

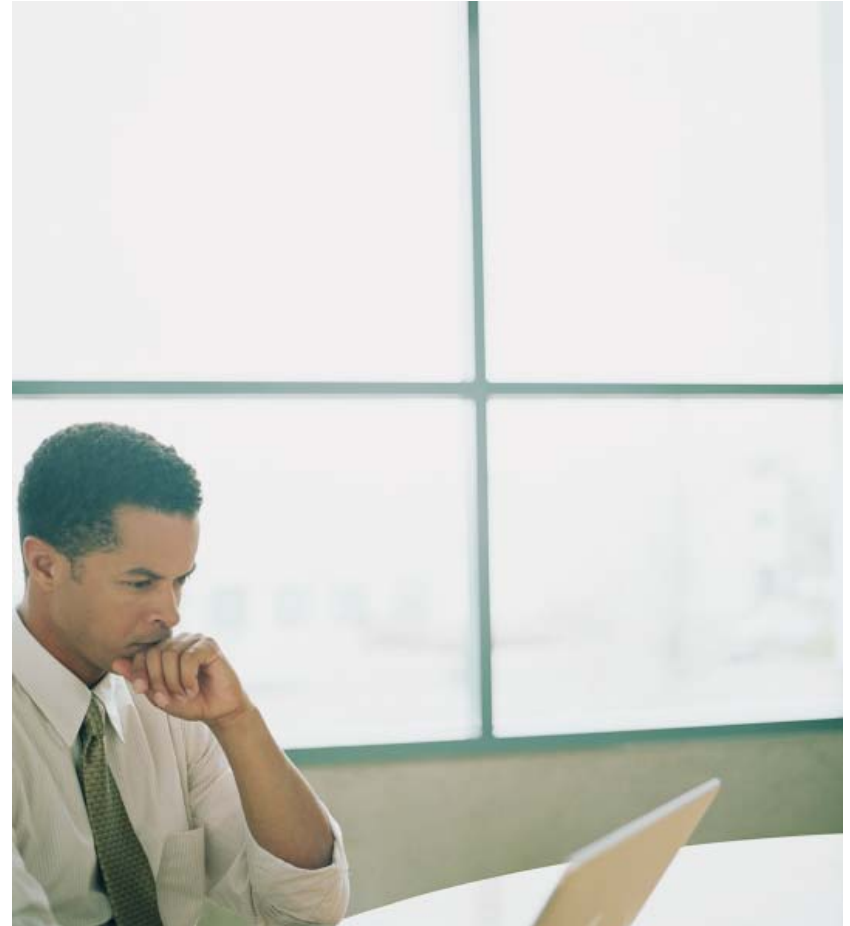
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Solvency II Tax Briefing

30 June 2011

Agenda

- **Non-Life Taxation**
- **Life Taxation**
- **Debt Funding**
- **Impact on group structures**



Non-Life Taxation

Claims Equalisation Reserves
Technical Reserves

Claims Equalisation Reserves (CERs)

- Generally disallowed for tax purposes
- Except: CERs for **credit (re)insurance business** where required by Regulator
- Under Solvency II, CERs will be eliminated

Impact of elimination?

- Increase in taxable profits in year of elimination

How should the release be taxed?

- Phased basis similar to IFRS transitional adjustment?

Claims Equalisation Reserves (CERs)

Should some form of CER be maintained?

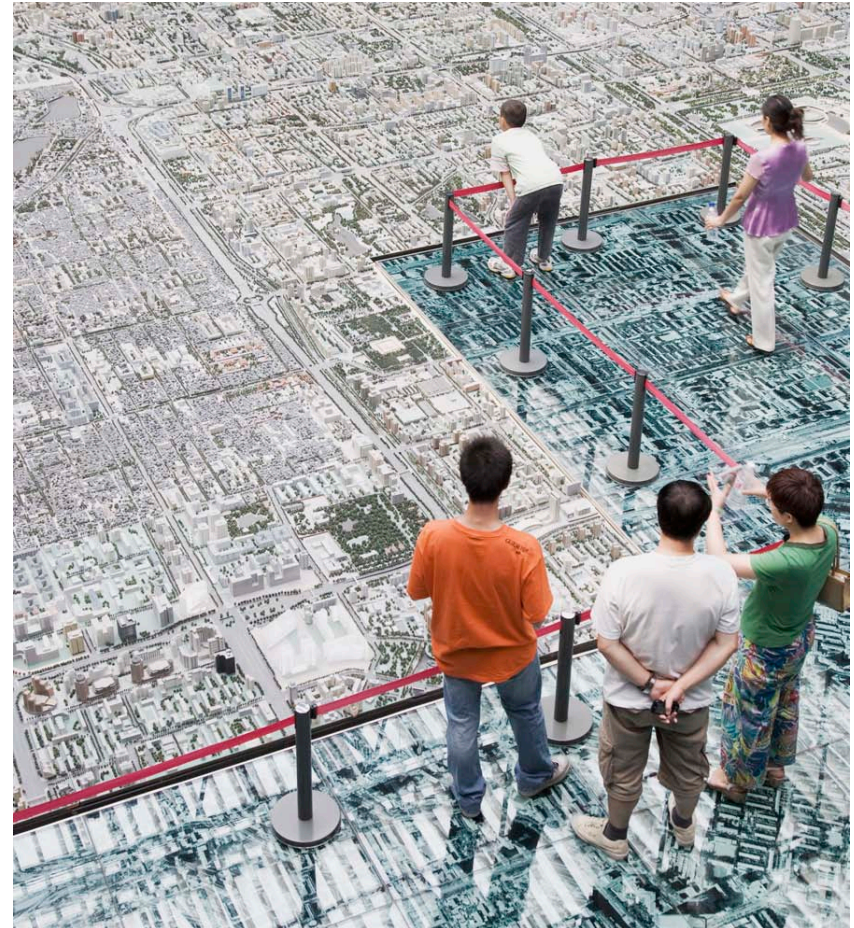
- Likely Revenue position?
- Competitive disadvantage for Ireland?
- What is the position in other countries?

**Industry needs to engage with Revenue /Department of
Finance**

Technical Reserves

Current Position

- Irish GAAP and IFRS
- Generally in line with the ABI SORP
- Methodology accepted by Irish Revenue as appropriate measure of tax deductible reserves



Technical Reserves

Solvency II

- Changes methodology for calculation of technical provisions for regulatory purposes
- ABI SORP/GAAP/IFRS ?

Therefore:

- No impact on accounting technical provisions
- No impact on non-life taxation

IFRS 4 Phase II

Implemented in 2014 ?

- **Measurement of insurance contract liabilities**
- **Single comprehensive model for all insurance contracts**
 - **measurement on a discounted basis**
- **Impact most/all insurers**
- **Phase II \neq Solvency II**

IFRS 4 Phase II

Accounting impact on adoption?

- Increase/decrease in retained reserves
- No impact on income statement

Tax impact?

