

# POSITION OF STRENGTH - BEPS

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Moving from London to Guernsey 20 years ago, I stepped out of underwriting into the fast growing and innovative captive industry. This was part of Malcolm Cutts-Watson's strategy to move captive management business away from an administrative focus to being technically and strategically equipped. The operational efficacy of the existing industry had to be matched with real insurance expertise – insurance managers needed insurance expertise.

It was a model quickly copied by others because, although Base erosion and profit shifting (BEPS) was not on the horizon in 1995, industry leaders were already forecasting the importance of true insurance expertise to engender substance and technical excellence.

Today, advisers commonly cite four key areas of concern: commercial substance; transfer pricing; governance and financial ratios. These are familiar matters to captive managers in Guernsey and present no significant or new challenge, just tweaking and better documentation at most.

## Substance

The need for real commercial substance has long been recognised by UK-focused domiciles in response to both tax and regulatory challenges there. The presence of an active branch of the Chartered Institute of Insurance will raise the bar for the local workforce and is reinforced by a maturing sector that now boasts an increasing breadth of experience as commercial niche insurance, reinsurance and ILS business develops. Key skills risks will be further reduced as the need to bring in outside expertise diminishes.

## Underwriting practice

With development of core insurance expertise, a community of significant underwriting expertise will grow – to provide proper underwriting methodologies based on actuarial modelling with a true appreciation and analysis of the risks insured. This need has grown not in response to tax considerations but to the UK regulatory environment. Models employed in some captive locations, in which brokers or even clients propose terms for consideration by the board of the captive, fall foul of UK regulation. Anyone deemed to be 'conducting insurance business' (eg: by setting premiums) is liable to substantial sanctions.

## Governance

Modern governance requires boards of real competence with an appropriate range of skills, with a degree of independence of mind, between the shareholder/policyholder and manager. Boards must also be able to conduct duties in a documented and effective manner within robust and compliant frameworks.

Boards require effective, knowledgeable and independent directors. While core skills in insurance, law and accounting are preferable, independent directors – and regular turnover of this group – ensure a board remains responsive to changing demands. The key is to have a board that has both the skills and independence to scrutinise and challenge what is put to it.

## Benchmarking

Current regulation and tax policy places much emphasis on the acceptability of key financial metrics. Both are concerned that level of capital employed is appropriate to the risks assumed, that profit on the business written reflects a reasonable return on that capital, and there is no unreasonable transfer of revenues from the location of the insured activity or assets. Supporting insurance programmes with minimum levels of capital and parental guarantees has never been good practice so having the captive located in a jurisdiction that applies modern standards of risk-based capital assessment is essential.

Proper underwriting techniques based on actuarial modelling ensure that, over the medium term, margins are appropriate to the risks assumed and the capital employed. Testing premiums against any available commercial comparisons will help to sense check pricing but cannot be relied upon as justification alone. A broker's 'desk

quote' or even the underwriters' price guide is not enough validation of proposed premiums.

## The Guernsey position

Our expanding insurance community combines professional skills with decades of experience to deliver real substance alongside the industry's core accounting and administrative expertise. It services an increasingly demanding clientele with advice on global risk financing strategies and programmes across all major lines of business, in all jurisdictions. From employee benefits to financial classes, property or casualty, and professional indemnity Guernsey's captive management industry is the most professional and experienced in the world.

With this professionalism in mind, the Guernsey Government joined forces with members of the insurance sector and wider financial services industry in the island to establish a BEPS working party at the end of 2015. The working party which is chaired by Guernsey's Chief Minister, Deputy Gavin St Pier, includes tax professionals from the Big Four, representatives of the Institute of Directors, the Guernsey Society of Certified and Chartered Accountants and the Guernsey Financial Services Commission.

Since forming, the working party has focused on assessing the potential impact of the action plans on the different sectors which comprise Guernsey's finance sector. Based on its initial findings it formulated a number of views mid-way through last year [2016] that will help to inform its future work.

- That Guernsey is already largely compatible with the BEPS agenda due to its long-standing focus on business substance, and is now focusing on identifying opportunities for business, whilst acknowledging that there will be some challenges. Guernsey's finance sector model and regulatory framework is not particularly conducive to Guernsey being exploited for base erosion and profit shifting and so ensures equivalent outcomes to those the OECD and EU Commission are seeking to secure.
- Guernsey can maintain stability and competitiveness as well as a commitment to any new international standards.
- That Guernsey businesses are already actively considering how to respond to the new global standards that the BEPS agenda will establish, and that the Guernsey Government, through further consultation with industry, will actively play its part in that through putting in place appropriate legislation and regulatory policy.
- That the BEPS agenda is one that government and businesses in Guernsey supports, and will demonstrate that support through its commitment to country by country reporting.

Guernsey's managers have long recognised the need to formally determine insurance terms on the island. Previously, this may have raised the hackles of brokers but the importance of being in control of the underwriting process, and having the right skills available to the captive board, is now accepted by all and has been key to successfully defending a number of tax challenges. The sector has transformed itself from an administration centre into a full value insurance management industry, providing best-practice strategic and technical advice.

For other centres the challenge will exist where local industry lacks those attributes and where the focus is for managers to administer insurance being underwritten and overseen elsewhere. For example, those jurisdictions where their traditional business has been US focused might not have previously needed to demonstrate local underwriting and program design etc. as this has often been done by brokers in the US itself.

## Conclusion

Guernsey has led the drive to set modern governance standards with its Code of Conduct, first published by the Guernsey Financial Services Commission in 2008 and regularly updated since. A highly qualified pool of local NEDs, with deep connections into London, brings world's best practice in terms of processes and frameworks, and insurance management expertise.

Finally, the island boasts long-established practices for performance measurement and reporting, the highest of accounting and administrative standards, and an appreciation for global regulatory and tax environments which is unlikely to be matched elsewhere. Whatever the remedial action required for your captive, in response to BEPS, I am confident that Guernsey will be able to meet them.

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WE ARE GUERNSEY is the brand under which Guernsey Finance promotes the island's financial services sector internationally. Guernsey Finance - the promotional agency for the island's finance industry internationally - is a joint industry and Government initiative responsible for the promotion of Guernsey. Under the leadership of Chief Executive Dominic Wheatley, the agency ensures that the core values and competencies of the island's finance sector are accepted and respected by the global community and that financial business development flows are enhanced.

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