

CEA position paper on the report from the Commission to the Council in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments

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The CEA, the European insurance and reinsurance federation, has closely followed the European Commission's work on the review of Directive 2003/48/EC "the Savings Directive", especially as regards the inclusion or not of insurance, pensions and annuity contracts in its scope. Indeed, CEA has closely participated in the European Commission's DG TAXUD ("EC") Expert Group on the same topic and actively contributed to the underlying discussions. As in the past, the CEA welcomes the opportunity present our views and engage in the discussions with the EC on this subject.

In light of the recently issued report (EC Report) and working document (EC Working Document) on the Savings Directive, the CEA would like to make the following comments.

I. The solutions presented by the EC

The CEA's figures¹ show that the level of cross-border life insurance activity remained completely stable on the first Savings Directive implementation full calendar year. Indeed, the average ratio of cross-border life insurance activity is 6.5% in 2006, following the stable trend registered in the precedent years of 6.67% in 2004 and 6.53% in 2005, year of the entry into force of the Savings Directive.

¹ CEA reply to the Expert Group on Taxation of Savings Questionnaire on Quantitative Elements, including the cross-border life insurance activity figures for the year 2006 in order to allow the analysis of the influence played by the Savings Directive in the cross-border behavior of the European Insurance Single Market (Annex 2 to MU 8102)

Neither the EC Report nor the EC Working Document referred to these figures since the EC's purpose was to provide past-related quantitative figures relevant for the past implementation of the Savings Directive and the life insurance activity was not covered by its scope. Nevertheless, it is the CEA's conviction that, in order to accurately and sustainably formulate future-related conclusions concerning the life insurance activity, consideration should be paid to the past evolution of the same activity under the Savings Directive influence.

Other reports quoted in the EC Report lead to the same conclusions:

- The Bank for International Settlements (BIS) states that *"notwithstanding structural breaks in the data, the share of withholding tax countries as a % of total deposits has decreased from 35.0% to 29.3% between mid-2003 and mid-2005 but stabilised after the introduction of the Directive."*
- EUROSTAT states *"Here again, the analysis does not show any significant change following the implementation of the Directive."*
- EFAMA also reports that *"the available data on UCITS and non-UCITS between 2002 and 2007 (...) shows that their share remained constant at 78% and 22% respectively."*

In light of the data provided when referring to the life insurance activity, and despite the lack of any quantitative influence of the Savings Directive on its correspondent level – as also confirmed by the data from other organisations – the EC concludes that *"Solutions based exclusively on exchange of information would also seem more appropriate for the purpose of ensuring that neither double taxation, nor avoidance of any taxation, arise in relation to life insurance contracts and pensions."*

Despite of this, the EC understands that *"However, until such purely information exchange solutions become fully operational between all MS, it could be worth considering transitional provisions extending the scope of the Directive at least to benefits from life insurance contracts providing no significant biometric risk coverage whose performance is strictly linked to income from debt claims or equivalent income covered by Art. 6 and which have characteristics (notably liquidity) allowing them to be marketed as substitute products to undertakings for collective investment."*

II. CEA comments

A) General principle

There is quantitative evidence that demonstrate the lack of correlation between the Savings Directive and the cross-border life insurance and pensions activity's correspondent level. Therefore the consideration of the same activity should remain fully separate from the Savings Directive.

The EC's conclusion on the life insurance and pensions activity consider the integrity of solutions based exclusively on exchange of information, in a clear allusion to Directive 77/799/EEC the Mutual Assistance Directive, that is to say, to a field formally separate to the Savings Directive.

On the other hand, the reasoning behind the alternative solution, which is clearly stated to be a second choice, remains unjustified by any concrete argument provided either in the EC Report or in the EC Working Document.

Given the above, the CEA believes that insurance, pensions and annuity products should integrally remain outside the scope of the Savings Directive. In this context, Preamble 13 to the Savings Directive should be kept, restricting its scope to savings income in the form of interest payments on debt claims and excluding all income relating to insurance, pensions and annuity products.

Life insurers have built IT systems, which reflect the different tax regimes across Europe and represent a major component in an insurer's investment and expenditure. If the proposed extension of the Savings Directive as a transitional measure were to go ahead, it would result in a significant burden disproportionate to its objective of ensuring *"that neither double taxation, nor avoidance of any taxation, arise in relation to life insurance contracts and pensions"*, and it would entail significant additional costs for insurers for no obvious gain or benefit for national tax exchequers. We doubt that an information exchange regime would add any benefit to the existing arrangements. There has been no thorough cost-benefit analysis that suggests that extension of the Savings Directive to life insurance will generate additional revenue. A more likely effect is that national administration will simply have to invest in more staff, IT systems and other measures to inspect the collection of exchange information, which could wipe out any increased tax revenue.

B) The special type of life insurance referred by the EC

The EC suggests Member States to consider transitional provisions extending the scope of the Directive to the benefits of *"life insurance contracts providing no significant biometric risk coverage whose performance is strictly linked to income from debt claims or equivalent income covered by Art. 6 and which have characteristics (notably liquidity) allowing them to be marketed as substitute products to undertakings for collective investment"*.

