

**OBSERVATIONS ON THE REVISED DRAFT ON THE ATTRIBUTION OF PROFITS TO  
PERMANENT ESTABLISHMENTS: PART IV (INSURANCE)**

**1. The Key Entrepreneurial Risk-Taking Function (KERT)**

For insurance, the OECD proposes to define the KERT function as that which requires active decision-making with regard to the assumption and/or management of risks or portfolios of risks that have been identified as the most important under the functional and factual analysis. This KERT function thus permits the determination of the place where decisions are made, in order to lead to an attribution of financial assets to the insurance PE. In concrete terms, therefore, the OECD is proposing to reduce insurance to one sole KERT function: the function of underwriting. Several activities would contribute to this process of underwriting, and their importance would vary according to the particular facts and circumstances.

This proposed KERT function gives rise to the following observations:

- The approach for insurance of limiting this one KERT function to the notion of “underwriting” is not really adapted to the different characteristics of our activity. Actually, the insurance sector is structured around several large branches, and the means through which the accepted or managed risk is an element of active decision-making are a function of the branch of activity in question. This multifaceted reality risks being difficult to capture in a single approach which will be complicated to apply for insurance companies.
- The KERT analysis must remain coherent with the criteria of Article 5 of the OECD Model Tax Convention which define the existence of a PE, and it must not call this framework into question. In particular, this article provides that a PE consists of the person who acts on behalf of an enterprise and has and habitually exercises in a Contracting State an authority to conclude contracts in the name of the enterprise. On the other hand, a person who collects premiums and thus exercises a pure underwriting function without having the authority to conclude contracts in the name of the enterprise does not constitute a PE. Thus, it is important that the status of this person not be reconsidered in light of the present draft which seems to generalise the functions included in the process of underwriting. At the same time, we do not think that is what was intended by the OECD. In respect of dependent agents, this point is already evident from paragraph 117. However, it would seem desirable to us that it be equally explicitly confirmed in the part of the report dealing with the underwriting function, that “the simple fact of collecting premiums does not automatically mean that the persons collecting those premiums are exercising locally the KERT function of underwriting if they are not authorised to accept insurance risk.”
- There are practical situations in which the management of risk is the key activity of the PE, rather than the underwriting activity. Combining these two activities in the one KERT function called “underwriting” is not appropriate. We therefore think that it would be necessary to define the insurance KERT function in such a way as to include these situations. In this respect, we would like to point out that the function of managing risk does not only occur systematically prior to the underwriting function but also subsequent to the acceptance of insurance risk. This function of managing risk seems to us to be an essential function of the insurance business in that it directly determines the capacity of a market player to accept a certain volume of risk and it therefore has a direct impact on the price-setting policy. Yet, the persons who perform this function of managing risks are not necessarily the same ones as those who perform the underwriting function. We think

the function of managing risks is a key function which ought to be included in the KERT definition, even if this management of risks is not necessarily performed on a day-to-day basis.

- In conclusion, we think it would be preferable to define the KERT function in a less specific way in order to cover different activities that can, in practice, depending on the particular facts and circumstances, contribute to the key function of accepting insurance risk. Referring to a notion of “accepting insurance risk” would therefore be more relevant.

## **2. Internal reinsurance**

We approve of the deletion of the section concerning reinsurance between associated enterprises which had appeared in the previous draft.

On the other hand, we regret that the current draft doesn't seem to recognise internal reinsurance. Actually, in the latest draft, reinsurance is no longer considered a KERT, and in general internal dealings are not taken into account. All the same, that remains necessary. In fact, in the framework of managing risks, a company may wish to reinsure with another enterprise. Instead of letting all the PE's reinsure separately, the company will develop and put into place a global reinsurance policy. Thus, this involves a reinsurance operation in the classic sense of the term, according to which the head office or a PE will have a centralising role.

Reinsurance, an activity which consists of transferring insurance risk to another entity, is an important component of the activity of insurance and, thus, on that basis could be part of the KERT function.

## **3. Attribution of capital and of investment assets**

The OECD proposes an attribution of profits and losses to a PE based on a functional and factual analysis of the activities of the PE.

Insofar as the allocation of capital is concerned, two types of approaches are put forward: capital allocation and thin capitalisation.

- This type of plan will be difficult to implement, all the more so because it is based on an external analysis, starting from functional and factual criteria, rather than on book-keeping entries. This approach can lead to recreating for each PE a balance sheet and a profit and loss statement which include items that differ from those resulting from accounting data, and which don't correspond to the characteristics of insurance activity. In fact, insurance activity is subject to strict local prudential rules, adopted by accounting, so as to determine the extent to which capital has to be attributed. The application of the local prudential rules reflects an economic reality and would be as simple to use for insurance companies as for tax authorities.
- Moreover, within the European Union, the authorities do not require an allocation of capital at the level of the PE, the capital of the head office serving directly to cover the risks or indirectly through internal reinsurance. It is essential that the OECD's approach to the attribution of capital recognise this situation and accept in that circumstance the solution accepted by the prudential authorities. It is important to avoid creating a distortion between, on the one hand, the accounting and prudential reality, and on the other hand, a fiscal concept based on a theoretical approach. The existence of such a gap would end up attributing to the PE notional capital and income and would tend to call into question the rules put forward at the Community level for the application of the principles of freedom of establishment and the “European passport”.

- In addition, it would be useful if the report tried to link the OECD method for attributing capital to a PE with the new standards of solvency to be applied pursuant to the “Solvency II” reform.
- In respect of investment assets and in the situations where the OECD approach would lead to the question of an attribution of these different from that reflected on the balance sheet, it is important to take into account all assets intrinsically linked to the insurance function, and in particular reinsurance claims, and not only income-generating assets.
- As regards income from investment assets, it is accepted in the draft that certain assets can be less “performing” than others, or that certain assets can even be “under-performing”.

There is also the question of applying, to these less or under-performing assets, “adjustments” to the yield by asset so as to avoid a “distortion” between the income of these assets and other assets.

In this respect, we would like explicit confirmation that these adjustments cannot have the effect of allocating to the different parts of the enterprise a total financial income that exceeds the financial income actually booked by the enterprise.