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# Market Bulletin

Ref: Y5325

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| **Title** | Identifying regulatory and tax risk location(s) |
| **Purpose** | To remind the market of the importance of correctly determining the regulatory and tax risk location(s), clearly identifying who the (re)insureds are on risk and how to add this to the Market Reform Contract (MRC) |
| **Type** | Event |
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| **Date** | 11 February 2021 |
| **Deadline** | |
| **Related links** | Risk Locator guidance and tool<br>Crystal<br>Stamp Decision Tool<br>MRC (Open Market) Guidance<br>Lloyd's Wordings Repository |
| **Appendices** | Appendix 1: How to complete the regulatory risk location field in open market MRC and declarations off of lineslips<br>Appendix 2: Binding authorities<br>Appendix 3: Lloyd's regulatory tools to determine risk location<br>Appendix 4: Risk location examples |

**What is risk location and why is it important to identify?**

Risk location(s) determine the country/territory whose laws, regulations and tax rules apply to a (re)insurance contract. All parties involved in the placement and processing of a risk, including underwriters and brokers, should comply with regulatory and tax obligations.

For insurance, regulatory risk location is often determined by reference to several different parameters including, but not limited to:

- The insureds' domicile(s)/address(es).
- Interest/subject matter of insurance.
- The class of business and the perils covered.
- Situation/territorial scope.
- Location of the producing broker and/or overseas broker.
- Country/territory in which the vehicle/vessel/aircraft is registered.
- Country/territory in which the vessel is being constructed.
- Country/territory in which property is located.
- Country/territory in which regulated activities are undertaken.
- Country/territory of origin.

For reinsurance, the location of the original risk is generally not a factor in determining the risk location of the reinsurance and the number of factors is normally limited to:

- The reinsured's domicile(s)/location of the cedant.
- Location of the producing broker and/or overseas broker.

Please note that each country/territory has its own definition of risk location according to local laws. It is not the case that all the above parameters always apply in every country/territory; the parameters that apply will vary from country to country and for different classes of business.

Failure to identify the correct territories and compliance with relevant obligations may lead to:

- delays in premium processing
- invalid (re)insurance contracts
- non-compliance with local regulations
- inaccurate regulatory reporting and funding
- incorrect tax returns and tax payments
- (re)insureds, intermediaries or underwriters subjected to fines
- damage to Lloyd's international reputation
- potential loss of licences

Therefore, it is important that the market carries out the necessary due diligence to correctly identify the risk location(s) and keeps appropriate records of their decision making.

**Multiple risk locations**

Generally, the countries/territories for regulatory and tax purposes are the same when determining the risk location. However, it is possible for a single contract to have different regulatory and tax locations because they derive from different rules. For example, the regulatory risk location for moveable property insurance in the EU/EEA is the country/territory where the insured is resident, but the tax risk location is where the moveable property is normally situated.

Additionally, more than one country's/territory's laws, regulations and tax rules may apply to a contract or even the same portion of premium. Reasons why this may occur, include:

- multiple (re)insureds
- contradictory and overlapping regulatory and tax rules
- multiple risks insured
- involvement of intermediaries

In some countries/territories, the location of the insured's residence or business establishment creates a risk location irrespective of the physical location of the insured property. Consequently, if the insured property is in a different country/territory from the insured's residence or business establishment, there may be two countries/territories for both regulatory and tax purposes applicable to the same portion of premium.

**How to identify the risk location**

To help correctly identify the countries/territories for regulatory and tax purposes, the following initial questions should be considered:

- Does the contract relate to insurance or reinsurance?
- What is the nature of the risk, for example, is it property (fixed/moveable), a vehicle (aircraft, ships and motor vehicles), travel or another type of risk (e.g. general liability)?
- Who is the insured and where are they located?
- Where is the producing broker/coverholder based?

This bulletin will go into further detail on these points below.

**Risks relating to property**

Property risks can be either fixed (e.g. buildings, oil rigs, pipelines, bridges or other structures fixed to land) or moveable.

Where the property is fixed, the risk location is usually the country/territory in which the property is situated. For moveable property, the risk location is usually where the property is normally situated. However, for regulatory purposes, EU/EEA member states view the risk location as the territory in which the insured is resident, or its business establishment is located. Lloyd's recommends that Crystal (see Appendix 3) is reviewed in conjunction with this guidance as country/territory specific information can be found there.