CEA would like to alert to the difficulties in defining and identifying the special type of product the EC suggests considering by means of transitional provisions, since:

1- Significant biometric risk is a diffuse concept

The concept of significant biometric risk is not a clear one and would generate intensive debate on what should be considered significant at the Member States level, in contradiction with a general objective of legal certainty also aimed by the Savings Directive Review. Furthermore CEA would require clarification on the EC proposed meaning of *significant biometric risk*.

2- Difficulties identifying the relevant life insurance contracts

As already stated in CEA's past contributions², CEA does not believe it would be possible to identify life insurance contracts whose performance is strictly linked to income from debt claims or equivalent income covered by Art. 6. This is in part because it is not easy to identify the element of any return received by an individual that arises from income from debt claims, i.e. "interest", for a number of reasons:

- i) Life insurance regulation does not define the appropriate asset mix for types of "fund". Instead insurers are required to hold balanced portfolios in order to manage the risks they take on. Insurance fund usually hold a mix of underlying assets that produce interest, dividends, rental income and capital growth. Even where one fund may predominantly hold interest-bearing assets, such as some pension funds, it would be difficult to distinguish it through a "fund" definition from a similar one that did not.
- ii) Income received by a fund legally and beneficially belongs to the life company. The policyholder holds a contract that requires the insurer to provide a defined return on surrender. The value of the policy on surrender will reflect a mix of capital gains, dividends, rental income and interest accrued over the life of the policy.
- iii) Policyholders do not usually have any right to annual payments of income, let alone interest, during the life of the policy. The exception is an annuity policy where the whole purpose of the contract is to provide a fixed or regular "income stream". However annuity income is not necessarily based on "interest" received in the fund for that policyholder, it can be made up of a mix of income types and capital from a variety of sources.

² CEA comments on the EC working document on the questions arising from a first analysis of the comments received on the Working Document prepared by the EC services on 14 March 2007 for the Expert Group on Taxation of Savings, dated 23 April 2008, under reference Annex 1 to MU 8102.

- iv) Even within unit-linked policies, where the underlying asset is more certain, the policyholder usually has the ability to change their investment choice without surrendering the policy. Therefore, unlike within the UCITS regime, there is no clear way of identifying whether the final returns on any particular policy are based wholly or predominantly on “interest”. As at surrender the final return could be based on a range of underlying assets, either the insurer or the policyholder has the flexibility to change their investment choices over time.

3- Only equal products should be regulated equally

A diversity of products with different characteristics offered in retail financial markets across the European Union meet different consumer needs. This wide choice of products presents consumers with an opportunity to select the product which suits them best.

CEA agrees that there should be a level playing field for equivalent products. However, this cannot be arbitrarily identified with regard to a single element of the value chain. Therefore, the issue of a level playing field can only be determined after the examination of all elements of regulation and products. Only equal products should be regulated equally and benefit from the same fiscal treatment, in line with the comprehensive argumentation concerning the ownership of the assets involved, the element of life risk cover, the solvency requirements and the consumers’ preferences already provided by the CEA in the past ³

Finally and apart from this fundamental issue, we have concerns as regards the right timing for analysing the Savings Directive extension to likely “substitute” investment products on consumers. Since most Member States are just beginning to implement Directive 2004/39/EC the MiFID Directive, it is too soon for any comparative analysis in this area. This lack of practical experience could call into question the rationale of a concrete tax review at this time. In general, CEA believes that frequent changes in the regulatory framework do not have the effect of fostering but rather of limiting consumer understanding of products.

Moreover, in different contexts, the European Commission Services have already stated that unit-linked life insurance products differ from UCITS in the following reference documents:

- The White Paper on Investment Funds published in November 2006 confirmed that uniform regulation of unit-linked life insurance products and UCITS falls into the trap of “comparing apples and pears” as they differ from each other.⁴
- The in-depth Study on Current Trends in Asset Management⁵, as released by the Commission Services in October 2006, did not confirm interchangeability between these products.

In conclusion, it is not appropriate to regard - at the EU level – life insurance contracts, namely unit-linked life insurance products, as substitutable to undertakings for collective investment.

III. CEA conclusions and recommendations

Taking these comments and facts into consideration the CEA would like to stress that:

- **Insurance, pensions and annuity products should integrally remain outside the scope of the Savings Directive. The opposite would result in a disproportionate burden for the industry.**

³ See chapter 3 of CEA position on the EC working document on the review of the operation of the Council Directive 2003/48/EC on taxation of income from savings, dated 28 September 2007, under reference MU 7175.

⁴ See the White Paper on Enhancing the Single Market Framework for Investment Funds, COM (2006) 686 final.

⁵ MARKT/2005/25/G.

- Only equal products should be regulated equally.
- It is too soon for any comparisons with the MiFID, therefore we would suggest the EC should wait with any such comparative analysis.
- There will be substantial difficulties in defining and identifying the special type of product that the EC suggests considering by means of transitional provisions.

About CEA

The CEA is the European insurance and reinsurance federation. Through its 33 member bodies, the national insurance associations, the CEA represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. The CEA, which is based in Brussels, represents undertakings that account for approximately 94% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of €1 122bn, employ one million people and invest more than €7 200bn in the economy.
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