

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY
FEDERATION FRANAAISE DES SOCIETES D'ASSURANCES]

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References: 2011-07-18_ffsa-irs_fatca_comments

Objet: FFSA's response to *IRS Notice 2011-34*

Dear Sir or Madam,

FFSA, the French Insurance Association, which represents most of the French insurance and reinsurance undertakings, wishes to comment the *IRS Notice 2011-34* regarding implementation of information reporting and withholding under the new Foreign Account Tax Compliance Act (FATCA) provisions.

Please find attached the FFSA position paper on this Notice, which comes in addition to the one expressed on the 29th of October 2010 in reply to the *IRS Notice 2010-60*.

Should you require any additional information, please do not hesitate to contact me.

Yours faithfully,

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FFSA, the French Insurance Association, which represents 90% of the French insurance market and almost a 100% of the international activities of those companies, wishes to comment the *IRS Notice 2011-34* which provides new terms for the implementation of the requirements of the FATCA regulation.

Those comments come in addition of those expressed on the 29 of October 2010 in reply to the *IRS Notice 2010-60*.

In the *Notice 2011-34*, the IRS deals uppermost with the bank activities but also wonders about the provision and the implementation of the FATCA regulation for insurance companies. That is why it seems necessary to emphasize on the following points:

1 Insurance and reinsurance companies should not be considered as FFIs as meant by FATCA

The FATCA regulation aims at fighting against the risk of tax avoidance by American citizens. For that purpose, it aims at forcing the FFIs to give information on their clients' accounts when these are American citizens.

For the following reasons, we consider that insurance and reinsurance companies should not be considered as FFIs.

1.1 Considering its own features, insurance is a field totally different from the banking sector in its exact nature. In Europe, it does not offer possibilities of tax avoidance.

The insurance contract does not meet the notion of "*financial account*",

- The insurance contract does not have anything to do with the notion of "*deposit*" or "*financial asset*" kept by a client. Indeed, an insurer is only covering risks in exchange of the payment of premiums which are becoming the property of the insurer.
- In order to fulfill its obligations, the insurer uses the premiums he received in order to purchase assets. But those always stay in the hand of the insurer that will be the only person managing and receiving the profits of the assets. The policyholder does not have any rights on those assets and cannot manage or receive any profits of the assets.
- Insurance activities are divided into many different fields fixed or defined by professional regulations: health insurance, retirement, car insurance, fire insurance, liability insurance, life insurance .
. . In some cases, clients may be exclusively companies: reinsurance, transportation insurance, marine insurance
. . . Those different cases show the variety and the sophistication of the insurance sector. But it also brings out the fact that most of those fields

do not have anything to do with individual investments and are unrelated to the concerns developed by the FATCA regulation.

- The mechanism of an insurance contract shall not be in any way compared to a bank account. The insurer collects the premiums and pays for damages. Unlike a bank account, the insurance contract is in no way the basis for financial transactions managed by the policyholder. In view of those facts, the policyholder does not have any rights on the assets owned by the insurer. It has only the right to demand to the insurer to fulfill its obligations. Within this framework, insurers are not frequently in contact with their clients and they only ask for necessary information in order to cover the risk when the policyholder takes out the insurance policy. When it is necessary, they also ask the information required by the anti money laundering regulation.
- Finally, the insurance sector is subject to many severe rules especially when it comes to territoriality of the covered risks. Indeed, insurers are not allowed to cover the risks located in a territory for which it does not have the right authorization. The European Union regulation recognizes the freedom to provide services between Member States. On the other hand, with the exception of transportation insurance, covering risks in another state generally cannot be done outside of a local setting-up of an establishment controlled by the authority of this country. De facto, the number of American clients in French or European insurance companies is low and negligible compared to the total number of clients of those companies. This situation will mostly be the result of a modification of the policyholder situation located in Europe at the moment of the closing of the insurance contract.
- Otherwise, it is important to reaffirm that the reinsurance activities ~ which have the same features than the insurance activities and additionally do cover only business to business relations ~ should be explicitly excluded from the definition of FFIs.

