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# Insurance & Reinsurance Industry Group: Global Corporate Insurance & Regulatory Bulletin

## US – Foreign Account Tax Compliance Act

The Foreign Account Tax Compliance Act (**"FATCA"**) legislation signed into law in March 2010 is designed to curb offshore tax evasion by U.S. taxpayers and will have a profound impact on the insurance industry when it becomes effective on 1 January 2013. FATCA applies to "foreign financial institutions" (**"FFIs"**), generally banks and other custodians of property, as well as entities that primarily engage in investing, trading or reinvesting in securities. Guidance issued by the Internal Revenue Service (**"IRS"**) clarifies that insurance companies, other than a company that issues only property and casualty policies, would be considered an FFI and subject to FATCA.

As a general matter, FATCA imposes a 30 percent withholding tax on certain "withholdable payments" to FFIs, including payments of U.S. source income and on gross proceeds from the sale of property that produces U.S. source dividends and interest (e.g., U.S. securities). In some cases, FATCA's withholding tax would be imposed on certain "passthru payments," which are payments that are not themselves withholdable payments but are attributable to a withholdable payment (e.g., non-U.S. source interest where the borrower has derived income from U.S. sources).

In order to avoid the imposition of FATCA's withholding tax, an FFI must enter into an agreement with the IRS that would require that the FFI conduct certain due diligence with respect to its clients and be obligated to report information pertaining to US clients to the IRS. To the extent that a client fails to provide the FFI with sufficient information needed by the FFI to conduct its due diligence obligations, the client would be considered "recalcitrant" and withholdable or passthru payments made to the client's account would be subject to a 30 percent withholding tax. In particular, the IRS considers a life insurance policy that has a cash value to be the equivalent of a bank or securities account. Accordingly, an insurance company that issues such policies would, pursuant to FATCA, be obligated to conduct due diligence and information reporting with respect to such policies. In certain instances, an FFI may be required to terminate its relationship with a recalcitrant client.

To the extent that an insurance company enters into an agreement with the IRS such that withholding tax is not imposed on payments to the insurance company, an insurance company may be obligated to withhold tax on payments made to its clients. As discussed further below, if an insurance company is required to treat a client as a recalcitrant client, the insurance company may be obligated to treat the payment of death benefits as a passthru payment subject to FATCA's withholding tax. The possibility of withholding tax being imposed on the payment of death benefits is likely to be a significant concern to the industry. Additionally, to the extent that a recalcitrant client receives a payment with respect to the surrender of a policy, such payment is likely to also be treated as a passthru payment subject to FATCA's withholding tax.

In the context of the insurance industry, FATCA's due diligence and information reporting requirements pose several concerns that differ from other financial institutions. One area of concern relates to the different types of insurance products that may be subject to the client identification and reporting requirements. Generally, FATCA looks to whether the FFI has "U.S. accounts," which do not, in practice, relate to products offered by insurance companies. For example, private placement insurance products, insurance wrappers, and separate account policies may be treated as accounts for purposes of FATCA. Accordingly, insurance companies will need to identify which of their products may be equivalent to an account for purposes of FATCA.

Insurance companies may not have sufficient information on hand needed to comply with the proposed account due diligence rules. In some instances, insurance companies do not collect or review documentary evidence or IRS forms that are necessary to identify the beneficial owner of the policy for U.S. federal income tax purposes. Accordingly, an insurance company may not be in a position to identify a policy holder as a U.S. or non-U.S. person. Insurance companies, unlike banks and other financial institutions, are likely to have limited contact with existing clients and could have difficulty in obtaining information needed to conclude that a client is not a U.S. person. It is possible that the insurance industry may have a greater amount of clients treated as recalcitrant clients subject to FATCA's withholding tax, as discussed above. Moreover, to the extent that an insurance company is obligated to treat a client as a recalcitrant client, because the company has not received such information from a client, the company is often barred by local law from cancelling the client's policy.

For more information about FATCA and its impact on the insurance industry, please review our full client alert on this topic which can be viewed here, or speak to your regular Mayer Brown contact.