If the contract insures fixed property at more than one location, and those locations are situated in more than one territory, there may be multiple risk locations.

In some territories, the location of the insured's residence or business establishment creates a risk location irrespective of the physical location of the insured property. Consequently, if the insured property is in a different territory from the insured's residence or business establishment, there are two territories for regulation and tax.

**Risk relating to vehicles**

The term "vehicles" include aircraft, ships and other vessels and motor vehicles. The risk location for vehicles may be determined by one or more of the following criteria:

- Jurisdiction in which the vehicle is registered
- Physical location of the vehicle
- Location of the residence or establishment of the insured

As one country's/territory's risk location rules might contradict or overlap with another's, there may be multiple risk locations. As with property risks, Lloyd's recommends that Crystal is reviewed for country/territory specific guidance.

For most jurisdictions (including all EU/EEA countries) the risk location for vehicles is determined by the registration of the vehicle insured. It is important that registrations are shown in **all** MRCs that insure such vehicles, either to identify the need for tax and regulatory compliance in such territories, or as confirmation that there are no risk locations in those territories.

**Other risks**

Risks that fall outside of the property and vehicle categories can be classed as "other". Examples of "other" risks could include miscellaneous financial loss risks and most third-party liability risks.

The risk location for these types of risks is generally the country/territory in which the insured is habitually resident, or its business establishment, to which the contract relates, is located. However, in some instances, the country/territory in which an insured peril or event takes place could create a regulatory or tax risk location.

Similar to property and vehicle risks, "other" risks can also have multiple risk locations. This may occur where the contract is taken out by more than one insured, for example, a contract could be taken out by a company's head office and it covers the entity's subsidiaries and/or affiliated companies that are located in multiple jurisdictions. Again, Lloyd's recommends that Crystal is reviewed for country/territory specific guidance.

## Identifying the (re)insured

An insured may be a natural person or a corporate entity, and their location may create a risk location. The location of a natural person is the country/territory in which they live, which is described as the country/territory of their "habitual residence".

The location of a corporate entity is generally the country/territory in which it is established[1]. Policies taken out by corporate entities can be more complex than those taken out by individuals. Where the MRC states that the definition of the insured includes any subsidiary, affiliate, associated company, branch, representative office, agency or other similar presence, then these entities should be recorded as multiple insureds under the MRC. This is the case even if a parent company arranges the insurance and pays the premium on behalf of its subsidiaries.

The MRC must clearly identify the principal insured and all other above mentioned "additional insureds" covered by the contract. These should be clearly listed, along with the country/territory in which each is located, to ensure that risk locations can be determined.

This requirement also applies to reinsurance business. Where reinsureds are located in more than one country/territory, they should be listed and the location of each must be clearly identified.

## Where is the producing broker/coverholder based?

In some countries/territories, the location of an intermediary involved in placing an insurance contract can create regulatory or tax responsibilities. Therefore, the location of intermediaries should be considered, and Crystal consulted for territory specific guidance.

## Premium apportionment

Once the regulatory and tax risk locations have been identified in line with the guidance above, it is necessary to apportion premium where risks are located in more than one country/territory.

There are no specific rules covering premium apportionment, or de minimis amounts for processing. The method used for any particular contract should be justifiable and documented in case of future audits conducted by tax or regulatory authorities.

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[1] Examples of establishments can include branches of companies, representative offices, factories, workshops, mines, oil and gas wells and drilling platforms that are fixed to the seabed.

Common apportionment methodologies used to allocate premium include:

- Staff number employed at different locations for insurances linked to employees, such as directors and officer's liability, employers' liability or corporate accident and health risks.
- The value of property at different locations for property or stock throughput risks.
- Turnover in relation to liability risks.
- Number of journeys or value of goods for goods in transit risks.
- The number of or value of vehicles for commercial fleet risks.
- The number of flight movements / landing and take-offs or value of hull for commercial aircraft risks.

