

## **COMPLIANCE COST REVIEW**

### **LIFE INSURANCE : INFORMATION DUTIES OF INSURERS**

(Section 83 and Schedule 28, Finance Act 2001)

#### **1. Introduction**

##### **1.1 Background**

In line with Government commitments to reduce the compliance burdens that are placed on businesses, HM Revenue & Customs (HMRC) assesses the likely change in compliance costs whenever a policy is introduced or changed. The results of that analysis are published in a final Regulatory Impact Assessment (RIA) when the associated legislation is laid before Parliament. Where a consultation document is published during the analysis period, it is accompanied by a partial RIA.

This document summarises the outcome of a post-implementation review of the final RIA that was published in July 2001 for the above-mentioned measure by the Inland Revenue (prior to creation of the new department, HMRC). The measure was implemented with effect from 6<sup>th</sup> April 2002 for the majority of Insurers or 6<sup>th</sup> April 2003 for those who opted to report to the Inland Revenue by electronic media. A copy of the published final RIA is attached.

This review re-assesses the compliance cost analysis published in the original RIA and addresses two main questions:

- whether the estimates of compliance costs used in the RIA were correct, with hindsight; and
- whether the processes used to estimate compliance costs were appropriate and reasonable, given the circumstances at the time.

HMRC intend to use this review to improve the RIA process, and also to assist in future policy development and evaluation work in general. As such, the emphasis is on identifying learning points for future assessment of compliance costs. The review does not revisit the original policy decision.

#### **2. The published RIA**

##### **2.1 Description of the policy change**

Prior to the introduction of this policy change, insurers had to complete a certificate for each chargeable gain and send it to the Inland Revenue to process. Over a million certificates were processed each year. It was not known how many of these certificates were copied to individual policy holders as well.

This policy change removed the onus on insurers to notify the Inland Revenue of these chargeable gains in all but those cases where substantial gains had been made. The trade off for this was that insurers had to inform all policyholders of the chargeable gains made on their life insurance policies. These policyholders would pay any additional tax owing on these gains under the self-assessment tax regime.

It was anticipated that this would reduce the amount of work in Inland Revenue offices and give policyholders more information about their tax affairs. The insurance companies would incur some additional compliance costs (mainly set up costs) but would benefit from being able to report these transactions in a format of their choice rather than using a prescribed Inland Revenue form.

The trade supported the underlying objective of ensuring that policyholders had the information they needed to deal with their tax affairs. The main sticking point was not the introduction of this change but the timing of its implementation. In practice, the new policy changes took effect from 6<sup>th</sup> April 2002. There was however a grace period of one year for companies who opted to report gains electronically. The policy is still in force.

## **2.2 Anticipated compliance costs or savings**

The affected population was the life insurance industry of about 300 providers. The RIA reported compliance costs as taking two forms:

### *Non recurrent (set up cost)*

These were estimated to be in the region of £8.9million to £16.8million, made up of

- £50k - £100k each, for the 100 largest life insurers (using computerised systems).
- £20k - £30k each, for the 125 middle insurers (mixed).
- £10k - £20k each, for the 75 smallest insurers (manual systems).
- £1.65m – £2.55m in total, for the industrial assurance sector (door to door sales).
- a saving of £1m to reflect a concession whereby the Inland Revenue would take responsibility for producing and distributing blank certificates

### *Recurrent (ongoing cost)*

- These were estimated to be in the region of £1.725m to £2.4m, made up primarily of staffing costs for those firms without computerised systems. Additionally, a handful of companies needed to issue more certificates than before.

Most of these figures were based on information supplied by the trade in response to consultation.

## **3. Conduct of the review**

Each compliance cost review is conducted individually, and the review process is adapted to suit the particular circumstances applying in each case. The emphasis is on

making sure that the review itself - and any burden of consultation - are sufficient to meet the objectives of the review, but proportionate to the likely benefits.

In this case, the review was led by an HMRC project team supported by consultants. The staff in the review team were completely independent of those involved with the original policy change.

An essential element of the review was consultation with those actually affected, and consultants were commissioned to carry out a small number of targeted in-depth interviews with some of those affected and their trade bodies. The research was not intended to deliver any degree of statistical robustness (to do so would have been costly and impractical) but instead to provide indicative findings. Coupled with the consultants' own knowledge and expertise, this has allowed the research to identify the major issues and any associated learning points.

