

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY  
ASSOCIATION OF INTERNATIONAL LIFE OFFICES]

**AILO RESPONSE ON NOTICE 2011-34 REGARDING  
THE FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA) PROVISION  
INCORPORATED INTO THE HIRING INCENTIVES TO RESTORE EMPLOYMENT ACT**

**6 June 2011**

Notice.Comments@irs.counsel.treas.gov

## **AILO**

The Association of International Life Offices (AILO) is a unique trade organisation whose Members are international life companies based predominantly in financial centres within the EEA and UK Crown Dependencies. AILO's Member companies market life assurance products internationally and cross-border within the EEA. AILO has been the main trade body for the cross-border insurance industry since 1987 and continues to strive to represent the interests of this niche sector.

Over 50 Member companies offer multi-currency life assurance products aimed at the international policyholder whose needs cannot be fully met by their domestic providers. AILO aims to promote the cross-border life industry and to encourage professionalism and high standards amongst its Members through the provision of market, regulatory and taxation information. It also represents its Members' interests through liaison with the EU Commission, relevant country governmental bodies, regulators, and local and international trade associations.

## **INTRODUCTION**

AILO is pleased to have the opportunity to provide comments on *Notice 2011-34* regarding the Foreign Account Tax Compliance Act (FATCA) provision incorporated into the Hiring Incentives to Restore Employment Act.

Whilst AILO respects the spirit of the legislation to prevent the evasion of US tax, we consider the rules to be onerous and disproportionate to the risk involved. AILO and its members submit the information and suggestions in this document in the spirit of working helpfully with the US authorities to promote an outcome that achieves the intention of FATCA, whilst keeping the cost burden placed on AILO member companies and their policyholders to a minimum.

At the same time our suggestions are intended to minimise any damage to the attractiveness to non-US insurance companies of investing in US financial markets.

## **WEALTH MANAGEMENT**

FATCA regularly refers to 'Wealth Management' companies or products being subject to the fullest searches and reporting. However, the use of the word 'Wealth' is a common marketing tool applied throughout the British financial services industry, including AILO members. This is designed to enhance sales and does not necessarily indicate that potential investors may be High Net Worth individuals. Indeed at least one 'Wealth' product on offer by an AILO member company requires a minimum investment of only £15,000 (circa \$ 25,000).

AILO submits that the inclusion of products or services within the ambit of FATCA should be determined by the nature of the product and size of investment, not by the marketing name applied to it or the product provider.

## **1. EXISTING POLICIES**

It is our belief that AILO insurance business does not pose a significant risk for US tax evasion. We believe that the costs of implementing the searches required under FATCA are disproportionate to the risks and will incur serious additional administration costs. Therefore, AILO submits that pre-existing accounts should be excluded from FATCA reporting unless they are enhanced after the effective date.

Nevertheless, we submit the following comments with respect to the proposals in *Notice 2011-34*.

### **1.1 Private Banking Accounts**

Notice 2011-34 includes more stringent requirements for "private banking" clients. The notice then seeks thoughts on whether other FFIs, and in particular insurance companies, should perform similar procedures with respect to holders of pre-existing individual accounts.

US Business ~ AILO statistics reveal less than 0.03% of premiums arising from US customers in 2009 (the latest geographical statistics available), so it is anticipated that few US Persons will be revealed by any form of search. AILO believes that the electronic searches of policyholders will reveal the vast majority with US indicia, estimated as high at perhaps 99% for some companies. Of course, not all those displaying US indicia will ultimately turn out to be US Persons unknown to the US authorities.

Nature of Insurance Contracts ~ by their nature, insurance contracts are medium/long term. After the commencement of a policy, it would not be unusual for there to be no contact with clients for many years. In this respect insurance contract are most unlike Private Banking Accounts and it would be completely unrealistic to class them in the same category.

Costs ~ The additional costs to AILO companies of attempting to manually search paper records for the small remaining number clients who have not shown US indicia by electronic search would be large and might undermine the viability of some member companies. In view of the minimal number of additional US persons such searches might be expected to reveal, it is submitted that such a requirement is seriously disproportionate and would place insurance companies at a severe and unfair disadvantage.