Underwriters should adopt a common-sense approach to premium allocation and apportionment. Determining premium is in principle a commercial judgment. Consequently, if an underwriter decides not to take into account a minor exposure in a particular country/territory, as to do so would not be economic, it is reasonable that no premium is allocated to that country/territory. However, the underwriter must be in a position to justify why they have not charged a premium for a particular risk.

It is important that the apportionment methodology used to allocate premium is evidenced in the documentation as regulators and tax authorities may request to see and potentially question the method used.

**Next steps**

Prior to drafting the MRC, the market should ensure that the relevant due diligence is completed to identify the regulatory risk location(s) and ensure that the MRC clearly reflects the countries/territories identified. The correct stamp(s) should be used to identify whether the risk is being written by Lloyd's underwriters, Lloyd's Europe or both.

Care should be taken to ensure a contract does not have exposure where international sanctions apply, prohibiting or limiting insurance transactions. Please refer to the sanctions and financial crime information available in Crystal.

It is recommended that market practitioners remind themselves of the MRC guidance, which can be accessed through the London Market Group's website.

Additional guidance on the completion of the Regulatory Risk Location heading on the MRC can be found in Xchanging's market communication 2019/028 28 March 2019, in addition to appendices 1 and 3 below.

**Further guidance**

For further information, please contact:

**Lloyd's International Trading Advice**
t: +44 (0) 20 7327 6677
e: LITA@lloyds.com

**Lloyd's Taxation Department**
e: taxdept@lloyds.com

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**Appendix 1: How to complete the regulatory risk location field in open market MRC and declarations off of lineslips**

Under the heading Regulatory Risk Location, specific countries/territories should be listed out in the MRC, clearly identifying where all regulatory risk locations arise. In line with Xchanging's market communication 2019/028 28 March 2019, it is not sufficient to add "EEA" and/or "non-EEA". This is so that Xchanging has enough information to determine the Foreign Insurance Legislation (FIL) coding, perform tax checks and ensure regulatory reporting can be completed appropriately. Except on lineslips, where the terms "EEA" and "non-EEA" are used, Xchanging may raise a query back to the broker(s) to clarify the actual country/territory of the risk location. The use of these terms is permissible under the heading only if properly qualified. Please refer to the MRC (Open Market) Guide for examples.

Conditional statements under the Regulatory Risk Location heading are also insufficient. Statements such as, "Country X (unless something else is present somewhere else in the slip)" and "Based on flags if known" do not provide certainty for underwriters or Xchanging. The regulatory risk location(s) should be identified before the MRC is drafted.

Section E.3 of the MRC (Open Market) Guide states that where there may be more than one regulatory risk location applicable, a separate schedule which includes all of the relevant locations may be used. In this instance, under the Regulatory Risk Location heading, a broker can add 'as per schedule'. Where a schedule is used for more than one heading (for example where a schedule is used for 'Taxes Payable by...' headings and the Regulatory Risk Location heading) it must be clear in that schedule which MRC headings it relates to.

Care must be taken to ensure that any tax or regulatory allocation of premium across countries/territories does not conflict with any allocations for other purposes: for example, if 75% premium is allocated to the BD Pool Re Risk Code, but only 50% of premium to the UK, Xchanging will query this, delaying signing. Mistakes in calculations are a common cause of queries back to the broker.

Xchanging will use the identified regulatory risk location(s) to ensure that the correct stamp(s) have been used. If the stamp(s) have been used incorrectly, for example where the Lloyd's Europe stamp has been used for a risk located in a territory where Lloyd's Europe is not licensed, a query will be raised back to the broker.

Bordereau relating to bulking lineslips should contain a comparable level of information to the above, in a similar format to the standards applicable to binding authority bordereaux that are referred to below.

**Appendix 2: Binding authorities**

Copies of model wordings for binding authorities and coverholder appointment agreements can be found on Lloyd's Wordings Repository (LWR). These wordings and appointments contain a section on Territorial Limitations which is split:

9.1 The coverholder is authorised to bind insurances only for risks located in the territory(ies) stated in 9.1 of the Schedule

9.2 The coverholder is authorised to bind insurances only for insureds domiciled in the territory(ies) stated in 9.2 of the Schedule.

9.3 The coverholder is authorised to bind insurances with territorial limits not greater than those stated in 9.3 of the Schedule.

