MARSH

SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED.

Gesamtverband der versicherungsnehmenden Wirtschaft (GVNW)

REGULATORY & TAX CHALLENGES FACING GERMAN MULTINATIONAL COMPANIES

25 September 2020

Praveen Sharma
Global Leader - Insurance Regulatory & Tax Consulting Practice

Sebastian Linck
Head of Marsh Stuttgart

MARSH & McLENNAN COMPANIES

Hardening market

Need for a local policy

Insurance premium tax audits

Reduced capacity

TCoR vs. Coverage vs Compliance

Challenges Facing Multinationals

Increased complexity

Premium allocations

Regulatory compliance uncertainty

Changing legislation

Quicker payment requirements

From local policy admin to local policy underwriting

Brexit

"Unbudgeted Surprises" for German MNC

1. Insurance terms (cover and limits) of local policies inadequate
   - Gaps in coverage: leading to company paying claims out of its own resources
2. No Director's & Officer's insurance policy in overseas countries
   - Unable to receive funding for defence costs and payments to third parties
3. Premium payment: Central vs Local
   - Adverse cash flow and foreign exchange, Transfer Pricing issues on cross border transactions
4. Premiums not allocated/recharged to group entities
   - Tax deductibility of expense foregone
5. Premium tax audits by tax authorities
   - Unpaid premium taxes plus interest plus penalties
6. Receipt of claim monies by parent company
   - Corporate income tax cost, double taxation risk, corporate finance anomaly
7. Evidence of insurance to third parties
   - No local policy & the insurer not licenced, contractual terms not fulfilled
8. Insurer not willing/able to pay claims to the insured or to the third party
   – Leading to claims being unpaid or the company funding the loss out of its own resources

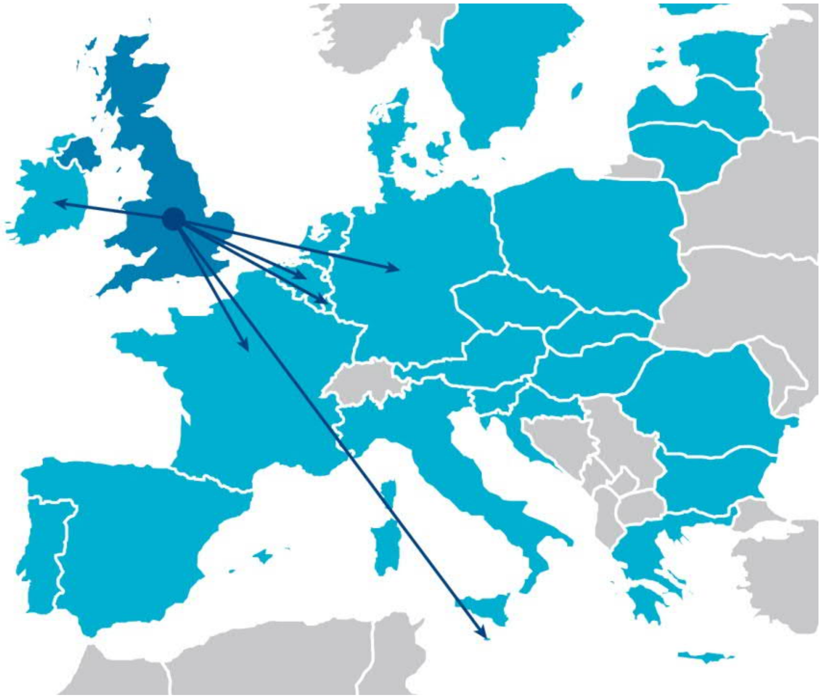
What are the Regulatory & Tax Challenges?

Shifting Regulatory Landscape

- **European Union**
  - Various EU Directives
  - Brexit: potential implications for Freedom of Service
- **Africa**
  - Generally restrictions on fronting, reinsurance, premiums, commissions and exemptions.
  - CIMA countries: restrictions on fronting and reinsurance
- **Asia**
  - General focus on risk-based solvency for local insurers.
  - Restrictions on reinsurance, premium rates, cash-before-cover
- **Argentina, Brazil, Russia, India, and China**
  - Strictly prohibit non-admitted insurance.
  - Reinsurance and foreign exchange control restrictions relaxed in Argentina and Brazil.
- **International Association of Insurance Supervisors (IAIS): Memorandum of Understanding – 74 signatories.**

