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ALTERNATIVE RISK FINANCING MARKETS

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Ladies and Gentlemen

THE CAPTIVE MARKET IN LUXEMBOURG

Thank you all for letting me give a few views of the life of a captive owner in Luxembourg. It would be very difficult for me to express the view of all captive owners in this little beautiful country since all of us will find their own comments about the domicile. This little lecture therefore is my own personal reflections together with my company Ericsson's.

I will start up with giving you a little bit of background about Ericsson then I will continue with the arguments discussed when choosing Luxembourg as a domicile, commenting the starting up phase and also the consolidation face of the business.

Ericsson

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Ericsson is a international group of companies mainly operating in the fields of telecommunication. The company is more than one hundred years old, is operating in about a hundred countries around the world and have 65 000 employees. We consider our selves to be a leader in the technology of telecommunications and are the world market leader in mobile telephony and base radio stations. The development of the company is strong right now and the future certainly looks bright to us.

Due to a lot of reasons no one really investigated the feasibility of starting up a captive operation until the mid eighties. In Sweden by that time already twenty companies had set up their own captive operation and there were just a few larger companies left that did not think it was worthwhile trying to put some energy into this issue of insurances. Ericsson's loss record during this century also has been excellent and subsequently the premium level was not remarkable high. An investigation made by an independent consultant company, however, showed that there might be some profit and other advantages in coordinating our world wide insurances through a captive company. So, the search for a suitable domicile started.

#### The search for the optimal Captive Paradise

Since Ericsson were not the first company in Sweden to set up a captive we naturally had a look at where all the others were domiciled. The majority of the others had been set up in Luxembourg and the rest were spread out around the world in Bermuda, Cayman Islands, Gurnsey and Sweden.

In 1981 Electrolux, who already then had a big production operation in Luxembourg, used their influence with the authorities in Luxembourg and started up the first captive operation in this country. Electrolux was followed by one after the other of the Swedish multinational companies. I guess they made the same assessment of the situation as we did in those days and as you may be doing today.

I will here discuss mainly five areas that are of interest when setting up a captive operation;

### Legislation

In this area we think there are mainly three areas to cover; The application procedure, direct insurance versus reinsurance and the basic approach to the concept by the local authorities.

The share capital in Luxembourg at that time was LUF 50 million (appr USD one million). The application procedure also seemed to be quite uncomplicated so this was considered to be a advantage.

The fact that Luxembourg only allows reinsurance captives was in those days no problem. Today, however, this will perhaps have a bigger impact in the decision making process than it used to have. Last but not least the local authorities were really supportive in there actions to attract captives to Luxembourg. In fact the positive approach by the local authorities in Luxembourg was considered to be a significant advantage in this decision making.

### Financial considerations

Under this headline falls mainly three areas;

The possibility of funding, the tax system and the financial operating environment.

The funding system in Luxembourg is rather positive. You are allowed to set aside untaxed reserves in an equalization reserve. This reserve is maximized to seventeen times the average premium for your own account the past five years.

The tax system in Luxembourg we expected to be very favourable. Who have not heard that Luxembourg is a tax heaven. Surprised we were when we found out that the local company tax is 48 %.

In those days that were almost as much as in Sweden. I can assure you that a lot of time have been spent throughout the years to explain to local authorities in other countries that Luxembourg is not a tax heaven and we are therefore to be looked upon as a respectable international company not trying to avoid taxation.

The operating financial environment in Luxembourg is excellent. The number of banks, funds and financial institutions in this little country is significant and offers a great variety. The professionalism and speed with which money can be handled is impressive.

#### Captive Managers

In those days there was only one alternative as a captive manager in Luxembourg; a company called SINSER. SINSER is owned partly by the Swedish insurance company Skandia and partly by the different captive owners they service. The fact that the captive manager spoke Swedish was definitely an advantage at the time. The market for captive managers has, however, increased in Luxembourg and so has the number of captive managers.

Today there would be some 15 captive managing companies present in Luxembourg and all kinds of languages are spoken. Sinser is, however, by far still the largest captive manager.

#### Accessability and Comfortness

Being situated right in the middle of Europe Luxembourg is and should be the perfect location from a communication point of view. To it's disadvantages, however, could be counted the reatively poor standard of Luxairs airplan fleet. A lot of rather uncomfortable, noisy and small propeller planes are used. Also mother nature could play you a trick sometimes since the fog many times in the wintertime hinders you from landing in Luxembourg.

The hotels, the restaurants and the general charm of this little beautiful country are all on the positive side.

#### What do others do?

Small children in sweden often play a game called "follow the leader". In the spirit of this game of course it is investigated what do others do when they set up a captive operation or shall we say instead where do they set up there captives?