Private Banking Relationship Managers ~ *Notice 2011-34* differentiates the services of Private bankers from mainstream banking by reference to the activities of Private Banking Relationship Managers; the additional personal information they gather; the individual services and advice given; and the regulatory treatment of such operations. Insurance companies, including AILO members, have no equivalent to Private Banking Relationship Managers or to the activities they undertake. A Private Banking Manager will necessarily have a relationship with their client whilst an Insurance company will rely on information obtained via their intermediary.

Regulatory ~ AILO member companies generally receive their business through independent financial intermediaries (commonly referred to as IFAs). The insurance companies do not provide any equivalent of the Private Banking Relationship Managers, nor do they provide the type of personalised services offered by Private Banks. Further, this organisation is not aware of any insurance company which is regarded by its regulator as being a Private bank or similar.

In the light of all the above points, AILO submits that it would be unnecessary and unfair to treat insurance companies in the same way as Private Banks.

## 1.2 Accounts of \$ 500,000 or more

We would appreciate more clarification as to what is meant by ‘diligent checks’.

As mentioned above, AILO believes that the electronic searches of policyholders will reveal the vast majority with US indicia. This being the case, AILO submits that further, presumably costly manual searches, would be unproductive and largely unhelpful to either the US authorities or the insurance companies.

To set the threshold on contract value is unworkable for AILO members, who often run contracts which are priced in relation to unit linked funds. Some of these funds price quarterly, or even bi-annually and the value given at any one day will only be indicative of the last known price. Many funds also have their own charges on surrender which means that the redemption value could be different from the actual day to day value. Furthermore, recently AILO members have been faced, post credit-crunch, with many funds which have liquidity problems and have suspended their pricing. For such funds their current value is impossible to ascertain (until time the fund manager announces the suspension is lifted). Most AILO companies have adopted a process to capture the last known price for such contracts ~ but these values may actually be grossly incorrect if the fund fails to recover.

While we accept that the recent notice provides a relaxation of the rules, we consider that for life insurance policies the \$ 500,000 threshold is still far too low. We would appreciate consideration of the following proposals:

- That insurers or the insurance groups of which they are members (at UK, EU or worldwide levels) might be exempted from any additional checking if the **average premiums** across all their products within a company

(or group) are less than, say, \$ 1 million.

- Assuming the Insurer's average premium exceeds any threshold agreed by the IRS then individual checks could then be considered on a premium basis rather than a valuation basis.
- The threshold could be raised to \$ 1 million **premium** which we believe is a more realistic reflection of high net worth clients. Furthermore, such cases would generally be checked more diligently under Anti Money Laundering requirements, so this would align with the additional requirements of the IRS.

## 2. Discretionary Trusts

A significant number of policies issued by AILO members are owned by the Trustees of Discretionary Trusts. However, the following points will also apply to the many Discretionary Trusts which are not related to insurance products.

A **discretionary trust** is a trust where the beneficiaries and/or their entitlements to the trust fund are not fixed, but are determined by criteria set out in the trust deed. Discretionary trusts give the Trustees the power to determine the beneficiaries (from within described classes) who are capable of receiving benefits from that trust. These classes are usually very wide and will generally include 'the blood relations of the Settlor' (in other words the children, grandchildren, brothers and sisters etc). Such a class will often include persons that are not born, for example referring to 'children of the Settlor whenever born'.

Although Discretionary Trusts may not name beneficiaries they sometimes name a person or persons who will receive benefit in default of the trustees using their power of appointment. Importantly, no beneficiary (including default beneficiaries) have a vested interest, they only have a hope that trust assets may be apportioned to them by the trustees using their power of appointment. It is certainly not common practice for such trusts to be written in a way which exclusively states that persons of a specific country (such as US) are not allowed to benefit from the trust. Even if trust draftsmen wish to include such a clause in future, it would be difficult to define due to the reasons we raised in part 4, below, re the broad and open definition of US Citizens. We understand that trying to restrict the trust instrument post creation is a legal matter, but one that we do not believe is possible.

Insurance companies can search for US indicia amongst the names of settlors and trustees, but the nature of these trusts means that most Discretionary Trusts written may potentially include US Persons as beneficiaries, even though most will have absolutely no connection with the US whatsoever. As FATCA is drafted this would mean most discretionary trusts would necessarily be treated as 'Recalcitrant'.