BREXIT: Summary

- UK has left the EU with effect from 31 January 2020
- UK based insurers have formed a new insurance company in an EU-27 member state
- EU-27 member states insurers have applied for a Third Country Branch licence in the UK
- They are also transferring relevant liabilities to the licensed entities/branches
- Seamless transition for insured groups to provide cover for risks located in the UK and EU-27
- Outstanding claims would be paid in a compliant manner to the EU insured entities
- Transitional rules apply until 31 December 2020



Shifting Taxation Landscape

- **Technical developments**
  - Kvaerner (2001) and A Ltd (2019) European Courts of Justice precedent: “Location of Risk”
  - OECD Base Erosion and Profit Shifting (“BEPS”): impact on captive insurance companies
- **Tax authorities want their “pound of flesh”**
  - Increasing number of insurance premium tax (IPT) audits being conducted – EU (Germany and Belgium in particular), US, Canada, Switzerland, New Zealand
  - UK tax authorities looking to bring in new regulations for payment of IPT on premiums paid to non-EU insurers
  - German tax authorities looking to tax premiums relating to risks located outside the EU/EEA
- **Tax rates and payment responsibilities**
  - Whilst income tax rates reducing, premium tax rates are increasing (or new rates being introduced)
  - In the UK and EU, the insurer must allocate premiums, collect and pay IPT thereon
- **South Africa, Chile, Peru, Australia, New Zealand, US, and Canada**
  - Premium taxes payable by INSURED directly to tax authorities on non-admitted insurance premiums
- **United States of America**
  - Direct/self/independent procurement taxes on premiums paid to “alien” insurers
  - Federal excise tax on premiums paid to foreign resident insurers
  - Base Erosion Anti-abuse Tax (“BEAT”) effective from 1 January 2018 in the USA on inter-company transactions including insurance premiums
- **Income/corporate tax implications**
  - Premium deductibility may be denied in certain territories.
  - Claims from insurers may be taxed – twice!

Shifting Premium Taxation Landscape

Premium tax rates 2008

- Netherlands: 7.5%
- Finland: 22%
- Greece 10%
- Hungary: NIL
- India: 12.36%
- Mexico: 15%
- Ireland: 2%
- South Africa 14%
- UK: 5%/17.5%
- Slovakia NIL
- GCC NIL
- Saudi Arabia NIL

Premium tax rates 2020

- Netherlands: 21%
- Finland: 24%
- Greece 15%
- Hungary: 10%
- India: 18%
- Mexico: 16%
- Ireland: 7%
- South Africa 15%
- UK: 12%/20%
- Slovakia 8%
- GCC 5%
- Saudi Arabia 15%

Potential Income Tax Paradox – An example

Global Liability $50M Controlled Programme (placed with EU insurers) **Exposure analysis suggests EML/PML could be $15m**	**Local Policy $1M Local Limit**	**$11M Liability Loss Suffered by Overseas Subsidiary**

	Profit & Loss Account	
	Overseas Subsidiary (Non-admitted not permitted)	**German MNC - Germany**
Loss suffered by the overseas subsidiary	**(10,000,000)**	
Claims received from non-admitted insurer – may be treated as "Taxable Income" by the local tax authorities		**10,000,000**
Tax may be suffered by Ultimate Parent on Claims – current effective German corporate tax rate 30%		**(3,000,000)**
Transfer of net cash by Ultimate Parent to Overseas Subsidiary – may be treated as income and suffer additional income tax locally	**7,000,000**	
Potential risk of Double Taxation: Tax liability by the Overseas Subsidiary on the amount received from the Ultimate Parent – say at 25%	**(1,750,000)**	

Regulatory and Tax risks case studies: are they real?

