GFIA

GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

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GFIA Comments on the OECD draft Commentaries on the Common Reporting Standard (CRS)

Introduction

The Global Federation of Insurance Associations (GFIA) through its 35 member associations represents insurers that account for around 87% or more than $4.0 trillion in total insurance premiums worldwide. GFIA is pleased to provide comments on the OECD draft Commentaries on the CRS. Our comments address the treatment of pre-existing cash value insurance and annuity accounts under the CRS. In particular, we have provided recommendations on the meaning of *"effectively prevented by law"* and on the application of the residence address rule under Section III B.1, in order to address unique concerns of the insurance sector. In addition, our comments discuss the definition of "Controlling Persons", and propose amendments clarifying that, in FATF member jurisdictions, the AML/KYC Procedures under the local AML/KYC rules should be treated as being consistent with the FATF Recommendations.

Treatment of pre-existing cash value insurance and annuity accounts under Section III of the CRS

GFIA believes that pre-existing cash value insurance and annuity contracts should be excluded from the scope of CRS to ensure a reasonable and proportionate compliance burden relative to the very low level of tax evasion risk these policies present.

Given the long term nature of life insurance, contracts may extend for more than 60 or 70 years. As a result, contracts and administration systems for pre-existing life insurance policies and annuities may have been designed many years ago, prior to any systems for the automatic exchange of information. Accordingly, the information necessary to identify a foreign tax person is often not available for review, as existing systems were not designed to capture and store this data or to permit an electronic search of such data. Furthermore, the number of policies in force makes any manual searching practically impossible.

In practice, in order to make a determination of a policyholder's tax residence status, insurers would be required to ask for new and additional information from policyholders. This would be very burdensome and impractical because:

- Life insurers have limited client interaction following the initiation of a policy, and therefore may have difficulty contacting policyholders since:
  - once the policy has been sold, any payments to the insurer may be made electronically
  - any payments made by the insurer may also be by electronic funds transfers
  - once the policy has been funded, which may be in just several years, there is no need for the policyholder to contact the insurer until a maturity, surrender or death claim is filed, which, given the very long term nature of the contracts, may be 40 or 50 years later.

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- Experience has shown that trying to obtain supplemental information from existing customers (other than on maturity or surrender) typically results in a very low level of response.
- Insurers lack the power to compel the provision of such information since the contracts cannot be cancelled unilaterally by the insurer under local insurance laws. (This protects the policyholders, since otherwise, it could be very difficult for them to obtain replacement insurance coverage at an affordable price, due to the impact of higher premiums due to advanced age or illness, such as having been diagnosed with a terminal illness.)

"Effectively prevented by law" requirement

The proposed clarification in the CRS Commentaries with respect to the *"effectively prevented by law"* requirement for pre-existing accounts solely by reference to regulatory barriers, and without considering whether a particular insurer has taken concrete commercial steps to market its products cross-border into a Reportable Jurisdiction, is not workable in the EU as a result of the EU Internal Market rules.

Accordingly, GFIA believes it is necessary that the Commentaries also reflect commercial practises of cross-border sales of insurance. Our recommendation would be to further clarify the definition of *"effectively prevented by law"*, by removing existing policies that are only sold domestically from its scope, by adding the following text (marked in red italics) in Section III, Paragraph A (3) of the Commentaries:

> Where the applicable law does not prohibit Reporting Financial Institutions from selling insurance or annuity contracts outright, but requires them to fulfil certain conditions prior to being able to sell such contracts to residents of the Reportable Jurisdiction (such as obtaining a license and registering the contracts), a Reporting Financial Institution that *(i)* has not fulfilled the required conditions under the applicable law*, or (ii) having fulfilled such conditions, has taken no active steps to sell into that Reportable jurisdiction*, will be considered to be 'effectively prevented by law' from selling such contracts with respect to residents of such Reportable Jurisdiction.

The application of the amended Section III, Paragraph A (3) of the Commentaries is further clarified with relevant examples in Annex 1.

Furthermore, sole reference to regulatory barriers would result in a need to review existing policies for tax residents of jurisdictions that enter into the CRS agreement and have no regulations on the sales of insurance from other countries into its territory. As the CRS is expected to be adopted by an increasing number of jurisdictions, it will be difficult for insurers to track the latest information on the legislation of each participating jurisdiction and to comply with this provision globally in a timely manner. Therefore, we recommend that the OECD (or each individual tax authority) provide financial institutions with a list confirming the existence/inexistence of insurance regulations of each participating jurisdiction.

Residence address rule

If, despite the above concerns, the proposed amendment of the *"effectively prevented by law"* requirement is not possible, GFIA believes that, at the very least, application of the residence address rule under Section III B.1 of the CRS should be further relaxed to take account of the specific practical difficulties for older insurance contracts.

