

Cross-border pensions

Gary Boal warns insurers that markets in European cross-border pensions are about to explode.

ADOPTION OF THE THIRD LIFE DIRECTIVE in 1992 has led to the creation of a significant cross-border European market in life assurance business. Recent landmark judgments by the European Court of Justice (ECJ) now – at long last – presage the development of another cross-border business for insurers, this time in the field of insured pensions. The dismantling of national tax restrictions is now becoming a reality and is expected to lead to dramatic change in the European pensions landscape.

Ramstedt case

In a ruling laid down on 26 June 2003, the ECJ delivered a long-awaited judgment on a landmark test case brought by the Swedish insurance company Skandia on behalf of its director, Ola Ramstedt. Instead of the usual Skandia Sweden pension arrangements, Mr Ramstedt had been offered pension policies from Skandia UK, Skandia Denmark, and Skandia Germany. Unsurprisingly, the Swedish tax authorities refused deduction for the contributions paid to the foreign pension providers, deeming the policies to be endowment insurance rather than tax-preferred pensions. The case

was then referred to the ECJ by the Regeringsrätten (the Supreme Administrative Court in Sweden).

Swedish legislation gives tax deductions to employers paying premiums to Swedish insurers, but denies those benefits to employers paying premiums to insurers based in other member states of the European Union (EU). The ECJ ruled unambiguously – after a notably short period of deliberation – that this is incompatible with Article 49 (freedom to provide services) of European Community law. The implications of the ruling extend beyond Sweden, as many other European countries currently apply similar tax discriminatory rules that so far have frustrated the establishment of cross-border pensions.

Sweden's attempted defence of the case, on the grounds of fiscal cohesion of the national system, was considered to be unconvincing. The court held that the need to prevent the reduction of tax revenue is not one of the grounds which would justify a reduction on the freedom to provide services. Member states already have three legitimate ways of safeguarding the taxation of pension benefits received by their residents:

◆ reporting by the individual taxpayer;

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- ◆ assistance from other member states under the Mutual Assistance Directive; and
- ◆ conclusion of agreement with the pension provider.

The story continues

The ECJ judgment in the *Ramstedt* case relates to employer-sponsored pensions. It follows closely on the court's similar ruling in 2002 in the *Danner* case, where tax discrimination by Finland in relation to Dr Rolf Danner's personal contributions to his individual pension arrangements in Germany was also held to exist.

The European Commission is now turning up the heat and taking determined action on pension taxation against more than half of the 15 member states. The spotlight turns next onto Denmark, which has been referred to the ECJ over pension tax discrimination, while letters of formal notice (the first stage of the formal infringement process) have been sent to Italy, Belgium, Spain, France, and Portugal. The Commission has also expressed 'serious concerns' in relation to possible incompatibility on the pension tax laws of the UK and Ireland (UK law requiring appointment of a UK-based administrator to deduct and remit taxation).

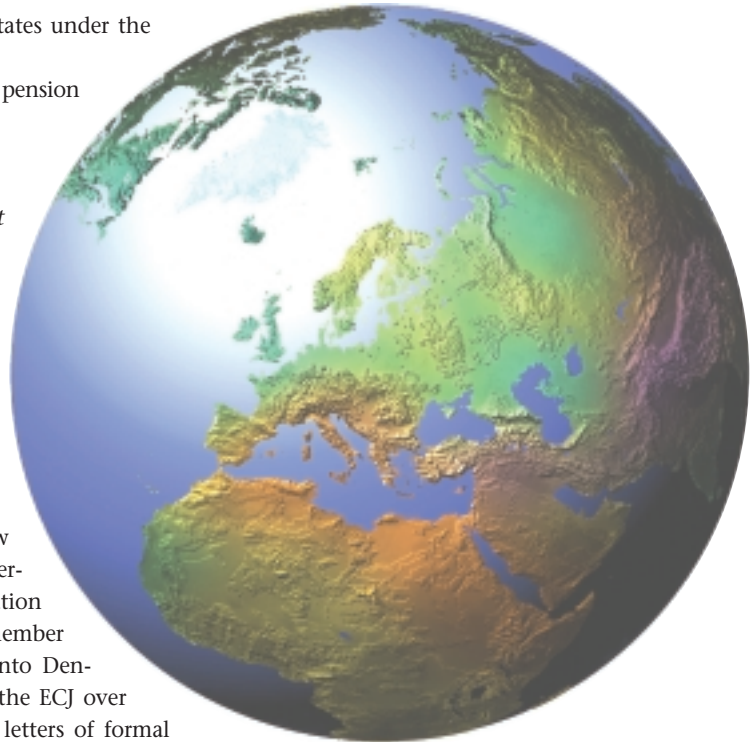
The writing is now on the wall, and life assurance companies should be planning to be in the vanguard of companies taking advantages of the opportunities arising from these changes.

Single insurance market

European life companies operating on a cross-border basis and wanting to write local pensions business have previously been frustrated by the need in most cases to establish insurance branches in other EU countries. This has hitherto been something of a hurdle, as the whole concept of the Third Life Directive was the freedom to transact cross-border insurance business without the need for a branch. With the tax hurdle being dismantled, it is logical to expect insurers to develop cross-border pensions in the same way as they have constructed a true cross-border market in life assurance. (For example, many of the largest life companies in Ireland are now international life companies transacting foreign business, rather than the traditionally dominant local companies.)

Companies writing cross-border business in the more flexible EU countries have a natural advantage over insurance companies in 'old' Europe, where over-regulation often still prevents the development of modern product structures. The successful transition in most EU countries to a common currency has undoubtedly boosted the potential cross-border market further.

European life companies should be looking over their shoulders at the threats posed by 'outsiders'



established or now establishing elsewhere in the EU, particularly in the more flexible environments where the appointed actuary system (in its traditional rather than future FSA form) holds sway. Ireland in this respect has quickly overtaken Luxembourg as the prime centre for cross-border European insurance business, and its potential for the same leadership position in relation to insured pension arrangements within Europe is equally real.

Implications for UK insurers

UK insurance companies should be actively considering the potential for significant new business in European markets. Exploiting gaps left by the diminishing role of state pensions, assisted by the successful adoption of the euro common currency, and being cognisant of the regulatory arbitrage opportunities will separate the winners from the losers.

Within the next five years UK insurers can expect to face real competition from other European insurers in the field of occupational and personal pensions, an area protected by fiscal barriers to entry until now. Equally, recognising that the EU is expanding from 15 members to 25 in May 2004, many UK insurers will – or should – be enticed by opportunities in the pensions markets of the 24 other member states.

What UK insurers need to examine carefully is whether a UK base is the optimal domicile from which to operate. My experience is that cross-border insurers in offshore European centres such as Ireland are, in many ways, best placed to roam across the new landscape, exploiting the numerous advantages they hold in crucial areas including taxation, regulation, and technology. Offshore opportunities have just got bigger. □



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