

Insurance Briefing Series: FATCA/Tax update Helping you navigate a changing landscape



Introduction

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FATCA
Getting ready

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Agenda

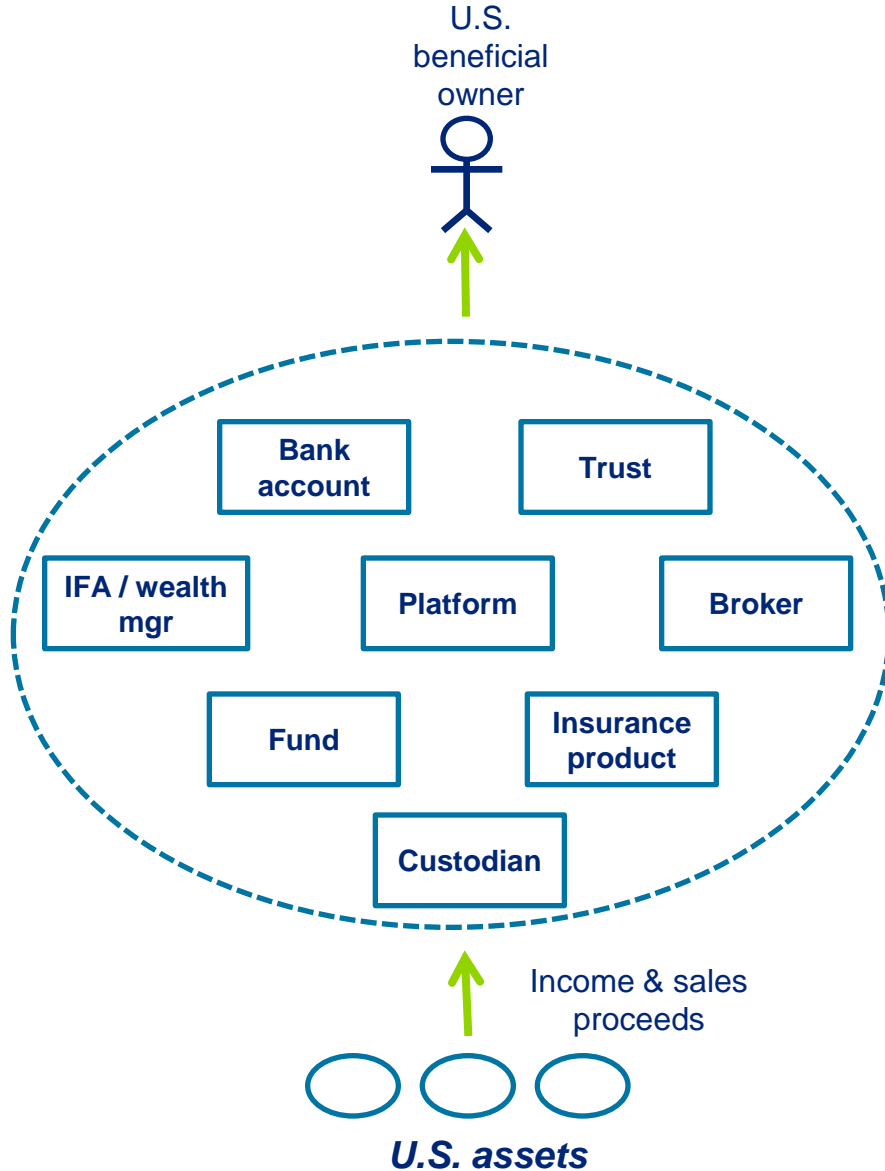
- Context and background
- Overview of the key provisions
- Practical issues affecting the insurance industry
- Getting ready for FATCA
- Conclusions
- Q&A
- Contacts

Context & background

What is FATCA?

- U.S. tax rules taking effect from 1 January 2013
- Designed to enforce compliance on U.S. tax evaders
- Significant operational and commercial implications
- Likely to affect all financial services organisations
- Financial services organisations targeted as providers of data re potential tax evaders

Purpose of FATCA



IRS concern

- U.S. persons evade tax obligations by holding U.S. assets through non-U.S. structures

IRS response

- Non-U.S. structures designated Foreign Financial Institutions, or "FFIs"
- Suffer 30% withholding on all U.S. income & sales proceeds
- FFIs that enter an IRS agreement (to become a "participating FFI") can have the 30% withholding disapplied.