Section III B.1 of the CRS provides for an exemption from the electronic indicia search for pre-existing lower-value accounts when a current residence held is based on documentary evidence. This approach is welcomed by the insurance sector, since an electronic indicia search (Section III B.2) could be very burdensome for the insurance sector, as it is likely to result in a high number of false positives. For example, a telephone number indicia search is likely to be problematic in practice and could generate many false positives[1]. As a result, insurers would be obligated to apply a "curing procedure", i.e. to obtain self-certification from the policyholder, which would be very burdensome on the basis of limited client interaction and a lack of power to compel the provision of such a form.

Furthermore, in respect of older, pre-2004 lower value accounts, many of which will have residential addresses in the same jurisdiction as the Reporting Financial Institution, based on the current draft Commentary, reliance would have to be placed on disproportionately costly B2 electronic search procedures rather than B1 residential address procedure.

The high cost of electronic searches arises due to the difficulty in amending older IT systems on which many legacy products are administered to capture data. Legacy systems are common in the insurance sector because of the very long term nature of the products (often more than 50 years) and the fact that insurers may build new systems as products are redesigned, with older products often being maintained on the older legacy systems. Also, when insurers buy blocks of business from competitors, or consolidate, they acquire the vendor's legacy systems. Thus the problem of legacy systems is much more significant for insurers than it is for other financial institutions. Accordingly, it would be costly and problematic to create search routines because of limitations inherent in the IT systems and the availability of IT expertise in the legacy languages and hardware on which the systems are maintained. Furthermore, legacy books can include multiple legacy systems, adding to the complexity. It is disproportionate, and increases the burden on the insurance sector, to build an electronic search capability for such older accounts. The insurance industry is facing a significant and disproportionate compliance burden in relation to older pre-existing policies which is not proportionate to the low risk of tax evasion using such products.

Based on the current wording, insurers will likely not be able to rely on the residence address test for two reasons:

1. The residence address held in records is in many cases known to be not *"current" (i.e. correspondence has been returned),* as an insurer's contact with the policyholder has been lost during the long duration of the contract (which may be 40 or 50 years).

2. No documentary evidence on the location of the policyholder has been held for pre-existing insurance contracts prior to 2004, when the current AML/KYC procedures were introduced.

Therefore, GFIA recommends the following amendments to the second and third requirements of the residence address test in order to enable insurers to apply Section III B.1:

- Second requirement (Paragraph 9 of Section III B.1):

  According to the draft OECD Commentaries, residence address associated with the individual account holder needs to be 'current'. The Commentaries contain an exception for dormant accounts and

[1] In the EU, it is not uncommon that a resident of one jurisdiction may work in another jurisdiction and would only provide a telephone number in that other jurisdiction.

recognise that a residence address associated with a dormant account would be considered to be "current" during the dormancy period.

Given the problems of maintaining current addresses for long term insurance contracts with very limited client interactions, insurance contracts are very similar in this regard to dormant accounts.

As explained above, life insurers have limited client interaction following the initiation of a policy as a result of the long-term nature of the products. This is particularly relevant for single premium policies, for which in many cases there is no contact between the insurer and policyholder until maturity or termination of the insurance contract. Therefore, in GFIA's view, cash value insurance and annuity contracts should be treated in the same way as dormant accounts for the second requirement of the residency address test.

Accordingly, GFIA recommends removing "*other than a Cash Value Insurance Contract or Annuity Contract"* from the definition of dormant account.

- Third requirement (Paragraph 11 of Section III B.1):

  The draft OECD Commentaries state that the current residence address needs to be supported by documentary evidence. At the same time, the Commentaries recognise that some accounts opened prior to 2004 might not fulfil this requirement.

  In the insurance context, the documentary evidence collected with respect to the account is the relevant documentation collected pursuant to AML/KYC procedures. Insurance policies prior to 2004 were not subject to current AML/KYC procedures and, as a result, documentary evidence was generally not collected at the time these insurance contracts were opened.

  Therefore, we recommend that if no documentation supporting residential address is held, the insurer can rely on the residential address held on the system for these older contracts. This is under the assumption that, in case of termination or maturity of the policy, the insurer will contact the policyholder or any other beneficiary and provide tax authorities with full documentation supporting the residential status. It is worth mentioning that between the opening of the insurance contract and its maturity or termination, typically no benefits are paid to the policyholder.

  Accordingly, we recommend the following amendment of Paragraph 11 (marked in red italics):

  > "As a result, such instances of accounts without Documentary Evidence should be exceptional, relate to low-risk accounts, and generally affect accounts opened prior to 2004. In such instances, the third requirement contained in subparagraph B(1) may also be satisfied if the Reporting Financial Institution's policies and procedures ensure that current residence address in its records is in the same jurisdiction (i) as that of the address on the most recent documentation collected by such Reporting Financial Institution (e.g., a utility bill, real property lease, or declaration by the individual Account Holder under penalty of perjury); ~~*and*~~ *or* (ii) as that reported by the Reporting Financial Institution with respect to the individual Account Holder under any other applicable tax reporting requirements (if any)." *For Cash Value Insurance Contracts or Annuity Contracts initiated prior to 2004, the residential address held on file satisfies the requirements contained in subparagraph B(1) prior to partial or total surrender, termination or maturity of the contract. Should any information required to be*

gathered for AML/KYC purposes on a surrender, termination or maturity event conflict with the country of residence in the residential address held by the Reporting Financial Institution this would constitute a change in circumstances.

