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Emergency budget a mixed bag for insurers

TUESDAY's "emergency budget" in the UK had a mix of welcome and unwelcome news for insurers, reports Kassim Meghjee of Steptoe & Johnson.

On the positive side, lower corporation tax rates and lower employment tax deductions are welcome news. The rise in the rate of value-added tax (VAT), much of which is not recoverable by insurers, is not so.

Also of significance, insurance premium tax (IPT) rates will rise from January 4, 2011. The standard rate (which applies to most general insurance, including property, motor and medical) will increase from 5% to 6%.

The higher rate (which applies to travel insurance and certain insurance products sold alongside motor vehicles and some consumer goods) will increase from 17.5% to 20%. The higher rate was introduced in 1997 to prevent the possibility of buyers evading VAT by reclassifying part of the sale price as insurance (previously such sales had been subject to VAT at 17.5%, whereas related insurance had been subject to IPT at only 5%).

Given the chancellor's decision to raise VAT to 20%, the increase in the higher rate of IPT is to be expected. Life assurance and other long-term insurance products remain exempt from IPT (and VAT).

It is anticipated £500m ($749.4m) per year will be raised a result of the rise in the IPT rates. That is presumably on the assumption that consumers will continue to buy insurance products at the same rate as before, notwithstanding the rising costs.

* Meanwhile, looking back at last week's Mansion House speech by the UK chancellor, Bruno Geiringer, a partner in the insurance group at Pinsent Masons, says: "Scraping the Financial Services Authority [FSA] for banks is right but the case is not made for insurers.

"Regulators always say no one size fits all but here the Bank of England's [BoE] new prudential regulator would appear to be just that and there is a danger this one-stop-shop regulator will focus too much on banking.

"In many respects, these changes for insurers are cosmetic as the European Union [EU] Solvency II Directive will set out the required system of prudential regulation for UK and EU insurers. The new regulator will have to implement Solvency II just as the FSA has been doing.

"What might be interesting is if the Consumer Protection and Markets Authority starts to change the conduct-of-business rules again and insurers are caught up in having to budget for redesigning products and systems.

"Insurers have, in the main, survived the financial crisis largely intact and without the scary threat of widespread meltdown like the banks. Insurers have anti-contagion rules and less inter-dependencies than the banking industry, in which they are so prevalent.

"From 2013, Solvency II, which was drafted to benefit from the lessons learned from previous financial crises to strengthen insurers' capital base, will mandate the capital requirements for UK insurers.

"But for insurers, there has been great concern, from the general election onwards, they have been lumped together with the banks and the BoE will be unable, possibly through a lack of understanding about insurance or by being too fixated on the banks in future, to ensure a system of prudential regulation will be appropriately applied to the insurers.

"Changing the regulatory structure does not automatically bring better regulation and insurers must make good use of the consultation phase before these changes are implemented to put their case forward.

"Insurance is a good product and works well for most people. Insurers pay substantial taxes to the Exchequer. If the system of regulation for insurers in the UK is too aggressive, delivered at more cost and the tax regime is too high, the UK insurance industry will move abroad.

"We may then have a very fine regulatory system but very little of the insurance industry left in the UK to regulate."

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This article first appeared in *Insurance Day* and can also be found at www.IDnewscentre.com