Implication

- All financial institutions with any direct or indirect nexus with the U.S. need to consider FATCA
- Even where no U.S. customers.

FFI agreements

What must participating FFIs do to avoid 30% withholding?

Key obligations....

Identify
investors

- Identify whether any investors are “U.S. persons”
 - Both direct and indirect investors
 - Both new investors and “pre-existing” ones

Report to
IRS

- Annual reporting to IRS
- Where local laws prevent reporting, waive or close accounts

Withholding

- Withhold tax on payments to certain investors
- Calculate passthru payment % (“PP%”)

Overview of the key provisions

Some key FATCA provisions

- Meaning of FFI
- Identifying “U.S. persons”
- Withholding
- Relaxations & deemed compliance

Meaning of FFI

Which products & organisations will be caught?

FFI definition

Includes any non-U.S. entity which:

- accepts deposits;
- holds financial assets for the account of others; or
- **engages in the business of investing, reinvesting or trading in securities**, partnership interests, commodities, or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities

Potentially includes....

**Banks & deposit
takers**

**Brokers, dealers
& custodians**

Funds

**Insurance
products**

CDOs & CLOs

**Wealth
managers &
IFAs**

Some relaxations

Identifying U.S. persons

Whose identity do FFIs need to determine?

Definition of a “U.S. person”

- U.S. Citizens, even if residing outside the U.S.
- People born in the U.S.
- Dual citizens of the U.S. and another country
- U.S. Passport holders
- Holders of a “green card”
- People “substantially present” in the U.S.

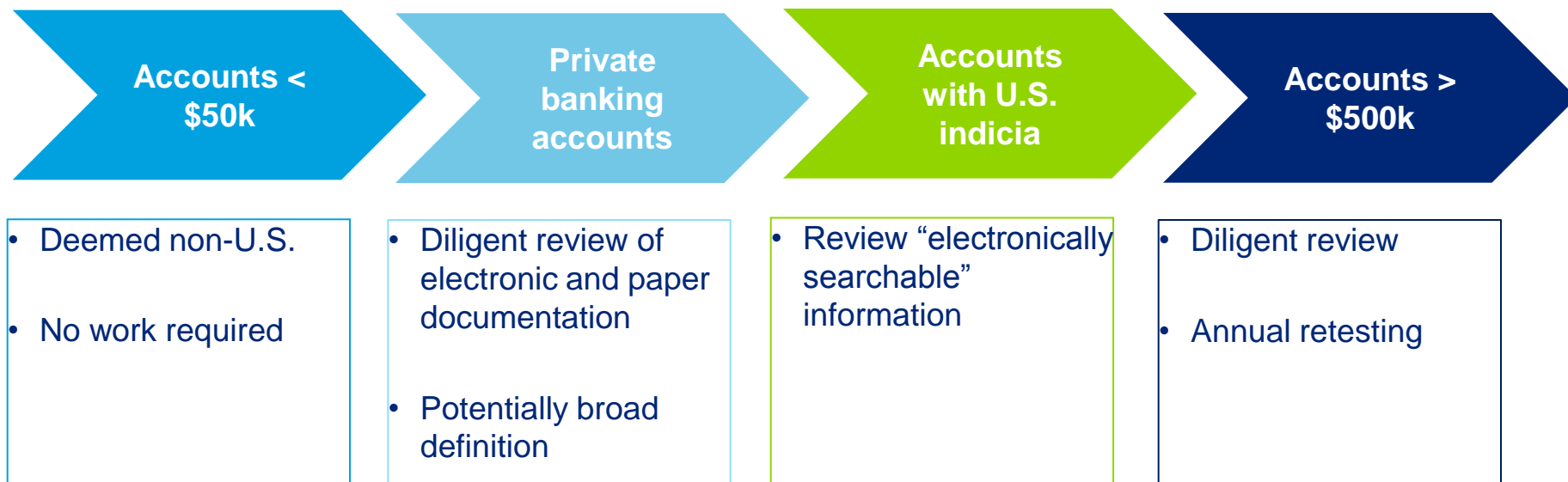
Implications

- Very broad definition
- Unlikely that all U.S. persons currently identifiable
- Many people will not know they are U.S. Persons.