## US -States That Have Enacted Or Are Considering Reduced Collateral Requirements For Credit For Reinsurance

Reform of reinsurance collateral requirements in the US continues to progress. Florida, Indiana, New Jersey and New York already allow unauthorized reinsurers to qualify for posting less than 100% collateral depending on their financial strength ratings as well as other factors. Other states, including Illinois, Louisiana and Texas, are considering bills that will provide for similar reductions in reinsurance collateral requirements based on ratings. The states with pending legislation will likely see primary activity on such bills in 2012. Other states are expected to consider similar legislation in the near future. States have been prompted to enact reinsurance collateral reduction measures due to, in part, the proposed amendments to the National Association of Insurance Commissioners (**"NAIC"**) *Credit for Reinsurance Model Law (#785)* and *Credit for Reinsurance Model Regulation (#786)*. The proposed amendments to the NAIC models allow for ratings-based reinsurance collateral reductions and will set a floor for collateral requirements that many states may follow. For more information on proposed amendments to the NAIC models, please see the below article, *NAIC Reinsurance (E) Task Force Continues to Take Steps to Amend Credit for Reinsurance Model Law and Regulation*.

We have prepared the following "tracking chart" regarding reinsurance collateral developments in the states to-date, including links to the relevant approved or pending statutes and/or regulations, summary of requirements for reinsurers to qualify for posting less than 100% collateral, effective dates for the changes and other relevant information. The chart can be accessed here. As other states adopt changes, we will update our chart in future monthly bulletins.

## US – Update – Dodd-Frank Nonadmitted Insurance and Reinsurance Reform Act Becomes Effective

On 21 July 2011, the Nonadmitted and Reinsurance Reform Act of 2010 (the **"NRRA"**), which is Subtitle B of Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act, became effective. The NRRA addresses, among other things, (i) the ability of states to impose premium tax on nonadmitted insurance, and (ii) the preemption of state credit for reinsurance credit rules with respect to nondomestic ceding insurers.

*Premium Tax on Nonadmitted Insurance*

Section 521(a) of the NRRA provides that no state other than the "home state" of an insured may impose a premium tax on nonadmitted insurance. "Home state" is generally defined in Section 527(6) of the NRRA as (i) the state in which an insured maintains its principal place of business or, in the case of an individual, the individual's principal residence, or (ii) if 100% of the insured risk is located outside of that state, the state to which the greatest percentage of the taxable premium for that insurance contract is allocated. The NRRA streamlines the obligations of insureds to pay, and surplus lines brokers to collect, premium taxes on transactions where the insured risk is located in a different state than the insured's home state. Section 522(a) of the NRRA further provides that except as otherwise provided in the statute, the placement of nonadmitted insurance is only subject to the statutory and regulatory requirements of the insured's home state. Section 521(b) of the NRRA expresses an intent of Congress that each state adopt nationwide uniform procedures, such as an interstate compact, for reporting and paying premium taxes on nonadmitted insurance for allocating among the states the premium taxes paid to an insured's home state. States have been revising their statutes and regulations to conform their laws to the NRRA and have provided guidance to excess and surplus line brokers and insurers with respect to the implementation of the NRRA in their states. For example, New York released Circular Letter No. 9 (2011) on 22 July 2011 (available at http://www.ins.state.ny.us/circltr/2011/cl2011_09.pdf) for this purpose. By contrast, the process for establishing a uniform interstate compact for the allocation of premium taxes among the states is still far from complete. For more information on state responses to the NRRA regarding premium taxes, please see our article from the March 2011 Mayer Brown Global Corporate Insurance & Regulatory Bulletin, *States Address Nonadmitted Insurance Premium Taxes in Light of Dodd-Frank Act*.

