ABI Budget & Spending Review Submission

The ABI and the UK insurance industry wants to work collaboratively with the UK Government to deliver on its 'levelling up' agenda, unlock infrastructure investment and support the transition to net zero. This submission sets out a summary of the industry's key policy priorities across insurance and long-term savings and highlights opportunities where additional government policy investment and spending can help to improve resilience, boost competitiveness, and unleash growth across society. From unlocking £0.9 trillion that could be invested in the transition to net zero, to protecting households from flooding and delivering high quality jobs across the UK, the insurance and long-term savings industry stands ready to work *in closer partnership* with the UK Government.

The insurance and long-term savings sector is a productive and inclusive sector, adding £29.1 billion a year to the UK economy. Our sector manages investments of nearly £1.7trillion, paying over £16 billion in taxes, and employing over 310,000 individuals in high-skilled, lifelong careers, two thirds of which are based outside London. Our industry is supporting towns, cities and communities across the UK by enabling trade, risk-taking, investment and innovation as well as providing a vital final safety net for our customers. We are also a global success story, the largest in Europe and the fourth largest in the world.

Summary

- **Compete to succeed:** In post Brexit Britain the Government has a chance to grasp the nettle of reform and create a complementary tax and regulatory framework that drives competitiveness, attracts overseas capital and promotes the UK as a place to invest, innovate and inspire. The implementation of new global tax rules must not lead to UK insurers incurring a multi-hundred-million-pound tax bill in a year simply because of differences in the timing of the recognition of income and expense under financial accounting and tax accounting rules.

- **Unlock investment:** Now that we have left the EU, the Government can set the UK apart from its continental competitors if it embraces reforms that enable institutional investors to support the Government's ambitions both to 'level up' across the country and take a leading role in transforming our economy and society to reach 'net zero'.

- **Invest to maintain the UK's flood defence infrastructure:** Access to affordable flood insurance and flood defence investment has been transformed over the last decade but it is vital that the Government recognises the value of investing to maintain this critical infrastructure. A JBA report commissioned by Flood Re and the ABI has shown that every £1 spent on flood defence maintenance saves £7 in capital defence spending.

- **Tax – keep it fair and simple:** IPT is a regressive stealth tax that drives up the costs of necessary forms of protection, disproportionately affecting the least well-off financially while disincentivising those who have more and can relieve the pressure on the public purse, for example through greater uptake of private medical insurance. **The rate of IPT should be frozen.** As people live longer and retire later, the Government should consider changes to the **pension tax relief system** that support rather than penalise increased saving for later life – scrapping the Money Purchase Annual Allowance and fixing the 'net pay anomaly' which prevents low-income earners from receiving pensions tax relief on their contributions. The necessary changes to the normal minimum pension age should minimise complexity and confusion for savers and unnecessary competitive consumer churn; the current proposals from

government add enormous complexity for savers which will result in a more fragmented, expensive and less well understood system.

- **Strengthen Consumer Resilience:** The state has an important role to play in driving behaviours and helping markets grow to support consumer resilience. From incentivising social care products, tax clarity on protection in the workplace, funding the fight against economic crime and extending the scope of the Building Safety Fund, the Government has the power to better help consumers help themselves and markets address society's challenges.

Compete to succeed

Following the UK's departure from the EU, the Government has a unique opportunity to boost competitiveness, drawing in overseas capital and promoting the UK as a world-leading financial services hub and place to invest, innovate and inspire. However, this can only be achieved by creating a tax and regulatory framework that supports industry. Rates, tax base and compliance complexity should not adversely impact UK insurers in comparison to other countries. Two key areas for the Insurance and Long-Term Savings industry where a critical juncture is being approached to set the tone on competitiveness is in the work of the OECD Inclusive Framework and the implementation of IFRS 17.

OECD Inclusive Framework on BEPS (Inclusive Framework)

The OECD Inclusive Framework will strengthen the international tax structure if they can develop consensus-based rules in their two Pillar approach to the tax challenges of the digitalisation of the economy. However, members of the Inclusive Framework must ensure that there is equity and fairness in those rules and that they do not create distortive outcomes. For insurance, it is critical that the Government continues to support the exclusion of financial services from the scope of Pillar One. In Pillar Two our biggest concern is with the calculation of the effective tax rate (ETR) under the Global minimum tax rules. The rules as currently drafted are not appropriate for long tail and long cycle businesses, such as insurance. Our request is for 'deferred taxation' not 'carry forwards', as the latter will not work for insurance (nor extractions, pharma or oil and gas) and potentially saddles UK insurers with a multi-hundred-million-pound tax bill in a year.

