association of financial mutuals

Chris Orchard
HM Revenue & Customs
CTIAA FPST, Room 3C/04
100 Parliament Street
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Dear Mr Orchard

OECD Common Reporting Standard
Standard for Automatic Exchange of Financial Account Information

The Association of Financial Mutuals ('AFM') is a trade body that represents Mutual Insurers, Friendly Societies and other financial mutuals across the UK. We represent 56 mutual organisations based in the UK and have 30 professional service firms within our associate membership.

Mutual Insurers and Friendly Societies are member-owned financial institutions that encourage self-help and personal responsibility. We assist the work of the Government by helping individuals to take responsibility for planning and providing for their own financial affairs. Our members typically have over 100 years of experience and heritage in financial services.

Mutual insurers bring choice and competition to both customers and to the insurance market, which is vital to a healthy financial services sector in the UK. Many Friendly Societies continue to specialise in providing products with very low premiums, which means that their services are accessible to all income levels.

The AFM welcomes the opportunity to comment on the OECD Standard for Automatic Exchange of Information ('AEOI') proposals.

Members

AFM has 53 member companies, almost all resident in the UK, who collectively look after the savings, protection and healthcare needs of over 20 million customers and managed assets of over £110 billion. The assets under management range from £1 million for the smallest members to £73 billion for our largest member. Further details of our membership is provided in Appendix 1.

Our members are all incorporated, or registered, in the UK (with the exception of one who operate exclusively in the Republic of Ireland), with the aim of offering financial products primarily to UK tax residents. As far as we are aware, the only other members with marketing activity outside the UK will be our largest members who may have operational units based in Dublin, Isle of Man, or possibly other territories within the European Union. Further, only a small minority of our members have fixed places of business outside the UK.

Our members offer a range of insurance products including tax-favoured products (pensions, Individual Savings Accounts ('ISAs'), Junior ISAs, Child Trust Funds ('CTFs'), investment life products including qualifying policies, and tax exempt savings plans ('TESPs')) and other non-tax favoured products (protection policies, general insurance and healthcare policies). Certain members also offer Holloway products (discussed further below).

A TESP is a product which can only be written by Friendly Societies. It offers the policyholder a gross of tax return, but in order to be eligible as a TESP a number of prescriptive conditions must be satisfied, including the amount of insurance cover and regularity and minimum payment term of premiums. The key condition from an AEOI perspective is that investors can only invest a maximum of £270 per annum across all TESPs. Investors are required to declare their eligibility on taking out a new TESP.

The issue

Our concern is the classification of the tax-favoured products offered by our members (see above for relevant products) as Excluded Accounts, as defined in Section VIII.C.17 of the OECD's Standard for Automatic Exchange of Financial Account Information Common Reporting Standard.

Should such products fall to be Financial Accounts (and not Excluded Accounts), this would place a considerable compliance, financial and administrative burden on the sector in respect of back book due diligence (which may require interrogation of paper records commonly still used by our members, in addition to electronic data), classification of current product offerings, and new procedures for on boarding of new policies. For some of our smaller members the financial burden, when considered alongside a wide range of other regulatory initiatives, could be prohibitive, forcing closure to new business or forced merger leading to loss of value to members. The compliance burden which would be placed on our membership is disproportionate to the anticipated minimal volume of non-UK resident persons and therefore reportable data under AEOI. We note there is no de minimis value threshold for insurance policies sold to individuals (as there is under FATCA) to remove low value financial accounts from the scope of AEOI. The low value of these contracts necessitates that margins for administration are low, and do not readily allow for the cost of additional administrative procedures. Adding new procedures potentially makes such products uneconomical and curtails their availability, to the detriment of poorer sections of society.

We set out below rationale to support Excluded Account status for the range of tax-favoured products offered by our members. We have restricted our comments to tax favoured products other than pensions, as we understand that other Industry bodies are making representations in respect of pensions.

ISAs, Junior ISAs, CTFs and TESPs

The relevant potential category for exemption for these products is Section VIII.C.17(b). The products meet all but perhaps of the conditions, namely:

- they are subject to regulation as savings vehicles for purposes other than for retirement.

- they are tax-favoured, as the investment income from the account is taxed at a reduced rate.

- annual contributions are limited to $50,000 or less. The table below shows that the annual contributions are significantly less than $50,000. $50,000 equates to approximately £29,480, using the exchange rate as at 8th May 2014 (1 USD : 0.590 GBP).

Product type	**Annual premium limit (as at 2014/15)**
TESP	£270 per annum
ISA	£11,880 per annum
Junior ISA	£3,840 per annum
CTF	£3,840 per annum

- Note the above limits apply to the aggregated premiums into policies of the specified type, and not to each individual policy.

The condition which is not obviously satisfied is:

- withdrawals are conditional on meeting specific criteria related to the purpose of the investment or savings account, or penalties apply to withdrawals made before such criteria are met.

The relevant products may not restrict withdrawals to specific criteria related to the purpose of the investment, but do have other restrictions on withdrawals:

- TESPs must be held for a minimum term of 7.5 years. Should a withdrawal be made from a TESP prior to this time (other than on death) the benefits withdrawn are subject to tax.

- Junior ISA / CTF – no withdrawals permitted until the person reaches the age of 18.

