

Swiss Insurance Club

Transfer Pricing for Insurance Groups

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Overview

1. What is transfer pricing and why is it important?
2. Significant transfer pricing issues faced by insurers
 - Reinsurance and distribution
 - Branding and other IP
 - Business Restructuring
 - Financial Transactions
 - Central services
3. Implementation
4. A view from the industry – Irina Diakonova

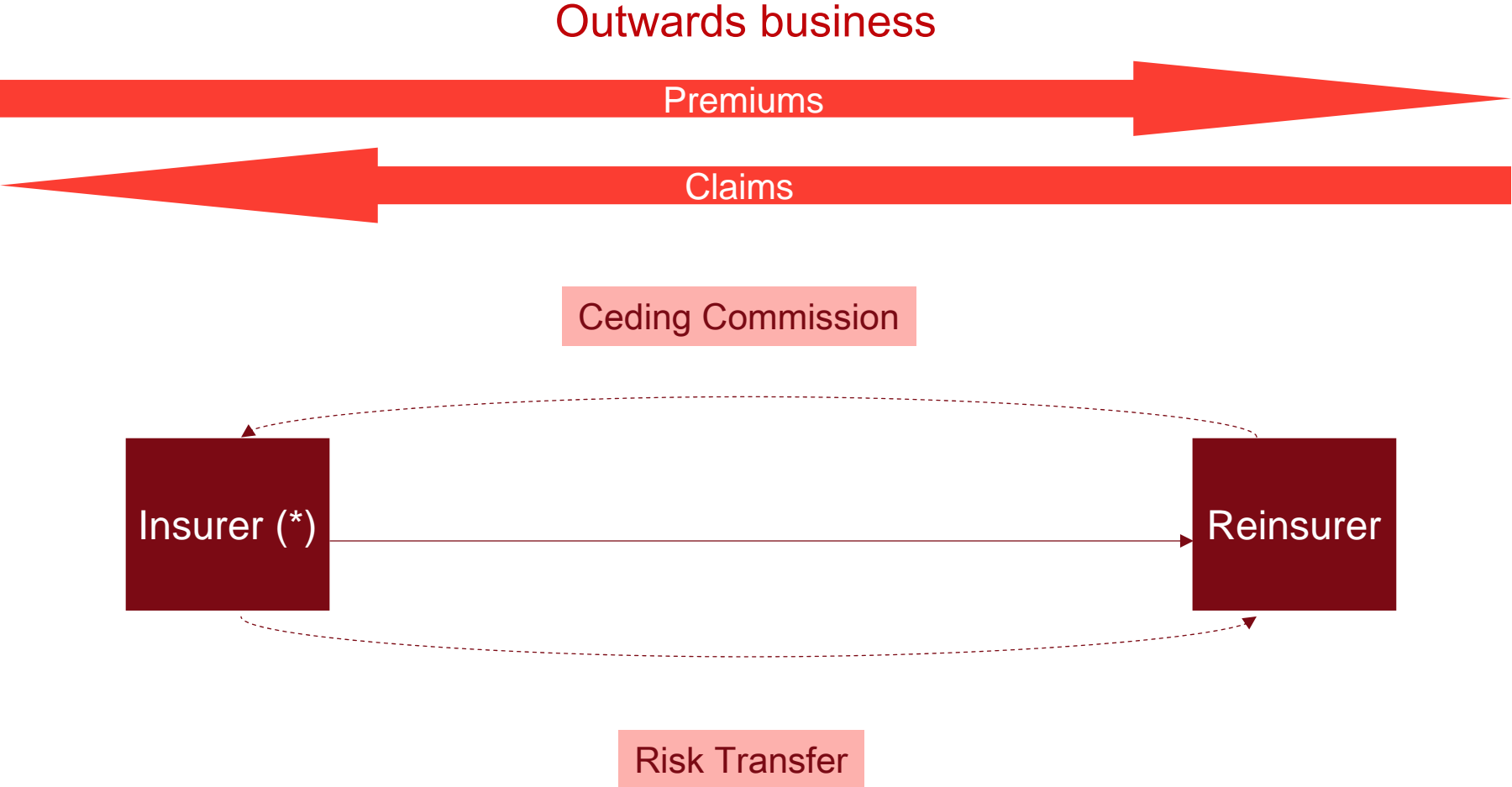
What is transfer pricing and why is it important?

