CAPTIVE INSURANCE COMPANIES ASSOCIATION

European Captive Insurance and Reinsurance Owners' Association

May 1, 2013

Bureau of the Committee on Fiscal Affairs
Centre for Tax Policy and Administration
Organization for Economic Cooperation and Development
2, rue André Pascal
75775 Paris Cedex 16
France

Subject: Base Erosion and Profit Shifting (BEPS) Report February 2013

Dear Sirs and Madams,

The Captive Insurance Companies Association (CICA) and the European Captive Insurers and Reinsurers Owners Association (ECIROA) are two associations organized on a multi-national, jurisdictionally neutral basis to speak for captive insurance companies and those who interact with captive insurance companies. Our representatives have reviewed the OECD's Report on Base Erosion and Profit Shifting and are disappointed and concerned about the references within the BEPS Report concerning captive insurance companies.

Those references, particularly those found on Page 6 of the Executive Summary, on Pages 41 and 42 of Chapter 4 of the Report, and on Page 48 of Chapter 5 of the Report, demonstrate a fundamental misunderstanding of the role and function of captive insurance companies and unfairly single out captive insurance companies for criticism within the context of the OECD review of base erosion and profit shifting.

CICA and ECIROA would like to accept the invitation described on Page 9 of the Executive Summary and on Page 52 of the Report to make our expertise available through either physical or virtual meetings with the CFA Bureau and the chairs of the working parties so that the final Report might present a more accurate depiction of the role of captive insurance companies in providing insurance coverages that are often not available in the commercial insurance market and the role of captive insurance companies in creating an environment of competition within insurance markets that benefits both the purchasers of insurance and the governments that rely on the success of the companies that utilize captive insurance arrangements.

CICA and ECIROA eagerly seek an opportunity to discuss this matter. Our principal contact in Europe is Guenter Droese. Mr. Droese is a founder and Chairman of the Board of Directors of ECIROA. He may be contacted at guenter@droese-partner.com; +49 (0)6171 2844314. Our principal contact in the United States is Dennis Harwick. Mr. Harwick is President of CICA. He may be contacted at dharwick@CICAworld.com; US 954-940-2627.

We realize that captive insurance arrangements are often outside the understanding of those not affiliated with the risk management/risk transfer industry, so we would like to take this opportunity to provide you with a basic understanding of the captive insurance industry.

- There are approximately 6,000 captives in existence worldwide, many of which have been underwriting the insurance risks of their parent and affiliate companies for many years. They operate in exactly the same way as traditional insurance companies in that they accept risk in return for payment of premium. They may retain all or part of the risk themselves and reinsure in the insurance market to protect their exposure. They are regulated in the same way as insurance and reinsurance companies and are recognized as such by the International Association of Insurance Supervisors as well as under Solvency I and Solvency II regulations.

- Captives are an integral part of the "enterprise risk management" of Multinational Enterprises (MNE). MNEs protect their risk via cross border global insurance structures (usually worldwide international programs). Captives are the state-of-the-art model providing a professional "total cost of risk" picture for all corporations engaged in production, distribution and provision of services within numerous different countries. They develop a higher level of risk awareness by the insured, more intensive/visible and reactive local risk management, lower vulnerability and ultimately lower cost of production and services for the end consumers. This structure provides the insured with a higher level of transparency in areas such as commissions, fees, and administration costs for claims handling and processing.

- Captives are the only tool available to MNEs to manage otherwise uninsured risk exposures in a formalized and regulated way. Captives insure more efficiently those risks which the professional insurance market does not want to accept because they involve high costs of administration and claims handling, i.e. the area of high frequency/low severity losses. Insurers and reinsurers support these models by the provision of fronting facilities because they are able to carve out "undesired risk" combined with high administration cost.

- Captives allow MNEs to reinsure risk directly to the reinsurance market (which is not possible without captive involvement) and thereby can access the higher levels of capacity they need to protect their risks. This is vital for MNEs which have very large risk exposures and for which the traditional insurance market cannot provide the desired level of protection.

- Captives allow their owners/parent company to insure risks which are, to a certain extent, uninsurable in the traditional insurance market. This has created an opportunity for the development of new insurance products once the "professional" insurers realize that the insurability (and quantification) of a risk they formerly declined to cover is calculable.

- Captives in Europe tend to be large MNEs. However, in the United States and other jurisdictions captives are widely utilized by small and medium sized businesses and not-for-profit organizations to address insurance placement challenges not addressed by the traditional insurance market. For example, a significant majority of non-profit hospitals in the U.S. utilize captives to cover their medical malpractice insurance requirements rather than relying on the volatile commercial insurance market that has a history of wild pricing and availability swings. Obviously, since the captives for these not-for-profit organizations are not subject to taxes, there can be no tax avoidance or tax deferral benefits, yet they are broadly labeled by the initial draft of the OECD's Report on Base Erosion and Profit Shifting as tax avoidance devices.

- Although many organizations form captives during a hard pricing market, those organizations retain and utilize captives even in a soft pricing market because of the non-pricing benefits such as better claims management, access to the reinsurance markets, and strong "ownership" of loss prevention efforts. In short, captives enable organizations to be flexible and accountable for their risk management and risk financing needs. This is a result that should be encouraged, not discouraged.

- A significant number of the 6,000 captive insurance companies are essentially reinsurance companies for the insurance risks of their parent or affiliate companies and utilize the services of a fronting company that is fully regulated in the jurisdiction where the risk is insured. Another standard characteristic of captive insurance companies is arms length pricing based on the opinions of consulting actuaries and actual market price, along with governance based on compliance and transparency.

The reference to Captives misusing their structures for tax circumvention or avoidance is misleading and without significant basis. Captives are extremely valuable risk management instruments which strengthen the market position of their parent company or organization during times of heavy claims and losses by facilitating the establishment of reserves to meet future losses (which is otherwise not possible under local GAAP/IFRS standards).

The most important point is that captive insurance companies are just that – insurance companies. Like all insurance companies, they are highly regulated by the financial authorities where they are registered. Captive insurance companies are a risk financing tool that is essential for stable business operations, not a tax avoidance business.

Equally important is the point that captive insurance companies pay local corporate taxes and policy holders pay insurance premium taxes (IPT), so that taxes are paid to all the appropriate jurisdictions where captive insurance companies do business.

Respectfully submitted,

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Captive Insurance Companies Association

Guenter Droese, Chairman
European Captive Insurance and Reinsurance Owners' Association

Background Information:

CICA was formed in 1972 to foster and support the development of captive insurance companies around the globe. CICA is the international domicile-neutral captive insurance association. That means that CICA is free from jurisdictional or commercial ties since it is not linked with a domicile or government entity. Founded by risk managers for their collective benefit, CICA continues to work to provide the foremost education, networking and leadership for captive and risk retention group professionals. CICA encourages its members to explore ways to broaden the use of their captives to increase flexibility in program design, to stabilize long-term program costs, and to increase access to reinsurance capacity. For more information visit: www.CICAworld.com

ECIROA is an association of European captive owners, engaged specifically on issues directly impacting captives. ECIROA advises its members on changes to the regulatory environment, including Solvency II, and is involved in lobbying on their behalf. ECIROA works with regulators to increase transparency and compliance, particularly in the area of international programmes, and cooperates with Insurance Brokers and Insurers on issues of common interest. ECIROA facilitates the exchange of information between its members and with the wider captive community. For more information visit: www.ECIROA.org