- Profits falling out of charge
- Profits taxed twice
- Measures required to prevent this
- Measures required to spread the impact

**Industry needs to engage with Revenue /Department of
Finance**

Questions?

Do you expect a profit surge on adoption of IFRS4 Phase II?

Maximise Relief for Project Expenses

Research & Development Tax Credit

What projects?

- Bespoke or innovative capital & risk management models
- Phase II system changes

What costs qualify?

- Salaries (direct/indirect)
- Material costs
- Indirect costs (e.g. HR, Finance)

Tax Benefits?

- Tax Credit 25%
- In addition to tax deduction 12.5%
- Effective 37.5% tax benefit
- Monetisation credit & generate cash

NB: Consider credit when documenting system changes/development

Life Taxation

Technical Reserves Regulatory Return Changes

Life Assurance

New Basis Business (NBB)

Technical Provisions

- Similar issues here as for non-life business (Phase II)
- Tax computation currently based on transfer to non-technical account
- This should continue to be the case
- A profit surge on recasting of technical reserves likely to be less significant here
- Long term business reserves already subject to discounting
- If there is a significant change, the spreading option would again be appropriate

Life Assurance

Old Basis Business (OBB)

Notional Case I (NC1)

- Currently based on regulatory surplus
- Post Solvency II: regulatory surplus available volatile and not readily reconcilable with IFRS

Options?

1. Continue with the **current methodology**
(but without a return to support the mechanism)
2. Use a figure extracted from **Solvency II regulatory return** (with appropriate adjustments)
3. Use a figure based on the adjusted statutory **accounts**

UK likely to move to an accounts basis.

Life Assurance

Old Basis Business (OBB)

1. Existing Methodology

Maintain actuarial figures for tax purposes only

- Impracticable
- Excessive administrative burden
- Particularly given OBB in run-off
- BUT – ability to manage impact of NC1

2. Solvency II Regulatory Return

- Could prove difficult
- Uncertainties connected with new return
- Mainly focused on capital adequacy i.e. not profits
- Subject to post implementation review
- Too much uncertainty for a business in run-off?

3. Accounts Basis

- A profit measure
- Already in place for NBB
- Logical option?

Life Assurance

Old Basis Business (OBB)

Transition from Regulatory return to accounts basis

Technical Reserves

- Assuming opening & closing reserves on accounts basis
- Change should not be relevant

DAC

- DAC per accounts at date of adoption
- Disallowed when released to income statement
- Prevents a double deduction

Life Assurance

Old Basis Business (OBB)

Transition from Regulatory return to accounts basis

Deferred Income (e.g. Commissions)

- Deferred income at date of adoption
- Disallowed when recognised in income statement
- Prevent double taxation

Undistributed Surplus

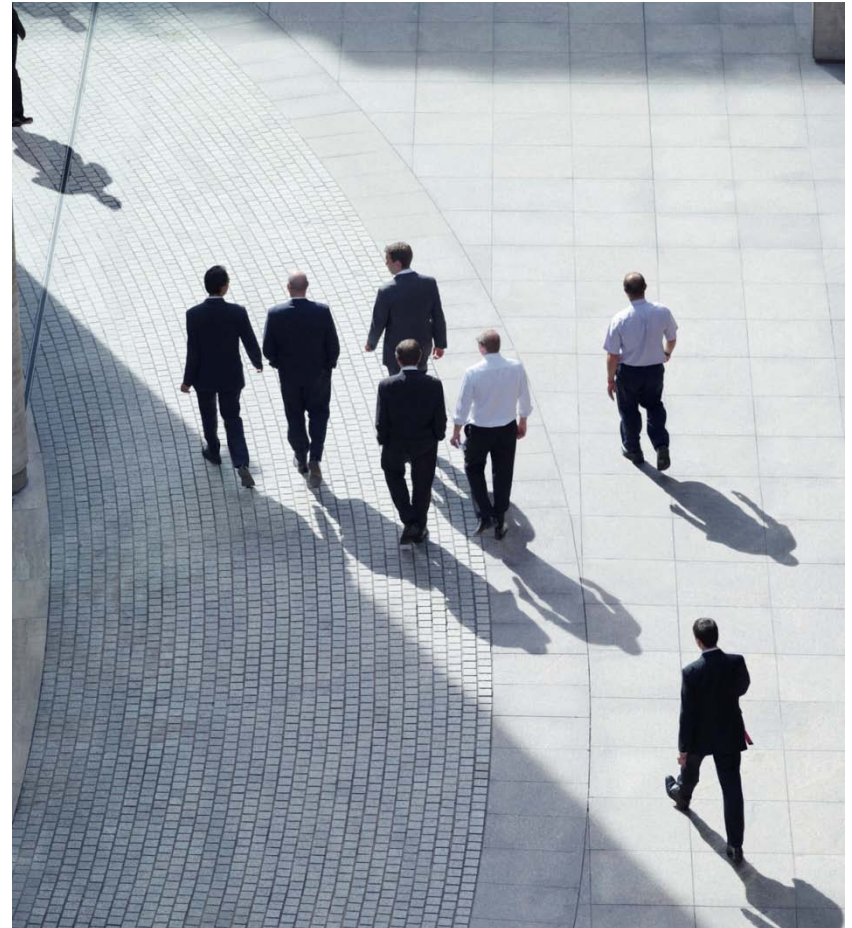
- Relates to profits already taxed?
- No adjustment for release of UDS?

Life Assurance

Old Basis Business (OBB)

Transition from Regulatory return to accounts basis

- Acceleration of Case I situation (NC1 > I)?
- Impact on tax position e.g. DTR?
- Future of I-E regime?



Questions?

Debt Funding

Impact on Debt Funding

Pre Solvency II Position

Banking

- Capital categorised as Tier 1 and Tier 2
- Tier 2: interest tax deductible subject to certain conditions
- Tier 1: more difficult to achieve a deduction BUT possible for certain instruments