- Intra-group pricing for goods, services, intangibles
- Risk of double taxation
- The Arm's Length Principle
 - Key foundation of the OECD Model Tax Convention
- Guidance from OECD Transfer Pricing Guidelines
 - Adhered to in tax rules of OECD countries
- US Transfer Pricing Regulations – More prescriptive
- Transfer pricing offers key benefits – Not just a tax risk!

Reinsurance

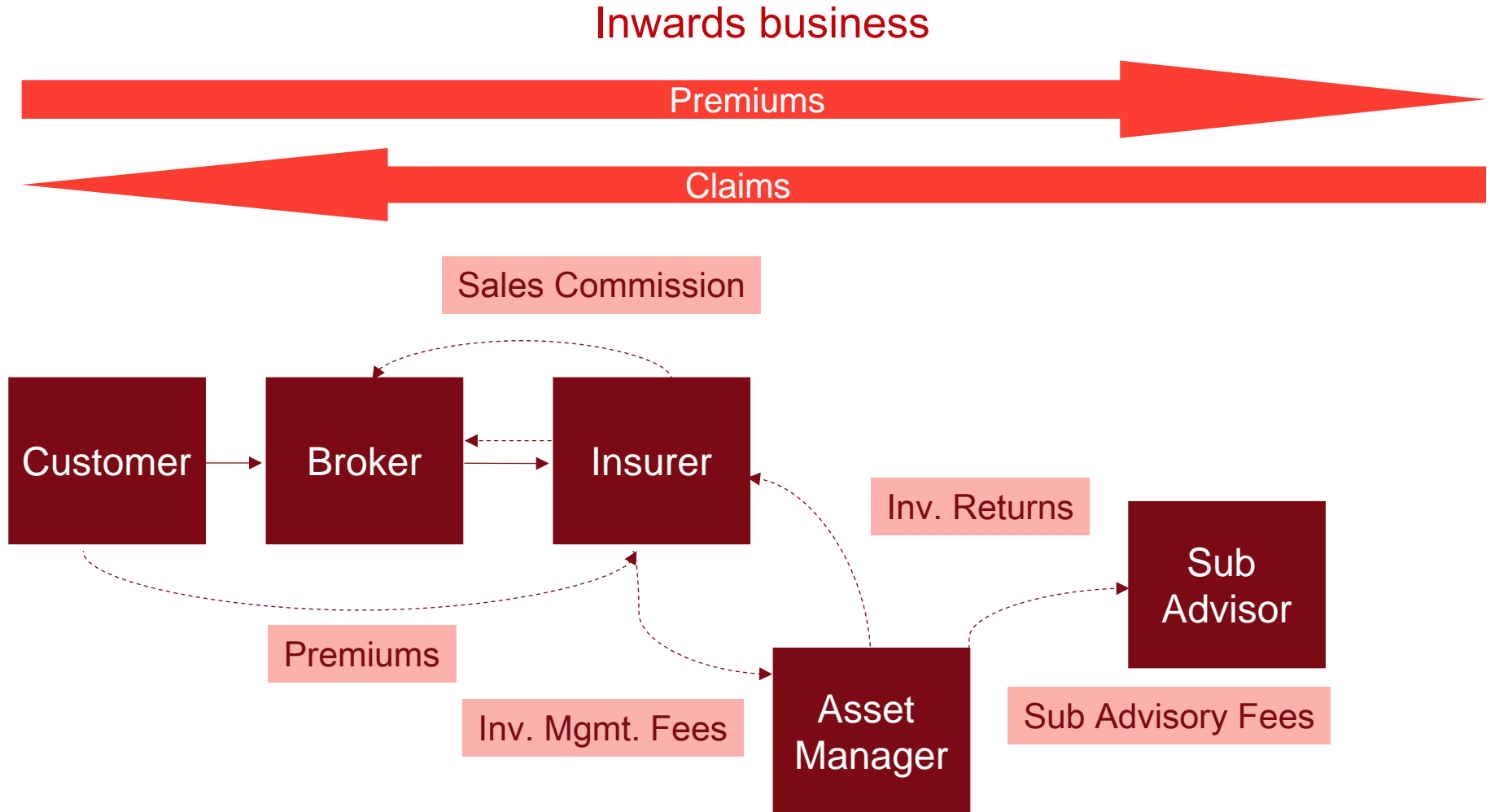
- Generally the most visible transfer pricing issue for insurance companies
- Often the issue with largest amount of tax at stake
- Generally poorly understood by tax authorities
- Very different transfer pricing methods required for non-proportional vs. proportional reinsurance

