer protection and regulation of sales practices.

This single authorization enables the insurance company to establish a presence anywhere in the European community on either a Freedom of Services (FoS) or Freedom of Establishment (FoE) basis. Under the FoS approach, the head-office company is deemed to have no permanent establishment in the territory in which business is sold and hence the company is taxed only in the home country. However, a company operating on a FoE basis is deemed to have a taxable presence in the local market and is therefore subject to taxation in the host country. While tax efficiency is obviously a key consideration, many other factors are important in choosing between the two approaches.

The IFSC

To capitalize on the EU single market Directives, the Irish government set up the International Financial Services Centre (IFSC) in Dublin in 1987, with the aim of attracting foreign financial services providers to Ireland. Companies based in the IFSC benefited from a low rate of corporation tax (10 percent) and were permitted to offer tax-free investment for policyholder funds, thereby placing them on par with their continental European counterparts. At that time, domestic life insurance companies were taxed on the internal build-up of policyholders' funds (the "I-E" basis, similar to the tax system that still applies in the UK) while only approved pensions business had tax-free accumulation (gross roll-up).

The decision to tax profits from cross-border business at 10 percent, combined with the benefits of gross roll-up, attracted a large number of life insurers with aspirations to transact pan-European business to Dublin's IFSC. However, the preferential tax treatment of companies transacting cross-border business from Ireland did not go down well with other members of the EU, who put pressure on the Irish government to end the discrimination. The government's response was to extend both gross roll-up of policyholders' funds and low corporation tax (which was increased from 10 percent to 12.5 percent for cross-border insurers) to all companies from 2001. This move made Ireland even more attractive to companies aspiring to transact cross-border business as it made Ireland's tax regime for life assurance less exposed to challenge from other member states, since the new tax regime applied to both domestic and cross-border business.

Other Advantages

Although a significant factor, the attraction of Ireland as a base for transacting cross-border insurance business is not just about low tax rates. Ireland also has a well-developed regulatory regime, which often gives greater

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flexibility in terms of capital requirements and product design compared to some parts of continental Europe.

Unlike the situation in its nearest neighbor, the United Kingdom, the Appointed Actuary system is alive and well in Ireland, and the Irish Financial Regulator has in effect devolved to the Society of Actuaries in Ireland the job of specifying many of the detailed technical requirements for solvency supervision through the medium of its Professional Guidance Notes for Appointed Actuaries. This has enabled the country to develop a sophisticated approach to capital management of life assurance companies and has fostered product innovation. Whether by good fortune or design, it has also resulted in a clean sheet in regulatory terms: since the passing of the landmark 1936 Insurance Act, not a single life assurance company supervised from Ireland has had to be bailed out or put into receivership.

Cost is also a key factor in helping Ireland's development as a centre for European and global cross-border life assurance business. A number of cross-border companies operate an outsourced business model, where external parties provide the traditional head-office functions such as the finance, legal, policy administration and actuarial functions. This often gives these companies a lower cost base and greater flexibility than their domestic counterparts, and can be invaluable for increasing speed to market.

An expanding market

The year 2004 saw the accession of 10 new member countries to the European Union, which increased the size of the potential market for pan-European life insurance business. Another major factor that is set to increase the size of the European savings and investment market is the shift from state-provided to private pension arrangements. Many European countries are currently facing a pensions crisis that has been caused by a combination of generous unfunded pension arrangements with demographic trends including increasing life expectancies due to mortality improvements, and falling fertility rates. State pensions (which are normally operated on a pay-as-you-go basis) are becoming increasingly unsustainable and governments are being forced to consider alternatives including increased private provision.

EU legislation aimed at enabling the concept of pan-European pensions is required to be implemented by member states in 2005, and many players see this as a market to watch. Ireland has already amended pensions legislation to comply with EU requirements, which should ensure Ireland remains an attractive location for pan-European business. □

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