Identifying U.S. persons

What identification work needs to be done for “pre-existing” accounts held by an individual?

For account holders other than those already documented as U.S.



Chief Compliance Officer (or equivalent) must sign off that identification work completed

Withholding

What payments to FFIs need to withhold on?

- Deduct 30% on certain payments including:
 - “Recalcitrant” accountholders
 - Non-participating FFIs
- Applies to:
 - Direct payments of U.S. income & proceeds
 - “Passthru” payments

Withhold on:

- Payments of U.S. income; plus
- Payment from FFI1 x FFI1's PP%

- Withhold on payments of U.S. income
- Calculate & publish PP% = U.S. assets/total assets

U.S.
beneficial
owner



Relaxations & exclusions

Will some entities & products be carved out?

Currently.....

In scope	Low risk	Deemed compliant / no reporting	To be confirmed
<ul style="list-style-type: none">• Most collective investment schemes• PE funds• Hedge funds• Investment bonds	<ul style="list-style-type: none">• Insurance products with no investment component• Some pension schemes	<ul style="list-style-type: none">• Regularly traded funds: ETFs & investment trusts• Funds with defined investor base• Local FFIs	<ul style="list-style-type: none">• IFAs / wealth managers• Platforms• Widely held funds

- Deemed to have met their FFI obligations or no reporting in practice
- However, still need to calculate PP% & may be asked to help other FFIs meet their obligations

Practical issues affecting the insurance industry

What insurance is in scope?

Impacts to Products

- Insurance products that “look more like traditional investment accounts” will need to be assessed for FATCA compliance requirements
- There may be a need to separate reporting and valuation rules tailored to certain insurance products, for example including the treatment of cash value accounts under FATCA
- There may be exemptions for certain products that can be characterized as having a low risk of being used for tax avoidance purposes (based upon a level of benefit or premium caps)

Impacts to Clients

- Impact to customers possibly including beneficiaries of whole life policies
- Insurance companies may need to develop processes to identify policy holders typically known to agents
- May need to document new persons

The Bottom Line

- References to insurance companies in the preamble to FATCA and in the two Notices issued to date make it clear that the U.S. Treasury and the IRS consider foreign insurance companies to be covered by FATCA
- In general, insurance and reinsurance contracts without cash value generally would not require FATCA reporting, while contracts with cash value or annuities remain covered
- Insurance companies should determine now what products are most at risk of remaining included under FATCA, and what information would need to be collected on pre-existing accounts
- Unlike banks who have gone through the AML and Know Your Customer (KYC) efforts, insurance companies will likely require more effort in complying with FATCA
- No insurance-specific guidance has yet been issued – lobbying remains key

Insurance – new business

- Risk products are expected to be outside the scope - thus general insurance, life protection and PHI products
 - Draft regulations to achieve this have not yet been published
 - There may be boundary issues re some products.
- Industry has lobbied for other savings products to be scoped out as presenting only a low risk of being used for U.S. tax evasion, for example:
 - Products and vehicles approved for retirement savings in their country of issue – particularly where eligibility is limited to those who are locally tax-resident, and there are limits on the amount which can be saved; and tax on the retirement income
 - Products which would be subject to tax on the investment build-up in the territory in which they are sold.
 - Products which are sold in the local domestic market place by locally-established companies:
 - Notice 2011-34 suggested “deemed compliant” status for some such companies but the relevant conditions may limit the usefulness of this provision.
- It is thus possible that some/all pension or other products may also be scoped out

Insurance – new business

- It may however be necessary to make changes to
 - T&Cs in respect of business sold after 31 December 2012 to ensure that you are entitled to obtain the required information; report on U.S. holders without breach of local law; and if necessary deduct and withhold on policy payouts.
 - IT and manual systems and processes to ensure that the required information is obtained and processed to enable required reporting and withholding.
- Potential reliances/dependencies upon IFAs or other intermediaries need to be assessed and evaluated
- Passthru payment mechanism
 - Appears to operate at the level of the life company. Whether the proposed mechanism is practicable and sensible for insurers and policyholders needs further consideration.
- As clarity is achieved as to what insurance business is within scope, further detailed issues are likely to emerge
 - Particularly as much of the mechanics has to date been developed in the context of banking rather than insurance business.
 - For example, the annual reporting proposals of Notice 2011-34 include amounts credited to the policyholder's account, which may not be readily identifiable in the context of insurance business.

