Report of the Equalisation Reserves Working Party

Members

Ron Akhurst
Andrew MacNair
Kathryn Morgan (Chairman)
Sean O'Ceallaigh
George Orros
Jonathan Piper

Government's Consultation Document

In July 1993 the Government issued a Consultation Document on Equalisation Reserves for insurance companies' non life business. This followed on from comments made in the Chancellor's budget speech. The Document is a response to pressure from the UK insurance industry to allow tax free transfers to this type of reserve so that the UK insurance industry is on a comparable footing with other EC companies.

The Document is available form the DTI or Inland Revenue at a cost of £4.50. The main points contained in the document are:

- The Government can see the case for reserves to smooth losses arising from the random incidence of very large claims in particularly volatile classes of business

- The Government does not accept the need for insurance companies, as opposed to other types of company, to be allowed to create tax free reserves to smooth the economic cycle

- The Government would require a system that could be regulated so that tax liabilities could not be managed by the insurance company and so that the DTI could regulate it

In the introduction to the Document the financial Secretary to the Treasury is quoted as saying that "Given the overall fiscal position , I am clear that it would not be appropriate for the Exchequer to suffer a net cost from the introduction of such a scheme." It is not clear from the Document whether this would apply to individual companies or across the industry as a whole.

The Document ids vary much a consolation document in that it makes no recommendations as to a possible system, but instead asks for responses on a wide range of points. These are

General points:

- whether equalisation reserves should be required for certain volatile types of business

- if so, what these types of business should be ,and

- what form the regulation should take for it to be effective and for the compliance cost to be acceptable

On the calculation of the reserves

- how the business relevant to the reserve should be identified and isolated
- whether the model should provide for the disaggregation of premiums
- how the ceiling for the reserve should be calculated
- whether there should be different levels of ceiling for different types of business
- what level or levels would be appropriate for the ceilings
- how transfers into or out of the reserve should be calculated
- whether the transfer rules should include an element favouring transfers into the reserve above transfers out of it
- what limits, if any, should apply to new entrants to a particular type of business and to insurers who cease to carry on relevant business
- to what extent the calculation of underwriting profits or losses should make allowance for expenses
- what special features of funded business need to be recognised in the calculation of transfers into and out of the reserve
- whether a company should be required to set up one overall equalisation reserve for all its relevant business, or a separate reserve for each category
- how credit insurance should be treated

In addition the Government asks for responses to the suggestion that transfers to a reserve should be treated as deductible for tax purposes and that transfers from the reserves should be treated as taxable trading receipts.

The Response of the Profession

The Working Party is currently drafting a response to the Document which will be passed to the GIJC. We hope that this response will be circulated before or at the Convention to from the basis for a discussion there. The deadline for responses is the 29th October, which is, of course, during teh Convention. However, the DTI have indicated that any comments from the Convention which would add to the debate will be gratefully received and considered even if received after the deadline.

In the interim, if you have any thoughts about the response, please contact Kathryn Morgan at

Anglo American
Guild House
36-38 Fenchurch Street
LONDON
EC3M 3DQ

Telephone 071 337 3158
Fax 071 929 5464