- **Case 1:** Regulator in Argentina imposed fines in respect of unauthorised (non-admitted) life insurance transaction – insured fined 8 times insurance spend, broker 15 times the premium.
- **Case 2:** Swiss insurance broker purchased a compulsory PI policy from a foreign insurer not admitted ins Switzerland. Swiss regulator didn't accept it as a valid contract, and prohibited the broker from practising in Switzerland.
- **Case 3:** Regulator in Mexico reminded the market of violating the local insurance laws and that potential penalties could be prison sentence of between 3 and 10 years.
- **Case 4:** Regulator in Brazil issued fines of US$6.2 billion to a US insurer for selling life insurance in Brazil on a non-admitted basis.
- **Case 5:** Kenya Regulator issued a bulletin in 2014 reminding companies to obtain formal authorisation before placing risks with overseas insurers.
- **Case 6:** In March 2018, the Enforcement Committee of the Financial Services Board in South Africa penalised Dell for selling Accidental Damage insurance to its customers without a licence.
- **Case 7, 8 and 9:** Washington State insurance commissioner fined and taxed Microsoft in 2018, Costco and Alaska Air in 2019 for breach of insurance regulations by their respective captives and non-payment of premium taxes.
- **Case 10:** Adidas India suffered a total stock loss (June 2009) that was greater than the local policy limit. German master policy paid the difference to Adidas AG, that was subject to German corporate income tax. Indian tax authorities wanted to tax the master policy claim monies, but the Delhi tax tribunal ruled (July 2019) that the FINC clause in the German master policy was a separate intangible asset cover and as such the claim monies did not belong to Adidas India.
- …………

MARSH

SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED.

WHAT is the solution for German MNCs?