Insurance

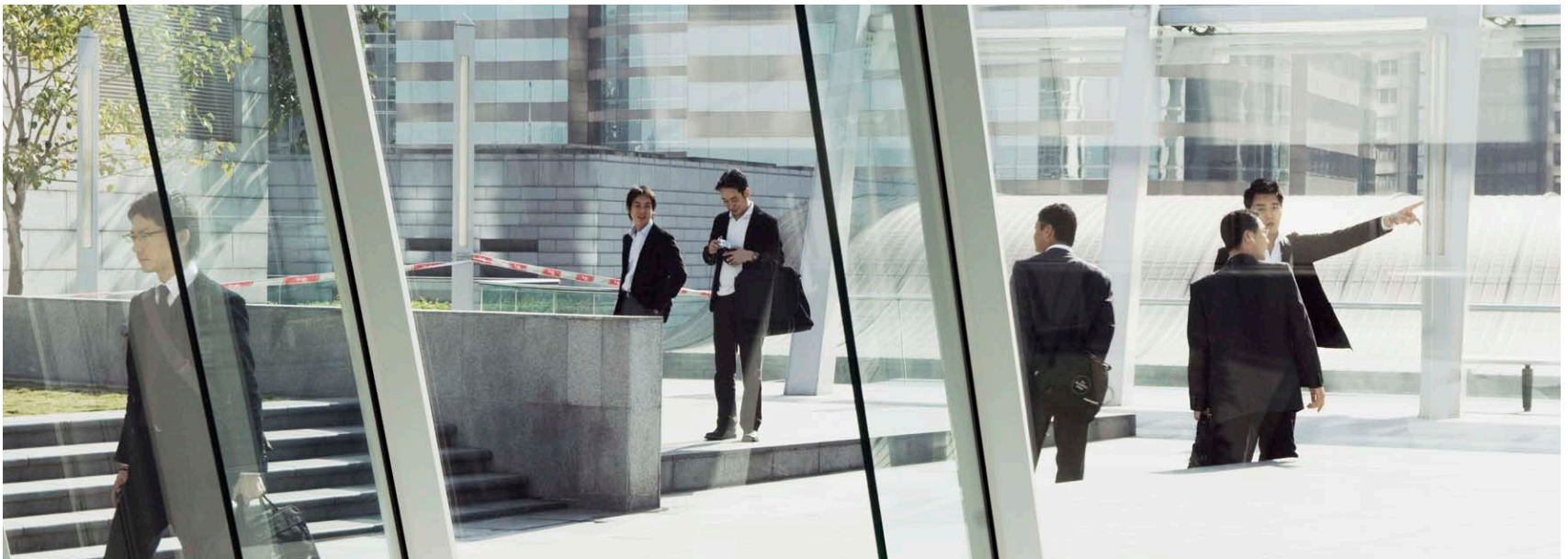
- No capital Tier structure
- Interest is tax deductible
- Subject to meeting certain conditions

Impact on Debt Funding

Post Solvency II position

Solvency capital: Tier 1, 2 & 3 classification

More scope for getting a tax deduction if within Tier 2 and Tier 3



Funding

Capital under Solvency II

Tier	MCR	SCR	Examples
1	>80%	>50%	Paid and called up share capital Share premium Reserves (e.g. retained earnings) Other capital instruments (>10 years)
2	Remainder	Remainder	Called up share capital Other capital instruments not Tier 1 (5 – 10 years)
3	n/a	Max 15%	Net Deferred Tax Assets Other capital instruments not Tier 1 or 2 (3 – 5 years)
Ancillary 2	n/a	Limited	Letters of credit, guarantees

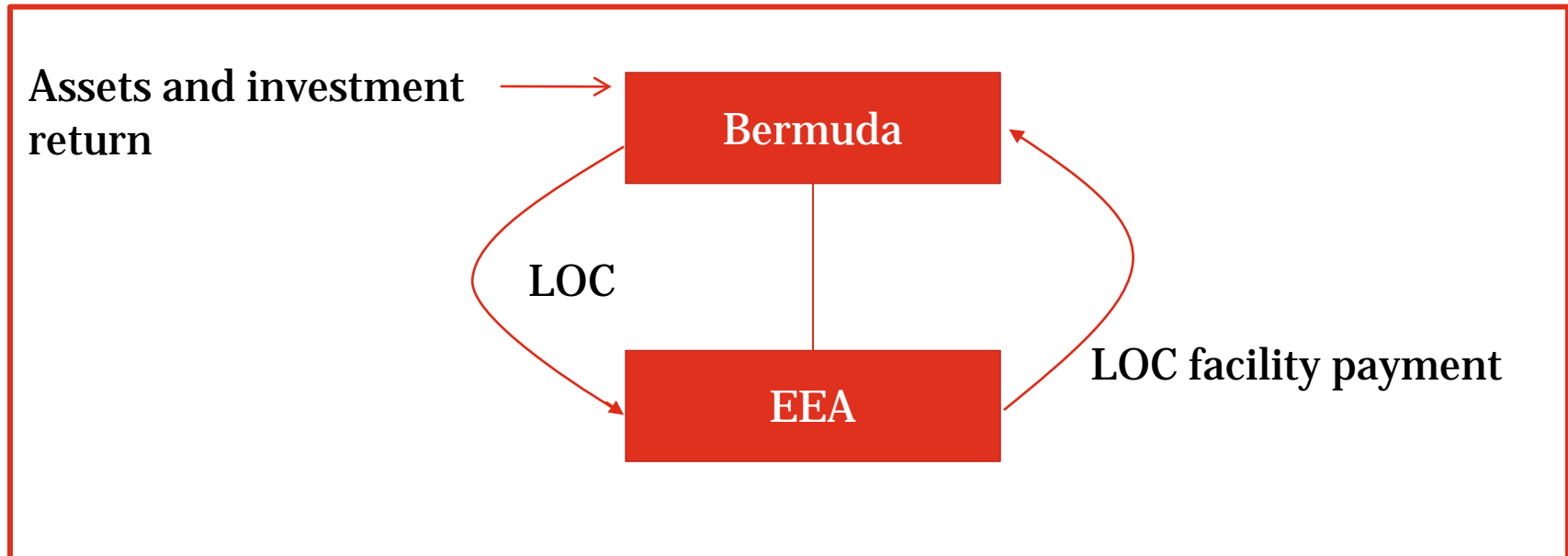
Technical specification appear to have been interpreted very widely and somewhat optimistically. EIOPA

Impact on Debt Funding

Standby credit facility

General appetite in the market to achieve maximum regulatory benefit – tier 2.

Potential benefits for non- EEA headquartered groups – obtaining tax deductible capital.