Insurance Transaction Flow (1/2)



(*) Ceding insurance company

Insurance Transaction Flow (2/2)



Distribution

- May be a key value driver (or KERT) for the business depending on business line
- Often assumed that underwriting is the key function; however, some insurance is 'sold' rather than 'bought'.
- Payment Protection Insurance
 - Super Profits
 - Offshore underwriter/onshore marketing
 - 'Entrepreneur' considered to be offshore
 - Limited contemporaneous documentation of pricing
- Cost plus for routine marketing?
- Profit split / entrepreneur model for marketing where commoditised?
- Recent ruling on DSG case

Charging for brand use

What creates a brand?



- Legal registration and protection*
- Setting of overall brand strategy*
- Implementation of the brand strategy locally*
- Sponsorship or other charitable activities*
- Setting of management procedures for operations, that leads to increased performance*
- Funding of costs associated with any of the above*



Who is the owner of the brand and should thus be paid?

Who to pay?



How can the brand benefit the business?



- With existing customers?*
- With the future customers?*
- With existing employees?*
- With potential employees?*
- With regulatory bodies?*
- With the public at large?*



Do any of these benefits require that a fee be paid for using the brand?



Other Considerations:

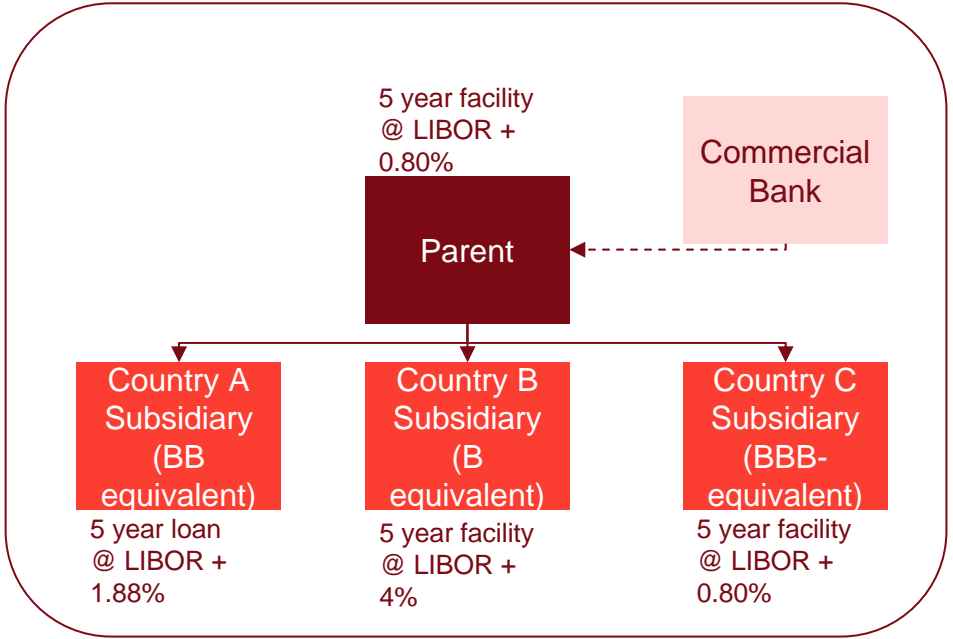
- Are the businesses profitable?
- Is the brand still adding value? Is it generating additional value through retained margins in the current business environment?
- Does the brand substitute for financial strength?
- Is there other intellectual property which should also be considered?

