

## Dedicated funds and investment freedom

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The core of a private placement policy is the fund to which it is linked. Insurers distinguish between external funds, which are investment funds open to the public and selected by the policyholder from a list, and internal funds, which the insurer creates within its own balance sheet. Internal funds may be collective, in which case several policyholders participate in the same pool of assets, or dedicated, in which case the fund is reserved for one policy or for a small number of policies held by the same family. In a dedicated fund, an asset manager chosen by the policyholder and approved by the insurer manages the assets according to an investment mandate that the insurer grants.<sup>1</sup>

The degree of investment freedom is regulated on two levels. Insurance supervisory law limits the assets in which a unit-linked fund may invest, so as to protect the policyholder against risks that he cannot assess and the insurer against assets that it cannot value or liquidate. Tax law in the policyholder's country of residence limits the influence that the policyholder may exercise over the investments, so that the policy remains an insurance contract for tax purposes. The two levels pursue different purposes and do not always fit together. An investment that supervisory law permits for a wealthy policyholder may be harmful to the tax recognition of the policy in his country of residence, and an investment strategy that satisfies the tax authorities may be too narrow for the policyholder's needs.

The question of influence is the point at which most structures succeed or fail. A policyholder who may choose between several investment strategies at the conclusion of the contract and change the strategy from time to time is generally regarded as exercising a permissible choice. A policyholder who instructs the asset manager to buy or sell particular securities, who contributes assets in kind that he continues to manage, or who can use the policy to hold shares of his own company exercises a degree of control that

many tax systems treat as incompatible with insurance. In the United States, this question is the subject of the investor control doctrine. In Germany, the statute contains a special provision for asset-managing insurance contracts. Both are examined in the section on taxation.

Contributions in kind deserve separate mention. Many policyholders want to transfer an existing portfolio into the policy without selling it, so that no gains are realised and the asset manager remains the same. Insurers in Luxembourg and Liechtenstein generally accept such contributions, subject to their own investment rules and the examination of the origin of the assets. The tax consequences in the policyholder's country of residence differ. Some countries treat the contribution as a disposal that realises the gains accrued until then, while others treat it as a continuation of the investment. A contribution in kind of shares in a family company is particularly delicate, since it brings together the questions of investment control, valuation and liquidity in a single transaction.<sup>2</sup>

## 1 Notes

1. On the classification of funds underlying unit-linked policies (external funds, internal collective funds, internal dedicated funds), see the supervisory rules of the respective insurance supervisors, in particular the Luxembourg Commissariat aux Assurances. To be verified. ↩
2. On contributions in kind (apport en titres, Sacheinlage) to unit-linked policies and their tax treatment in different countries, see the practitioner literature. To be verified. ↩

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