

EU REGULATORY EQUIVALENCE: GIFT HORSE OR TROJAN HORSE?

In an era of unprecedented international pressure towards a global order, two key ideas have emerged. The first is that prescriptive regulation is the only effective means of controlling risk in financial services; and the second is the concept of restricting trade through the insistence on regulatory equivalence for cross-border transactions.

A good example of this is the attempt by the EU to impose equivalence on the international wholesale insurance industry under their proposed Solvency II solvency regime. It is entirely reasonable for the EU to seek to restrict the admissibility of reinsurance assets purchased by the companies it regulates from entities outside its control. On the face of it there may be a number of reasons why an independent jurisdiction such as Guernsey might wish to consider pursuing EU regulatory equivalence and thereby ensure the admissibility of its reinsurers' assets by the EU. However, in reality the cost benefit analysis of doing this is unproven and involves uncertainty - hardly the basis for making a key strategic policy decision.

HOW HIGH WILL YOU NEED TO JUMP?

The short answer here is that no-one needs to jump. However, there are some requirements hard-wired into the Solvency II regulations that will establish a bar significantly above current (and perfectly adequate) requirements in relation to regulatory capital and disclosure standards.. That said there are a number of other areas in which it can reasonably be expected that regulatory standards will need to be increased substantially above existing (and again perfectly adequate) international standards, including those set by the International Association of Insurance Supervisors.

AND HOW HIGH WILL THE BAR GET?

Of course the EU is keen to get other jurisdictions to sign up for equivalence as they are seeking to establish their regime as the basis of global regulatory standards. This agenda will be pursued not only through the active selling of the concept in which the executives of CIEOPS are already involved, but also through the membership by a number of EU national regulators of the IAIS where they will be promoting the incorporation of EU standards within the IAIS's core principles.

It is also apparent that current standards are unlikely to remain the same for very long. Once

signed up to equivalence, jurisdictions will have to constantly enhance their regulatory requirements in order to preserve their equivalent status. By this means the EU will hope to exercise its influence far beyond its own membership and curtail the efficiency of more appropriately regulated jurisdictions.

HOW GREEN IS THE GRASS ON THE OTHER SIDE OF THE FENCE?

Advantages claimed for equivalence range from the inaccurate, to the irrelevant, occasionally via the fanciful.

Many small, independent jurisdictions have insurance industries comprising a small domestic insurance sector and a significantly larger international sector.

This latter group is made up mainly of insurance subsidiaries of international companies and groups providing risk financing services within their corporate insurance programmes(that is to say what is often referred to colloquially as "captive" insurance companies) with smaller numbers of international life companies and, in a few circumstances, a discreet number of commercial insurers and/or reinsurers.



Generally their regulatory regimes reflect the unusual risk profile inherent in the business they oversee and provide a flexible, pragmatic business environment in which captive insurance has flourished and delivered great value to captive owners.

For many small independent jurisdictions the overwhelming majority of their business is captives of one sort or another. Many of these act as reinsurers to commercial carriers who provide and service the direct policies issued to the owner of the captive and to its sister companies. These carriers are commonly referred to as "fronters" in this context.

It is held in some quarters that regulatory equivalence will better facilitate fronting arrangements of insurance into the EU by ensuring that the reinsurance asset provided to the fronting insurer by the captive is recognised as such within the calculation of regulatory capital by the fronting insurer. This is, as far as can be determined at this point, inaccurate since commercial fronting insurers have never themselves recognised the validity of captive reinsurance assets and have always ensured that such assets are fully secured, typically by Letters of Credit issued by rated banks.

There are those who assert that equivalence is part of the inevitable march of history as the world moves into a new era of ever closer global cooperation on regulation. This is fanciful. Solvency II is not even yet certain to be implemented in the EU nor is there any certainty of what may or may not be implemented.

In short there are no really hard reasons why any jurisdiction such as Guernsey would at this stage be interested in immediately adopting equivalence.

SO, DO WE LOOK IT IN THE EYE OR BURN IT?

It is difficult to see what attractions equivalence might have for small independent jurisdictions where captive insurance is their main international insurance business.