General - TP issues in the context of Business Restructuring

- The nature of Business Restructuring – cross border redeployment of functions, assets, risks – typically consisting of conversion of fully – fledged distributors into limited-risk distributors or commissionaires for a related party principal
- History – 2005 – Joint Working Group (1 and 6)
- End 2007 - OECD decided unresolved/ uncertain TP issues – Working Party 6 to address (WP1 to address PE threshold issues)
- Key issue – is the generally intended re-allocation of profits from Business Restructuring consistent with the arm's length principle?
- Recently released discussion draft of 19 September 2008 – four sections:-
 - Special consideration for risks
 - Arm's length comparison for the restructuring itself
 - Remuneration of post-restructuring controlled transactions
 - Recognition of actual transactions undertaken
- Article 9 not Article 7 relevance
- Relevance to/impact on insurance sector
- OECD seeking comments by 19 February 2009

Treasury services

- External funding obtained by central treasury, finance or holding vehicle, with centre on-lending to business (often via other financing entities)
- Lending often tends to be on “pass-through” rates or small margin added
- Most often the lending is not based on “arm’s length” terms based on any credit rating analysis of subsidiaries
- Often based on “rules of thumb” that may or may not reflect market conditions, reliance on casual bank quotes, and “guesstimates”
- Triple impact on thin capitalisation, interest rates and guarantee fees
- With regards to thin capitalisation, there could be a re-evaluation of tenor of financing to subsidiaries and a potential adjustment of debt/equity mix, in light of local thin capitalisation requirements
- On interest rates, there are arm’s length interest rate ranges matching the specific terms & attributes of debt instruments/benchmarking



Step 1. Determine the Level of Risk for the Internal Borrower
 (Pro-forma financial statements analysis and credit rating on a “stand-alone” basis)

