

Response to OECD Public Consultation on the Progress Report on Amount A of Pillar One

1. Introduction

- 1.1. GFIA welcomes the OECD/G20 Base Erosion and Profit Shifting (BEPS) Progress Report on Amount A of Pillar One and the public consultation on the overall design of Amount A rules prior to final agreement.
- 1.2. Schedule C of the Progress Report, on the exclusion of Regulated Financial Services (RFS), reflects many of the key technical features of the insurance and asset management sectors, as highlighted in GFIA's previous submissions to OECD public consultations. This is a welcome confirmation of the consideration given by the OECD secretariat to these key issues.
- 1.3. While much progress has been made on the RFS exclusion, GFIA has identified a few remaining areas of concern: notably, the definitions as set out in Section 20 of Schedule C.

2. Summary

- 2.1. GFIA would like to reiterate that it is a crucial matter of tax certainty that reinsurance is excluded from Amount A. Reinsurance, like insurance, is subject to both prudential and capital regulation. There is no need for a reallocation of reinsurance profits under Pillar 1, as reinsurance is a highly regulated business which is subject to stringent capital requirements and should be treated in the same manner as insurance. This regulation aligns the location of capital to the location of the (re)insurance company. Regulation in the reinsurer's location ensures that it is appropriately capitalised to be able to honour its liabilities to its policyholder (the insurer).
- 2.2. While the Progress Report demonstrates the welcome efforts to address the specificities of the (re)insurance and asset management sectors, the definitions set out in Section 20 Schedule C require further fine-tuning as currently there is a risk that these definitions do not adequately encompass all the insurance policies which (re)insurers are licensed to write.
 - 2.2.1. For instance, the Progress Report defines only three types of insurance: insurance contracts, annuity contracts and insurance products, which do not encompass all insurance policies. Each jurisdiction has its own market particularities and regulatory requirements and the (re)insurance market is meant to evolve and adapt along with society in these jurisdictions, recognising and addressing new and emerging risks and developing new classes of (re)insurance that may not be covered by the current definition.
- 2.3. Total Reported Income (Schedule C Section 20.18), which is defined as "the revenue, as reported on the Entity's financial statements submitted to the relevant financial regulator", does not account for Solvency II and other regulatory reporting, where returns do not include P&L or

financial statements from which revenues can be identified for each entity. In addition, not all entities will submit Solvency II or other regulatory returns on a solus basis. Total Reported Income should be collected from entity financial statements/consolidated financial statements like the rest of Pillar One.

- 2.4. GFIA has noted comments that “A separate document, with sections on administration and tax certainty will be publicly released separately”. It is important that the process of complying with the rules is as simple as possible and for this to be possible firms will require ample time to understand the process prior to implementation. General timelines for large IT system updates or changes require 18- 36 months for comprehensive implementation and this process can only begin when IT teams have sight of full and complete rules with adequate and appropriate guidance.

3. Definitions (Schedule C, Section 20)

- 3.1. GFIA has noted that the current rules use “revenue” and “income” interchangeably. This can add a layer of complexity to our members due to their alternative definitions, as those terms have very specific meanings in financial statements. It is the view of GFIA that one term should be used. If, however, there is a deliberate reason why the OECD’s use of “revenue” is different to “income”, this should be clarified. An example of this is the definition of Total Reported Income which equals revenue. It would also provide certainty for the insurance industry if the definition was clarified to define revenue as either gross or net of reinsurance.
- 3.2. As noted above, the definition of Insurance Institution (Schedule C, Section 20, Paragraph 11 (c)) refers only to three types of insurance business. To avoid a definition that would not cover all the insurance business as licensed under various forms and particularities across OECD countries, the income criterion could refer to the income “...*arising from all Insurance Contracts, Annuity Contracts, and Insurance Products (including investment income from assets associated with such contracts) written by the insurer or the reinsurer, pursuant to the license granted by their local Regulator ...*”
- 3.3. In the same vein, the definition of Insurance Product (Schedule C, Section 20 Paragraph 12) is potentially limiting as it makes specific references to “a contract which the issuer agrees to make one or more payments to another party on death or on other specified dates” and does not make any reference to events. It is the authorisation to write business (and the accompanying regulation) which is the important factor, not the specific features of the products authorised. GFIA, therefore, suggests rephrasing the definition as follows: “Insurance Product means a contract under which the issuer agrees to make one or more payments to another party on death or on other specified dates or events and that the issuer is permitted to issue under its licence to carry on an insurance or reinsurance business”.
- 3.4. There are also concerns with the definition of Insurance Contract’ (Schedule C, Section 20, Paragraph 10) and its referral to “significant” insurance risk. Insurers and reinsurers write

policies to address risks listed under the regulatory definition of the classes of insurance for which they are licensed to operate: it is not always a matter of level. GFIA, therefore, suggests rephrasing the definition as follows: “*Insurance Contract means a contract under which the issuer accepts insurance or reinsurance risks from another party by agreeing to compensate that other party if a specified uncertain future event affects that other party.*”