1.2 Specific case of life insurance

In the *Notice 2011-34*, the IRS mentions specifically the case of life insurance. Yet, even if life insurance has obviously a financial aspect for the policyholder, this type of insurance is based on the same principles and the same general rules than those reminded above. In addition:

- life insurance is based on a long term commitment linked to the human life span. Again, there are no legal links between the profits collected by the insurer throughout the year because of its investments and the revaluation of the commitment with regard to the policyholder for the same period. Of course, in unit linked contracts, this revaluation is indexed to the value of some assets but that is only indexation. The insurer is still the owner of the assets and the legal recipient of the profits. There is no payment to the policyholder and it will only be when the insurer has to fulfill its obligations ~ in case of a payout or at the end of the contract by achieving the risk covered ~ that such a payment occurred. What's more, the period going on between the taking out of an insurance policy and the end of the contract will be generally very long (in France, it will often be after at least eight years);
- besides life insurance is characterized by a regulated mechanism of profit-sharing or "participation aux benefices". The structure of it permits to the insurer to revalue its contracts according to the commitment it has taken and the results of its financial management. Particularly, the insurer has to fund its accounts with a sum equal to part of the profits it has made during the year for the collectivity of its policyholders. Then this sum has to be inserted into the revaluation of the contracts into the eight years following the taking out of the insurance policy. This "smoothing" mechanism throughout the time for the assets management's results highlights the lack of direct links between the profits made by the insurer during the year and the payout or the revaluation of the current contract for the same year;
- in Europe, life insurance is already subject to strict control regulations and shows very low risks of tax

avoidance. In France, the life insurers also have to declare all the payouts to the national tax authority. This operation applies also for the contracts taken out by the non-residents;

- the prudential regulation submits the insurance companies to a specialty principle or “principe de specialite”: the insurance companies can exercise only insurance or reinsurance activities. By exception, the life insurance companies can however distribute contracts called “capitalization”. Those are based on the same financial method but, unlike the insurance contracts, are not built on a risk related to the human life span. This activity is very minor: in France, the mathematical reserves linked to capitalization contracts are less than 4% of mathematical reserves of life insurance contracts;
- as for the other insurance fields, life insurance is subject to strict territoriality rules. As the covered risk is the life or the death of the policyholder, only risks corresponding to the insured person living in a Member State of the European Union can be subscribed by European insurers. In other words, it is not possible for a European insurer to accept to cover a person who does not live in the UE at the time it takes out an insurance policy. Here is one of the main differences existing with the rules regarding bank accounts. Because of this rule, the number of US persons taking out a life insurance policy in Europe can only be very low compared to the total number of clients of the European life insurance companies.

Then, it should be accepted that insurance does not match the concerns pointed out by the FATCA regulation and that the companies of the insurance sector should not be considered as FFIs in the sense of this regulation.

2 Yet, if the IRS and US treasury should consider that life insurance contracts with a payout value, as mentioned into the *Notice 2011-34*, are “*financial accounts*” with regard to the FATCA regulation, it matters that the terms of appliance of this regulation take into account the specific features of this case

If such a trend should be followed, it would be important to confirm beforehand that all the damage insurance contracts, health insurance contracts, retirement insurance contracts to be paid as an annu-

ity, and reinsurance contracts are not part of the scope of the regulation. It will be necessary to let outside of the scope the contracts covering death or disability risks as well. Indeed, given the feature of the insured risk, those contracts do not obviously come within the followed objective of the FATCA regulation.

Only the classical life insurance contracts (bringing together life and death guaranties to be paid as a capital) should be concerned. Then it should be admitted than an adapted solution has to be found.