Pragmatic and Practical Approach and Disciplined Process

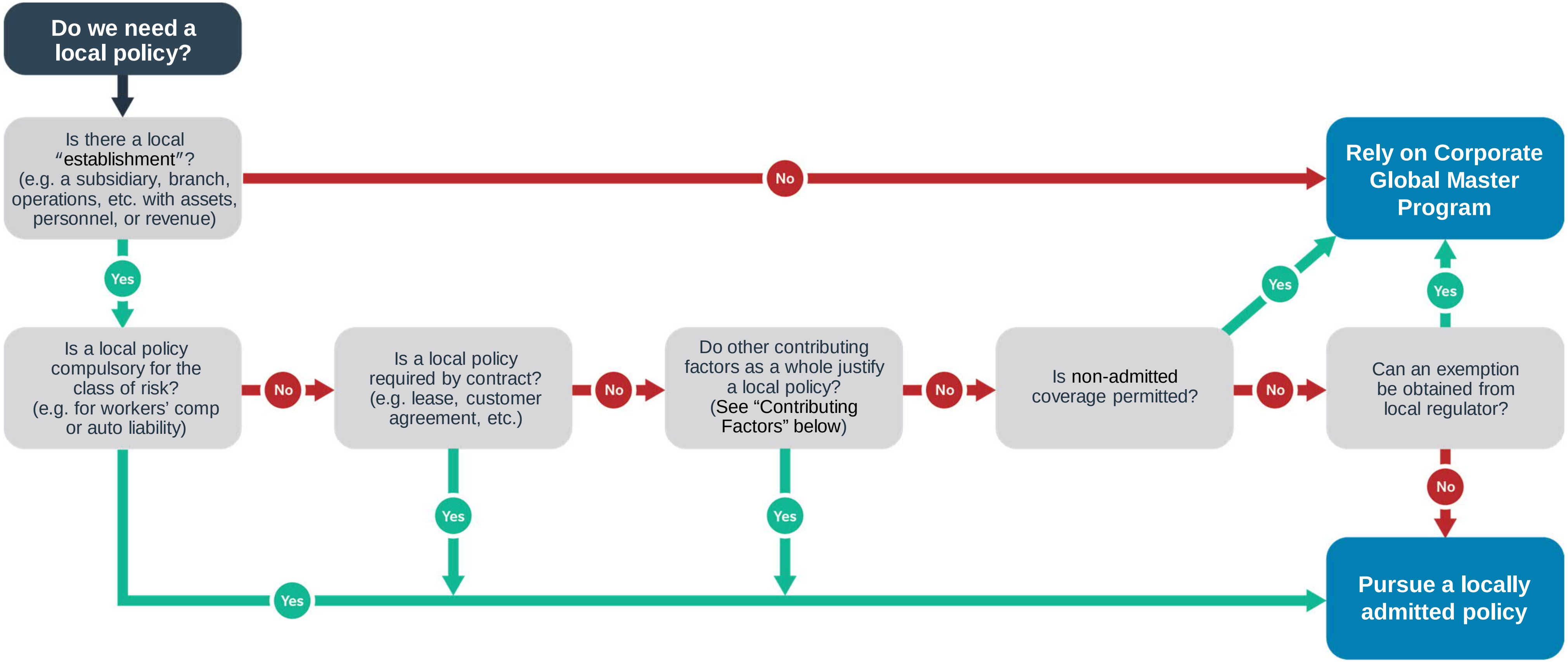
MARSH & McLENNAN COMPANIES

How to Balance “Competing Factors” & NO SURPRISES

Understand your risks	Evaluate your needs?	Establish & challenge insurers approach?	Premium Allocation methodology	Corporate income taxes on premiums/ claims?	Premium related taxes?
• What is the risk tolerance of the group? • What are the insurable risks? • Where are the insurable risks located? • What is the internal Business Model? • Who has an “insurable interest” in the loss? • Awareness of regulatory and tax risks	• Why insurance – what is the value of insurance? • Determine appropriate level of cover – locally and group-wide • Establish how the risk could be covered • Clarify where claims need to be paid by insurer? • Cost/Benefit analysis of potential options	• Pre-underwriting process • Terms and conditions that are “fit-for-purpose” • Policy wording/ Endorsements • Compliance with the insurance and tax regulations • Where will the insurer pay the claim?	• “Just and reasonable” basis? • Simple allocation methodology may not be equitable • Use of appropriate underwriting factors? • Agreement of all parties? • INSURANCE MANUAL • PREMIUM ALLOCATION MODEL DOCUMENT	• Premium deductibility? • Premium recharge consistent with allocation? • Transfer pricing - connected parties • Potential double taxation on claims?	• Premium taxes unpaid where insurer unlicensed? • Insured’s premium tax liabilities in various countries