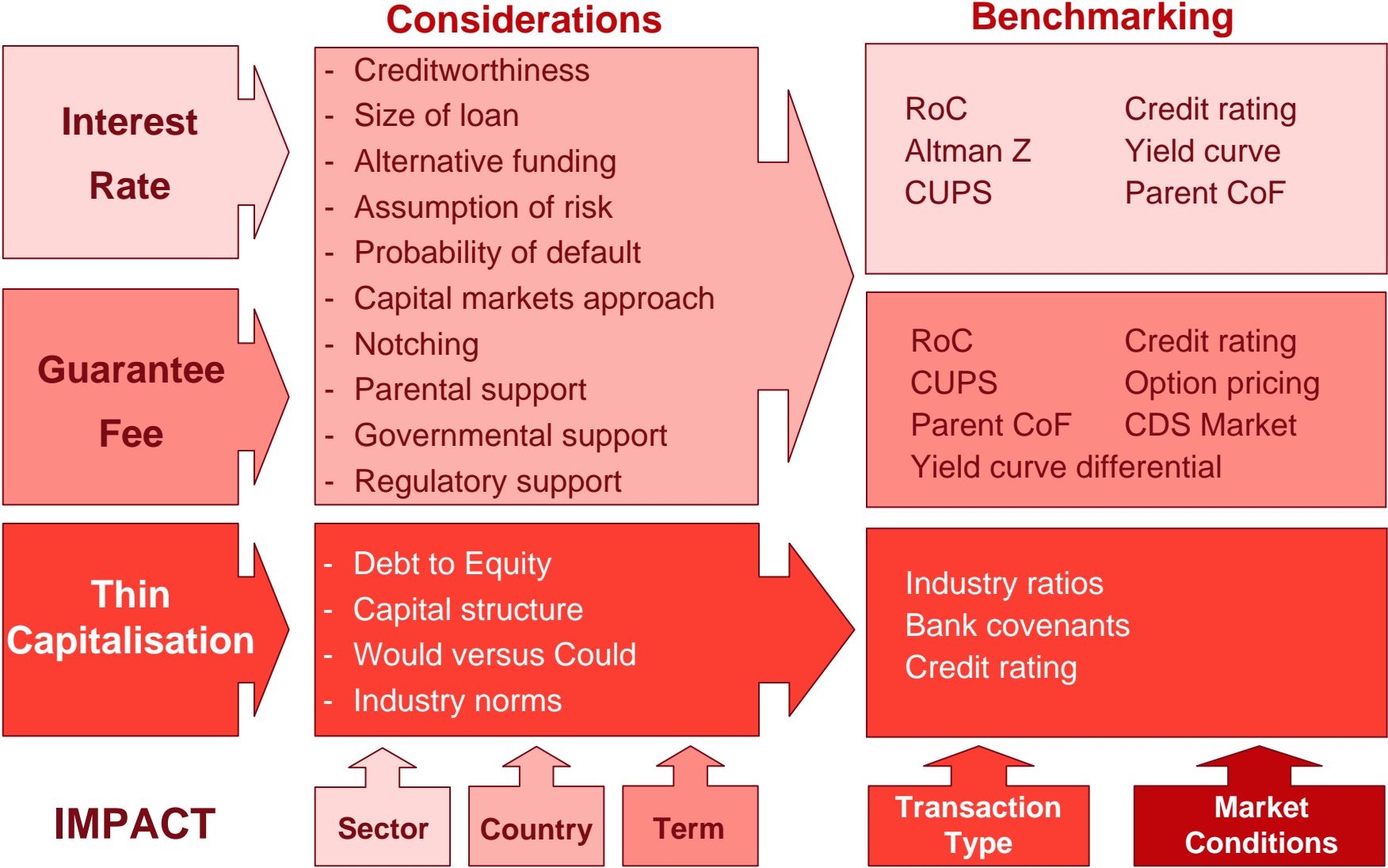
Step 2. Adjust the Risk for Specific Debt Characteristics
 (e.g. term of loan, currency, rate base, convertibility, options (call/ pre-pay), collateral, etc.)

Step 3. Determine Interest Rate Based on Market Sources
 (interest rate benchmarking matching the specific terms and attributes of debt instruments)

Credit Matrix & Pricing Grid

IQ Ranges (spreads in %)	Maturity (Years)			
	1.00	3.00	4.00	5.00
Ratings	Year 200X			
AA+/AA/AA-	0.32 0.65	0.33 0.67	0.37 0.71	0.43 0.77
A+/A/A-	0.43 0.77	0.48 0.82	0.52 0.88	0.54 0.90
BBB+/BBB/BBB-	0.58 0.94	0.62 0.96	0.66 0.99	0.71 1.05
BB+	0.65 0.99	0.71 1.05	0.77 1.11	0.82 1.16
BB	0.71 1.05	0.77 1.11	0.82 1.16	0.88 1.22
BB-	0.77 1.11	0.82 1.16	0.88 1.22	0.88 1.28
B+	0.82 1.16	0.88 1.22	0.94 1.28	0.94 1.33
B	0.88 1.22	0.94 1.28	0.94 1.33	0.99 1.39
B-	0.94 1.28	0.99 1.33	0.99 1.39	1.05 1.45

Benchmarking approaches



Central Services – Where is the “Value Added”?

- Central services companies in insurance businesses
- Providing services/staff/bearing all costs
- TP depends on the facts and functions performed