2.1 Terms adapted to the features of the activity and contract

As mentioned above, due to the result of the territoriality rules for the taking out of an insurance policy, the number of US citizens is extremely limited. It is important to take into account this situation in order to avoid imposing disproportionate research or monitoring to insurance companies. Indeed, it will generate important costs unrelated to the followed objective.

The *Notice 2011-34* described an application process with several steps and in particular a step 3 dealing with private asset management accounts. The IRS wonders however on the fact of knowing if this step 3 could be implemented for “*accounts*” different from the bank accounts especially the life insurance contracts with a payout value.

We do not think so. Indeed:

- as mentioned above, it does not exist regular exchange between the insurer and the policyholder unlike in the bank sector;
- in addition, the insurer only knows its clients. It cannot group the different contracts of a same family and an individual data research in its files will be necessary. Besides the individual based management is most of the time a service offered by the distributor of the contract or by a fund manager and not by the insurer producer of the contract.

On the other hand, the general process of electronic research on the basis of pieces of information already available electronically is still possible;

- a withholding tax is conceivable only if it applies to the outgoing flows of the contracts, namely at the end of the contracts or in case of a payout of the contracts, which are the single flows able to include a part of “income” for the policyholder or the beneficiaries. This eventual “income” does not

correspond to the global amount paid to the policyholder but only to the part of this amount which exceeds the amount of premiums previously paid. But, it is another matter to know if the companies are capable to determine the part of this “income” subject to the withholding tax or not (cf. see hereinafter).

2.2 For the ongoing contracts, a “grandfather” clause should be applied

Considering the specific features of the insurance sector, the application of the FATCA regulation to the ongoing contracts would raise important difficulties and the companies would be in a delicate situation towards their clients. Indeed:

- the terms and conditions of every insurance contracts are set between the insurer and the policyholder at the time they are signing the contract. The insurance companies cannot change or stop the contract unilaterally in order to meet the data collection and transmission standards given by the FATCA regulation;
- the exchanges between insurers and clients do take place only when the premium or the benefits are paid. Information that is asked to the clients is mostly the one required when a contract is taken out and information requested by the anti money laundering regulation. There is no other exchange during the life of the contract besides the unilateral information letter sent by the insurer to its clients. In this framework, it will be very complicated for the insurers to obtain any further information or documents requested by the FATCA regulation from its clients identified with a US-citizen indication;
- The requirements of data collection provided by the FATCA regulation are the source of legal issues. According to the *Notice 2011-34*, it will be asked to the person born in the USA a written explanation on their giving up of the American nationality or the reasons why they did not take the American nationality by birth. It will also be asked to the persons identified as US persons to renounce to their rights on personal data transfer. But in Europe, those rights are fundamentals rights granted by the European fundamental rights Charter. A fundamental right is inviolable and therefore

it cannot be reconsidered in its very substance.
Any renunciation would not have any value and could not be used by the insurer in any contestation case later on. Then, it is to fear that the insurer itself will be penalized at the end by withholding taxes.

2.3 The mechanism of passthru payments is totally inapplicable to the life insurance sector

The mechanism of passthru payments has a very broad scope since it provides to apply the withholding tax on the payments made to recalcitrant account holders or non American financial entities which did not conclude a FFI agreement with the IRS (non-participating FFIs).

As a consequence, it will catch in the FATCA regime a large number of operators which have neither American assets nor American clients, but which are solely in relation with a FFI in the sense of FATCA. Indeed, the regulation will require systematically from the operators without any link with the USA to respect some heavy obligations on the basis that they have business relations with other operators which have concluded a FFI agreement with the IRS in order to avoid the application of a withholding tax. Here again, however, in case the client does not reply, the legitimacy of the withholding tax application will be legally questionable. The payment by an operator of a withholding tax on incomes issued from a French insurance contract will have obviously some problems of compatibility with the French law. In fact, it is here again the FFI which could support at the end the tax weight. This mechanism and its result would then be disproportionate to the objective of fighting against tax avoidance and in contradiction with this objective.

