ABI

Association of British Insurers
Submission to the International Trade Select Committee inquiry: UK-US trade relations
November 2017

Executive Summary

1. The Association of British Insurers (ABI) welcomes the opportunity to respond to the International Trade Select Committee's inquiry into the future of UK-US trade relations. This is a particularly important relationship as the US has the largest insurance market in the world.

2. The UK's insurance industry is the fourth largest in the world (after the US, Japan and China) and the largest in the EU. The ABI's 250 members include most household names and specialist providers who manage investments of £1.6 trillion, and in 2014, contributed £12 billion in taxes[1] to the UK Government. The UK insurance industry employs over 300,000 people,[2] two thirds of whom are based outside of London in 145 locations across the UK.

3. The UK's insurance and pensions sector is a valuable export for the UK economy, as it is the fifth largest trade by services exported, and has the second largest trade by services surplus of £12.8 billion.[3]

4. The US is an important market for British insurers, with 31% of the UK's export of insurance and pensions services going to the US in 2015.

5. Good regulatory cooperation and dialogue is essential between the UK and US markets given the increased globalisation of the insurance and reinsurance markets. This is particularly important during the current period of political change.

6. Ahead of considering negotiating an Free Trade Agreement (FTA), there are a number of practical, more immediate actions that should be focused on, which we cover in our submission: firstly, to reduce some of the regulatory uncertainty and emerging concerns as a result of the UK's upcoming departure from the EU; and secondly, issues that will be of concern regardless of our departure.

7. It is important for the UK Government to consider what plans will be put into place as a result of the UK no longer being able to use certain agreements secured by the EU, namely the EU-US Covered Agreement and the EU-US Privacy Shield, and how future UK-US dialogues would operate and interact within existing mechanisms.

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[1] PWC, Total Tax Contribution of the UK Insurance Industry (2014)
[2] Office for National Statistics licensed under the Open Government Licence v.3.0.
[3] Office for National Statistics; Pink Book (2016)

8. The UK Government will also need to engage with the US administration on proposed Tax reforms[4], in particular plans for an excise tax on insurance premiums (and other specified amounts) paid by a US corporation to a related foreign corporation or the alternative of an additional US income tax on such transactions. If either of these proposals form part of the final Tax reform it will have a detrimental impact on the insurance and reinsurance market outside of the US and has implications for the credibility of tax treaties with the US in the future.

The US insurance market is important for UK insurers

9. In 2015, the US boasted the largest insurance market in the world, in terms of premium volumes for both life and general insurance. It comprised 29% of global premiums and is three times bigger than the next biggest market, Japan, which made up 10%.[5] Comparatively, the UK made up 7% of the global market share.

10. The UK has a good trade relationship with the US. Both are open and liberal markets and so share similar outlooks on trade as there are few barriers to market access compared to other jurisdictions.

11. UK firms are able to establish a branch, for example in the US, while relying on the supervision of the UK authorities, however there is no general right to sell directly from the UK to the US, or vice versa.

12. Reinsurance collateral remains one of the few areas where there is currently a difference in treatment between the domestic and foreign reinsurers operating in the US. However, this is being addressed in the EU-US Covered Agreement.

13. The UK's insurance and pension sector is a valuable service exported from the UK, and in turn makes a significant contribution to the economy. In 2015, the UK exported $4 billion of insurance and pensions services to the US, while importing £146 million from the US. This is mainly due to London being a centre for global insurance trade, and as a result, this has given us a trade surplus of £3.9 billion in this sector.[6]

14. The US is the top destination for UK insurance and pension services exports. In 2015, the UK exported 31% of its insurance and pension services to the US, compared with 28% to the EU. This does not capture the numerous UK insurers who operate a subsidiary in the US. Similarly, a number of US insurers also operate in the UK.

15. It is therefore important, given the size and the scale of UK interaction with the US, for the UK Government to engage with the US now on developing a framework for regulatory and

[4] Deliberations are currently underway in the US House and Senate and so the actual details of the reform are still in progress.
[5] Swiss Re, Sigma (No 3/ 2016) – World Insurance in 2015: steady growth and regional disparities
[6] ibid

supervisory cooperation, addressing the potential impact of taxation proposals, and seeking an arrangement for the transfer of data.

16. This Committee has the opportunity to play a role in helping the UK Government in identifying the appropriate bodies to engage with in the US, i.e., at the State or Federal Government level. Similarly, it would be worthwhile identifying the priorities of the US to help inform the UK Government's approach. Unlike other financial service sectors, insurance is state regulated.

17. While the UK may want to negotiate an FTA in the long-term, it is important to note that these do not in general encompass financial services. We would therefore recommend that the immediate focus for the UK Government be to pursue regulatory arrangements and dialogues.

Establish an open dialogue and regulatory cooperation with the new US administration

18. As an initial priority, the UK Government should focus on maintaining and enhancing effective regulatory and supervisory cooperation with the US. This will be crucial in ensuring a mutually beneficial trade relationship for insurers going forward. For example, establishing mechanisms for close cooperation between supervisors.

19. One element of a framework of cooperation between two jurisdictions is the EU-US Covered Agreement. Negotiations for this concluded in January 2016, and it is currently going through the US Congress and an EU legislative process before being formally adopted.

20. The UK would currently benefit from the Covered Agreement, however upon leaving the EU, it will be important for similar levels of dialogue and cooperation, regulatory and between supervisors, to be established.

