Joint Industry FATCA Seminar

Breakout Session 3 - Insurance

Y-Le Ho
Senior Manager, U.S. Tax,
PricewaterhouseCoopers
Hong Kong

Lennard Yong
Councillor of Life
Insurance Council,
Hong Kong Federation of
Insurers

Jeffrey Woo
Associate Director,
Financial Advisory Services,
Ernst & Young Advisory
Services Limited

Hon Yuen
Director,
Advisory,
KPMG China

FATCA for the Insurance Industry

- For many life insurers, **investments in US securities**, including US Treasury securities, may be **a meaningful portion** of their total investment portfolio, potentially increasing their need to avoid a new 30% withholding tax. Life insurers rely on the returns generated from this investment portfolio to deliver **expected payments** to their customers.

- Insurance remains in scope for FATCA despite many lobbying efforts made by global insurance companies.

- There is still some uncertainty around the product scope for insurance. Most Asian-based life insurance companies and products (cash value insurance contracts and annuity contracts) generally are expected to **fall within the scope of FATCA**. In general, insurance contracts without a cash value component, such as term life, disability and health and property and casualty, **are products that can be excluded from FATCA**.

- Term life contracts where the amount payable on termination cannot exceed the premiums paid are out of scope. This will remove products that have a return of premium feature.

- Insurance contracts with a cash value will be in scope subject to a $250,000 de minimis rule for pre-existing accounts. Mapping of products to US definitions is crucial before applying the de minimis rule.

FATCA Impact on Life Insurance and Annuity Products

Product Classes	Description	Cash value	In/Out Scope
Annuity	► A contract where the owner (typically an individual, though potentially also a trust) makes payment in return for a guaranteed distribution of income annually, until either death or a predetermined date or for life with a period certain	✓	✓
Term Life	► Insurance contracts without a cash value which are in force for a set term of years. May be referred to as a pure life protection contract.	X	X
Variable Life/ Unit Link	► Similar to variable annuities. The cash value and, in some cases, the death benefit vary based on the return of a portfolio of investments.	✓	✓
Fixed Life	► Similar to fixed annuities. Main difference is that US tax law requires an amount at risk depending in part on the age of the insured. The cash value and, in some cases, the death benefit are fixed in relation to premiums paid.	✓	✓

FATCA Impact on Other Products of Insurers

Most likely in scope	*Most likely out of scope*[1]
• Investment management operations • Segregated funds/mutual funds • Banking products • Assumption reinsurance with cash value • MPFs / ORSOs	• Certain group benefits plans • Reinsurance indemnity • Property & casualty

- The view from the Treasury and the IRS in the FATCA notices was that FATCA is not applicable to insurance or reinsurance contracts without cash value, such as property and casualty insurance or reinsurance contracts or term life insurance contracts.
- The proposed regulations was consistent with the intent in the FATCA notices and provides clarity that a refund to the policyholder of a previously paid premium under an insurance contract is out of scope for purposes of FATCA.

(1) The above are products which do not fall within the definition of financial account. However, consideration for legal treatment of NFFE status is required.

FATCA Challenges for the Insurance Industry

- Dealing with “recalcitrant” policy holders will be a challenge as the IRS only provides two options – close the “account” or withhold on payments to the “account”. Both of these options may difficult due to **contractual agreements with the policy holder**.

- **Distribution channels** (eg Brokers, IFAs, Tied Agents) used by insurers would all need to be evaluated and consideration given as to whether they need to be FATCA compliant and report to the IRS

- As distribution of the products will often have been through diverse channels, data collection and access to **core information** may be a challenge

Uncertainties for the Insurance Industry

- In the FATCA notices, the IRS discussed potentially granting exceptions from FATCA for insurance companies issuing solely property & casualty and reinsurance contracts. In the proposed regulations, there is no deemed compliant status for such companies.

- The Treasury Department and the IRS request comments regarding whether there should be **additional categories of deemed-compliant FFIs** not addressed in the proposed regulations. Consideration is being given to provide a category of **deemed-compliant FFIs for entities that issue certain insurance or annuity contracts** that have requirements that are analogous to the requirements for local FFIs.

What needs to be done

Strategic Discussions

- Comply?
- Negotiate?
- Ban US clients?
- Divest from USA?