Insurance - pre-existing business

- Pre-existing general insurance, life protection and PHI business is again expected not to be in scope.
 - Any exclusion of pension or other “low risk” products will also reduce the scale of the pre-existing book to be considered.
- To benefit from the more relaxed provisions of Notice 2011-34
 - It will be necessary to identify individually held policies as distinct from those held by entities.
 - Electronically searchable information will still need to be searched.
 - Will need to be able to value policies to apply the thresholds.
 - How beneficial is the \$500,000 limit for other accounts?
- Insurance of group pensions schemes
 - Notice 2010-60 imposed draconian tests on non-U.S. retirement plans to be excluded from withholding under FATCA. These are expected to be relaxed.
 - Not yet clear to what extent UK pension schemes will ultimately be treated as exempt from withholding under FATCA or as deemed compliant FFIs.

Insurance - pre-existing business

- “Private banking”
 - The definition includes wealth management, departments dealing with high net worth customers, and departments providing personalised services. The definition is thus not limited to authorised banks.
 - Further, the US tax authorities have explicitly stated that they are considering whether analogous procedures should be applied by other FFIs to certain types of business. Insurers, and private placement life insurance, are specifically mentioned.
- For EU businesses, there remains conflict between EU data privacy laws and FATCA reporting requirements.
 - For future product sales, a waiver is likely to be included in the product T&C.
 - Obtaining a waiver from an existing policyholder is likely to be problematic, and if regarded as obtained under duress would have no validity.
 - It is also unlikely that existing T&C would permit termination of an existing life policy if a waiver cannot be obtained, as would be required under FATCA.
 - These conflict of law provisions continue to be the subject of lobbying, to non U.S. Governments and EU as well as to the U.S.
 - There may also be a question of the legality of withholding of tax under foreign law – will the cost fall on the company as a whole rather than the U.S. policyholders?

“Deemed compliant” life business

- **Deemed-compliant members of participating FFI groups**
 - The expanded affiliated group includes one participating FFI.
 - The following restrictions apply to the local FFI member;
 - No operations outside its country of organization.
 - Does not solicit account holders outside country.
 - Must implement pre-existing account and customer identification procedures.
 - Customer identification rules for new business apply on take on and subsequently if there is “reason to know” circumstances have changed.
 - If US accounts are identified, local FFI will either sign an FFI Agreement, transfer them to a participating FFI, or close such accounts.
- **Could any insurance companies qualify for “deemed compliant” status?**
 - Constraints of pre-existing account and customer identification procedures and actions re “tainted” accounts.
 - Could this be a more practicable option as overseas operations expand into new territories?

Practical issues affecting the insurance industry

- Consider effects on distribution channels
- IT & systems
- Client relationships & management
- Operational & strategic dimension