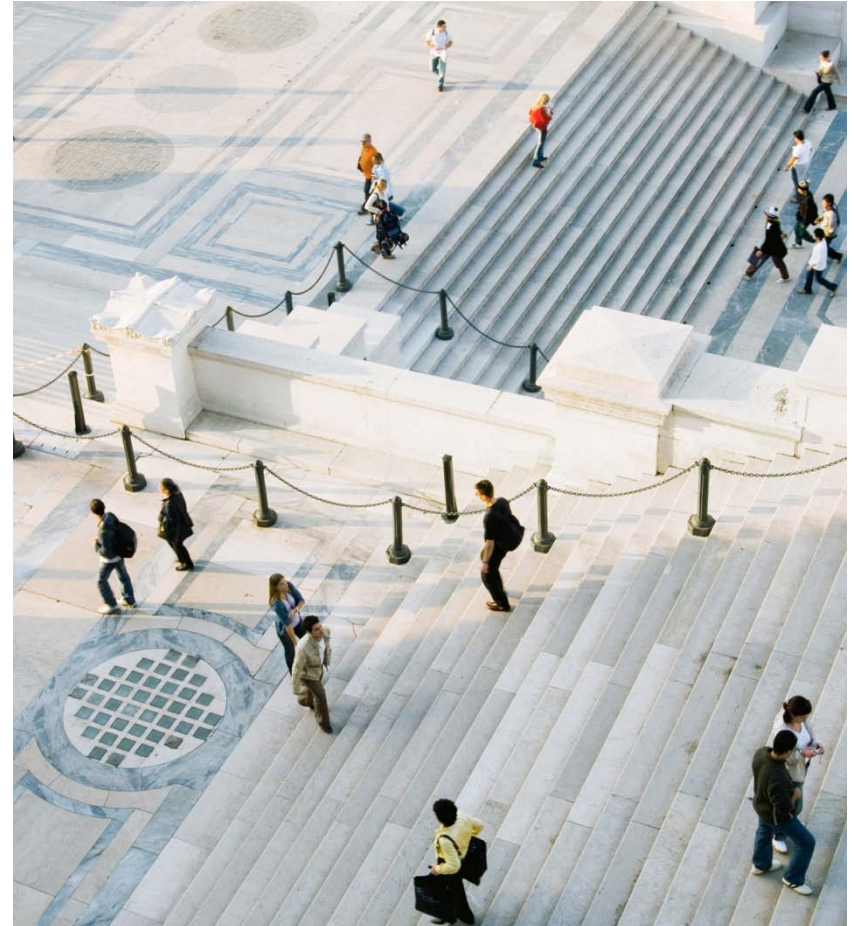
Questions?

Impact on Group Structures

Solvency II drivers of restructuring

Restructure

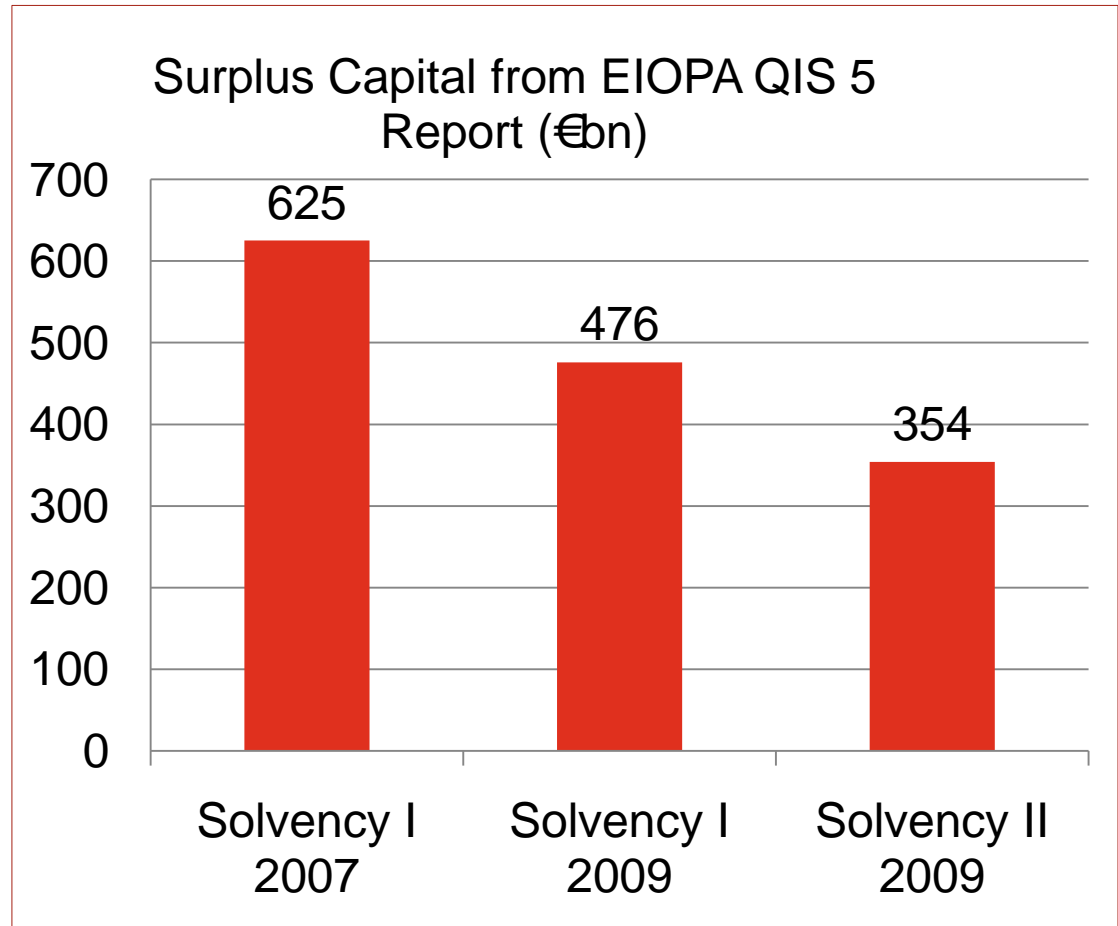
- Capital
 - Fungibility
 - Diversification
- Legal structure
- Operational efficiency
- Group supervision



Drivers of restructuring Capital

The surplus capital position has worsened over the past few years, and it will deteriorate further as a result of Solvency II

15% of participants in QIS 5 reported deficit against Solvency II Standard Capital Requirement (SCR) but the position may improve with use of internal models.



