Boal & Co
Actuaries & Consultants

Insurance News

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Insurance Regulatory Comparison - Ireland vs. Luxembourg

Over the last ten years Ireland has emerged as *the* European centre of excellence for the domicile of cross-border insurance companies. This position is evidenced by Boal & Co's annual survey of cross-border premium income in which Ireland has overtaken Luxembourg and held the number one position for the last three years.

There are a number of factors contributing to this success, of which one of the most important is the regulatory environment. This note majors on the regulatory driven business advantages for Irish based insurance companies, although there are other important factors. In particular it considers the advantages for an Irish company versus a Luxembourg company, both of whom wish to write Pan European business.

Overview of regulatory advantages

The Irish Regulator adopts a "Principles" based approach to regulation. This contrasts with a more rules based approach adopted by Luxembourg's regulator, the Commissariat aux Assurances (CAA). The "principles" based approach provides insurance companies with much more flexibility on how they run their business. For example:-

- Greater Investment Choice
- Freedom from product approval
- Lighter regulation backed with Appointed Actuary regime

These advantages stem basically from a difference of approach and perspective, rather than whether or not the two jurisdictions have fully implemented EU regulations and norms. These items are considered in more detail below.

Other Advantages of Ireland

In addition to the regulatory advantages considered within this note, the following factors contribute significantly to Ireland's success:-

- **Corporation tax rate of only 12.5% vs. Luxembourg's effective rate of approximately 30%**
- **Access to outsourced administration expertise vs. virtually no outsource options in Luxembourg**
  - **Enables low fixed cost base for start-up companies**
  - **Provides access to unit-linked administration expertise**
- **Lower staff costs in Ireland (although the gap has reduced in recent years)**

Against this Luxembourg has banking secrecy, extensive language abilities and geographical proximity to many central European markets. However, generally these issues are less significant than, for example, the corporate tax rates.

The importance of each of the above issues varies from company to company, and between the different target markets. The presence of a wide range of advantages has ensured that Ireland has been able to attract, and meet the needs of, a well diversified group of European insurance companies.

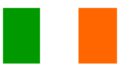
Regulatory Comparison

Provided below are comparisons of the key different regulatory approaches in Ireland and Luxembourg. The following areas are examined:-

- **Investment Choice**
- **Freedom from product approval**
- **Style of regulation**

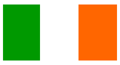
Information is also provided on the capital requirements required in each domicile, although you will see that this is an area where there is much similarity.

Investment Choice

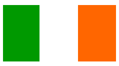
	Irish Insurer Insurance companies are allowed to invest in a very wide range of assets to back policyholder liabilities. This has allowed insurance companies to offer the following types of product:- · Unit linked products linked to hedge funds · Portfolio bond products which create individual investment portfolios for HNW · US style variable annuity products with guarantees which utilise sophisticated hedging strategies · Index-linked products backed by issuers of structured notes · UK/Irish styled with-profits

	**Luxembourg Insurer** Regulations place more restrictions on the assets which insurance companies can purchase to back policyholder liabilities. There are detailed rules on the types of assets that can be purchased, e.g. unregulated funds such as hedge funds are excluded. There are also complex and restrictive rules prescribing the minimum/maximum spread of assets that must be purchased. These rules are relaxed for larger contracts but the limits are set very high (i.e. € 250,000, € 500,000 and € 2.5m). In theory these rules protect the policyholder by diversifying the asset base, but they tend to stifle investment choice and innovation. The close supervision of assets underlying policyholder liabilities remains a main supervisory tool, and assets attributable to insurance contracts must be segregated from other assets (i.e. with separate custodianship) and have special rules applying to them.

Style of Regulation

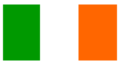
	**Irish Insurer** The Irish regulator has adopted a light style of regulation backed by the Appointed Actuary regime. A long-established and independent actuarial profession allows the regulations to rely more on expertise and judgement than prescriptive rules – by way of the Appointed Actuary regime. The Appointed Actuary provides the Irish regulator with independent comfort that a company is operating in a manner which is not endangering the solvency position of the company. This "arms length" style of regulation provides for a more business friendly environment. The Appointed Actuary regime also allows the regulations to be implemented appropriately for each individual company without the need for over-prescriptive rules.
	**Luxembourg Insurer** Luxembourg has adopted a more traditional style of regulation. The tight regulation which existed prior to the Third Life Directive resulted in a more technical role played by actuaries. This has changed but actuaries still generally have less influence on insurance company management than in Anglo-Saxon markets. There is no distinct Appointed Actuary role (a person familiar with the Companies operations, but independent and with a "public good" role). This requires the regulator, the CAA, to supervise the activities of insurance companies in more detail ands leads to a less business friendly environment. It also requires CAA to have very prudent prescriptive rules to ensure that all companies following the rules will have sufficient and appropriate reserves to cover liabilities.

Constraints on Product Approval

	**Irish Insurer** The Appointed Actuary must certify that products are being written on a profitable basis. Products will also be designed to comply with local tax rules. There are no other product approval constraints.
	**Luxembourg Insurer** The CAA moved from the traditional an "*a priori*" style to an "*a posteriori*" position on conditions and tariffs, following implementation of the Third Life Directive in 1994. Whilst not a legal requirement, experience indicates that it is wise for insurance companies to enter into discussions with the CAA, prior to the issue of products which could be regarded as "innovative". The CAA must be supplied with a technical note of the product in advance of its sale and in theory the CAA could demand changes if it considers the financial stability of the company could be threatened by a poorly designed product. In addition the CAA require to be notified in advance of the proposed use of any new internal fund.

Capital Requirements

This is included for completeness, however overall, as can been seen from the table below, the differences in capital requirements are generally not particularly significant.

	**Irish Insurer** As indicated above the Irish regime allows a more flexible approach to calculating reserves. For example, in products with guarantees the Irish regulator has been more open to allowing credit to be taken for dynamic hedging techniques. Solvency margin requirements in Ireland and Luxembourg are very similar, with both following EU requirements. Unit linked products normally require only a very small solvency margin, 25% of maintenance expenses and generally significantly less than 1% of reserves, unless the insurance company is underwriting an investment guarantee or where product rules do not allow future levels of charges to be increased. Products with investment guarantees carry a 4% solvency margin. There is an additional solvency margin requirement of 0.3% of the risk capital (life cover). The regulator requires companies to target solvency margins of at least 150% of the required calculated margin. Irish insurers must follow the EU regulations on a minimum solvency margin requirement, currently €3m.
	**Luxembourg Insurer** The Luxembourg reserving regime is more prescriptive (and hence generally more prudent). In accordance with European norms, Unit linked products require a solvency margin of 25% of annual long term expenses if charges are flexible, or 1% of reserves if they are not. Whilst the regulator checks the expense position and this may be affected by local market rules, most UL products would require reserves below the former limit of 1%. The solvency requirement is 4% for other life and annuity products. There is an additional solvency margin requirement of 0.3% of the risk capital (life cover). Luxembourg insurers must also follow EU regulations on minimum solvency margin requirements. The regulator will require solvency to be adequate according to the rules but there is no imposition of 150%.

Irish Companies Currently Writing Business in Europe

The following companies are examples of Irish companies writing significant volumes of business in Europe:-

- AXA (currently launching)
- Barclays
- Euroben Life and Pension (part of Handelsbanken)
- Generali
- Mediolanum
- Prudential
- San Paolo Life
- SEB Life Ireland
- UBS International Life