Darryl Wall,
HM Revenue & Customs,
Financial Services Team, Room 3c/06,
100 Parliament Street,
London SW1A 2BQ

12 July 2016

Dear Darryl,

Part Surrenders and Part Assignment of Life Insurance Policies

Thank you for the opportunity to respond to the HM Revenue & Customs Consultation Document – Part surrenders and part assignments of life insurance policies, issued on 20 April 2016.

The Association of Financial Mutuals (AFM) is the trade body that represents mutual insurers, friendly societies and other financial mutuals across the UK. Between them mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland with annual premium income of £15.9 billion and nearly 38,000 employees.

A financial mutual is an organisation that supplies financial services products and which is owned by its customers or members. That means there are no shareholders to pay dividends to or account to, and a mutual can concentrate entirely on delivering products and services that best meet the needs of its customers.

We set out below our responses to the question posed in this document, and would be pleased to discuss any of the issues raised further.

Yours sincerely,

Chief Executive
Association of Financial Mutuals

Question 1 - Of the suggested options for change, what is your preferred option? Please explain why?

Our preference is for option 2 (the 100% allowance). This will be relatively easy for policyholders to understand and will be fairly straightforward for insurers to introduce. In our view this is also the option that is most in line with the stated HMRC desired outcomes that include:

- policyholder understanding
- changes being simple to administer and understand
- as few systems changes as possible for insurers
- prevents inappropriate taxation of economic losses

Question 2 - Do you have any comments on the assessment of impacts, either generally or in relation to the specific options set out?

The HMRC assessment of impacts seems reasonable. In addition to the impacts set out we would add the following:

- Option 2 (the 100% allowance) could lead to a small increase in the number of policyholders that withdraw more than the current annual cumulative 5% allowance (as a disincentive to limit withdrawals to 5% would be removed).
- Options 1 (taxing the economic gain) and 3 (deferral of excessive gains) are likely to lead to increased policyholder confusion. These options would also be likely to increase policyholder costs as more would seek independent advice.

Question 3 – Are there options beyond the three presented in this document that would better meet the desirable outcomes including ensuring that disproportionate gains could no longer arise?

We cannot think of an option better than option 2 (the 100% allowance).

Question 4 – For each option, do the insurers' current reporting rules require amendment in any way?

For options 1 (taxing the economic gain) and 2 (the 100% allowance), we do not believe the rules for reporting gains to HMRC will need to change. For option 3 (deferral of excessive gains) extra reporting could be necessary to provide HMRC with information on deferred gains.

Question 5 - What costs would insurers have to incur, for each option in:

- Changes to their current IT systems to allow gains to be calculated and reported on each basis,
- Advice to policyholders on the change to the tax rules, and
- On-going costs in support of the changes.

Option 2 (the 100% allowance) would involve the simplest system changes and therefore incur the lowest costs. Options 1 (taxing the economic gain) and 3 (deferral of excessive gains) would be the most difficult from a systems perspective and therefore likely to be the most costly.

The added complexity of Options 1 and 3 would lead to greater numbers of policyholder queries and also increased numbers of queries from independent advisers that are likely to be engaged by policyholders to assist them (particularly if option 3 was adopted). The more complex the adopted solution, the more additional training (and hence ongoing costs) would need to be given to members' staff, in order for them to be able to fully understand the more complex gain / taxation calculations.

Question 6 - What possible effects would each option have on the market for life insurance products?

The complexities of Taxing the Economic Gain or for Deferral of Excessive Gains is likely to have a detrimental impact on the market for life assurance products in that it would be difficult for policyholders to understand these options and hence require independent advice. The 100% Allowance Option is likely to be more easily understood by the market

Question 7 - What possible extra burdens would each option place on policyholders, and how might each option affect policyholder behaviour?

As explained above Options 1 and 3 may result in policyholders seeking advice to understand the position. Our view is that Option 2 is likely to be understood by policyholders.

Question 8 – What possible tax avoidance risks does each option present, and how can these be countered?

We do not see that there are significant tax avoidance risks from the options. The deferral of tax gains is already a feature of the current system.

Question 9 - Are there any circumstances in which the A/ (A+B) formula would not give rise to an appropriate proportion of the policy's economic gain?

In the example for option 1 (taxing the economic gain) quoted in the consultation paper (on page 10) the policyholder invested £100,000 and within the first 12 months made two withdrawals of £4,000 each leading to a gain of £82. In this situation the policyholder would have been better off making three withdrawals, £4,000, £1,000 and finally £3,000.

Question 10 - Is there a fairer method of calculating the part of the premium that would be deductible from the amount withdrawn when calculating the gain?

No comment. Our preference is for Option 2 (the 100% allowance).

Question 11 - Policyholders would need to request a policy value in order to know what gain any part surrender or part assignment will give rise to. Are there any difficulties for policyholders and insurers in accessing this information?

Option 2 (the 100% allowance) would mean policyholders would be less likely to need to request valuations when considering a withdrawal. Option 2 is therefore most convenient for policyholders and easier for insurers to administer.

Question 12 - In the example provided, the pre-determined amount, above which gains are deferred is 3%. What would be the most appropriate way to set this predetermined amount?

We are unable to comment on an appropriate way to set the pre-determined amount.

Question 13. Are there any circumstances in which this option would not give a reasonable result?

The result could be unreasonable in circumstances where the actual return on the investment has been less than the pre-determined amount and withdrawals per insurance year exceed 5% plus the actual return.

Question 14. Assignment of a policy may not crystallise all or even part of the deferred gains on that policy. What is the best way to ensure that assignees would be are fully aware of these deferred gains and the circumstances in which they may be crystallised?

No comment. Our preference is for Option 2 (the 100% allowance).