Drivers for restructuring

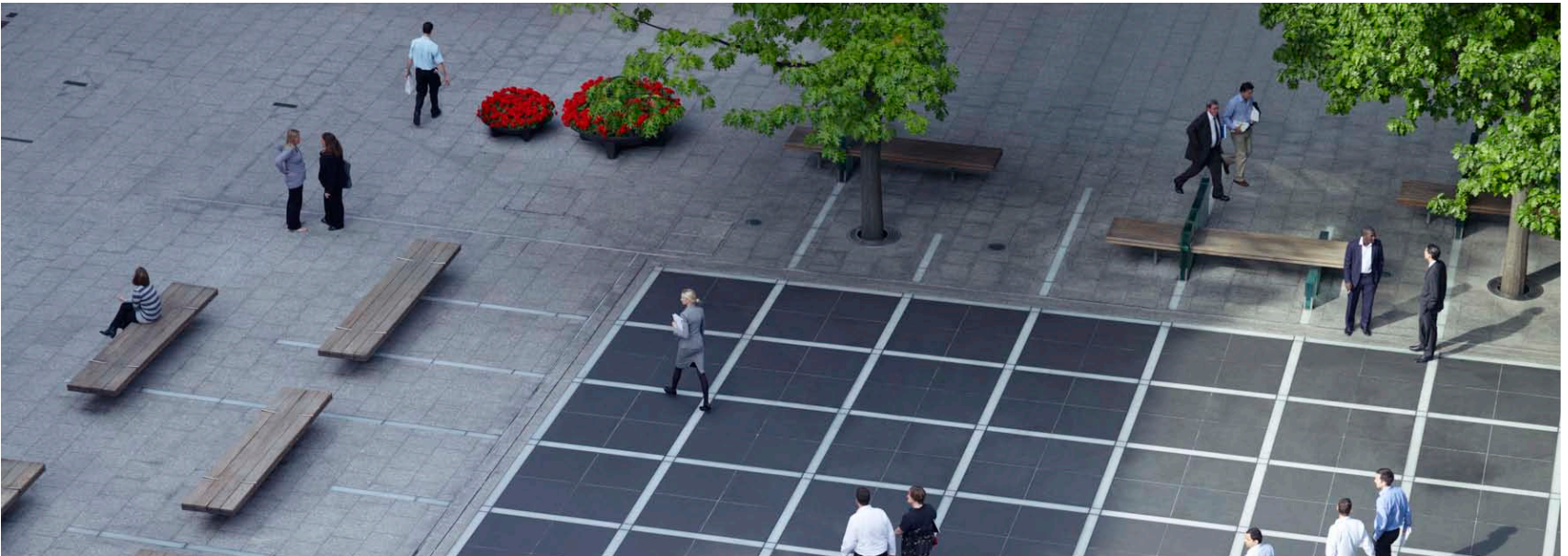
Fungibility

- Group Own Funds may not include all Own Funds from group members
- Need to be fungible and transferable
- Demonstrate how capital can be moved
- Multiple entities can increase trapped capital
- Consolidating balance sheets concentrates any surplus

Drivers for restructuring

Diversification

- QIS 5 highlights uncertainty on level of diversification available
- Consolidate risks in a single entity
- Driver of M&A activity



Drivers for restructuring

Legal structure



- **Complex groups structures have arisen for capital and tax purposes**
- **Solvency II encourages simplified structures**
- **Relocation of certain activities or even re-domestication outside the Solvency II net will change its impact**

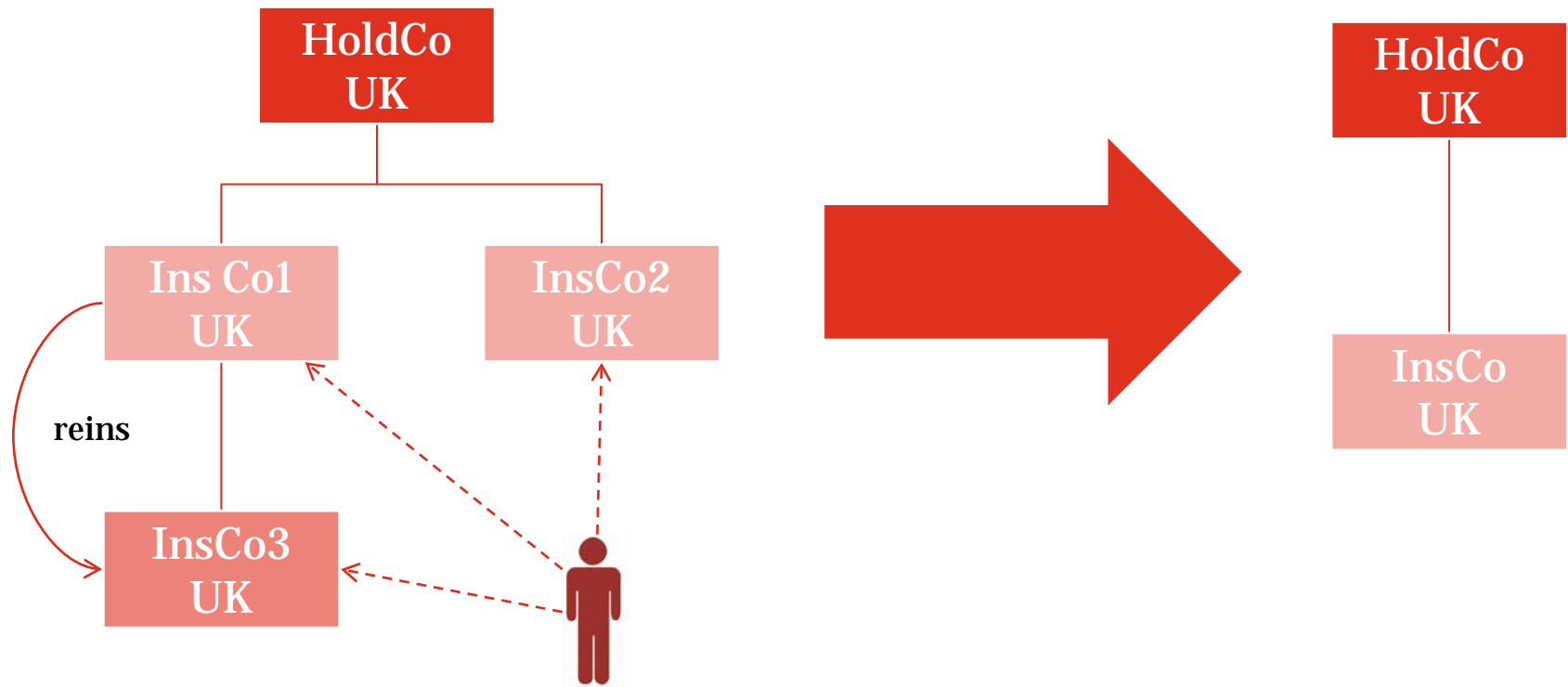
Drivers for restructuring

Operational efficiency

Reorganising structure can enhance efficiency

- Easier route to SII compliance
 - Entities
 - Model approval
 - Risk management
- Reduce time and cost of reporting
- Reduce level of disclosure
- Improve competitive position

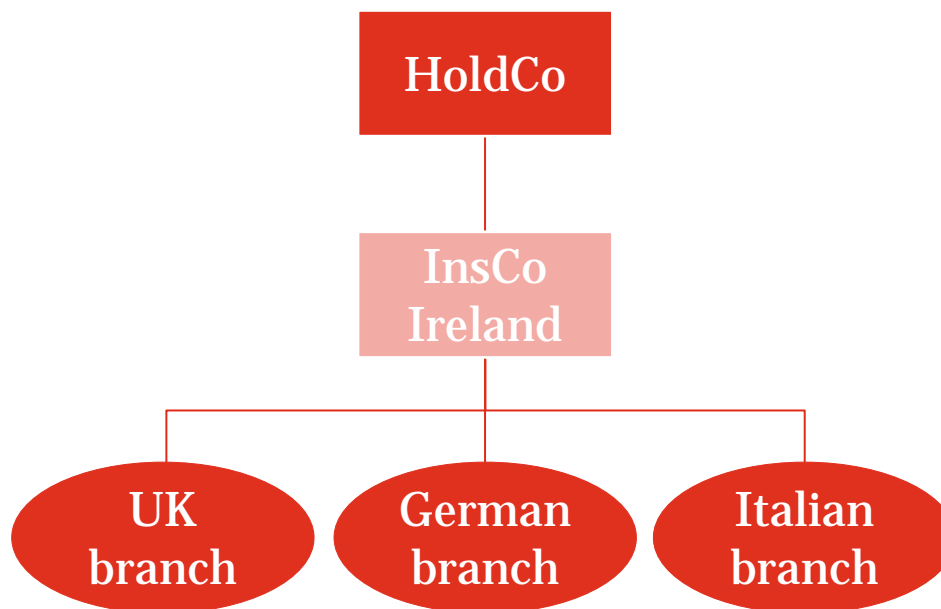
Efficient structure 1: **Rationalise local entities**