DEFINE | DESIGN | DELIVER

Local Policy Decision Tree

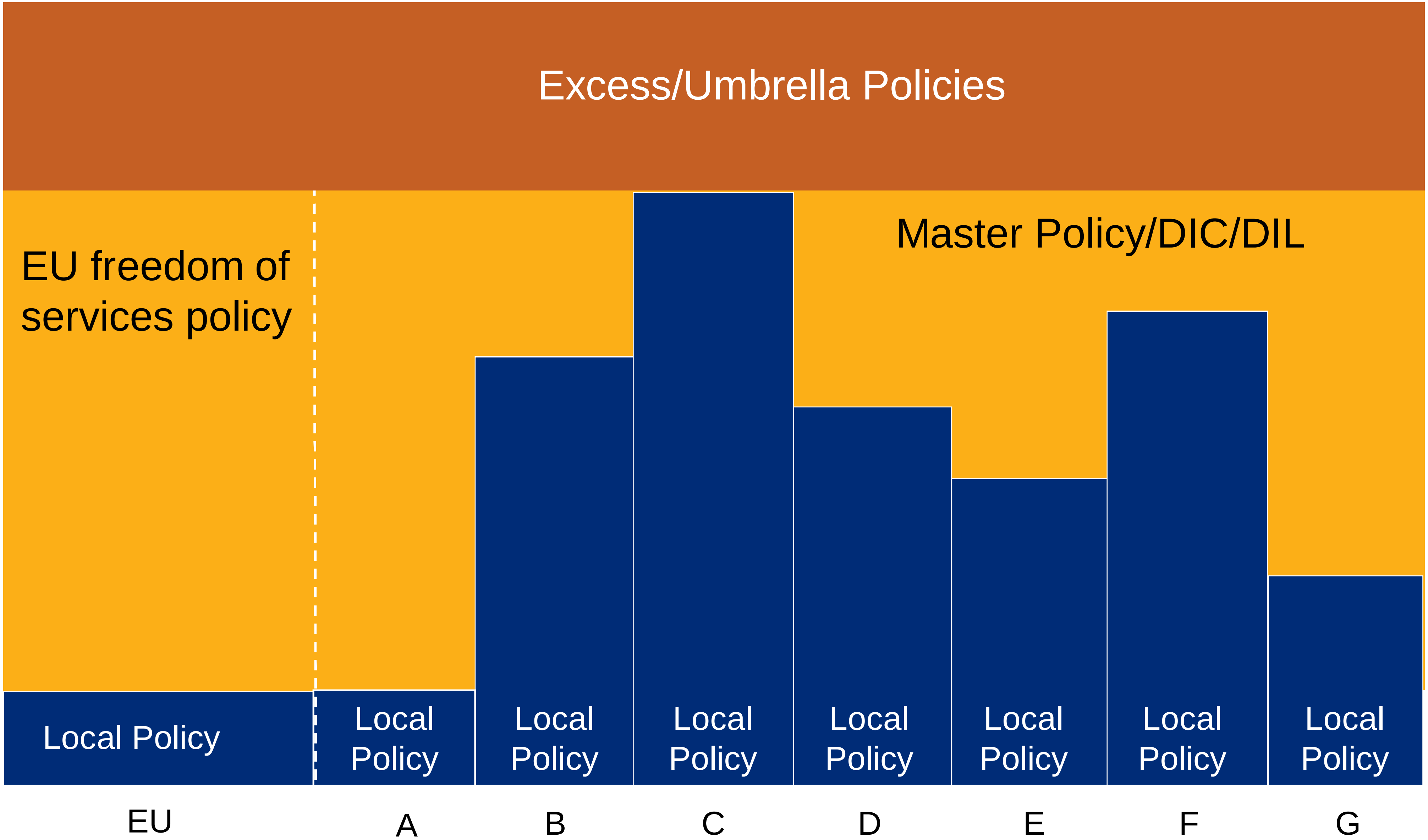


CONTRIBUTING FACTORS

No one factor is controlling; all factors need to be considered in order to decide if a local policy is needed

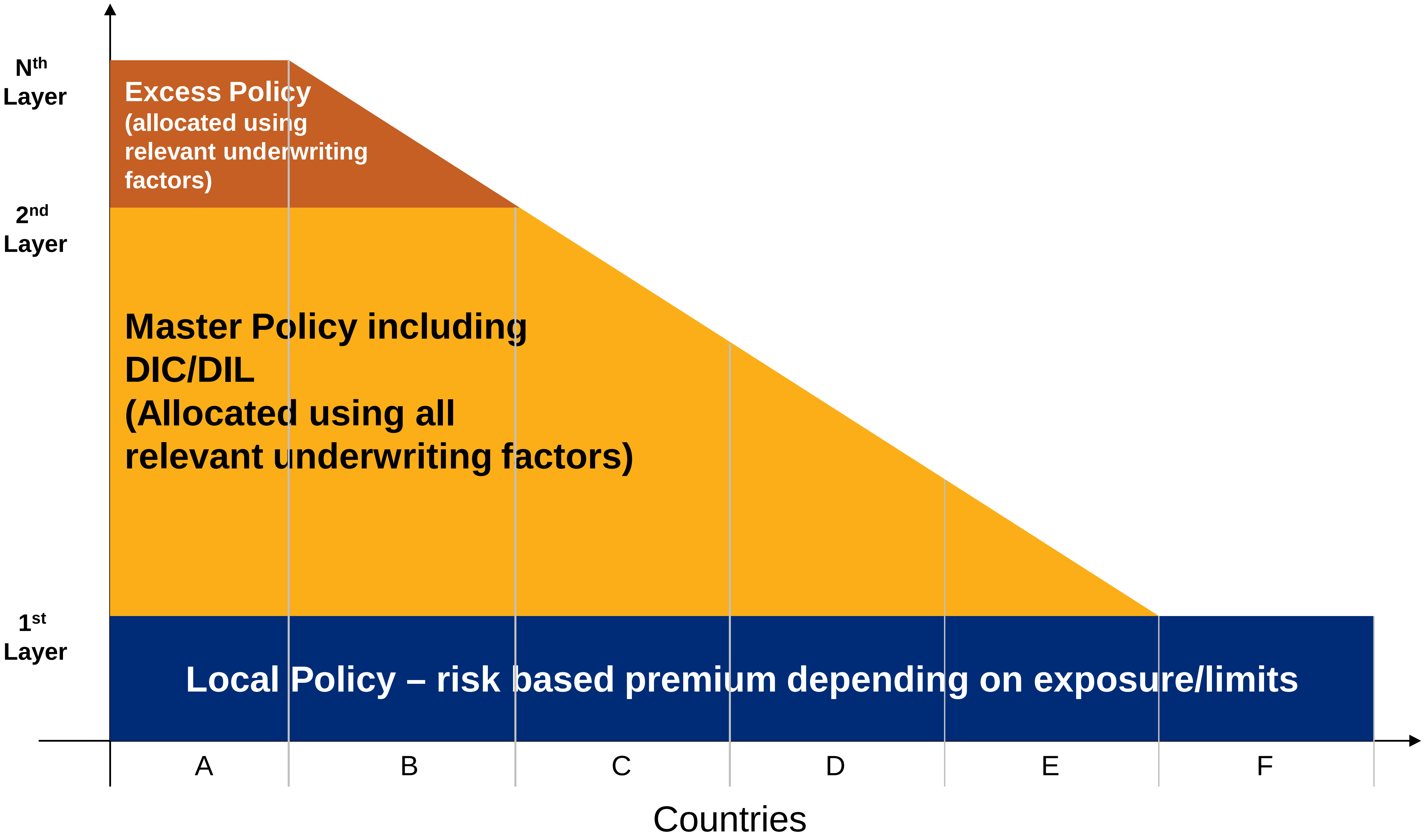
- If a premium tax is applicable to non-admitted premiums, can, and will, the local insured remit the tax?
- Is there a need to recharge premiums to local operations, either for finance or income tax purposes?
- Is the insurer willing to pay a claim across borders into the country?
- Is local insurer representation important, such as for claims handling or risk management consulting?
- Can the global insurer issue a local policy?
- Is the added cost of a local policy low?
- Are insured exposures high in the country?
- Are there important coverage extensions on local policies that are not available on the master?
- Will the local operations unnecessarily purchase local policies on their own thus duplicating coverage?
- Are limits required by contract higher than those already locally in place?