Key challenges

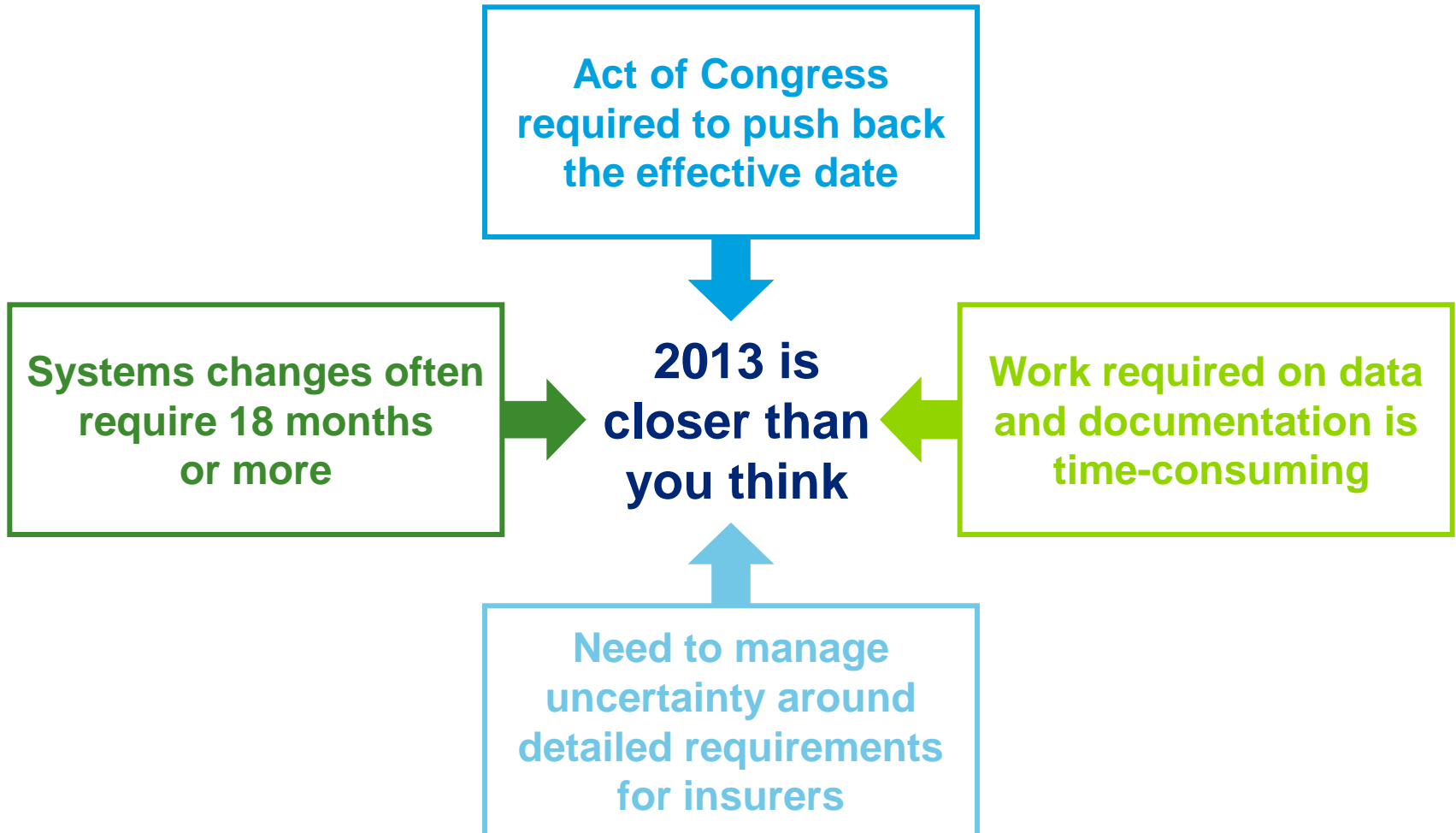
Client Relationships and Client Service	<ul style="list-style-type: none">• Need to communicate new changes to existing clients and manage commercial impact.• Need to “prove a negative,” that your foreign accounts are not U.S. Accounts.• Need to identify U.S .persons behind companies and trusts.• Determine how to handle clients that will not provide information.• Need ways to monitor if any account becomes a U.S .Account during the year.
Information Technology and Systems	<ul style="list-style-type: none">• Comb electronically searchable data for U.S. indicia.• Significant system changes required to gather account information across entire organisation and capture it in systems.• Ability to identify and report the required data in respect of U.S. accounts.• Managing systems change in a consistent manner across the group with its different systems.• Delivering change in extremely limited time and at a period when there are very significant other IT and systems projects (eg SII).• Identifying interaction with and maximizing the leverage of other projects.
Know Your Customer and Anti-Money Laundering	<ul style="list-style-type: none">• Expands current procedures and documentation required from existing customers and new accounts.• For any entity, FATCA requires identification of account holders with more than 10 percent ownership, much smaller than existing rules.• For investment entities any U.S. ownership must be identified.
Operations and the Overall Organization	<ul style="list-style-type: none">• Need to enter into FFI agreement with the U.S. Treasury.• Identify all subsidiaries and affiliates to be included in agreement.• Co-ordinate compliance to ensure that all business units are consistent and compliant.• Can we divest of everything that generates U.S. Sourced income and avoid this regime?