For the avoidance of doubt, 9.1 should be completed with the applicable regulatory and tax definitions of risk location that apply. For classes of business where risk location is determined by the domicile of the (re)insured, it therefore follows that 9.1 and 9.2 should be identical. It is important to note that for some classes of business 9.1 (risk location) and 9.3 (territorial limits of declaration) may differ: for example, a coverholder appointment agreement for EU/EEA vessels would be completed with the Binding Authority Registration (BAR) category Europe A in 9.1 but might show 'Worldwide' under 9.3 if those vessels are sailing worldwide.

Lloyd's Coverholder Reporting Standards state the core set of regulatory, tax, premiums and claims information coverholders and Delegated Claims Authorities (DCAs) are required to report into the Lloyd's market for all classes of business in all territories. Full details of the standards along with guidance on completion can be found in the user guide, which is available on the Reporting Standards webpage. Care should be taken to ensure that where there are multiple tax and regulatory risk locations applicable to a single declaration that these are all clearly identified in the bordereau along with the relevant premium allocations.

**Appendix 3: Lloyd's regulatory tools to determine risk location**

Pursuant to Lloyd's Minimum Standard 10, Lloyd's provides the market with a suite of regulatory tools to help identify the regulatory and tax risk location(s) and the correct stamp(s) to be used. The tools include:

- **Risk Locator Tool** – provides guidance on how to identify the legal risk location of an insured risk for tax and regulatory purposes.
- **Crystal** – Lloyd's international regulatory and tax database.
- **Stamp Decision Tool** – enables underwriters to determine whether a policy should be underwritten through Lloyd's underwriters and/or Lloyd's Europe based on the risk location.

Enhanced access to these tools, along with general guidance on how to identify the regulatory risk location, including class of business guidance, is available through Lloyds.com.

Online training about how to use the regulatory tools is available to Lloyd's market participants on the Lloyd's University market portal. Participants can sign up to access the portal here.

## Appendix 4: Risk location examples

**<u>Example 1</u>**
**<u>Marine – Ship's Hull & Machinery</u>**

### Details of the risk

- The insured is located in Qatar.
- The vessel is registered in Germany.
- The vessel ordinarily operates in Germany.
- Open market business.

Ship's Hull and Machinery is a risk relating to a "vehicle" and as such the risk location may be determined by the following factors:

- The country/territory in which the ship is registered,
- The country/territory where the ship is physically located, and
- The country/territory in which the insured is resident or has its establishment most closely associated with the risk.

Whether or not a factor is relevant will be dependent on the countries/territories identified.

### Analysis

**Qatar:**
Under Qatari law local risk is defined as real estate, properties or assets situated in Qatar.

The fact that the insured is resident in Qatar does not determine a regulatory risk location here. In this scenario the risk will not fall within the Qatari regulatory or tax regime.

**Germany:**
EU insurance law which is applicable in Germany states that "a risk is located in an EU/EEA member state if relates to:

- A building (and its contents if covered under the same policy) situated in that member state.
- A motor vehicle, ship, yacht or aircraft registered in that member state.
- A travel policy for four months or less taken out in that member state.
- For all other types of insurance, it is a risk of that member state if the insured is habitually resident in the member state or for a business or an organisation if the establishment to which the contract relates is situated in that member state."

As the vessel is registered in Germany the risk is located in Germany and subject to the German regulatory and tax regime. The fact that the vessel operates out of Germany is irrelevant to the risk location as this concept is not recognised under EU law.

As there is a single risk location and it is located in Germany, the risk must be written by Lloyd's Europe using the Lloyd's Europe stamp.

**<u>Example 2</u>**
**<u>Marine – Marine cargo (goods in transit)</u>**

**Details of the risk**

- The insured is resident in Hong Kong.
- The insured's goods are going to be in transit by sea from Hong Kong to South Korea.

For marine cargo risks, the risk location may be determined by the following factors:

- The country/territory in which the insured is resident, or its establishment is situated, and
- Where the goods are physically situated or being transported to and from.

Whether or not a factor is relevant will be dependent on the countries/territories identified.