- 3.5. A similar issue is also found in the definition of Insurance Risk (Schedule C, Section 20, Paragraph 13), which specifically excludes financial risk when, in fact, financial risk can and is insured (eg loan or deposit insurance). GFIA, therefore, suggests rephrasing the definition as follows: “*Insurance risk means a risk associated with an insurance or reinsurance contract, transferred from the holder of a contract to the issuer of the contract.*”
- 3.6. Insurance companies often hold and manage investments supporting insurance liabilities through subsidiaries. Those investments in subsidiaries support the reserves and capital of the Insurance Institution. If an investment subsidiary has a majority owner which is an Insurance Institution, the investment subsidiary should also be considered a Regulated Financial Institution, and accordingly the investment income earned through those investment subsidiaries should be included in the RFS exclusion.
- 3.7. Article 4 Section 4 refers to a “reliable method” in the sourcing of revenues. Although GFIA accepts that methods of revenue sourcing will differ from group to group, there are concerns that the standard at which “reliable” is measured will vary across jurisdictions.

4. Funds Clarification

- 4.1. The income criterion, as defined in Schedule C, Section 20, Paragraph 11 (c) refers to “...investment income from assets associated with such contracts...”, which GFIA members understand as meaning all financial investments necessary to allow the insurer or reinsurer to operate. It would be helpful for this to be confirmed.
- 4.2. Clarification is needed as to whether funds which are consolidated in the Group’s accounts can be ignored for the purposes of calculating non-RFS revenues, both in respect of dividend and fair value movements under Articles 5(2)(b)-(c).

5. Continued Exclusion of Reinsurance from Amount A

- 5.1. The exclusion of reinsurance from Amount A is crucial for the efficient operation of insurance for customers and businesses across the world. Reinsurance and retrocession are inextricably linked to the underlying insurance contract between the insurer and the customer. The underlying contract with the customer, drives the need for reinsurance or retrocession. Likewise, reinsurance whether of the primary contract or the reinsurance contract allows cedants to write more business, as a portion of the risk that they assume is transferred to reinsurers. Reinsurance, therefore, plays a key role in the insurance industry value chain.

- 5.2. Reinsurers pursue the same business model as primary insurers. They contract with the primary insurer (cedant) to reimburse future claims that the primary insurer may have against the payment of a premium today. The relationship is linked to the cedant's commitments and the occurrence of an insurance event. To meet future claims, reinsurers apply the same insurance techniques to manage risk as primary insurers.
- 5.3. Reinsurance, like insurance and asset management, is a highly regulated industry. As noted, the reinsurance contract with primary insurers stems from the commitment covered by an insurance contract. As a result, prudential regulation for reinsurance is similar to that of a primary (direct) writer of insurance and aligns the location of capital to the location of the (re)insurance company. Regulation in the reinsurer's location ensures that it is appropriately capitalised to be able to honour its liabilities to its policyholder (the insurer).
- 5.4. For insurers and reinsurers, risk and capital cannot be separated; there can be no assumption of risk without the provision of appropriate capital in a (re)insurance context. The regulatory capital rules to which (re)insurers are subject are designed to ensure that the company bearing the risk of the loss has the capital available to meet such losses. (Re)insurance company's business models, therefore, focus on the assumption and management of risk. At all levels, primary, reinsurance and retrocession, companies manage the level of risk they retain through diversification either through writing uncorrelated business or via reinsurance. They will often use reinsurance or retrocession to reduce the risk that they assume in a specific business line or geographic territory.
- 5.5. Reinsurance and retrocession are integral components of an insurance company's business model providing it with the ability to manage risk (and capital) before a decision is made to write the primary business. It is artificial to try and separate insurance and reinsurance in the context of Pillar One, when the management of risk and capital at all levels is interdependent.

GFIA thanks the OECD Secretariat for the opportunity to comment on the current state of the ongoing works on Amount A of Pillar One, and the consideration given so far to key issues of the industry. As Pillar One is a novel tool in the international tax system, there continues to be scope for improvement. In that respect, GFIA would like to reiterate the importance of having a formal mention of the exclusion of reinsurance from Amount A and the need for definitions that are more aligned with the technicalities of the industry.



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About GFIA

The Global Federation of Insurance Associations (GFIA), established in October 2012, represents through its 40 member associations and 1 observer association the interests of insurers and reinsurers in 67 countries. These companies account for 89% of total insurance premiums worldwide, amounting to more than \$4 trillion. GFIA is incorporated in Switzerland and its secretariat is based in Brussels.