*Credit for Reinsurance*

Section 531(a) of the NRRA provides that if a state of domicile of a ceding insurer is a NAIC-accredited state, or has solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and permits the ceding insurer to take credit for reinsurance on a ceded risk, then no other state in which the ceding insurer is licensed may refuse to recognize that credit for reinsurance. As all fifty states are currently NAIC-accredited, Section 531(a) of the NRRA effectively preempts all nondomestic state credit for reinsurance rules for all reinsurance agreements involving a ceding insurer based in the U.S.

The NAIC is in the process of evaluating proposed amendments to its *Credit for Reinsurance Model Law (#785)* and *Credit for Reinsurance Model Regulation (#786)*, which if adopted will provide for reduced collateral requirements for credit for reinsurance. Many states base their credit for reinsurance statutes and regulations directly on the NAIC models or have a framework in place that is substantially similar to that of the NAIC models. NAIC models are not recognized as law in any of the states, but the models are influential as accreditation standards. If the proposed amendments are adopted by the NAIC, states may choose to amend their laws and regulations to conform to the models. However, since the proposed amendments to the NAIC models establish a floor for collateral requirements, states that choose to maintain their current stricter requirements will meet the accreditation standard. For more information on the proposed amendments, please see the below article, *NAIC Reinsurance (E) Task Force Continues to Take Steps to Amend Credit for Reinsurance Model Law and Regulation*.

*State Actions*

Both California and New York have taken measures that recognize the consequences of the preemption by the NRRA of state credit for reinsurance statutes and regulations. On 11 April 2011, the California Department of Insurance released Bulletin No. 2011-2, *Implementation of Reinsurance Provision of the Federal Nonadmitted and Reinsurance Reform Act*, in part, to explain how the California Department of Insurance will exercise its regulatory powers in light of the credit for reinsurance provisions of the NRRA. Bulletin No. 2011-2 states that the California Department of Insurance will not deny financial statement credit for reinsurance that has been recognized by the domiciliary state of a ceding insurer. For more information on the response of California to the NRRA and its effect on California statutes and regulations, please see our article from the April 2011 Mayer Brown Global Corporate Insurance & Regulatory Bulletin, *California issues bulletin for guidance on implementation of reinsurance provisions of Dodd-Frank Act*.

The New York State Insurance Department made a series of changes to its credit for reinsurance regulation, Regulation 20, that became effective on 1 January 2011. One such change was a provision stating that New York's credit for reinsurance regulation would no longer apply to a non-New York ceding company if its state of domicile is an NAIC-accredited state, or has financial solvency requirements that are substantially similar to the requirements for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk. In addition to such language acknowledging the preemptive effects of the NRRA, the changes to Regulation 20 allow for reduced

collateral requirements for credit for reinsurance obtained from unauthorized reinsurers. For more information on New York's credit for reinsurance regulation, please see our article from the December 2010 Mayer Brown Global Corporate Insurance & Regulatory Bulletin, *New York's Changes to Credit for Reinsurance Regulations*.

## US – NAIC Reinsurance (E) Task Force Continues to Take Steps to Amend Credit for Reinsurance Model Law and Regulation

Reinsurance reform in the United States has been a long-developing process and the subject of great debate. An important element of reinsurance reform has been the deliberations of NAIC aimed at amending its credit for reinsurance model law and regulation. On 11 July 2011, the NAIC Reinsurance (E) Task Force conducted an interim meeting to discuss proposed amendments to the *Credit for Reinsurance Model Law (#785)* and the *Credit for Reinsurance Model Regulation (#786)*. Coming out of the interim meeting, the Reinsurance (E) Task Force released for comment exposure drafts of proposed amendments to Model 785 and 786 dated 26 July 2011. The deadline to submit comments on the exposure drafts is 24 August 2011. After the conclusion of the 30-day comment period, the draft models will be voted on by the Reinsurance (E) Task Force and the Financial Condition (E) Committee at the NAIC national meeting on 31 August 2011. The NAIC Executive (EX) Committee and Plenary will consider the drafts at a future date, with a goal of adopting the amended models before the end of 2011. Under the amended NAIC models as currently drafted, a reinsurer may qualify for reduced collateral requirements on a sliding scale based upon the rating assigned to the reinsurer by a state insurance commissioner. Factors that may be considered by the commissioner in determining the ratings for a reinsurer include, among other things, the reinsurer's financial strength ratings from acceptable rating agencies, compliance with reinsurance contractual terms and obligations, business practices in dealing with ceding companies, reputation for prompt payment of reinsurance claims and the existence of any regulatory actions against the reinsurer.