Identify

- Impacted Entities
- Business Lines in scope
- Assets in scope
- Products in scope

Education

- Internally
- Reach out to Clients

Readiness Assessment

- Business Processes
- Legal Implications
- IT Infrastructure / Warehousing

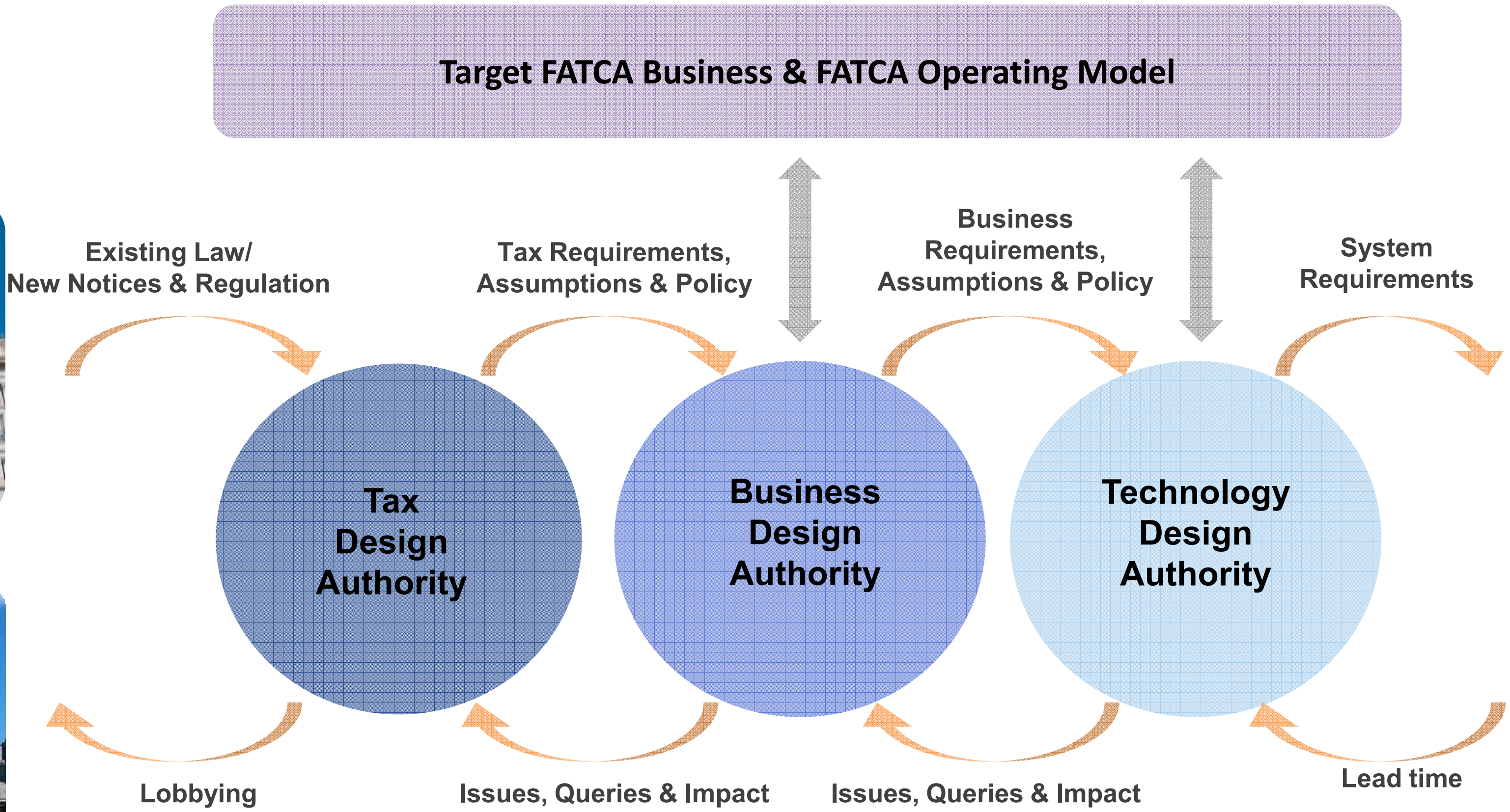
Negotiate

- Engage with US Treasury

How to manage uncertainty, conflict and evolving requirements

IRS

Domestic Governments & Regulators



Knowledge Dissemination & Feedback are essential to achieve FATCA capability and consistency