The scope, and appetite, for non-UK resident persons using these products to avoid tax is limited given restrictions on sale of the products and the low value of annual contributions permitted into the products. Specifically:

- ISAs, Junior ISAs and CTFs can only be sold to UK resident individuals. Should a holder of one of these accounts become non-UK resident, the account held at migration maintains its tax favoured status, but no new funds can be added to the existing account or new accounts opened.

- Should ISAs, Junior ISAs, CTFs, and TESPs to be classified as Excluded Accounts then when funds are transferred from the account to a non-UK bank account the transfer would not be reportable by the provider. However, to the extent that proceeds are paid into a bank account they will become subject to local reporting and withholding.

- The low annual premium cap for TESPs makes this an unlikely vehicle to be used by for the purpose of tax avoidance.

In light of the above, we consider it appropriate that ISAs, Junior ISAs, CTFs and TESPS are considered to satisfy the principles of Section VIII.C.17(b) and therefore be classified as Excluded Accounts.

Holloway Business

This is a form of PHI (disability) insurance that originated in the 1800s and is still written and/ or maintained by 9 Friendly Societies. The basic premise is that the member pays high contributions (to meet adverse claims experience, say caused by epidemics, which were a more frequent occurrence at the time of development of Holloway than today). On termination of the contract, typically when the person reaches a specified retirement age, any excess of contributions over the claims and administration costs are refunded to the member in the form of a bonus. The bonus paid also includes an element of investment return on the refunded excess contributions (as defined above) paid in effect to compensate the member for the time value of money.

The product is an insurance contract that is regulated as a PHI contract in accordance with its primary function, i.e. to provide income protection. Holloway business may therefore fall to be a Financial Account if it is considered to be a cash value insurance contract. Cash value is defined in Section C8 and excludes amounts payable under an insurance contract relating essentially to protection or mortality benefits. The key exclusions in respect of Holloway are:

- “A personal injury or sickness benefit”. This exempts any claims made during the life of the product from giving rise to a cash value.

In respect of the termination bonus paid:

- “A refund of a previously paid premium (less cost of insurance charges whether or not actually imposed) under an Insurance Contract (other than a life insurance contract) due to a decrease in risk exposure during the effective period of the contract”. The bonus paid on termination is essentially a refund of premiums (adjusted for the time value of money) due to a decrease in risk exposure over the effective period of the contract. In certain circumstances the bonus may be paid as an annuity rather than a single lump sum, but this doesn’t change the nature of the bonus from that outlined above. This would appear to support that the bonus should not be considered to give rise to a cash value.

In summary, it therefore appears appropriate to classify Holloway business as an Insurance Contract with no cash value, meaning that it is not a Financial Account and so is outside the scope of AEOI.

Should HMRC not concur with the above, and seek to classify Holloway as a Financial Account then as the product typically runs until the person reaches a specified retirement age it could perhaps be considered to be a retirement account and therefore potentially an Excluded Account under Section VIII.C.17(a). We have not considered this further at this time, given that Holloway does not appear to be cash value Insurance business so is not a Financial Account, but note that classification as an Excluded Account (on the basis of it being a retirement account) would be consistent with the position reached for U.S. FATCA.

Summary

In summary we consider it appropriate, in light of the principles of AEOI and the nature of the products in term of value and markets, for:

- ISAs, Junior ISAs, CTFs and TESPs to be classified as Excluded Accounts, and so outside the scope of AEOI.

- Holloway business not to be classed as a Financial Account, and so outside the scope of AEOI.

If you would like to discuss any aspect of the above do not hesitate to contact me.

Yours sincerely,

Chief Executive
Association of Financial Mutuals

Appendix 1: Membership of the AFM

- Ancient Order of Foresters Friendly Society Limited
- Anglo-Saxons Friendly Society
- B&CE Benefit Scheme
- Benenden Healthcare Society Ltd
- British Friendly Society Ltd
- Bus Employees' Friendly Society
- Cirencester Friendly Society Ltd
- Civil Service Healthcare Society Limited
- Compass Friendly Society Limited
- Cornish Mutual
- CUNA Mutual
- Dentists and General Society
- Dentists' Provident Society
- Druids Sheffield Friendly Society
- Ecclesiastical
- Engage Mutual Assurance
- Equitable Life
- Exeter Friendly Society Ltd
- Family Investments
- Forester Life
- Grand United Order of Oddfellows Friendly Society
- Health Shield Friendly Society Limited
- Healthy Investment
- Holloway Friendly
- Irish Public Bodies Mutual Insurance
- Kensington Friendly Collecting Society Ltd
- Kingston Unity Friendly Society
- LV=
- Marine and General Mutual
- Metropolitan Police Friendly Society Ltd
- National Friendly
- Newbridge Road Assurance Society
- NFU Mutual Insurance Society Ltd
- Paycare

- PG Mutual
- Police Mutual
- Railway Enginemen's Assurance Society Ltd
- Red Rose Friendly Society Ltd
- Reliance Mutual
- Royal London Insurance Group
- Scottish Friendly Assurance Society Ltd
- Sheffield Mutual Friendly Society
- Sovereign Health Care
- Sunderland Marine Mutual Insurance Company
- Teachers Assurance
- The Oddfellows
- The Shepherds Friendly Society Ltd
- Transport Friendly Society Ltd
- UIA (Insurance) Ltd
- Veterinary Defence Society
- Wesleyan Assurance Society
- Wiltshire Friendly Society Limited