Possible Structure: Global Liability/D&O Programme
- “Manhattan Skyline”



Countries

Suggested Premium Allocation Methodology



Global Insurer's Solution

EU Excess Freedom of Services (FOS) Policy.

Subsidiaries are directly insured.

Countries In Which Non-admitted Insurance **IS** Permissible.

Master Policy: Difference in conditions (DIC)/difference in limits (DIL).

Subsidiaries are directly insured.

Countries In Which Non-admitted Insurance **IS NOT** Permissible.

Master Policy *with financial interest cover – subsidiaries are <u>not</u> directly insured — only parent company for its financial interest in the subsidiary.*

EU: Primary "local " policies.

Local policy:

Non-admitted **is** permitted.

Local policy:

Non-admitted **is** permitted.

No local policy:

Non-admitted **is** permitted.

Local policy:
Non-admitted **is NOT** permitted.

Local policy:

Non-admitted **is NOT** permitted.

Local policy:

Non-admitted **is NOT** permitted.

No local policy:

Non-admitted **is NOT** permitted.

EU **NAP*** **NANP****

*NAP: Non-Admitted Permitted
**NANP: Non-Admitted Not Permitted

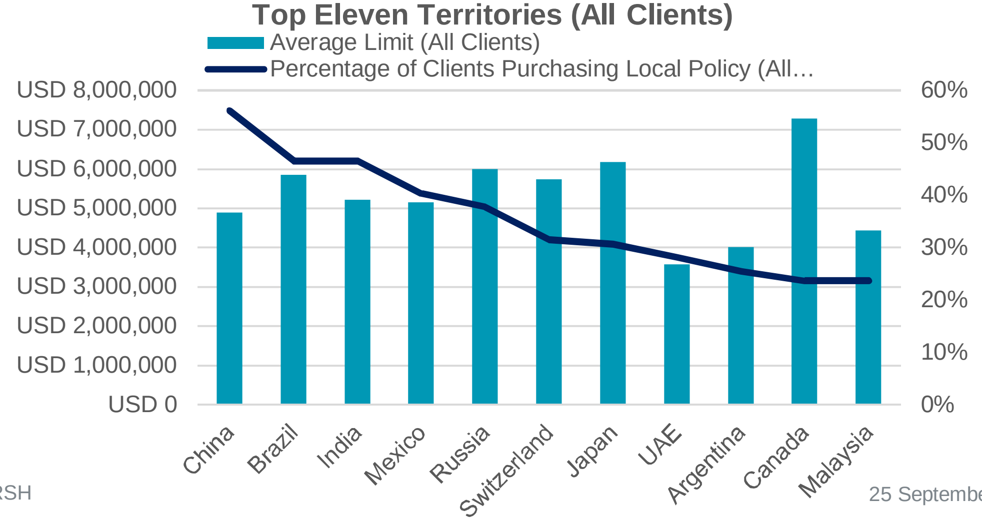
COUNTRIES

Total Cost of Risk and D&O Local Policies in Top 11 Countries

Source – Marsh Benchmarking Database Information

All Clients		
Top Eleven Territories for D&O Local Policies (All Clients)	Percentage of Clients Purchasing Local Policy	Average Local Policy Limit Purchased
China	56.1%	USD 4,900,000
Brazil	46.5%	USD 5,800,000
India	46.5%	USD 5,200,000
Mexico	40.4%	USD 5,200,000
Russia	37.7%	USD 6,000,000
Switzerland	31.6%	USD 5,700,000
Japan	30.7%	USD 6,200,000
UAE	28.1%	USD 3,600,000
Argentina	25.4%	USD 4,000,000
Canada	23.7%	USD 7,300,000
Malaysia	23.7%	USD 4,400,000

- Non-admitted not permitted countries are the leading countries for local policies
- USA is not top 11 territories
- Local policy limit varies from US$ 4M to US$ 6M.