The UK is a global (re)insurance hub, and many multi-national insurers are either head-quartered or have regional holding companies here. Therefore international, not just UK, aspects of the application of the Pillar Two rules will impact the UK insurance industry.

IFRS 17 Implementation

The introduction of IFRS 17 from the start of 2023 will significantly change the way that insurance technical provisions are valued. It is already clear that there will be large adjustments on transition to the new regime for many IFRS reporting insurers, with billions of pounds at stake across the industry in accelerating taxable profits or reversing previously taxed profits. We are liaising with HMRC on the tax treatment of transition through the industry working group.

It is important that the change in accounting standard does not lead to inequitable outcomes which disadvantage some industry members and the competitiveness of the UK industry. We request that the ABI's proposal for Insurance Groups to be able to elect for either a transition of 6 or 10 years is accepted. This proposal is in line with precedent changes to accounting and tax practice and it is also easy to understand and implement. It meets the objectives of

both industry and the Government by mitigating any significant short-term Exchequer risk while also ensuring that insurers do not face potentially permanent tax disadvantages.

Responding to future systemic risks

The scale and widespread impact of the pandemic has shown the difficulties in providing widely available and affordable cover to protect against systemic risks. The ABI set up a working group to constructively look at how the industry and Government can work together to ensure that UK businesses and households have greater resilience to future risks than has been the case with the Covid-19 pandemic. It is likely that some level of private-public partnership may be required to protect against these 'Black Swan' events. Of particular importance among these future risks is the threat of large-scale cyber-attack, and it is widely considered to be a matter of when, not if, this occurs. Cyber insurance is one of the fastest growing insurance products but research by the ABI indicates that only 10% of SMEs in the UK are adequately protected from cyber or ransomware attack. Recognising that insurers are often a first port of call for those seeking better cyber resilience, the ABI is working with the National Cyber Security Centre to promote cyber insurance guidance for SMEs.

We welcomed the announcement in the November 2020 Spending Review that HMT will review the Government's Contingent liabilities and we call on the Government to work with industry to look at solutions for how we address these systemic, societal risks in the future.

Unlock Growth & investment

As large-scale institutional investors, the sector could play a key role in investing in infrastructure, given the right regulatory and fiscal frameworks. Our members manage investments worth £1.7trillion. Recent KPMG analysis, commissioned by the ABI, has identified £95billion that could be unlocked through targeted reform of the Solvency II matching adjustment and risk margin. In July 2021 the ABI published a Climate Roadmap, setting out how the sector can achieve net zero, which identified an additional £0.9trillion which could be unlocked for investment in green infrastructure.

This scale of investment can only be realised with the right regulatory and fiscal environment. In post Brexit Britain the Government can set the UK apart from its continental competitors if it embraces reforms that enable institutional investors to support the Government's ambitions both to 'level up' across the country and take a leading role in transforming our economy and society to reach 'net zero'.

Reform of the Solvency II Regulatory Framework

We support the Government's aims in reviewing specific, targeted elements of Solvency II to spur a vibrant internationally competitive insurance sector, continue to protect policyholders and provide long-term capital to underpin growth. Now is the time to seize the moment and build a framework that meets the needs of the UK, while staying consistent with emerging international standards. Brexit combined with the current negative real interest rate environment offers an exceptional opportunity to reform Solvency II to adapt it to the unique nature of the UK market (rather than continue with a regime designed with 28 Member States in mind), substantially boosting insurers' capacity to provide affordable up-front lending for large infrastructure projects.

Independent KPMG modeling commissioned by the ABI demonstrates that, with no additional cost to the taxpayer, two specific reforms to Solvency II risk margin and matching adjustment can unlock £95 billion to help level-up our communities, help tackle

climate change and invest in the businesses of the future, while still upholding high levels of protection to international standards.

Key benefits of ABI proposals for Solvency II reform:
- **£60billion of funds** to invest in a broader range of green and socially useful assets through reform of the matching adjustment criteria.
- Unlock **£35billion** of capital backing the risk margin through a 75% reduction in the risk margin.
- £16.6billion generated in annual GDP – c.£190billion in additional GDP between 2021 and 2051 **without the Treasury having to spend a penny.**
- Direct benefit to consumers with a potential reduction in annuity premiums of up to 6%.
- An **extra £1.4billion** could be generated in tax receipts for the Exchequer by 2030.