It is, therefore, submitted that compliance with FATCA is impossible with respect to the beneficiaries of Discretionary Trusts until any benefits are paid out.

Since Discretionary Trusts are widely used in common law jurisdictions, it is submitted that the searching for US Persons among beneficiaries of Discretionary Trusts should be allowed to wait until benefits are actually paid. At this time the identity of the beneficiary could be ascertained with certainty and the life office could ask the necessary questions to determine if that person is a US person.

### 3. Trust Companies

Trust Companies are fiduciaries and treated in the same way as Private banks in this legislation. However, a number of AILO members run their own trust companies as part of their service to clients. These companies are only used by clients buying a life policy from the insurer ~ they are not for general use. Whilst they offer an administrative service as fiduciary they generally only obtain the same personal information as the Insurer. The trust companies are therefore in no better position to obtain information than the insurer ~ and any information will still be held on the Insurer's systems.

Therefore, AILO requests that consideration be given to exempting from the Private Banking rules any fiduciary which is a subsidiary of, parent of or direct associate of an insurance company **provided that its services are offered only to customers of the insurance company**. In other words, the US Authorities might rely on the reporting of the insurance company instead of requiring duplicate information from the related fiduciary.

### 4. US Persons

The definition of US Persons is set out clearly.

However, as would be expected, US Persons includes US Citizens. Unfortunately, there are a number of ways of becoming a US Citizen that an insurance company would be most unlikely to discover.

For example, insurers do not ask if an applicant has ever held a Green Card at any time in their life, nor do they ask if a parent/grandparent/great grandparent was born on US soil.

It would be of great assistance if the US Authorities would limit the extent of searching and questioning required of insurance companies by limiting the US Citizen criteria. Alternatively, we would be grateful if the IRS could clarify the information an FFI should obtain to ascertain whether a person is a US Citizen.

### 5. Data Protection

Isle of Man and EU laws currently prohibit all transfers of the data required under FATCA to the US and none of the exceptions to the general rule prohibiting transfers apply. This affects both existing and new policies.

Obviously, insurance companies can ask policyholders to waive their rights. However this would not be effective if obtained under duress of threat of termination of the subject's policy.

Clearly an insurer does not have such leverage over a policyholder on existing contracts as unilateral termination for failure to provide a waiver will not be a term of existing contracts.

Consequently, AILO requests that the FATCA requirement to report on existing policyholders be removed.

## 6. Recalcitrant Clients

Experience shows that many clients will simply not respond to requests for information. This may be because their address information has changed, and the Insurer has not been informed, or because they fail to read the important information sent.

It would be very difficult for Insurers to draft such a communication to ascertain if clients were in fact US Citizens as given in the indicia (ref *section 4*). Very often clients themselves may be blissfully unaware that they are in fact a US Citizen by definition, so any response would surely reflect this.

Given most AILO members clients will have no connection to the US to capture clients that fail to respond as US Persons would defeat the objectives of the IRS. Even if we did receive a good response rate, this may not reflect the client's true position unless a clear definition of a US Citizen is provided by the IRS.

The notice also refers to 'long term' recalcitrant accounts and suggests that *"it should not, however, become a permanent substitute for collecting and reporting information with respect to US accounts"* and *"Treasury and the IRS continue to consider what measures should be taken to address long-term recalcitrant accounts, including whether, and in what circumstances FFI agreements should be terminated due to the number of recalcitrant account holders remaining after a reasonable period of time"*

AILO requests that the IRS consider the comments here and understand the limitations of such mailings to clients. 'Long term' recalcitrant clients will occur simply due to errors in address information the Insurer holds. We also know from experience that a significant number simply will not reply, irrespective of how the Insurer words their mailing.

Repeated mailings under such scenarios would be futile, especially if address information is incorrect. It may be several years before this can be corrected as we often have to wait for these clients to contact us.

We therefore request that the IRS should 1) clarify the search indicia for a US Person (including a US Citizen) and make this clear so we can relate this to our policyholders. And 2) allow an approach of "best endeavour" in this regard and acknowledge the circumstances in which Insurers have made sufficient attempts to contact their recalcitrant clients. The number of recalcitrant clients should not be held against an Insurer if they can show that they have, to the best of their ability, tried to contact these clients.

Yours sincerely,

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