

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY  
INVESTMENT AND LIFE ASSURANCE GROUP]

7 June 2011

CC:PA:IPD:PR  
Room 5203  
Internal Revenue Service  
PO Box 7604  
Ben Franklin Station  
Washington, DC 200044  
USA

Dear Sir

**Supplemental Notice to Notice to 2010 ~ 60 providing further guidance and requesting comments on certain priority issues under Chapter 4 of subtitle 4 of the code**

On behalf of the Investment and Life Assurance Group (ILAG), I respond to *Notice 2011-34* ('The Notice') to provide comments and highlight practical burdens and problems for the UK insurance and investment industry associated with the proposed Foreign Account Tax Compliance Act (FATCA) measures.

ILAG represents members from the Life Assurance and Wealth Management industries in the UK. ILAG members share and develop their practical experiences and expertise, applying this practitioner knowledge to the development of their businesses, both individually and collectively, for the benefit of members and their customers.

ILAG previously submitted comments on the Internal Revenue Service (IRS) Notice 2010-60 in a representation dated 10 November 2010.

We are pleased to note from public comments that the IRS and US Treasury continue to study comments and representations on the definition and scope of FATCA in respect of insurance. We remain of the view that the regime could have severe consequences for the insurance industry, disproportionate to the risk of insurance products being used for US tax evasion, unless appropriate regulations and guidance are developed which recognise the specific nature of insurance products and the regulatory environment.

Our previous submission (i) discussed the low risk nature of much of the UK insurance industry, and suggested criteria which could be applied to recognise low risk policies that we recommended be excluded from the application of the measures, (ii) illustrated industry specific issues relating to pre-existing business, and noted the practical issues of gaining additional information (including both the long term nature of insurance contracts, the lack of contact between the policyholder and insurance company from issuing a life product until a life product is drawn, and the legal prohibition

for insurance companies to unilaterally terminate contracts due to non-response from policyholders), and (iii) identified various issues regarding recalcitrant accounts.

This letter, following on from that previous submission, continues to recommend that criteria be developed to identify and exclude low risk policies, and recommends that all pre-existing policies be exempt from the measures indicated in the Notice; failing this, we recommend that a higher 'qualifying threshold' be applied to determine those pre-existing policies which need to be considered. We also address certain new comment areas resulting from *Notice 2011-34*, regarding the development of measures for the insurance industry similar to those under the private banking proposals, the new local Foreign Financial Institutions (FFI) treatment, and the clarification of the passthru and reporting issues.

### **Pre-existing Business**

Our previous letter illustrated the problems that our members would have in obtaining additional information from existing policy holders, including both practical and logistical issues.

Accordingly, we welcome the simplification inherent in the proposed 5 step process for identifying pre-existing individual accounts, and the focus of that new approach on higher risk products. However, this new approach applies only to individually held products; as we have previously indicated; our members may face serious practical problems first in segregating individually held products from other products and then in obtaining the necessary additional information from policyholders.

Hence, as previously discussed, we continue to recommend that all pre-existing life saving policies be excluded from the identification requirements of the FATCA regime. Failing that, we would support the recommendation of Canadian Life and Health Insurance Association in their letter of February 1 2011 of a \$ 1,000,000 threshold for pre-existing policies, which should apply to all such policies irrespective of whether or not they are individually held.

*Section 1.B of Notice 2011-34* solicits comments regarding extending the definition of private banking arrangements to insurance and in particular private placement life insurance. Private placement variable life policies, i.e. policies that are directly negotiated with and designed for each policyholder to meet his/her specific needs, are not ordinarily offered by life insurance groups in the UK. The UK's 'I-E' system of taxation of insurance companies seeks to tax both the policyholder and the life insurance company's profits simultaneously and the policyholder tax suffered by the company is ordinarily recharged to the policy holder through the unit pricing. Hence the income and growth in an investment portfolio 'wrapped' inside an insurance policy, is ordinarily taxed annually ~ unlike a US private placement life insurance product. Accordingly, UK life insurance companies do not ordinarily write private placement life insurance policies in the UK.

### **Recalcitrant Accounts**

We note that you are still considering whether FFI Agreements should be terminated if the number of recalcitrant accounts is too high. We strongly believe that the insurance industry should be exempted from this measure. As previously discussed, insurance companies are unable to terminate policies unilaterally and so face significant constraints in their ability to compel policyholders, particularly pre-existing policyholders, to provide the necessary information.