The ABI's changes would still ensure the industry holds in excess of £138bn of solvency risk capital plus capital management policy, enough capital to withstand 1 in 200 years shocks (in line with Solvency II and international standards) and meet its obligations whilst managing its assets responsibly and safely.

Green investment
As institutional investors managing nearly £1.7trillion of assets, the industry also has a crucial role to play in supporting infrastructure and green assets. The current reviews of Solvency II and the Future Regulatory Framework for Financial Services are key opportunities to develop an operating environment that meets the UK's needs and enable the industry to unlock investment in green infrastructure, and support the Government's net zero ambitions, to a much greater extent.

Insurers and long-term savings providers are already seeing increasing interest in ESG investments as well as sustainable insurance products and ABI members are responding to meet this demand. From setting up Green Bonds and sustainable pension funds, to providing insurance for electric vehicles and supporting SMEs working on renewable energy projects, the industry is already innovating and adapting to the green economy.

We know c£2.7trn of investment is needed over 2021-35 to hit the UK government's Net Zero target (which assumes a 78% reduction in carbon emissions against the 1990 baseline by 2035). ABI member investment capacity could support up to one-third of this investment (c£0.9trn) from the c£2trn of our sector's new business and reinvestment flows – equivalent to c£60bn each year up to 2035. Unlocking the full investment capacity requires an increase in the supply of opportunities, reductions in complexity of the investment process and structuring the investment opportunities so they deliver financial returns in a way that meet the needs of long-term savings and pension providers. This can include bundling together opportunities to invest in innovative new schemes into hubs, to reduce the overall risk, and structuring schemes so they include an element of phased, predictable returns throughout their lifespan.

Despite the insurance and long-term savings sector being well-positioned to invest for the long-term and having capacity to deliver a significant proportion of the required Net Zero investment, barriers exist to full deployment of ABI members' investment capacity. Action will be required to address these constraints. There needs to be active collaboration and alignment between those prioritising investment opportunities (such as the Green Investment Bank) and

financial regulators, to ensure that where green investment opportunities are identified as strategic priorities for UK plc, regulators do not place unintended barriers on investing in them.

The current low interest rate market environment makes investments in large-scale infrastructure projects attractive for insurers, however, these market conditions are unlikely to persist indefinitely. ABI members face three broad categories of constraint on Net Zero investment: lack of supply of net zero transition opportunities to invest in; Complexity of the investment process; Financial attractiveness of investing in net zero transition opportunities. The Government has an opportunity to act now to ensure as much of the insurance sector's investment potential as possible is deployed.

Investing to maintain the UK's Flood Defence Infrastructure

We welcomed the Government's commitment to providing £5.2 billion in flood defence infrastructure investment between 2021 and 2027, although this falls short of the Environment Agency's estimate that £1 billion annual investment will be required up to 2065. We urge the Government to ensure that adequate annual investment is allocated to flood defence maintenance projects as part of the new funding cycle. We continue to call for a longer-term plan on increasing investment in flood defence maintenance to respond to the increased risk of flooding. As part of the original memorandum of understanding between the Government and the insurance industry for the establishment of Flood Re, the Government committed to providing 6-year funding cycles for capital spending. We continue to encourage the Government to set out a long-term funding settlement for flood defence spending.

A joint report carried out by flood research experts JBA, commissioned by the ABI and Flood Re, 'Modelling the Impact of Spending on Defence Maintenance on Flood Losses' identified the following:

- River flood defences provide protection to flood risk communities valued at £568 million a year. Without such defences the research suggests flood losses of approximately £958 million a year. With defences, inland flood losses reduce to £388 million a year, saving £568 million.
- Flood defence maintenance is very cost effective - for every £1 increase in maintenance spending almost £7 is saved in capital spending on defences. The report highlights that increasing current maintenance spending by 50% could extend the lifespan of defences by an average of eight years.
- Well-funded flood defences rarely breach. If a flood defence does not deteriorate to, and remain in, a poor condition, then it is unlikely to breach – which is why it is so important that flood defences are maintained in good condition. Conversely, if maintenance spending is cut, the lifespan of a flood defence reduces, and overall annual costs will rise.
- Based on the current state of existing flood defences, London and the South East have the highest estimated annual flood loss with 30% (£117. 4m) of the total, followed by the North West at 11% and central Scotland at 8%.
- With the country's surface water flood risk increasing, it is important to ensure that other flood risk management measures, such as clearing culverts, are also funded appropriately.