The NAIC models are not binding law in any state. However, the models are important as accreditation standards. States have to be in compliance with and conform to the NAIC models in order to maintain NAIC accreditation. Individuals states are likely to enact laws and regulations that closely track amended Models 785 and 786 upon their adoption by the NAIC. Several states, including Florida, Indiana, New Jersey and New York, have already revised their credit for reinsurance statutes and regulations along the lines of the draft amendments to the NAIC models. Additional states have such reforms currently pending. Please see the article and chart below: *States That Have Enacted Or Are Considering Reduced Collateral Requirements For Credit For Reinsurance*. In addition, as a result of the Nonadmitted and Reinsurance Reform Act of 2010 (see separate article), states that have not adopted such reforms are nonetheless required to recognize the credit for reinsurance allowed by states that have enacted such reforms with respect to ceding insurers domiciled in those latter states.

## US – President Obama Nominates Roy Woodall to Serve as a Voting Member of the Financial Stability Oversight Council

On 24 June 2011, President Obama announced his intention to nominate Roy Woodall as the independent member of the Financial Stability Oversight Council (the **"FSOC"**) with insurance expertise. The FSOC was created pursuant to Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the **"Act"**). The FSOC's mandate includes identifying risks to the financial stability of the United States, promoting market discipline, and responding to emerging threats to the stability of the United States financial system. The FSOC consists of fifteen members (ten voting and five non-voting). Three insurance representatives sit on the FSOC. Two of them, Missouri Insurance Director John Huff and Federal Insurance Office Director Michael McRaith, serve as non-voting members. Mr. Woodall, if confirmed, will serve as a voting member of the FSOC.

The FSOC has the authority to designate nonbank financial institutions, including insurance companies, as "systemically significant" under the Act. Such a designation would result in federal, in addition to state, regulators having the ability to examine an insurance company's affairs and possibly the imposition of enhanced capital standards on such company. The nomination of Mr. Woodall is an important step towards having a voting member of the FSOC who understands and represents the interests and concerns of the insurance industry. As the FSOC has already been conducting meetings with the voting insurance member position vacant, there had been concerns in the insurance industry that the lack of adequate representation of interests of insurers could lead to certain insurance companies being inappropriately designated as systemically important nonbank financial institutions.

Prior to his nomination to the FSOC, Mr. Woodall worked in the insurance industry in various capacities, including serving as the Kentucky Commissioner of Insurance and most recently as the Senior Insurance Policy Analyst at the U.S. Treasury Department. Mr. Woodall's confirmation hearing before the Senate Banking Committee took place on 27 July 2011, and he has yet to be officially confirmed as a member of the FSOC.

## UK – Solvency II – proposed delay to 2014

The Committee of Economic and Monetary Affairs of the European Parliament has published a draft report on Omnibus II which includes the proposal that the full requirements of Solvency II should not be implemented until 1 January 2014.

Solvency II is due to be implemented at the start of 2013 but it is proposed that its implementation is delayed due to the lack of preparedness of many smaller insurers and member states' regulators.