Key challenges

Reporting & Withholding	<ul style="list-style-type: none">• Need to track and withhold for FATCA on top of any current U.S. withholding.• Need to calculate and publish PP%.• New annual IRS filing asks for at least five pieces of information per U.S .Account.• Possible need for centralised withholding and reporting systems and processes.
Legal and Compliance	<ul style="list-style-type: none">• Potential conflicts with local secrecy laws and requirements for waivers under FATCA.• Monitor organization's compliance with FFI agreement to ensure one affiliate does not put entire affiliated group's agreement to be at risk.
Programme Planning	<ul style="list-style-type: none">• Coherent, consistent and well-communicated group-wide project framework and delivery.• Requirement for dedicated programme team which includes business line personnel and access to subject matter experts (specialists in data, technology, processes and KYC and AML requirements and FATCA).• Clearly specified working assumptions and contingency analysis.• Budget (effort required + cost).• Communication: Internal communication for onboarding, withholding, reporting processes.• Co-ordination of pilot reviews.
Organisation	<ul style="list-style-type: none">• Development of a resource requirements plan to identify resource shortfalls and consider solutions, including use of contract personnel or secondees. Leveraging experience from other projects.• Clear identification of third parties and establishment of an appropriate system to monitor and assess their FATCA readiness and its acceptability or otherwise for your purposes.

Getting ready for FATCA

Time to act



Assessing the impact

- **Impact Assessments**

- Notwithstanding the remaining uncertainties as to the full detail of the regime, some insurance/investment management groups are now performing impact assessments, to understand the impact of the FATCA on their operation, identify gaps and develop an implementation plan
- Some are coming under pressure from elsewhere in their distribution channels to discuss their approach to FATCA readiness
- The scale of any such project will depend upon the geographic spread of the group and the nature of its businesses and business models.

- **FATCA awareness and sponsorship across the organisation**

- How well informed is senior management at group and in the businesses?
- What work has been done to date?

- **Group structure**

- Classification of legal entities (including pension schemes, employee trusts etc) for FATCA purposes
- Could any FFIs be deemed compliant FFIs or benefit from other relieving provisions?

Assessing the impact

- **Business and product analysis** - for both current product range and the in-force book, need to understand
 - What insurance products are clearly risk products and thus likely to be out-of-scope
 - Any insurance products which might be borderline as between risk and savings
 - Analysis of the investor base.
- **Current business**
 - Key features, distribution channels and target market
 - Operational models, and dependencies on third parties.
- **Pre-existing business**
 - How/can individually held accounts be differentiated from those held by entities (companies, trusts etc)?
 - What is the scale of the task for each classification?
 - What information is electronically searchable?
 - What businesses might fall within the “wealth management/ high net worth relationships” category?
 - For individually held accounts, what remains in scope given the \$500,000 limit – and what might come into scope over time?

Development of insurance-specific guidance

- IRS have previously signalled they want to understand more about insurance business
 - How does it work?
 - What makes it different?
 - What would be the art of the possible?
- Comments on Notice 2010-60
 - Extensive written comments on insurance-specific issues, from trade bodies and individual groups
 - Significant consistency in global responses
 - Bilateral meetings to explore issues and possible solutions in more detail.
- Notice 2011-34
 - Comments were required by 7 June 2011.
 - Opportunity to respond to insurance specific aspects of Notice 2011-34, eg.
 - Need for further relaxation of requirements re pre-existing policies (however held)
 - Practical issues of identifying individually held and other policies
 - Insurance dimension to proposals re passthru payments and reportable information.
 - Likely extent of the deemed-compliant status for “locally operating” companies
 - Opportunity to refresh/reiterate previous comments not yet acted upon.
- Notice on insurance-specific issues?

Conclusion

In conclusion

- FATCA is here
- Unlikely to get full insurance carve out
- Assess its impact on your business, now
- Optimise your lobbying effect
- Plan for compliance.

Q&A

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