Tax – keep it fair and simple

The pandemic has placed an increased strain on the finances of individuals across the UK. The products and services our members provide play a key role in helping people protect the things that matter most and prepare for later life from providing an income in retirement to supporting those who have been flooded, from supporting individuals who are unable to work through illness or injury to drivers on the roads.

Freeze the rate of Insurance Premium Tax
Insurance Premium Tax is a regressive tax that disproportionately affects the lowest earners in our society and punishes hard working people who are doing the right thing in taking out insurance to protect their families, homes and businesses. The ABI is therefore calling for a freeze in the rate of Insurance Premium Tax (IPT).

A 2019 report by the independent Social Market Foundation (SMF) shows that IPT, which has doubled since 2015 to 12%, is costing households, on average, £223 per year. This is up from £87 per year in 2009/10. The lowest income families are being hit the hardest – they spend 4.1% of their post-tax income on insurance, compared to 1.6% for the highest income households. IPT now raises more revenue than beer and cider duty, wine duty, spirits duty or betting and gaming duties. Since 1994, the standard rate of IPT has increased more rapidly than tobacco duty.

Businesses are also losing out. Unlike VAT, businesses cannot claim back IPT so a higher rate of IPT translates into lower net profits for businesses and in turn, reduces the ability of a business to invest in becoming more productive or to take on new staff. Around half of what households spend on IPT is what businesses pass on to the consumer - this is the only way businesses can cope with this steep increase in tax on their products.

IPT also disincentivises the take up of products such as Private Medical Insurance (PMI). Throughout the pandemic, PMI providers worked closely with the Independent Health Network to support the NHS and increase capacity and will continue to play a key role in easing the burden on the NHS as the backlog builds.

A study undertaken well before the Coronavirus pandemic by the Centre for Economic and Business Research (CEBR) also calculated 200,000 people have moved away from health insurance and onto NHS care as a result of the increases to IPT. CEBR's findings provide an estimate that each 1 per cent rise in IPT would result in 31,500 private patients cancelling their cover and returning to the NHS. The financial impact of that change is a £21.5 million cost for the NHS.

An increase to the rate of IPT would impact those who continue to be most heavily affected by the Coronavirus crisis at a time of significant economic uncertainty and we urge the Government not to increase the tax.

Simplify Pensions Tax Relief
Pensions tax relief plays a crucial role in providing an incentive to save and acts as a supplement to help people achieve adequate income in retirement. However, years of tinkering and adjustments to allowances have led to the current convoluted tax relief system.

Two examples of this which urgently need addressing are the Money Purchase Annual Allowance (MPAA) and the net pay anomaly. Last year we welcomed HM Treasury's call for evidence on pension tax administration, and we urge the Government to consider utilising HMRC's Real Time Information (RTI) system to enable c1.75m low paid workers to receive tax relief on their pension contributions. It is our view that the RTI solution is best placed to rectify this issue as HMRC would use data it already collects via PAYE RTI to identify, after the year end, those who have contributed to a Net Pay Arrangement scheme and who have not earned above the personal allowance. It is also the only proposed solution which does not create winners and losers in its implementation.

The MPAA threshold of £4,000 is too low and penalises people for doing the right thing and continuing to pay into their pension if they have accessed funds. While our data suggests that pension withdrawals have not materially increased during the Covid-19 crisis, the continued economic uncertainty and insecure job market may mean that more people will have to access their savings to live. The threshold should be removed and replaced with further anti-recycling rules or at minimum be moved back to the original £10,000 to allow people to continue to save towards their retirement.

Any wider reform to the pensions tax relief system must be done in consultation with industry to ensure that unintended consequences and further complexity is avoided.

Further complexity will also be created by the proposed method to increase the Normal Minimum Pension Age (NMPA). The proposals to increase the NMPA unnecessarily add complexity, which would be baked in for decades and harm customer engagement, as well as distorting the market. We support the policy to increase NMPA to 57, but it would be undermined by the approach being proposed, as several million policies would have a protected pension age and still more would have the ability and incentive to acquire one. We urge the Treasury and HMRC to rethink the proposals.

Excepted Group Life Policies

Currently the government levies taxes on Excepted Group Life Policies held in discretionary trusts. The tax revenue generated from these arrangements is less than £1 million, whereas the cost [to trusts] of complying with completion of the relevant tax returns are estimated to be potentially three times this amount and the overall additional costs, including specialist lawyers and advice significantly higher still. These policies are not investments, for which the rules were originally designed and we ask that the Government consider removing these taxes on pure protection policies affecting approximately one million policyholders.