**Analysis**

**Hong Kong:**
Under the Insurance Ordinance (Chapter 41), a risk is deemed to arise in Hong Kong, for specific classes of business, where there is:

- An insured in Hong Kong.
- A risk located in Hong Kong.
- A policy proposed, issued, signed, accepted, submitted or received in Hong Kong.

In the case of goods in transit business, a risk is deemed to arise in Hong Kong if it is underwritten in Hong Kong as described in the definition of Hong Kong insurance business.

As the policy will be issued to the insured who is resident in Hong Kong this would fall within the definition of Hong Kong insurance business. Therefore, under the Insurance Ordinance, the risk is deemed to arise in Hong Kong.

**South Korea:**
A risk is deemed to be a South Korean risk where the insured is a South Korean resident, as defined under the Foreign Exchange Transactions Act. This is an individual whose address or place of residence is within South Korea or a company whose main office is within South Korea.

As the definition of risk location for South Korea does not include the physical location of goods, i.e. moveable property, a regulatory risk location does not arise in South Korea. Therefore, in this scenario there is a single regulatory risk location, and this arises in Hong Kong. As such, the contract will be subject to the regulatory regime in Hong Kong.
This risk must be written by Lloyd's underwriters using their syndicate stamp.

**Example 3**
**Goods in transit with storage**

**Details of the risk**

- The insured is resident in France.
- The insured's goods are going to be in transit by land from Luxembourg to Belgium.
- The policy will also cover damage to the insured goods when they are in storage in Belgium for 90 days,
- The business is placed through a French coverholder.

For goods in transit risks, the risk location may be determined by the following factors:

- The country/territory in which the insured is resident, or its establishment is situated, and
- Where the goods are physically situated or being imported to and from.

Whether or not a factor is relevant will be dependent on the countries/territories identified.

**Analysis**

**France:**
EU insurance law which is applicable in France states that "a risk is located in an EU/EEA member state if relates to:

- A building (and its contents if covered under the same policy) situated in that member state.
- A motor vehicle, ship, yacht or aircraft registered in that member state.
- A travel policy for four months or less taken out in that member state.
- For all other types of insurance, it is a risk of that member state if the insured is habitually resident in the member state or for a business or an organisation if the establishment to which the contract relates is situated in that member state."

As the insured is located in France, the risk has French risk location and is subject to the French regulatory and tax regime.

**Luxembourg and Belgium**:
The EU rules mentioned above are applicable in Luxembourg and Belgium. The fact that the goods are going to be in transit by land from Luxembourg to Belgium is irrelevant to the regulatory risk location as this concept is not recognised under EU law, therefore this does not create a regulatory risk location in either of these countries.

However, as the policy is insuring goods that will be stored in Belgium for more than 60 days, a tax risk location will arise in Belgium because the moveable property is located there. Therefore, a premium apportionment will need to be carried out and the premium allocated to the goods in storage element of the risk will be subject to the Belgian tax regime.

As there is a single regulatory risk location and it is in France, the risk must be written by Lloyd's Europe using the Lloyd's Europe stamp.

**Example 4**
**Reinsurance**

**Details of the risk**

- The reinsured is a head office in the UK.
- The cover will also reinsure subsidiaries in Gibraltar and Israel.
- Open market business placed through an intermediary in the UK.

For reinsurance risks, the risk location may be determined by the following factors:

- The country/territory in which the reinsured(s) is established, and
- The location of the producing broker and/or overseas broker.

Whether or not a factor is relevant will be dependent on the countries/territories identified.

**Analysis**

**The UK**:
As the risk covers the reinsurance of an insurer's head office located in the UK, the contract will have a UK regulatory risk location.

**Gibraltar**:
As the risk covers the reinsurance of an insurer located in Gibraltar, the contract will trigger a regulatory risk location in Gibraltar.

**Israel**:
A reinsurance contract is considered an Israeli risk if it reinsures an insurer located in Israel. As the Israeli subsidiary is a party to the contract, the contract is subject to the regulatory regime in Israel.

In this scenario, all three territories create a regulatory risk location. As the risk is located in more than one territory, it is a global contract. The risk locations are entirely outside of the EU/EEA therefore, the risk must be written by Lloyd's underwriters using their syndicate stamp.

As mentioned earlier in this bulletin, it is necessary to apportion premium where risks are located in more than one territory.