Solvency II per se is not under criticism here. It is a legitimate response to concerns about large commercial insurance and reinsurance security whose failure has potentially damaging implications for the host economy.

However, Solvency II is not a suitable basis on which to regulate captive insurance; this much is heavily witnessed by the efforts of insurance industry associations and other representatives of EU based captives seeking accommodation under so-called “proportionality” rules that allow a more appropriate regulatory approach to be taken to accommodate the needs of the EU captive industry

For an offshore observer, it is somewhat ironic to see the EU fall over itself to embrace risk based regulation and solvency when for decades it has attacked the regulation of the offshore insurance industry which has successfully operated under such a regulatory regime. There is no one more fervent advocate than a convert!

CORPORATE TAX REFORM

In 2008, in response to changing international standards in tax policy, Guernsey introduced its Zero-10 Corporate Tax Regime as part of a two stage process (the second stage being a review of the effects of Zero-10 originally scheduled to take place after an initial three year period). Recent global economic developments and feedback from the EU Code of Conduct Group have brought forward the timetable for this review and Guernsey, as well as the other Crown Dependencies (Jersey and the Isle of Man) are now working within a similar framework.

The review is at a very early stage and consultation has commenced with industry representatives and tax professions. The finance industry is represented by the Guernsey International Business Association (GIBA) of which the Guernsey International Insurance



Association (GIIA) is a member. Both GIBA and GIIA have set up working parties to deal with this issue, both of which include representatives from Willis. In December 2009, GIBA issued a statement on the reforms which stated that:

“A major element of the review will include Government working closely with the finance industry, through its representative body, GIBA. This consultation will enable Guernsey to ensure that any changes it makes to the corporate tax regime will accommodate the needs of existing and future business in the Island.”

In addition to this statement from GIBA, the Chief Minister has already committed to public record the five key principles which are underpinning the Government’s review process.

These are, that any new corporate tax regime for Guernsey:

- Must be “internationally acceptable”
- Must be “competitive”
- Must “promote a sustainable economy in Guernsey”
- Must be based on a simple, solid rationale (and not over-complicated)
- Must give rise to other benefits such as double taxation agreements

On 21 June 2010, Government announced the commencement of a period of public consultation due to conclude on 27 August 2010 with a feedback document being published during the Autumn.

<http://www.gov.gg/ccm/general/corporate-tax-review-public-consultation-document-published.en>

Identified within the consultation document are five ‘technical approaches that could be used as a foundation of a revised regime’. These are:

- Territorial System
- Corporate Transparency
- Repayable Tax Credits
- Flat rate
- Abolition of Corporate Tax

Willis will be briefing our clients and their Boards as the consultation period progresses. However, it remains our expectation at this time that captives based in Guernsey will continue to pay tax at a zero rate.

For further information on the corporate tax review, please contact Karlene Wright on 00 44 (0) 1481 735604 or via email at karlene.wright@willis.com.

NEW CODE OF CORPORATE GOVERNANCE

The topic of Corporate Governance has become an issue of vigorous debate since the consultation paper on a revised Code was issued earlier in the year by the Guernsey Financial Services Commission (GFSC). Aimed at all Companies registered, licenced or regulated by the GFSC, its intent was to provide the basic outline requirements for a sound corporate governance regime. As a result, its attentions focussed specifically on eight key areas:

- The Board
- Directors
- Business Conduct and Ethics
- Accountability
- Risk Management
- Disclosure and Reporting
- Remuneration
- Shareholder and Stakeholder Relations

The original Code was structured around a proposed set of defined Outcomes, Best Practice Provisions and Guidance whilst introducing a “Comply or Explain” regime which enabled companies to provide an explanation to the GFSC where either non-compliance, or compliance by alternative means, applies.

Three levels of definition were initially outlined:

- Level One – this represented the outcomes of good corporate governance and set out the required standard for compliance by Boards. These outcomes would represent a mandatory element of the new Code.
- Level Two – this comprised best practice provisions on how to comply with the required outcomes of Level One. Best practice is expressed as statements which will commonly include the word “should” to allow alternative approaches to be employed, subject to a satisfactory “Comply or Explain” response.