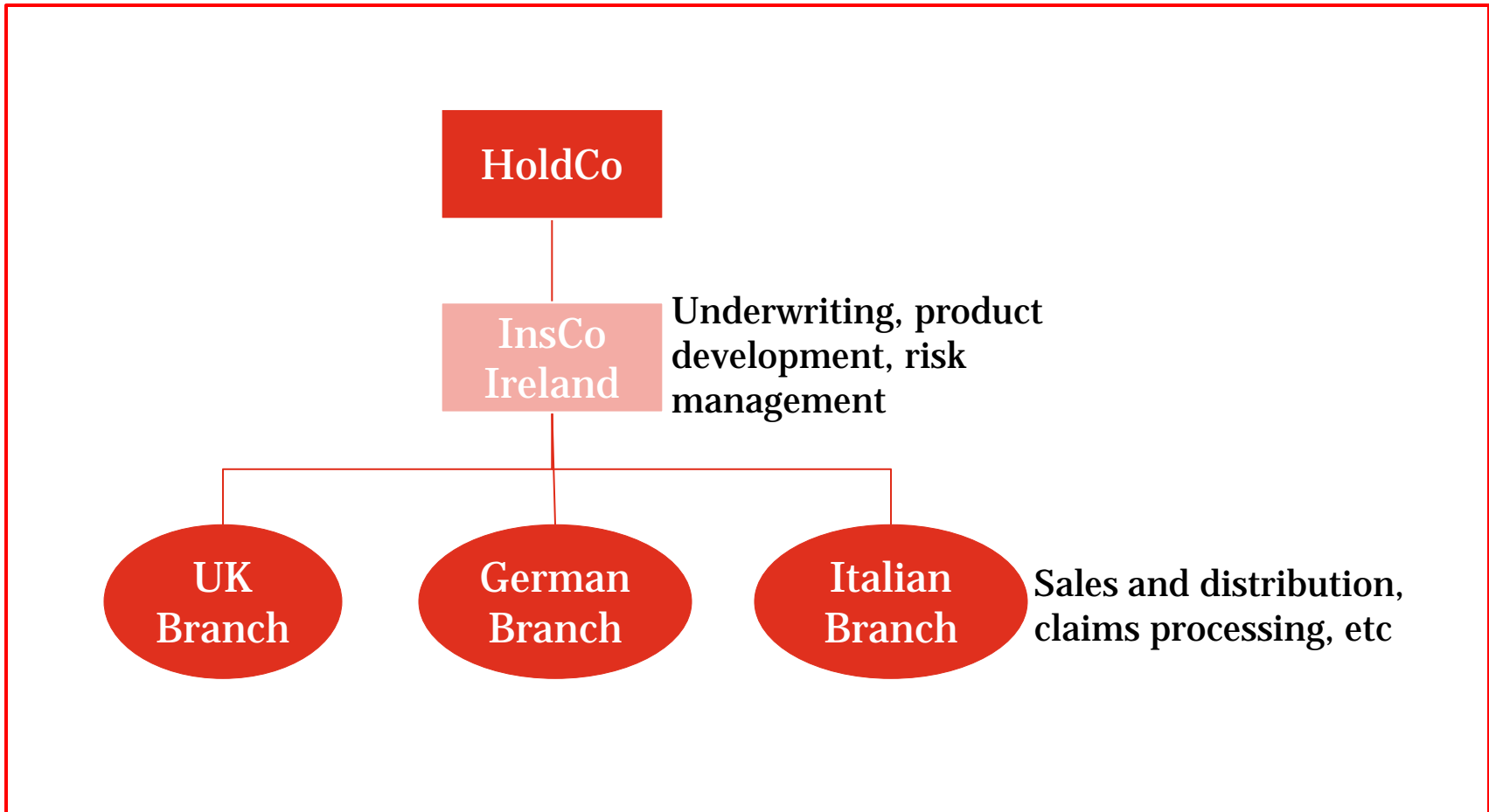
Efficient structure 2: The move to a branch model

Branch Model

- Centralise capital
- One internal model
- One regulator
- One corporate governance structure
- One risk management structure
- One audit
- Centralise costs/expertise



Efficient structure 2: **The move to a branch model**



Functional analysis

Head office and branch profits:



Moving to a branch structure

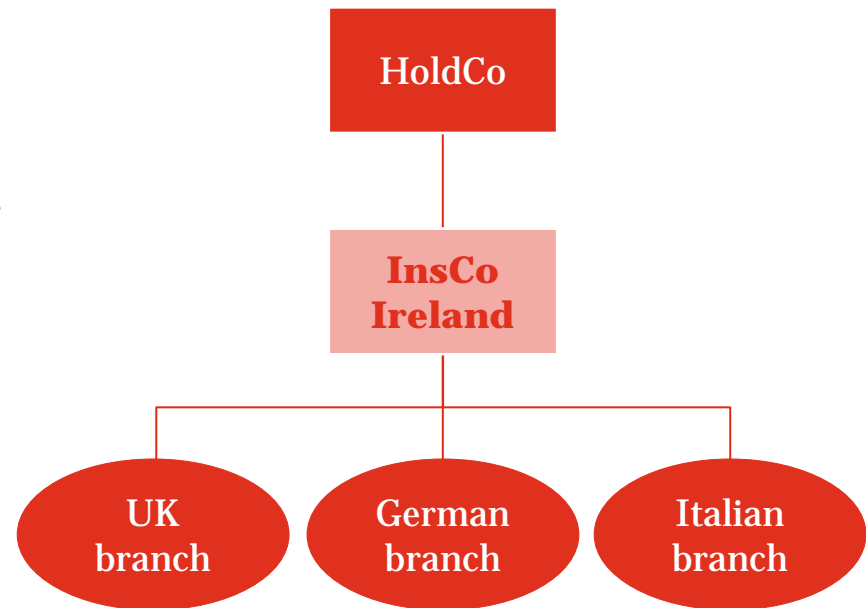
Issues on conversion

Moving to a branch structure:

1. Run off subsidiary and transfer renewal rights
2. Reinsure existing book and transfer renewal rights
3. Portfolio transfer of business
4. Cross-border merger