Paul Clarke, global Solvency II leader at Pricewaterhouse Coopers has commented that: "*This is a positive development as it brings us closer to ending the distracting debate over whether there will be a delay. Despite the delay in start date, the reality is insurers cannot afford to be complacent with their plans as they will still be required to file Solvency II information over the course of 2013 to prove their readiness. This means insurers will need to have the appropriate systems and processes in place by the end of next year.*

*The industry is likely to welcome the Parliament and Council's consensus on pushing back the implementation date to 2014, especially as a lot of the technical detail is still to be finalised. The more crucial piece for the industry now is how the areas of disagreement on some of the Level 2 implementing measures are resolved. We are unlikely to get any clarity on this until autumn and the rules won't be finalised until well into 2012."*

Peter Vipond, director of financial regulation and tax at the Association of British Insurers (**"ABI"**), however, has warned that the proposal to delay implementation could lead to added cost for insurers. They commented that "*the UK industry has already spent hundreds of millions preparing for Solvency II, and stands ready to meet the January 2013 launch date. This may help some firms, and would certainly help some continental regulators but it is a double edged sword. For example, firms would have to run Solvency I in 2013, and in the UK they may have to renew their individual capital adequacy standard for one year."*

## UK – UK PLC: open for business?

Since 2007, the UK government has been consulting on reforming the UK's controlled foreign companies (**"CFC"**) rules, with the aim of making the UK a more attractive and competitive place for business.

The UK CFC rules are anti-avoidance provisions which are intended to prevent the artificial diversion of profits from the UK to jurisdictions with lower corporate tax rates. In broad terms, the rules operate by imposing a tax charge on UK companies in respect of the profits of their CFCs.

In June 2011, the government published a new consultation document on the reform of the CFC rules and stated that *"a key ambition to help achieve this [encouraging private sector investment and growth] is to create the most competitive tax system in the G20. As well as lowering corporation tax rates, the Government wants to make the UK the best location for corporate headquarters in Europe."* The amendments to the rules have in part been prompted by the high-profile relocations of the headquarters of a number of insurance groups away from the UK.

Interim improvements to the CFC rules are contained in the recently published Finance Act 2011. The full regime is intended to come into force next year when the Finance Bill 2012 receives royal assent.

Following the publication of the interim improvements in the Finance Act 2011, Lancashire, the London-listed Bermudan reinsurer, announced on 27 July 2011 that it intended to move the tax residence of its holding company from Bermuda to the UK. The announcement was prompted by the introduction of a statutory exemption for foreign subsidiaries which, as a consequence of a reorganisation or change to UK ownership, come within the scope of the CFC regime for the first time. Lancashire's Bermudian (and other non-UK) subsidiaries will, for a period of three years, remain outside the scope of the CFC rules, meaning that there will be no effect on Lancashire's UK tax liability. However, the change of tax residency gives the Lancashire board of directors greater operational flexibility, since they are no longer required to fly to Bermuda for board meetings.

It remains to be seen whether Lancashire's announcement will prompt other previously UK-headquartered groups to move back to the UK. This is certainly what the UK government is seeking to achieve.

## UK – ABI Director General outlines ten-point plan for improving reputation and customer service in the insurance sector

Otto Thorensen, Chief Executive of the ABI has, four months into his role, set out his initial thoughts on the challenge posed by the pressing issue of reputation and service to customers of the insurance industry. He calls on the industry to 'act now' if it is to fulfil its potential and play a central role in the future of the UK economy.

Mr. Thorensen set out a ten point plan for talking the issue of reputation and customer experience. In brief, his ten points were as follows:

1. Communication should be made simpler and more understandable.
2. Products should be made simpler and more understandable too.
3. Staff should be trained to improve their understanding of the business and how the products and systems work.
4. Insurers should work with the Financial Ombudsman Service to understand better the ombudsman's perspective on how to deal with customers.
5. There should be emphasis on designing more equivalence and standardisation in product features.
6. Insurers should accept that treating customers fairly makes sense, and it should be used as a framework to deliver better customer outcomes.
7. Insurers should work with government and regulators to better manage the flow of change.
8. Insurers should be quicker to acknowledge when they have got something wrong and respond to put it right.
9. Service should be relevant and accessible to the type of customer being serviced.
10. Insurers should start early by continuing to support developing financial capability for consumers; education in schools, awareness and education in the workplace and education approaching retirement.

Mr. Thorensen's think piece can be viewed here.

If you have any query in connection with anything in this Bulletin, please do not hesitate to get in touch with your usual Mayer Brown contact or one of the contacts referred to below.


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