- Level 3 – this comprised guidance on how to comply with the outcomes and best practice and frequently used the word “should” in order to allow alternative approaches to be used. At this level, there remained additional work to be undertaken and it was anticipated that further detail would be issued later in 2010 by the GFSC following extensive consultation with the respective industry sectors.

The new Code was structured in an attempt to introduce a more flexible approach than could otherwise be achieved through formal legislation, whilst simultaneously complementing existing law and regulation. It was also expected that, once introduced, it would help to create greater transparency within the various regulated sectors.

However, in June 2010 the GFSC issued a further statement to the effect that, following significant feedback from industry, an independent third party had been mandated to review, analyse and collate industry’s questions, issues and concerns. As a result of this report, the GFSC has elected to revisit the Code and, in conjunction with the practitioner working party, to redraft it. It is now expected that this review will take some months to complete and will be followed by a further consultation process now anticipated for the end of 2010.

Willis Management (Guernsey) Limited is regularly monitoring developments to ensure compliance on behalf of our clients. It is our view that the introduction of a Code for all regulated financial services businesses is to be generally welcomed as a key part of the development of a healthy regulatory framework in the Bailiwick.

For further information on developments, please contact Carolyn Dorey on 00 44 (0) 1481 735633 or via email at doreyc@willis.com.

ANTI MONEY LAUNDERING UPDATE

The month of June 2009 saw the first GFSC Anti Money Laundering on-site visit at the offices of Willis Management (Guernsey) Limited, since the introduction of the new Handbook for Financial Services Business on Countering Financial Crime and Terrorist Financing on 15 December 2007. The visit included a discussion on Willis’s internal AML/CFT policies and procedures and concluded with a review of a number of client files. We are delighted to report that there were no major issues arising from the on-site visit.

The GFSC has advised that a common theme amongst the businesses subject to enforcements had been poor corporate governance with Boards paying insufficient attention to AML/CFT

requirements. Board consideration of AML/CFT matters must be formal, minuted and comprehensive. The GFSC has emphasised that it is not sufficient simply to note that no AML/CFT issues have arisen since the last Board Meeting or that compliance with particular requirements has been reviewed.

Between November 2009 and March 2010 a number of instructions (Numbers 1-9 on the GFSC website) were issued by the GFSC as a result of a review of compliance issues as a whole arising from international AML/CFT assessments. Included within the instructions are immediate action points to be taken by the Board of financial services business. Willis will be advising client Boards as appropriate of the actions that they may be required to take.

There have been recent announcements in the press regarding proposed changes to AML/CFT legislation in Guernsey. These changes will bring postage stamp and bullion dealers together with firms of accountants within the ambit of AML/CFT legislation for the first time, but will not impact upon Willis clients.

Willis continues to keep abreast of any amendments to the AML/CFT Regulations and will implement any changes as soon as practicable and ensure that their client Boards are kept informed of any changes.

For further please contact Sue Montgomery on 00 44 (0) 1481 735 622 or via email at susan.montgomey@willis.com.

GUERNSEY INTERNATIONAL INSURANCE ASSOCIATION (GIIA)

The Guernsey International Insurance Association (GIIA) was originally formed in 1983 to represent the combined interests of both Guernsey insurers and Guernsey insurance managers.

GIIA plays a fundamental role in ensuring that the island's insurance industry's voice is heard by the local government, local regulators and international bodies. Its lobbying activities have been supplemented by its efforts to raise the industry's profile and ensure a sufficient depth of informed insurance professionals to enable the maintenance of Guernsey's reputation among the elite of the world's insurance domiciles. It does this through the organisation of conferences and seminars both in Guernsey and abroad, and the provision of education sessions to all levels of the Guernsey insurance industry

Corporate membership extends beyond insurers and insurance managers to those industries that support the insurance activities on the island such as accountants, lawyers, investment professionals, bankers and actuaries. Individual membership is available to anyone interested in the operation of the insurance industry in Guernsey, such as consultants and non executive directors.

For all enquiries relating to GIIA membership, please go to www.giia.gg or email giia@giia.gg

We communicate with you to understand your business, providing the expertise and creativity to develop and deliver excellent captive solutions, and we do so with passion.

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