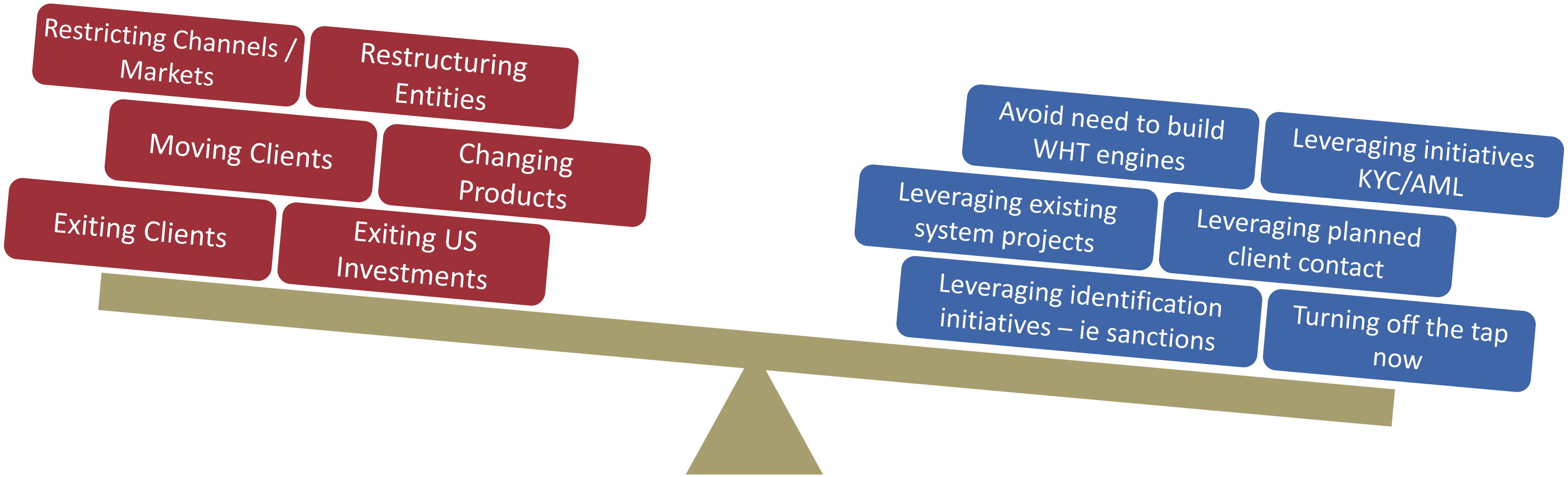
Can you reduce the business and operating model impact?

Can you reduce the Business Model Impact?

Change the business to reduce impact

Can you reduce the Operational Impact?

Change operations to comply



Which functions need to be involved in a FATCA program?

		Impacted Functional Groups									
	Workstream	***Tax***	***Legal***	***Regulatory & Compliance***	***Customer Facing***	***KYC/ AML***	***Finance***	***Operations***	***Product Mgmt***	***IT***	***Risk***
A	FFI Agreement	√	√	√			√		√		√
B	Onboarding		√	√	√	√		√	√	√	√
C	Remediation		√	√	√	√		√	√	√	√
D	Tax Withholding	√					√	√	√	√	
E	Tax Reporting	√					√	√	√	√	
F	Compliance	√	√	√	√	√		√	√	√	√

Objectives of a FATCA workgroup

- To reduce the intrusive impact of FATCA upon the Business by:
  - Informed and effective lobbying of the IRS and the domestic regulators / governments
  - Finding smart solutions to being compliant
  - **Leveraging existing initiatives** where possible
- Ensuring the organisation is sufficiently compliant by:
  - Accurately identifying the impact and ensuring that the business does not unknowingly stray into scope
  - Actively managing the IRS perception
  - Prioritising things that are already on the **critical path** eg. On-boarding Systems changes
- To reduce the costs of FATCA by:
  - Ensuring the business understand the requirements and have sensible assumptions
  - Reducing the risk or rework by **not getting too far ahead**
  - Finding ways to more accurately target remediation
  - Controlling spend where change is likely

FATCA Timeline

Phased implementation starting in 2013, and ending in 2017

Major key dates:

- **January 1, 2013**: USFIs need new account procedures in place
- **July 1, 2013**: FFIs need new account procedures in place (assumes FFI agreement effective July 1, 2013)
- **January 1, 2014**: FATCA withholding commences on withholdable payments
- **July 1, 2014**: Due diligence is complete on pre-existing high value accounts
- **September 30, 2014**: First FATCA reporting is due
- **January 1, 2015**: FATCA withholding commences on gross proceeds
- **July 1, 2015**: Due diligence is complete on all pre-existing accounts
- **January 1, 2017**: FATCA withholding scheduled to commence on foreign passthru payments

FATCA Certification for Responsible Officers (for FFI agreements effective July 1, 2013)

2013 | **2014** | **2015** | **2016**

- **Jan 1 2013** – FFI can enter into FFI Agreement online (Note 1)
- **Jul 1 2013** – IRS encourages FFIs to sign up by July 1 2013 to ensure readiness by Jan 1 2014
- **Jul 1 2014** – **Certify completion of review of pre-existing high value individual accounts** (Note 2)
- **Jul 1 2015** – **Certify completion of account identification procedures and documentation requirements for all other pre-existing individual accounts**
- **Ongoing from Jul 1 2014**– Periodically c**ertify that the FFI complies with terms of FFI agreement, including adopting written policies and procedures and conducting periodic reviews of compliance with written policies and procedures**

(1) IRS may make the online FFI registration system available before Jan 1 2013

(2) As part of the first certification, FFI must certify that it did not have any procedures in place from August 6, 2011 that would assist account holders in the avoidance of FATCA