### **Local FFIs**

We welcome the proposals which would enable some members of a group which contains a participating FFI to be treated as being deemed compliant. However we note that the criteria for this treatment appear to be extremely onerous. We are concerned that this will limit the impact of this proposal. We envisage the following issues for the UK life assurance industry;

- The requirement to undertake the pre-existing account and customer identification procedures is likely to be a significant compliance burden that reduces the impact of the concession. Consistent with our previous comments, we believe that pre-existing policies should be excluded from this requirement.
- According to the current draft rules as set forth in the Notice, a FFI with a branch or permanent establishment in another territory could not be classified as a local FFI and thus a deemed compliant FFI. We would recommend the definition is widened to include companies with operations that only service customers within its country of organisation, or customers in another country through an established branch operation in that country.
- We understand why the draft rules require confirmation that new products are not taken out by US persons. We are however concerned that the customer identification rules would create practical issues where, for example, a customer becomes a US person subsequently, through circumstances unconnected with any form of tax evasion. We would recommend that consideration be given to further relaxation of this constraint.

### **Passthru and reporting requirements**

We welcome the effort illustrated in the Notice to clarify the passthru payments and reporting requirements associated with FATCA. We appreciate the Notice seeks to simplify the passthru

payments, but have concerns as to how the proposed calculation will work in relation to the insurance industry.

The Notice dictates that the calculation should be undertaken using the quarterly financial statements which are used to report to stakeholders;

- A local subsidiary of a dual listed group may need to report to its parent under US GAAP (for example). However, it may file its local statutory accounts under IFRS or local GAAP. In this circumstance, there would be uncertainty as to which financial statements should be used for valuation purposes.
- Many UK life assurance companies do not currently report externally on a quarterly basis. From 2013, the Solvency II regulatory regime will require quarterly reporting but on a defined basis which may apply different valuation rules to the relevant external reporting. This will create further uncertainty as to the reporting basis to be used for FATCA purposes.

[We also note that policyholder returns in an insurer are often based upon the performance of a specific investment fund, rather than the assets of the insurance company as a whole. A passthru payment mechanism based upon the assets of the company as a whole may present calculation simplification, but may result in outcomes which are not aligned to the investment of an individual policyholder.]

### **Reporting on US Accounts**

The requirements set out in Section IV detailing the reporting on US Accounts are focused on bank accounts and we would recommend that specific reporting requirements be developed for insurance policies which are practicable, reflect the nature of the policies, and are based upon readily available information.

### **Data Privacy**

EU law (Article 25 (1) Directive 95/46/EC) prohibits the transfer of data or personal information to a country or territory outside the European Economic Area unless that country ensures an adequate level of data protection is in place in relation to the processing of that personal data. The EU Commission has issued a list of countries to which data transfer would be lawful, and the US is not included in this list. Therefore, the data required to be transferred under the measures proposed in the Notice cannot lawfully be transferred. This affects both new and pre-existing business/policies.

In addition to EU legislation, the UK law (Data Protection Act 1988) mandates that personal data may only be controlled by the data controller (insurance company) in accordance with the UK data protection legislation and solely in respect of the data controller's required use. Therefore transfer of information to the US from the UK insurance industry may also breach UK legislation. Should insurance companies fail to comply with the UK law, and transfer information to the US which breaches the law, they may ultimately see their license to conduct insurance business suspended.

In order for the transfer of information to be lawful, a waiver must be obtained from the policyholder. This creates not only a large administrative burden. Further, attempts to obtain waivers may not address the issue. We have previously commented upon the typically low response rate to insurance policyholder mailings; further, a waiver obtained under the threat of curtailing/cancelling their policy might be deemed obtained under duress and thus not lawful.

We believe that this data transfer/protection issue must be resolved between the US and EU/UK to allow insurance companies to comply with the measures as set out in the Notice in a lawful manner.

## **Conclusion**

Notice 2011-34 has clarified certain issues for the insurance industry and we welcome these changes. However, we would urge the IRS to continue to develop insurance-specific exemptions and reporting requirements to the FATCA regime. This document is a high level review of our comments, and we believe it is likely to be consistent with other representation you receive from the insurance industry and insurance companies.

We hope there will be more time for consultation in order to further tailor and streamline the FATCA measures as they apply to insurance, in order to achieve an outcome which focuses on higher risk policies and minimise the compliance burden for insurance who do not write such policies.

Yours faithfully

Graham Wilson  
Chairman, ILAG Practitioner Group  
Investment & Life Assurance Group