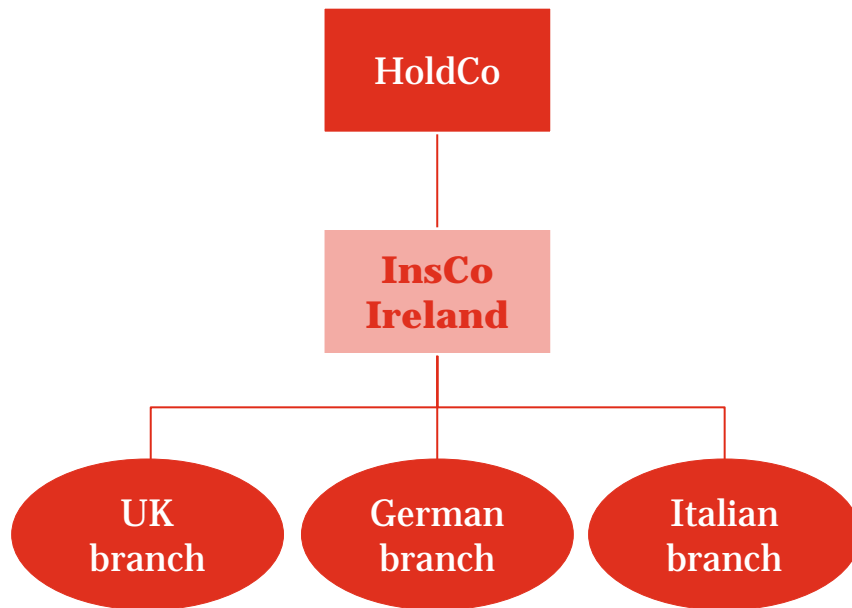
Organising staff and services:

1. Move into the branch
2. Move into a local service entity
3. Move into the Hub
4. Centralise in a shared service entity



Moving to a branch structure

Issues on conversion



Key direct tax considerations:

- Tax on goodwill and VIF
- Carry-over losses/other tax assets
- Transfer and property taxes
- Capital base of the InsCo
- Taxation in Hub location

Why is Ireland being used as a hub location?

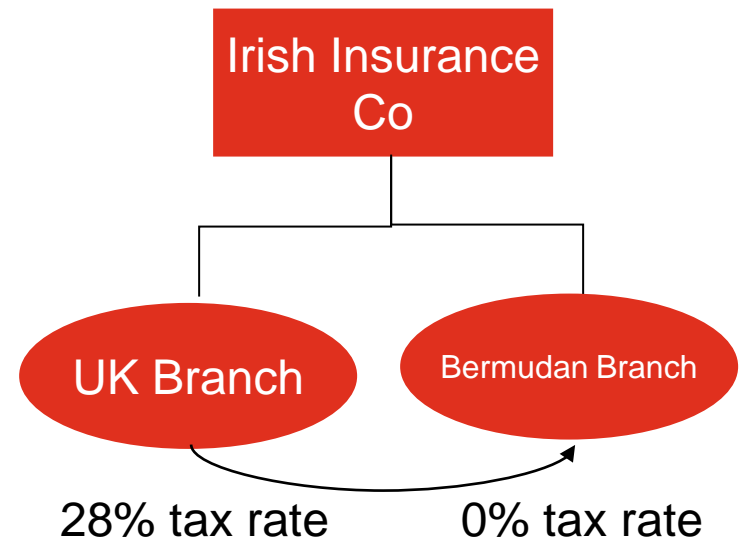
Favourable tax regime for foreign branches

- Branch profits taxable at 12.5% with credit for foreign tax suffered on branch profits
- Foreign tax rates generally exceed 12.5%=> effective branch exemption
- On-shore tax credit pooling regime

Why is Ireland being used as a hub location?

Onshore pooling

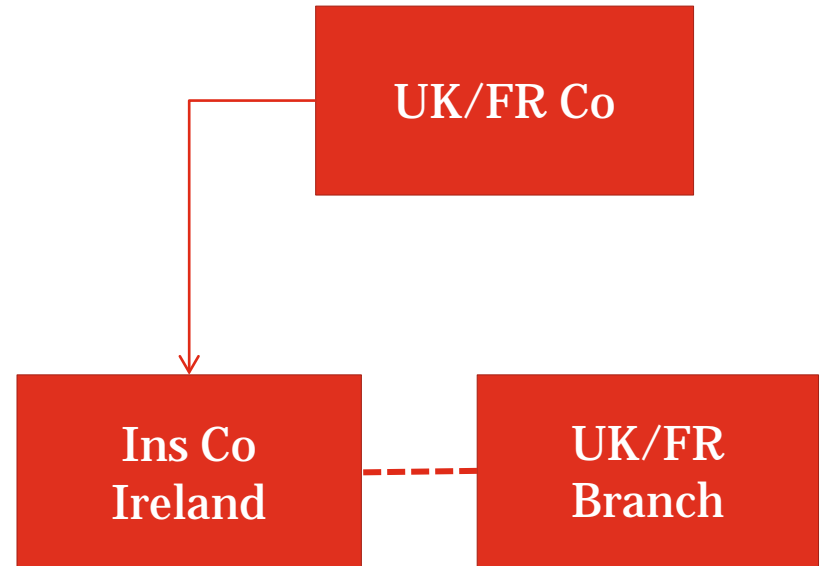
- Onshore pooling regime for foreign tax paid on branch profits of Irish companies
- Allows pooling of excess credits from branches in high-tax jurisdiction
- To reduce Irish tax on branch profits in low-tax jurisdiction
- Applies to branches in both treaty and non-treaty countries
- Carry forward of unused credits with no time limit



The key VAT Challenges

VAT Aspects of the restructuring – where to start

- How to minimise VAT on intra-group transactions & services?
- No one size fits all! Strict, structured & step-by-step approach
 1. Is there a supply and where does it take place?
 2. Availability of Transfer of Business relief?
 3. VAT Grouping – infringement procedures
 4. Country specific exemptions or reliefs
 5. Portfolio transfers and Swiss Re
- Every step should be assessed locally and carefully



The key VAT challenges (2)

