PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

First Delegated Legislation Committee

DRAFT TAXATION OF REGULATORY CAPITAL SECURITIES (AMENDMENT) REGULATIONS 2015

Monday 14 December 2015

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not later than

Friday 18 December 2015

STRICT ADHERENCE TO THIS ARRANGEMENT WILL GREATLY FACILITATE THE PROMPT PUBLICATION OF THE BOUND VOLUMES OF PROCEEDINGS IN GENERAL COMMITTEES

The Committee consisted of the following Members:

Chair: Steve McCabe

† Buck, Ms Karen *(Westminster North)* (Lab)
† Burns, Conor *(Bournemouth West)* (Con)
† Gauke, Mr David *(Financial Secretary to the Treasury)*
† Heappey, James *(Wells)* (Con)
Jenkin, Mr Bernard *(Harwich and North Essex)* (Con)
† McCartney, Karl *(Lincoln)* (Con)
McDonagh, Siobhain *(Mitcham and Morden)* (Lab)
† McDonald, Andy *(Middlesbrough)* (Lab)
† Marris, Rob *(Wolverhampton South West)* (Lab)
† Nokes, Caroline *(Romsey and Southampton North)* (Con)
† Rayner, Angela *(Ashton-under-Lyne)* (Lab)
Ryan, Joan *(Enfield North)* (Lab)
† Stride, Mel *(Lord Commissioner of Her Majesty's Treasury)*
† Tugendhat, Tom *(Tonbridge and Malling)* (Con)
† Vickers, Martin *(Cleethorpes)* (Con)
† Whately, Helen *(Faversham and Mid Kent)* (Con)

Alda Barry, *Committee Clerk*

† attended the Committee

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[STEVE MCCABE *in the Chair*]

Draft Taxation of Regulatory Capital Securities (Amendment) Regulations 2015

4.30 pm

The Financial Secretary to the Treasury (Mr David Gauke): I beg to move,

That the Committee has considered the draft Taxation of Regulatory Capital Securities (Amendment) Regulations 2015.

It is a great pleasure to serve under your chairmanship this afternoon, Mr McCabe. The regulations amend the existing Taxation of Regulatory Capital Securities Regulations 2013. They clarify the tax treatment of securities issued by insurers in order to meet new regulatory requirements designed to improve financial stability. Insurers, like banks, are required by regulators to hold capital instruments that will absorb losses in the event of the insurer experiencing financial stress. Those are known as regulatory capital instruments.

From 1 January 2016, the EU solvency II directive will introduce a new harmonised regulatory regime across the EU for insurers. This is designed to make insurers more financially stable, and the Government therefore support the principles behind it. Existing tax law predates the development of the new regulatory regime, so it does not explicitly set out the tax treatment of instruments compliant with the new regulatory standards. This uncertainty of tax treatment risks inhibits insurers from issuing new regulatory capital instruments, as well as deterring potential investors. To ensure that tax rules complement the regulatory reforms, where regulatory capital is issued in the form of debt securities these will be taxed as debt instruments. This does not include shares. This aligns with the treatment provided to banks and building societies that issue similar instruments to accord their own regulatory standards, as prescribed by the EU capital requirements directive IV.

This statutory instrument brings tier 1 and tier 2 regulatory capital securities issued by insurers for the purposes of compliance with the EU's solvency II directive into the existing tax rules for banks and building societies issuing similar securities. There are also consequential amendments and changes to update the statutory language used in respect of the taxation of corporate debt. These reflect updates made by the Finance (No. 2) Act 2015, which received Royal Assent on 18 November.

The Government are supporting the financial stability of the insurance industry by making these regulations. The amendment will take effect from 1 January 2016 in order to align with new regulatory rules. It will provide certainty of tax treatment for issuers and holders of such instruments. I commend the regulations to the Committee.

4.33 pm

Rob Marris (Wolverhampton South West) (Lab): It is a pleasure to serve under your chairmanship, Mr McCabe, as a fellow MP for the west midlands, which is becoming the powerhouse of the country.

I do not fully understand the detail of the regulations, although I think that I understand the overarching architecture and the need for financial stability. The regulations were foreshadowed in what are now section 31 of, and schedule 7 to, the Finance (No. 2) Act 2015. I have been somewhat hampered in my investigations, as has my admirable researcher, Imogen Watson, because the tax information and impact note was not available today. I trust that one has been published, but I could not get a copy of it. However, I did manage to get a copy of the 2013 version, which I think mirrors this, because similar regulations were introduced in 2013 to deal with RCSs for banks and building societies, as the Minister has said, and now they cover insurers.

We are again, as we were in the Finance Bill, in the territory of the loan relationships regime—that somewhat awkward wording is the technical term—with these regulations, which follow the European Union's solvency II directive, which will take effect on 1 January. Because that directive is being transposed via the Finance (No. 2) Act 2015 and these regulations, a new type of regulatory capital for insurers will be introduced for the purposes of complying with the equivalent of the Basel III requirements: 6% for tier 1 and 2% for tier 2.

As I understand it, these regulatory capital securities are hybrids; they have features of debt and equity. However, under the regulations the Government propose to tax them as debt and not as capital, despite their name. The 2013 tax information and impact note for the banks version of the regulations suggested that, were an entity to get into financial difficulty, the potential tax burdens would be lower. Although the regulations are welcome in terms of financial stability, my colleagues and I would like reassurance that they are not feather-bedding the insurance industry by allowing it to get away with paying lower tax than it should be paying by issuing capital instruments that are taxed as debt and not as capital.

4.37 pm

Mr Gauke: As I set out in my opening remarks, the regulations provide necessary amendments to the existing Taxation of Regulatory Capital Securities Regulations 2013. They are required to clarify the tax treatment of securities issued by insurers to meet new regulatory requirements designed to improve financial stability. The taxation of regulatory capital instruments should be absolutely clear and support regulatory principles of financial stability, but the existing regulations, which provide clarity to the banks, are silent on the tax treatment of similar securities for insurers.

The securities included in these regulations are akin to loans made to the business rather than capital investment. They are therefore more like debt than equity and the tax treatment should reflect that.

Rob Marris: I have two points. First, clarity is always welcome in tax legislation, even though one may be clarifying a policy with which one does not agree, hence our discussion. Secondly, I remain bemused, because the Minister said that regulatory capital securities are akin to loans and more like debt, but they seem to me to be the cost of doing business. Many businesses require capital to do business, and those in the insurance and banking sectors, in particular, and for obvious reasons, have greater capital requirements, which are statutory. Why are they being treated that way?

Mr Gauke: The hon. Gentleman is aware that there are capital requirements on financial institutions because they need instruments that will absorb losses in the event of financial stress. The position for insurers is decided at EU level, as I said in my earlier remarks. In circumstances of financial stress, the debt can convert to equity. It is not simply a matter of it being a cost of doing business that many businesses would experience; it is part of a regulatory regime to ensure that insurers are well funded in circumstances of financial stress so that that does not cause wider difficulties in the financial system.

The hon. Gentleman expressed a concern—I do not know whether it was probing or likely to drive him to oppose the motion—that the regulations could be seen as being soft on insurance companies. I reassure him that they are about providing clarity on the tax treatment of securities that have debt-like qualities and are required to be held for the stability of insurers. The original regulations approved by the House in 2013 are designed to support the EU regulatory frameworks for financial institutions by taxing returns as interest and ensuring that a tax charge is not triggered in the event that coupon payments are altered or suspended as a result of the issuer falling into financial stress.

I hope that those points are helpful and that the regulations will be supported by all members of the Committee.

Question put and agreed to.

4.41 pm

Committee rose.