FCA INSURANCE BROKERS

INSURING IN CANADA

Considerations for International Programs including Canadian Risks

It is a simple fact that more and more business operates across multiple territories. New technology, harnessed to the Internet, means that global commerce is now a routine reality.

Another global reality, however, is that each country regulates financial transactions, business and taxation within its own borders individually. No two jurisdictions follow the same rules in protecting their public and various stakeholders.

Cross-border commerce means additional compliance and regulatory considerations for insurance programs, considerations about which brokers must be well-informed and well-resourced if they are to offer effective advice and assistance. Today there is an ever-increasing pressure for accountability on governance and compliance, and even existing regulations are attracting renewed attention.

In Canada, there is continuing evolution of the application of taxes on cross-border insurance placements. The federal Canada Revenue Agency (CRA), generally responsible for a number of levels of taxation, has recently adjusted some of its most rigid interpretations of legislation, but specific criteria must still be met.

In order for an insurance placement to be compliant, the Canadian Excise Tax Act has two requirements:

- **that a risk is insured by a Canadian-licenced Insurer** (authorized by the Office of the Superintendent of Financial Institutions – OSFI - or one of the parallel provincial regulators), **AND**
- that where one or more brokers is party to a placement, a Canadian licenced broker must be involved and shown on policy documents.

Where these requirements are met, the Insured is protected by OSFI, which provides solvency and reserve supervision. Taxes are built into the premiums and are automatically remitted to the government without further client responsibility. The client is also automatically protected by additional regulations in place in case of Insurer failure.

If both Excise Tax Act requirements are <u>not</u> satisfied, however, clients automatically incur some serious tax and regulatory exposures:

- tax liabilities, at a minimum of 10% federally but with additional, and sometimes substantial, provincial tax levies
- liability for associated penalties and interest
- potential for unlimited legal and accounting expense, as well as consumption of the client's own time
- potential tax challenges on premium allocations between jurisdictions
- potential complication of claims situations or subsequent accounting treatment of settlement amounts
- lack of protection under Canadian system in the event of an Insurer failure
- responsibility to remit provincial sales taxes

For the non-Canadian broker, as well, a failure to point out and address these risks could create an exposure to their own security.

The CRA's interpretation of the Excise Tax legislation, which refers to the broker "*directly retained or instructed by the insured and not through any other broker or agent*" has been adapted to recognize business realities for complex placements. In determining the involvement of the licenced Canadian intermediary, auditors now look primarily at the broker shown on the policy documents, along with their examination of the Insurers in place. Assessments can go back up to four years.

> Example 1: *Manufacturer A has a head office in Houston and plants in six other US states. They also have distribution warehouses in Newmarket, Ontario and Trois-Rivieres, Quebec. Their insurance program is written through Insurer A who does not do business in Canada and so has simply accounted for Canadian premises under 'Unnamed Locations'. When the CRA sends Auditor Z to visit Manufacturer A, a question arises about allocated premiums and the coverage is reviewed. Manufacturer A finds themselves facing assessment and compounded penalties, plus mounting auditor and legal fees.*

> Example 2: *Enterprise B is domiciled in Atlanta with several branches, including one large operation in Winnipeg, Manitoba. B's insurance carrier is licenced in both the US and Canada. Carrier B issues a separate Canadian policy and records premium through their Canadian branch, with policy documents showing the lead US broker. When Auditor Z arrives for a routine GST audit, he also asks to see the insurance file and observes that there is no Canadian broker involvement. Enterprise B is assessed for Excise tax and penalties going back four years. The CFO's first urgent and irate call goes to their US broker while her assistant is still tracking down the accountant.*

To avoid the risks of unnecessary taxes and unlicenced cover, insurance purchasers and their insurance advisors should ensure that:

- **Clients' operations and locations in Canada are insured with Canadian-licenced Insurers, whose policy documents' evidence the Insurer's Canadian address, and**
- **A Canadian licenced broker is appointed, shown on the policy documents and involved in the pre-placement discussions to maximize the additional benefit of their local expertise**

The CRA does also recognize that risk managers speak directly for the client, that insurance purchasers may themselves not actually be located in Canada, and that more than one broker may participate in discussions.

But while satisfying tax requirements, the involvement of the local broker also creates much greater added value for clients and their out-of-Canada advisors. Local representation can play a substantial role in mediating with Insurers and surveying market availability. Where the client's Insurer-of-choice is licenced both at home and in Canada, coordination between underwriters ensures that coverage is consistent, meets local standards and that overall costs stay in line. At other times, it may be preferable to place separate coverage with specific Canadian Insurers; in that case, the Canadian broker still dialogues with those arranging coverage elsewhere to verify consistency.

Of course, business reasons may always dictate an unlicenced placement. In those situations, Canadian regulations require that both the client and broker report those placements by specific deadlines. The specific rules, and in some cases additional procedures required, vary widely between provinces, so expert advice is strongly advised. The client must also remit the relevant taxes due; there are substantial penalties for late filing or remittances.

Where policies are arranged outside of Canada, which cover both Canadian and non-Canadian risks (for example, an umbrella policy whose underlying risks include locations in Canada), the Insured is still responsible for self-reporting to the CRA for the Canadian portion of those policies. Otherwise, again, stiff penalties may apply.

On occasion, coverage is simply not available from Canadian-licenced sources, for example, if very large limits or particularly specialized coverage is required. In this case, clients may apply to the CRA for an exemption from the excise tax; if approved, the tax is refunded. Canadian broker associations have ongoing discussions with the CRA to facilitate the exemption-request process, streamlining the documentation required and sharing information about current market availability.

Most often, however, it is in the client's best interests to place a program meeting local requirements. Working with a broker experienced in these situations entails minimal extra inconvenience or cost to the client. On the contrary, clients then also derive a host of additional benefits:

- Avoidance of tax and regulatory uncertainty and resulting additional costs
- Direct, personal contact with client's local representatives
- Facilitate local service eg certificates, lease reviews, inspections etc.
- Language considerations (eg on parle français au Québec)
- On-the-ground familiarity with exposures and local insurance standards, with ready access to information
- Leverage with local Insurers and knowledge of the immediate insurance market
- Collection and remittance of provincial sales taxes, where applicable

The domestic broker also gains a trusted Canadian ally to help in supporting their client.

As professional intermediaries themselves, brokers recognize the real value of first-hand knowledge and expertise. With evolving Canadian rules and insurance markets, it will be crucial both for clients operating internationally and their brokers to seek out the resources that will help them maintain awareness of current situations. Insurance purchasers must partner with reputable and informed advisors to assure their best protection in insuring their Canadian risks.

About FCA Insurance Brokers:
FCA Insurance Brokers is an independent, privately-owned brokerage based in Toronto, Canada, specializing since 1919 in custom insurance solutions for commercial and corporate clients across Canada. Within the Canadian and international insurance communities, FCA professionals are active in leadership roles, focusing on compliance, regulatory and competitive issues. With its specialized cross-border practice, FCA is well prepared to work with brokers and their clients in other jurisdictions, who need to ensure that their Canadian insurance program is effected with full attention to value, effectiveness and compliance.

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