21. It will be essential that the UK Government seeks a similar arrangement for when the UK leaves the EU to ensure that: UK reinsurers are not discriminated against in the US; and further that we are not at a competitive disadvantage to EU reinsurers who would benefit from this Agreement.

22. The Covered Agreement sets out a framework under which the EU and US policymakers and regulators have agreed to cooperate in three areas of prudential insurance oversight: reinsurance, group supervision and exchange of information between supervisors.

23. The most important element of this Agreement for insurers is that it prevents the host regulator from imposing additional collateral requirements on foreign reinsurers that do not apply to domestic reinsurers. It is important to highlight that the UK does not impose collateral requirements on foreign reinsurers and so this Agreement is beneficial for UK insurers. It eliminates the amount of collateral that EU reinsurers are required to hold in the US (and vice versa), thus freeing this collateral to be invested by insurers.

24. The Agreement is a useful example of policymakers and supervisors cooperating for the mutual benefit of insurance and reinsurance policyholders and other consumers.

25. It will be important to consider how future UK-US dialogue is formally conducted, and how this would interact with existing mechanisms, such as through the existing global regulatory dialogue led by the International Association of Insurance Supervisors (IAIS).

26. The Joint EU-US Financial Markets Regulatory Forum, the EU's formal regulatory dialogue with the US since 2002, could also be used as a template by the UK for a framework for future dialogues with the US. This Forum has been used to exchange information and views on financial regulatory developments, with a view to identify areas of cooperation and potential cross border implementation issues.

Ensuring a workable flow of data between the UK and the US through a new arrangement

27. Data flows between the UK and the US are essential to many industries and the economy, including insurers. Having a robust framework is integral to making sure that personal and corporate data can be transferred in a safe and transparent manner.

28. It is imperative that (re)insurers are able to transfer personal and corporate data between the UK and non-EU jurisdictions, including the US, to carry out their daily business activities, enabling them to continue to offer services to individuals and businesses. There are many instances in which insurers may need to transfer data across the Atlantic; these include insurers needing to transfer data within their Group, which operates across the transatlantic, or if some data processing activities are outsourced. For example, a UK insurer may transfer the personal data of its customers to a US based cloud.

29. The US currently enjoys a special relationship with the EU in terms of data protection transfers. This arrangement, the EU-US Privacy Shield, sets a framework around which the US needs to protect personal data transferred from the EU. In return for US companies being able to access EU personal data, the EU is assured that their data is transferred in a safe manner to the US and it receives the right level of protection.

30. UK (re)insurers are able to use this arrangement while the UK remains a member of the EU. We would suggest that the UK Government should consider now what alternative arrangements should be put in place with the US to ensure that businesses activity is not disrupted once we leave the EU. Further, any future arrangement with the US would need to take into account the EU-UK data framework which may be agreed as part of the EU exit negotiations.

Understanding the implication of potential taxation reforms for the insurance industry

31. The UK has a long history of working closely and cooperatively with the US on a number of taxation issues, including on matters relating to tax evasion and tax avoidance. It is important that this relationship is continued, and that any measure for cross-border business taxation is appropriate.

32. The ABI has strong concerns over the current tax reform proposals that have recently been released by both Houses of the US Congress. The draft Bill released by the Chairman of The House Ways and Means Committee[7] contains clauses that apply an excise tax (currently at an expected rate of 20%) on insurance premiums and other specified amounts paid by a US corporation to a related UK corporation. As an alternative, a UK corporation can elect to subject the specified amount less deemed expenses to US income tax.

33. The Senate Committee on Finance Chairman's Mark released on 9 November 2017[8] includes a proposal whereby reinsurance payments paid to an affiliate would be treated as base erosion payments and subject to the proposed base erosion minimum tax. This tax would be computed as the excess of 10% (12.5% after 2025) of modified taxable income over regular tax liability. Modified taxable income is defined to be regular taxable income increased by the amount of the base erosion payment (reinsurance premium in this context).

34. As a result, the minimum tax is equal to 10% of the premium payment, slightly offset by the rate differential on otherwise taxable income. Effectively therefore the minimum tax operates as an excise tax, as the base against which it is applied does not reflect net income associated with the business, but simply the gross reinsurance premium paid.

35. If either of the proposed Bills are enacted as currently drafted, they are very likely to harm reinsurance and certain insurance transactions, which would be detrimental to the UK insurance market. In particular, the proposals would discriminate against the provision of insurance by foreign (re)insurers into the US. At present, the UK is one of the top five countries to which US risk is ceded by reinsurance.[9]

36. Such proposals may prove to be incompatible with the World Trade Organisation (WTO) principle concerning WTO members not being allowed to discriminate against imports or subsidise their exports. Further, the proposals would be expected to result in a significant drop in insurance capacity in the US, as well as increasing insurance prices for US consumers.

[7] H.R. 1 – 2 November 2017 and later amendments
[8] The Chairman's Mark of the Tax Cuts and Jobs Act – 9 November 2017
[9] Reinsurance Association of America (RAA) - Offshore Reinsurance Report – 2015

37. As mentioned at the outset, it will be useful to assess the US administration's priorities to inform the UK's approach, and if the proposals contained in either Bill or similar provisions[10] are enacted, it will be important for the UK Government to reiterate these concerns.

The ABI would be more than happy to expand on this submission at a future meeting of the Select Committee. Please contact Seth Williams via seth.williams@abi.org.uk or 020 7216 7354.

[10] Such as those provisions included in the Bill introduced by Senator Warner and Representative Neal in September 2016.