Alternative due diligence procedures for Pre-existing Accounts

The Commentaries are silent on what happens if the Financial Institution holds primarily paper records for lower value accounts. This situation could arise in operations in developing countries or in respect of books of accounts in force but closed to new entrants. In this situation, the FI might not be able to use the procedures in either B1 or B2. The Commentary should clarify that, for such lower value accounts, a paper record search would not be required. This could be addressed by modifying paragraph 6 in Section III B on due diligence requirements on page 23 (with new text in red italics) as follows:

> "Where domestic law allows Reporting Financial Institutions to apply the residence address test and a Reporting Financial Institution elects to apply it, the Reporting Financial Institution must apply such a test with respect to each Lower Value Account or clearly identified group of such accounts (as permitted by domestic law). If the Reporting Financial Institution decides not to apply the test or one or more of the requirements of the test are not satisfied, then it must perform the electronic record search with respect to the Lower Value Account." *If a Reporting Financial Institution can apply neither the residence address test nor the electronic record search to lower value accounts, e.g., limited electronic records are kept for a book of business closed to new entrants, then no due diligence will be required beyond such assurance necessary to identify that the accounts concerned are not high value accounts.*

Definition of "Controlling Persons"

Financial institutions typically implement AML/KYC procedures in accordance with the local AML/KYC rules and it is not possible for financial institutions to ensure that the local AML/KYC rules are consistent with the FATF Recommendations. FATF member jurisdictions are currently working on amending their local AML/KYC rules to be consistent with the FATF Recommendations. Where the local AML/KYC rules are inconsistent with FATF Recommendations currently, it is practically impossible for financial institutions to implement AML/KYC procedures based on the FATF Recommendations as well as the local AML/KYC procedures solely for the purpose of complying with the CRS.

In this case, the AML/KYC procedures under local laws and regulations in the FATF member jurisdiction should be considered consistent with FATF Recommendations. To clarify this, we recommend the following amendment (marked in red italics) of Paragraph 137 of Section VIII:

> "Where a Reporting Financial Institution relies on information collected and maintained pursuant to AML/KYC Procedures for purposes of determining the Controlling Persons of an Account Holder (see subparagraphs D(2)(b) of Section V and A(2)(b) of Section VI), the Reporting Financial Institution must ensure that its AML/KYC Procedures are consistent with Recommendations 10 and 25 of the FATF Recommendations (as adopted in February 2012), including treating the settlor(s) of a trust as a Controlling Person of the trust and the founder(s) of a foundation as a Controlling Person of the foundation." *In this context, the AML/KYC Procedures in accordance with the local AML/KYC rules in FATF member jurisdictions will be considered to be consistent with the FATF Recommendations.*

Conclusion:

To ensure a reasonable compliance burden on life insurers, the Commentaries should be revised as noted above, to take into account the unique aspects of life insurance (such as the very long term nature of contracts, which can extend for 40 or 50 years) and the fact that life insurance is historically a much lower risk of being used for tax evasion than other financial products.

Annex 1

The following examples clarify the application of amended Section III, Paragraph A (3) of the Commentaries:

- Example A (within the EU) – A UK Insurance Company wishes to write cash value insurance contracts into the Netherlands without establishing a permanent establishment in the Netherlands. In accordance with the EU Life Assurance Directive, the UK Insurance Company needs to first notify the UK Regulator of the intention to sell into the Netherlands. Cash value insurance contracts sold directly by the UK insurance company would have to be reported under the CRS.

- Example B (within the EU)– A UK Insurance Company had wished to write cash value insurance contracts into France without establishing a permanent establishment in France. In accordance with the EU Life Assurance Directive, the UK Insurance Company notified the UK Regulator of the intention to sell into France. Following notification to the UK regulator, the UK insurance company decides to change strategy regarding the French market and establishes a French subsidiary to provide products to French residents. The UK Insurance Company does not act upon its regulatory notification to sell directly into France and consequently would not be required to report on its pre-existing policies under the CRS.

- Example C (outside the EU) – A French Insurance Company wishes to write cash value insurance contracts into Jersey. In order to do so, the French Insurance Company will have to apply directly to the Jersey regulator for permission to conduct business in Jersey and sell directly to Jersey residents. Cash value insurance contracts sold directly by the French insurance company in Jersey would have to be reported under the CRS.

About the GFIA

Through its 35 member associations, the Global Federation of Insurance Associations (GFIA) represents the interests of insurers and reinsurers in 56 countries. These companies account for around 87% of total insurance premiums worldwide. The GFIA is incorporated in Switzerland and its secretariat is based in Brussels.