In addition, the provisions on passthru payments are not adapted to the insurance sector. As mentioned in part one:

- the insurers, and not the policyholders or insured persons, are the owners of the assets. Thus, at the time of the payout, the policyholders do not receive any US income. It is so surprising to operate a US levy on such incomes;
- life insurance is based on the principle of the commitment. A “payment” as meant by FATCA only occurs at the time of a capital or annuities’ payment which intervenes only when there is a payout by the policyholder;
- the financial products of the insurer are due to the financial management of its assets, which are diverse. The policyholder does not receive directly or indirectly any income, whatever is the source of it. Furthermore, these products are fungible and intend to cover the commitments as regards with all

the policyholders. Trying to identify and follow some products that could be considered as participating to the revaluation of a contract held by a recalcitrant person is not, in most cases, conceivable from a practical point of view;

- as mentioned before, the euro funds investment return is composed of two elements: the “guaranteed minimum rate” or “taux minimum garanti”, by which the insurance company promises to fix a minimal remuneration for all the payments made during the year, and the “profit-sharing” or “participation aux benefices”, according to which the life insurance and capitalization companies deliver to their clients a part of their technical and financial profits. This delivering occurs at the end of a certain period (eight years in general) during which the interests produced by the contracts are in reserve. In such a mechanism, trying to follow US incomes in order to be able to submit them to a withholding tax at the time of the payout creates some conceptual difficulties;
- for the unit-linked contracts, which achievements are functions of the evolution or the performance of the units determined, the difficulties are comparable.

These units are in general shares of UCITS (in French, OPCVM), shares which insurer remains the only owner. These shares can be either shares of UCITS, which realize distributions, or shares of UCITS, which capitalize their incomes.

If the UCITS conducts distributions, the dividend is logically paid to the insurer. According to the regulation on the unit linked contracts, this insurer allocates afterwards a surplus of value to the contract, after deducting the costs contractually foreseen, as additional shares of UCITS allocation. Therefore, we note that the allocation is issued by the insurer: this allocation is analyzed as a “profit-sharing” or “participation aux benefices” and does not correspond ~ neither at law nor de facto ~ to an allocation of dividends to the contract.

If the UCITS does not conduct distributions but contents itself to capitalize its own incomes, the insurer allocates periodically to the contract the variation of the value noticed on the unit. This increase in value is realized without any financial flows.

In addition, in these two categories of unit linked contracts, the subscriber remains exposed to a risk of loss because the development of units can be negative.

2.4 It would be at last necessary to find, for the insurance companies, a particular status of “*deemed compliant FFI*”

The conditions proposed in the *Notice 2011-34* in order to obtain the “*deemed compliant FFI*” status as regards FATCA are too strict. It is now impossible for a group of companies to have access to this status.

New conditions should be adopted in order to make this status more accessible to non American financial operators, and especially to life insurers, when the local regulation does not allow them to accept as a client a person who resides in the USA, at the moment of the contract underwriting.

Furthermore, the procedures to be implemented in order for an insurer to have the “*deemed compliant FFI*” status should be adjusted to information that this insurer has to collect for the proper needs of its activity.

2.5 Specific case of investment funds dedicated

The *IRS Notice 2011-34* provides that some categories of FFIs have the “*deemed compliant FFI*” status as regards the FATCA regulation. In particular, an investment fund is qualified as “*deemed compliant FFI*” in certain cases listing in Section III - C of the above Notice.

The case where an investment fund is exclusively hold by NFFEs is not provided. However, in the context of asset pooling strategies, the insurance and reinsurance companies create some investment funds dedicated to them. The entities of an insurance or reinsurance group invest in these funds up to assets which represent their insurance or reinsurance commitments.

Considering that these situations do not present some risks of tax avoidance, the “*deemed compliant FFI*” should be extended to the investment funds which investors are exclusively insurance or reinsurance companies in case it is confirmed that these companies are NFFEs.