- On average 7 local policies purchased
- In total in 91 countries
- Average limit of US$ 5,8M.

Marsh Multinational Management Liability – Output

Summary

	Risk and Legal Framework Issues				Indemnity Issues		Insurance Issues	
	Regulatory Risk	*Legal System Type*	*Board Systems Type*	*AML Statute in place?*	*Indemnification Permitted?*	*Advancement of Costs Permitted?*	*Can a risk be covered by a non-admitted Insurer?*	*Broker Caution?*
Australia	High	Common Law	Unitary	Yes	Yes	Yes	Yes	
Brazil	High	Civil Code	Unitary	Yes	Yes	Yes	No	Caution (See Comments)
Canada	High		Unitary	Yes	Yes	Yes	Yes	
China	High	Civil Code	Dual	Yes	Unclear	Unclear	No	Caution (See Comments)
Japan	High	Civil Code	Optional	Yes	Yes	Yes	No	Caution (See Comments)
Malaysia	Moderate		Unitary	Yes	No	Unclear	No	
Mexico	Low	Mixed Common Law and Civil Code	Unitary	Yes	Yes	Yes	No	Caution (See Comments)
United Kingdom	High	Common Law	Unitary	Yes	Yes	Yes	Yes	
United States of America	High		Unitary	Yes	Yes	Yes	Yes	

	Risk and Legal Framework						Indemnity Issues				Ins. Reg. Position					
	Litigation Risk		*Regulatory Risk*		*Money Laundering Statute Risk*		*Indemnification Permitted?*		*Advancement of Costs Permitted?*		*Can a risk be covered by a non-admitted Insurer?:*		Subtotal	Broker Caution		Total Score
	High = 3, Moderate = 2, Low = 0		*High = 3, Moderate = 2, Low = 0*		*High = 2, Moderate = 1, Low = 0*		*No = 2, Only by Shareholder Vote = 1, Unclear = .5, Yes = 0*		*No = 2, Unclear = 1, Yes = 0*		*No = 2, Unclear = 1, Yes = 0*					
	Score	Weighted	Score	Weighted	Score	Weighted	Score	Weighted	Score	Weighted	Score	Weighted		Score	Weighted	
Australia	2	4	2	4	2	2	0	0	0	0	0	0	10	0	0	10
Brazil	1	2	2	4	2	2	0	0	0	0	2	20	28	10	25	53
Canada	2	4	2	4	2	2	0	0	0	0	0	0	10	0	0	10
China	1	2	2	4	2	2	0.5	2.5	1	5	2	20	35.5	10	25	60.5
Japan	0	0	2	4	2	2	0	0	0	0	2	20	26	10	25	51
Malaysia	0	0	1	2	2	2	2	10	1	5	2	20	39	0	0	39
Mexico	1	2	0	0	2	2	0	0	0	0	2	20	24	10	25	49
United Kingdom	2	4	2	4	2	2	0	0	0	0	0	0	10	0	0	10
United States of America	2	4	2	4	2	2	0	0	0	0	0	0	10	0	0	10

In Conclusion…An I D E A

I dentify	group exposure and location of risk
D etermine	regulatory and tax rules for major territories
E stablish	various options for an efficient global program
A dopt	disciplined and consistent approach & **AVOID SURPRISES**

Questions and Answers?

Contact Details:

Praveen Sharma, Managing Director

Insurance Regulatory & Tax Consulting Practice – Global Leader

Direct Tel: +44 207 357 5333

Mobile: +44 798 357 8035

Email: praveen.sharma@marsh.com

Sebastian Linck, Head of Marsh Stuttgart

Member of the Management Board, Marsh GmbH

Direct Tel: +49 711 2380-339

Mobile: +49 152 0162 7339

Mail: sebastian.linck@marsh.com