Strengthen Consumer Resilience

The state has an important role to play in driving behaviours and helping markets grow to support consumer resilience. From incentivising social care products, tax clarity on protection in the workplace, funding the fight against economic crime and extending the scope of the Building Safety Fund, the Government has the power to better help consumers help themselves and markets address society's challenges.

Social Care funding reform

The insurance and long-term savings industry has an important role to play in the future of social care funding in later life, and the Government's announcement of the Health & Care levy, supported by a cap, is a welcome step forward. Clarity and certainty are needed to create the right environment for our members to offer a **suite of products** to help people pay for care. Whilst it is unlikely that there will ever be a single insurance product that covers individuals for all their potential circumstances, the simpler and clearer the rules about what the state will provide, the easier it will be for insurers to respond to and support customers to meet the cost of care. Reform must also be long-term and provide stability, for decades not years. People need to be able to plan for the long term and have confidence that the system in place is robust and will remain largely unchanged for a reasonable amount of time.

The cap should be viewed as a solution to avoid catastrophic care costs and not as a way to enable a private market - a cap in and of itself will not prompt a market to develop but can serve as a foundation for people to plan and will hopefully stimulate greater demand for products. This is critical because at present there is a lack of demand for financial services products to pay for care which hampers product take-up and innovation, and people also routinely underestimate the cost of care. There is therefore a need for Government to deliver

a public awareness campaign, as promised in 2014, about how much individuals are expected to pay for their care costs, both now and in the future.

To this end, Government departments must work together to improve access to advice and guidance, with social care funding considered holistically as part of policy and financial planning for retirement. The Money and Pensions Service has an important role to play here and should include social care funding in its pension guidance responsibilities. Government should also consider offering tax incentives for financial products covering care which would encourage people to make plans for meeting care costs, which could help overcome behavioural biases.

Group Income Protection policies and Operational Remuneration Arrangements (OpRA)

HMRC's interpretation of the 2017 optional remuneration changes have resulted in adverse impacts upon the tax treatment of employee top-ups to group income protection policies. Group income protection policies play a key role in preventing workplace absence in the first instance through early intervention services, supporting employees unable to work through illness or injury, and helping workers back into the workplace. Although initial discussions with HMRC have led to a change from their original position of taxing both premiums as a benefit and claims as income, problems persist.

HMRC's current (although not widely publicised) position is that tax is applied to the employee but not the employer premium component and the corresponding part of the claim is tax free. This appears to create undesirable tax outcomes (e.g., part of a claim will be taxed as income and part not taxable), there appear to be unfavourable interactions with universal credit and messaging to brokers and individuals becomes complex.

This policy disincentivises take up of this valuable insurance against hardship arising from long term sickness/illness. We ask the Government to legislate to confirm that both employer and employee contributions are not a taxable benefit and return to the position before OpRA.

Ensuring funding for tackling economic crime

We are wholly supportive of the aims of the Economic Crime Plan. The Government proposes to impose a levy upon private sector organisations within scope of the Money Laundering Regulations from FY 2023/24, so it is vital that the Government makes a long-term commitment to support and share the funding burden to implement the Plan measures effectively. There must also be proper oversight and transparency of expenditure so that a full, proper and informed assessment can be made of the effectiveness of the Plan Actions and their impact upon the economic crime landscape.

Funding the removal of dangerous cladding and historic fire safety defects

The ABI has welcomed the additional funding for the Building Safety Fund to remove dangerous cladding. The ultimate solution to the issues faced by leaseholders living in high rise buildings with dangerous cladding is for remediation to be completed as quickly as possible. We are calling for the scope of the Building Safety Fund to be extended to cover wider fire safety defects, not just cladding, and for sufficient funds to be committed to ensure that defects in those highest risk buildings can be addressed as quickly as possible. The ABI has welcomed the progress of the Building Safety Bill through Parliament and we continue to engage with DLUHC on support for leaseholders living in buildings with dangerous cladding and on the Government's plan for professional indemnity insurance for those professionals signing off on EWS1 forms. To ensure the

successful implementation of the legislation it is essential that a sufficient multi-year funding settlement and resource is provided for the Health & Safety Executive, and the new Building Safety regulator, to carry out their additional regulatory and enforcement duties, which will be established by the Building Safety Bill.