Central Services

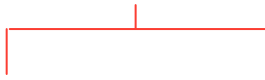
- Accounting
- HR
- Legal



Support staff

Payroll

- Payroll
- Employment



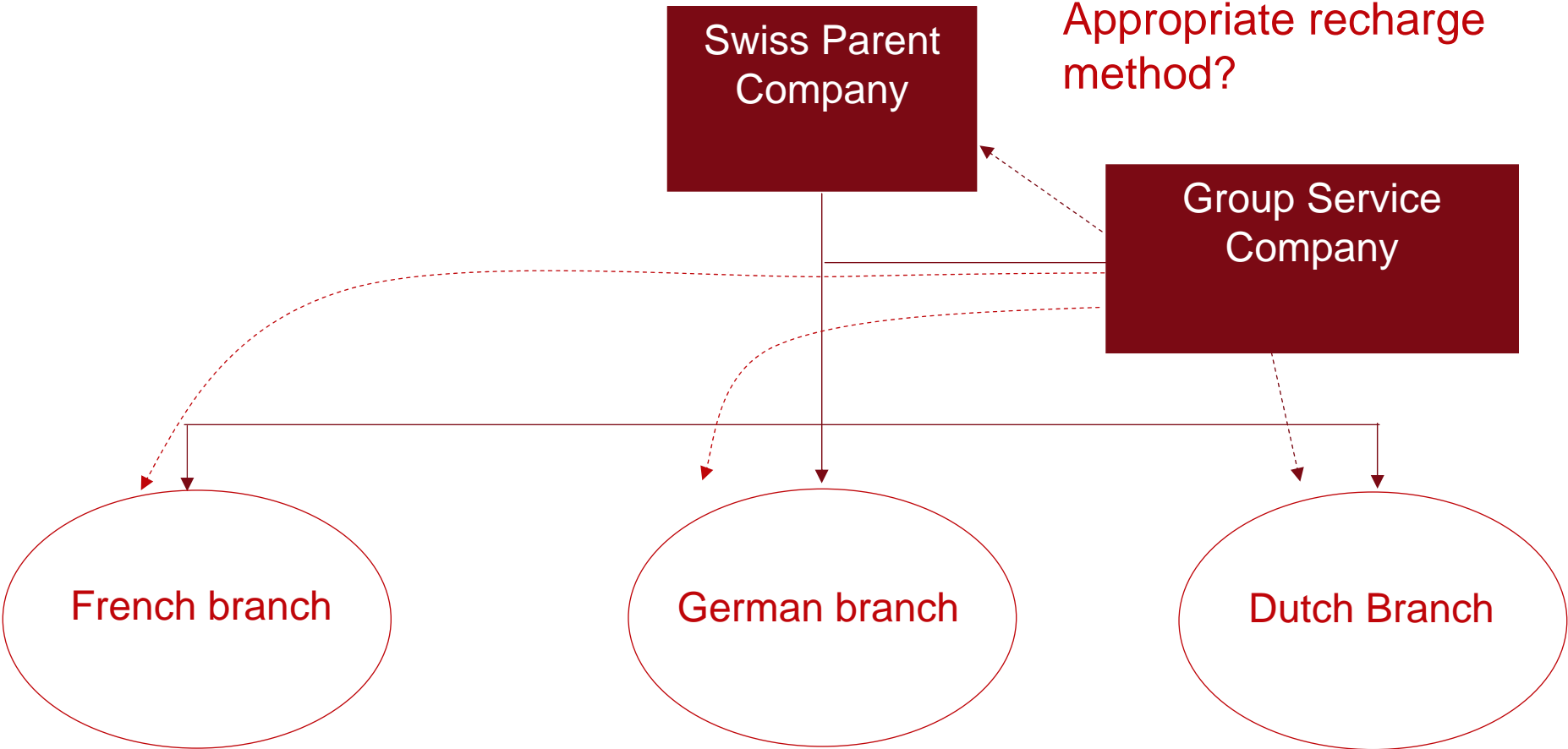
All staff

All Costs

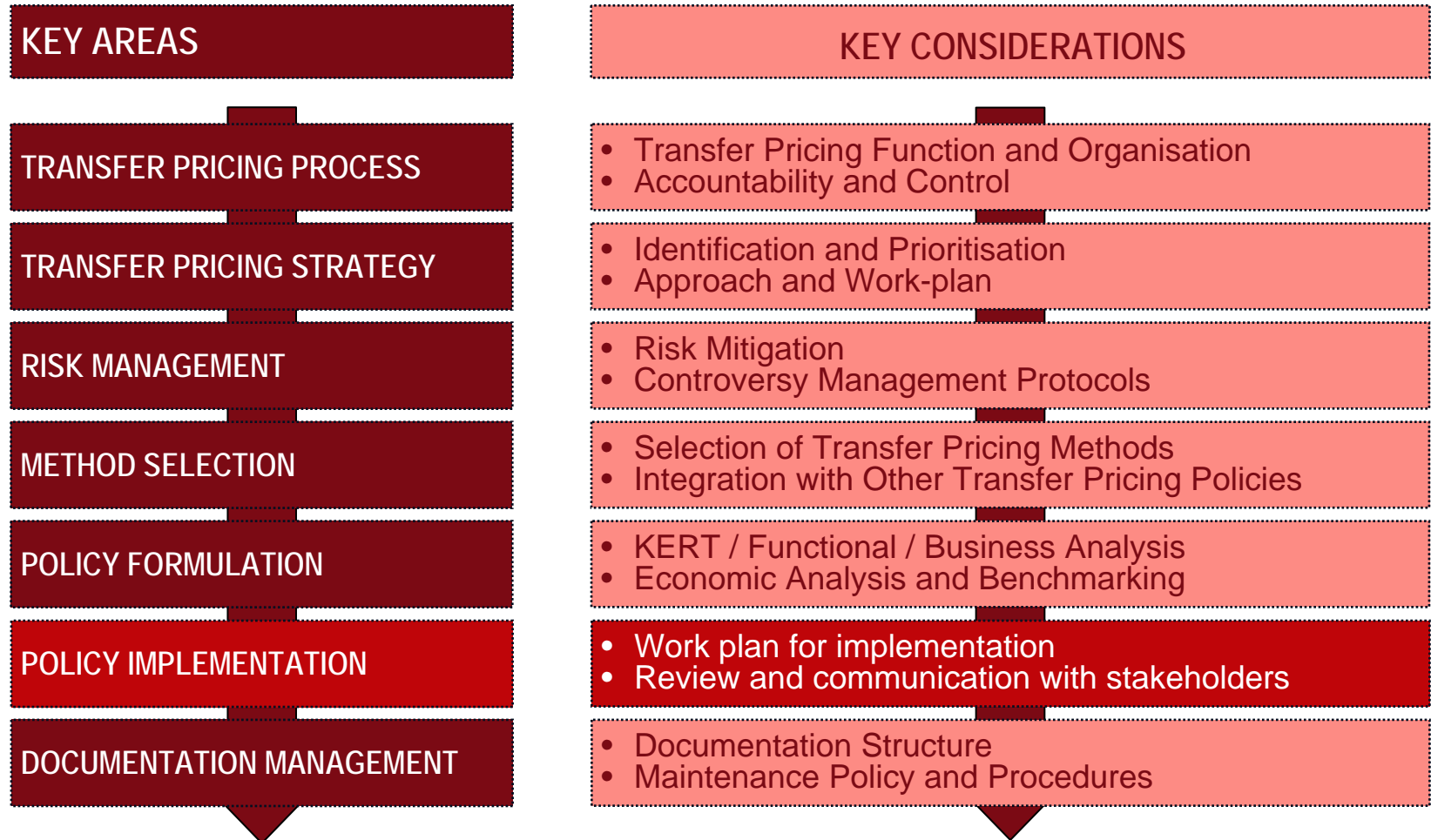


All staff/assets/bills

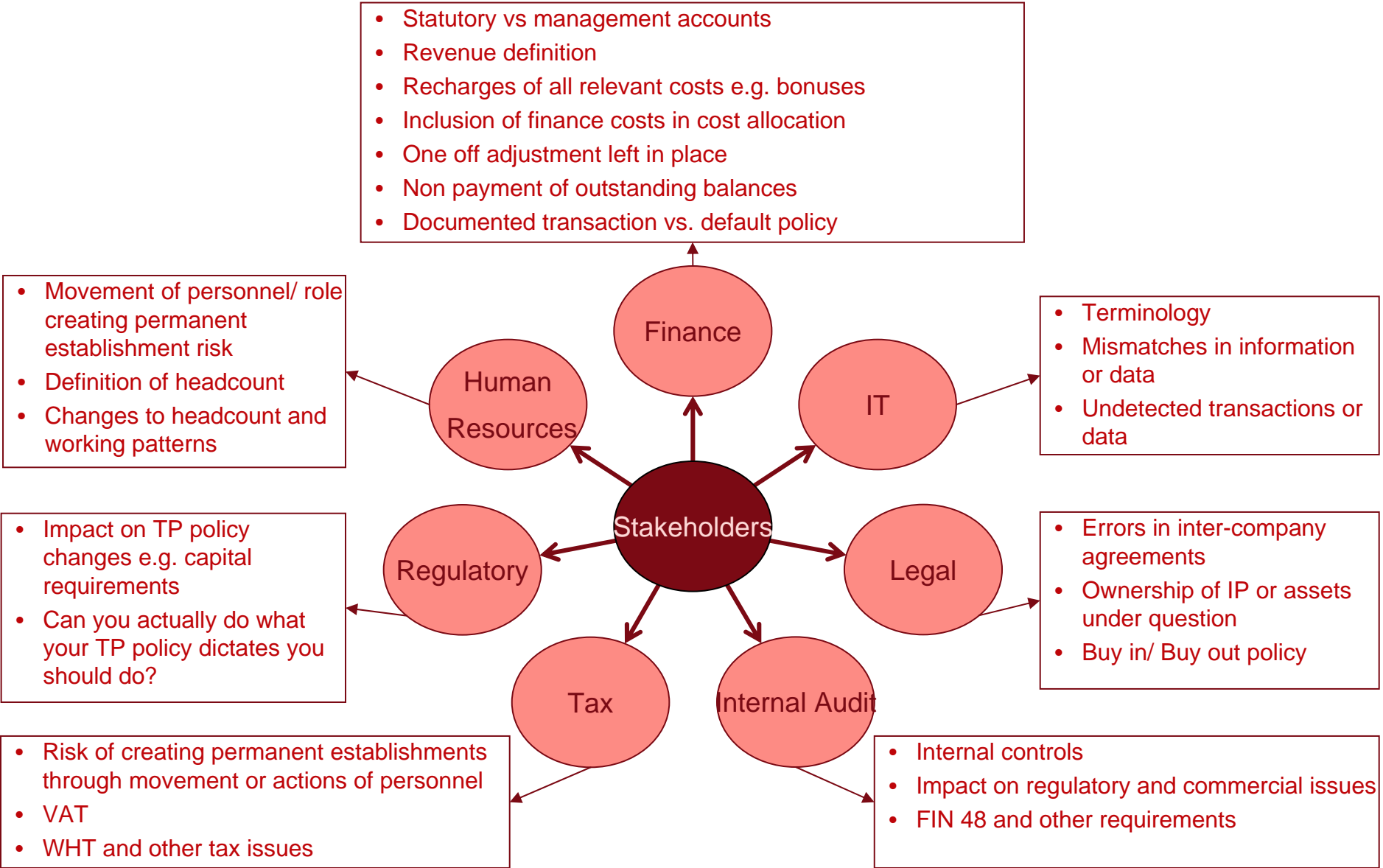
Central Cost Allocation



The Transfer Pricing Function



Stakeholders and Key Issues



Implementation support

How do I manage successful implementation?



Questions to ask

- Have chosen transfer pricing methods been applied consistently on a global basis?
- What framework is in place to identify transfer pricing risks and what systems are used to manage transfer pricing on an ongoing basis?
- Have transfer pricing methods been implemented in an integral way?
- What level of quality, consistency and robustness is the data which has been used in implementing the policy?
- Does the transfer pricing tax reconcile with the management & statutory accounts?
- Are protocols and steps for transfer pricing adjustments reviewed regularly and are adjustments reconciled with intercompany differences?
- Are transfer pricing adjustments settled and invoiced as relevant?
- Are there protocols in place for system upgrades and/or replacements?
- How is the transfer pricing documentation managed?

Thank you