Of course you could make a joke out of this but there are some seriousness in this question. We think that a  
with quite a few captive companies could work

If many captive owners and captive managers gather together in one domicile a lot of creativity will come out of this positive environment. There are natural opportunities to meet in such a domicile and to have informal discussions of how to proceed or how not to proceed. This last point have, now in retrospective, shown to be correct.

For us to chose Luxembourg as domicile have meant a lot. Many ideas have been brought to discussion in Luxembourg and many even better ones have been brought home from there.

The start up phase and the consolidation phase

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During the years since 1986 when we set up the captive a lot of travelling have been made to Luxembourg. However, I have to admit that quite a lot of the day to day work have been done by the local captive manager, SINSER. Their professionalility have certainly helped us to concentrate on coordinating the world wide programs instead of the administrative routines.

In the consolidation phase that we now are entering also the captive manager have an important role to play. The administrative routines have to be more precise now when the cash is flowing in faster. The reporting systems to the captive manager and from the captive manager have to be adjusted to suite both the brokers reporting systems and the inhouse reporting systems.

We today think it definitely was a correct decision to set up the captive in Luxembourg. The captive manager, the banks and also the authorities have been very positive to this new business and we also have the impression that they will be so in the future. The only really disadvantages we can see today is the lack of possibility to set up a direct insurance captive.

I will end up my part of this session with giving a rather philosophical comment on countries and authorities in general.

My experience is that big countries have a big population. In big countries with big population also the administration grow very big. In a big and old administration tradition effects rules and regulations. Also Machiavelli and his thoughts in the fifteenth century effects the day to day business for people and companies in these countries.

Small countries have small population. Subsequently the administration is rather small. Fewer people are involved in the decision making process and therefore the flexibility is relatively high. Small countries have either in the past been occupied or they have been left alone looked upon by bigger countries as nothing to bother about. Small countries therefore have a tendency either to try to get independent or to keep on struggling for their already achieved independency.

In a small country like Luxembourg, where today live 350 000 people of which 100 000 are immigrants, a very creative environment has been developed. In this small country they have no trade deficit but an excess of more than one billion USD in 1989.



This is proof of flexibility and I can only hope that the forming of a common market in Europe will bring this development even further. It will be very interesting to be an active part of what will happen in Europe in the future.

In my invitation to RIMS as a speaker it was said that I should mention something about Luxembourg as a captive market. I think, however, looking at Ericsson's insurance structure for the 1990's it would do you great injustice if I did not mention anything about Ireland as a new captive domicile.

#### IRELAND

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Ireland have been well known around the world to be a place in Europe which eagerly have tried to attract manufacturing capacity from United States, Japan, Europe, etc. To a certain extent they have succeeded in doing this. A few years ago they proposed to the European community that they would have a possibility to open up a financial centre in the Docklands of Dublin as a sort of "backoffice" to London. This proposal successfully passed all instances in the European community and have now been approved.

My personal belief is that Ireland will raise as a star among at least the European captive domiciles.

I can see a number of reasons why to set up a captive company in the financial centre in Dublin. A very important factor for us swedes is that Ireland is situated within the European community. Ireland also fits into Ericsson's structure since we have had manufacturing on the island for quite a few decades. Ericsson employs 700 people in Ireland in five different companies already.

Another one advantage is of course that Ireland has been granted permission by the European community commission to extend its 10 % tax rate, applicable for a number of years to overseas investments in the manufacturing industry, to apply to financial service companies, including insurance. This tax relief is promised up till year 2000. Honestly, if we scrutinize our minds, in how many other areas are we allowed a planning horizon of ten years?

If we look at the same parameters as I used for Luxembourg it is legally more difficult to set up a direct captive operation in Ireland than to start a reinsurance activity in Luxembourg. I don't think this have anything particular to do with the Irish authorities. I would rather say that the direct insurance area in general is more regulated than the reinsurance area.

The financial environment in Dublin is rather good today and will certainly be developed much more in the near future. The number of captive managers setting up in Ireland is rather high, I think there are five or six who already have permission to operate in the financial center. Access to Dublin is as good as Luxembourg, and I can not avoid to mention that the telecommunication system seems to be more efficient then the one in Luxembourg.

The question what others do I can only answer with saying that only Ericsson and the German car manufacturer BMW have set up direct captives so far. I know, however, that there are many captives companies to follow in the pipeline.

There is, however, a little catch in this project and that is local employment. The Irish authorities of course expect to attract foreign capital in order to improve employment in Ireland. Besides the legal requirements that have to be dealt with together with the department of Industry and Commerce you also have to discuss future employment with the Industrial Development Authority of Ireland, IDA. All authorities on this island, however, have showed us a very positive approach and I am sure that you all, if you think of going to Ireland, will be treated in the same way.

I can only once again verify that a small country, with a small population and a rather small administration have succeeded in pushing development forward. I certainly congratulate them and wish them luck in the future.