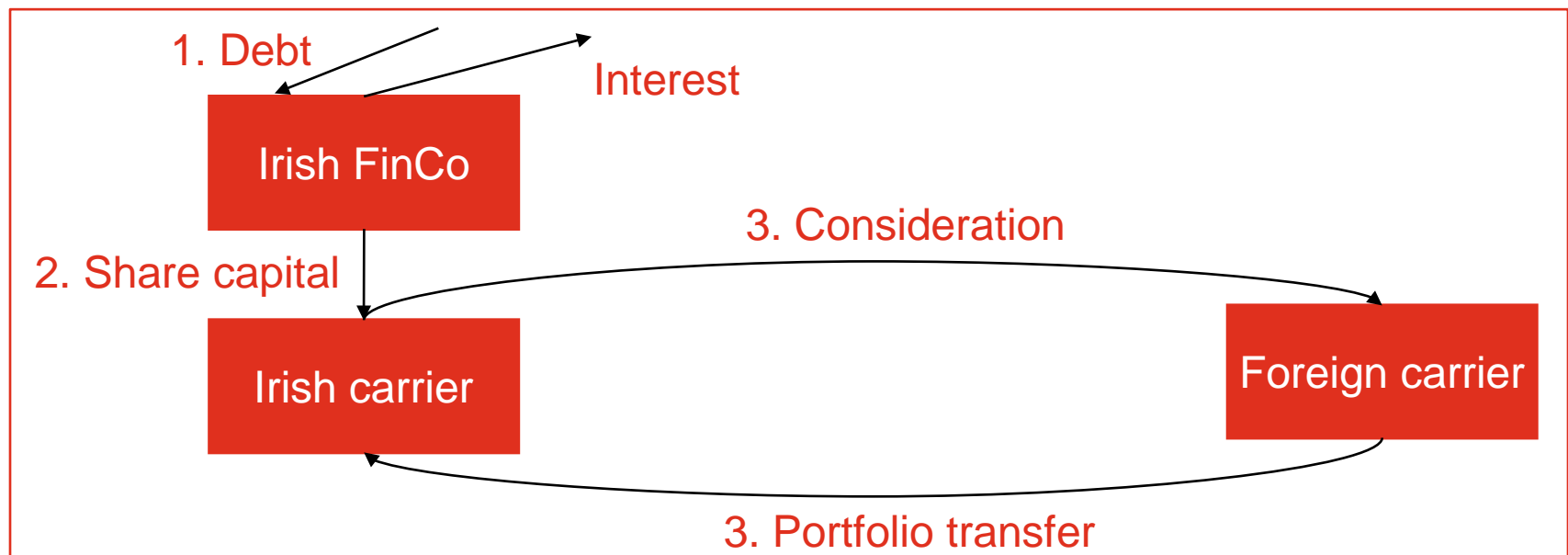
Potential VAT liabilities on cross-charges

- How to assess the services by a Service Co (or SSC)
 - One composite supply? Or separate services?
- Inconsistencies across the EU
 - Back office admin, lead-generation
- X-border compliance issues
- Limitations to grouping relief
- Structured solutions
- HO/branch scenarios; Societas Europaea (SE); X-border VAT grouping
- Cost sharing exemption; EEIGs

Move to a branch structure

Debt financing

- Interest payments by Irish FinCo tax deductible for Irish carrier
- 100% debt financing possible – no thin capitalisation rules
- Substantial reduction in Irish effective rate



Drivers for restructuring

Group supervision

- A huge issue for the industry
- Much wider than group solvency calculations
- Group ORSA, disclosure, reporting, governance and risk management
- Driving structural change
- A particular issue when there are non-EEA members
- Equivalence is important

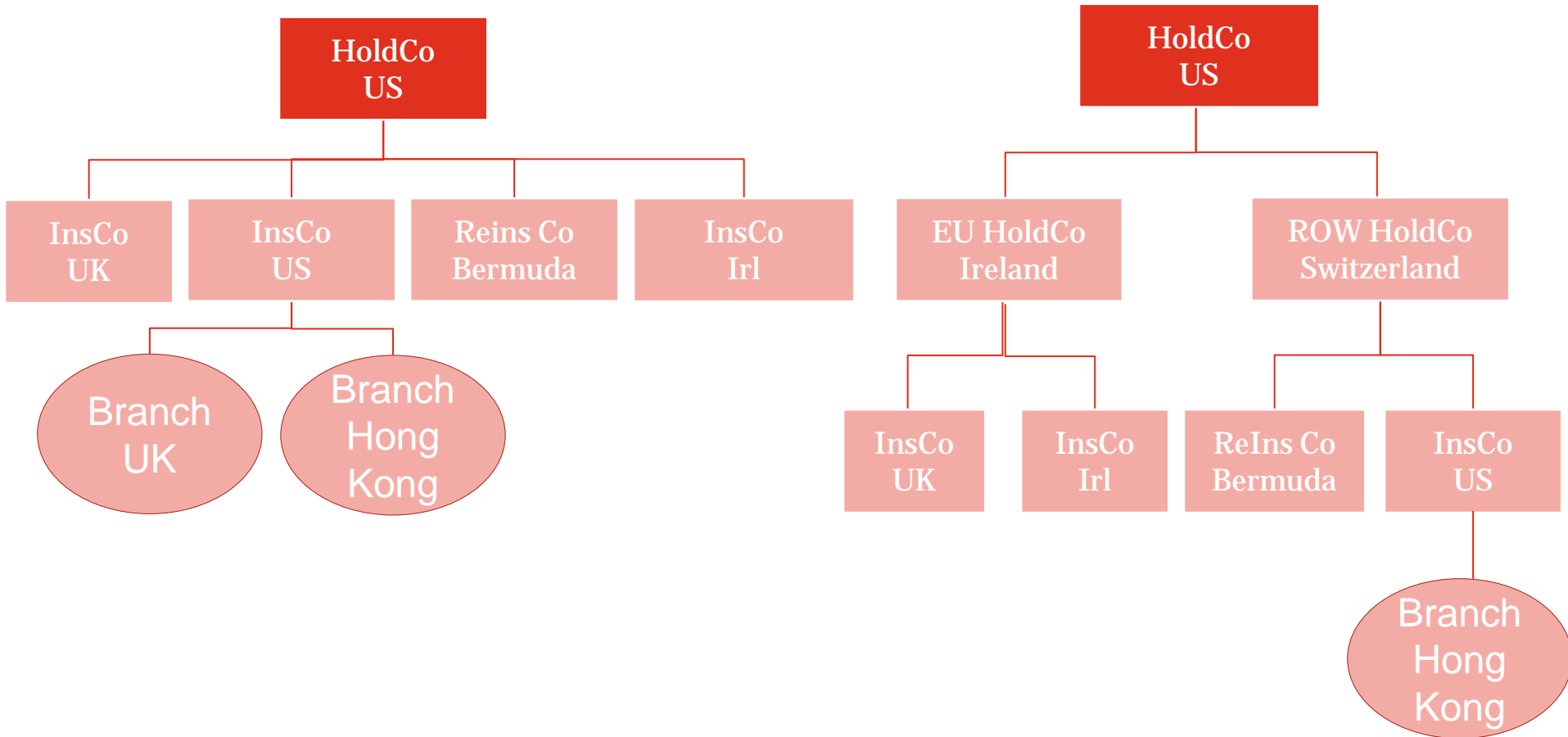
Equivalence

What is the impact?

Equivalence

- Relevant to firms where the HQ is located outside the EU. If the HQ regulator is deemed equivalent, then the group will be exempted from group supervision at the European Level
- If equivalence is not achieved, other methods of supervision may be put in place by the EU supervisors, including an EU holding Company
- Country equivalence will be assessed in “waves” – the first wave will commence in July 2011 and includes only Switzerland and Bermuda.
- Propose transitional provision whereby countries are deemed equivalent for 5 years.

Reduce scope of group supervision:



In conclusion . . .

- Significant group reorganisation and rationalisation
- Growth in the use of branches
- Reducing scope of group supervision



Restructuring = Tax Opportunity

Questions?

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