The external research was complemented by an internal review of HMRC paperwork and electronic files.

#### **4. Were the original estimates of compliance costs accurate?**

This section addresses two main aspects – the nature of the change in compliance costs (i.e. what did people have to do differently) and the monetary impact of that change (what did it cost or save them).

Question	Comments
Were the specific types of cost and benefit identified in the RIA (e.g. reading legislation, filling in forms, updating IT systems, saving time etc.) incurred?	In the RIA, the costs were broken down by the size of the insurance company involved and estimates provided for large, medium and small. Stakeholders report that their one-off costs were generally higher than predicted and, in some cases, substantially so. Views on ongoing costs were mixed, with some respondents agreeing with the RIA and others not. Those who disagreed were equally split between those believing the RIA to have been optimistic and those who felt it was pessimistic. But there was a strong feeling that correspondence with policy-holders (forecast to fall in the RIA) had not changed.
Were costs/savings incurred at the expected time?	Yes – subject to the above point about reductions in policyholder correspondence.
Were costs/savings incurred by the expected people?	Yes.

Were any other costs/savings, not identified in the RIA, incurred ?	No. The predicted reduction in assignments paperwork was achieved, although a subsequent change in 2003 had the same effect and it is difficult to isolate the two.
If the type of costs/savings varied from the original estimates, why was that?	The nature of the costs and savings was predicted correctly.
Could such variances have been foreseen at the time?	Not applicable.
What is the assessment now of the total value of costs and savings?	The recent consultation provided further data for a range of insurers. The research format (in-depth interviews) limited the sample size so a robust industry figure is not available. Overall the findings are mixed: one-off costs were higher than expected, and correspondence hadn't fallen, but apart from that the RIA was broadly accurate.
If different from the original RIA, what has caused the discrepancies?	The original analysis was based on data supplied by businesses at that time. The sample was small and respondents feel that with hindsight there was insufficient time to consider costs in the appropriate level of detail. The more recent research has identified some differences in accuracy between industrial and non-industrial assurance estimates (the former were more accurate).
With hindsight, were the compliance cost estimates accurate?	Set-up costs – no. Ongoing costs – yes.

## 5. Was the process used to estimate compliance costs reasonable?

Irrespective of whether the analysis turned out to be correct, the review has considered whether the original analysis was completed in a reasonable way.

Question	Comments
Who worked on the original RIA?	The RIA was a collaboration between tax policy experts, analysts and Better Regulation advisors.
Was an adequate audit trail maintained?	Partially. Staff have moved on and the original documentation was fragmented. There are some learning points but nothing serious.

<p>Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?</p>	<p>Yes, and Cabinet Office were contacted over a couple of issues because of the large impact on compliance costs.</p>
<p>How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?</p>	<p>The insurance industry were asked to supply estimates of compliance costs and these formed the basis of the estimates included in the RIA. However, there is no indication of how the figures that appear in the RIA were determined, and whether they were taken directly from the trade or used to inform an Inland Revenue model. As such, it is not clear how much effort was used to produce the final analysis. There is no evidence of specific problems, however.</p>
<p>Were the right people (both internal and external) consulted, and were their views reflected appropriately?</p>	<p>Respondents identified some concern that although trade bodies were consulted, independent insurers without representation may not have been. Although RIAs are put into the public domain, earlier discussion may have been limited to those with representation. Three insurance industry representative bodies made detailed representations about the partial RIA published on Budget day. These were reflected to a significant extent in the final RIA.</p>
<p>Did those who were consulted when the RIA was written express views on the reasonableness of the process?</p>	<p>No.</p>
<p>Have those who have been consulted now as part of this compliance cost review expressed views on the reasonableness of the process?</p>	<p>Yes. Comments made include:</p> <ol style="list-style-type: none"> <li>(1) The point about non-members of trade bodies being consulted less fully.</li> <li>(2) Whether enough time was provided during consultation for stakeholders to assess the situation and provide reliable numbers.</li> <li>(3) The corollary is whether, when businesses identified complexities, the Inland Revenue then had enough time to reflect that feedback in the final proposals.</li> <li>(4) Whether the process took account of insurers' needs to maintain good customer service to their clients.</li> <li>(5) Whether additional written guidance could have been provided prior to implementation.</li> </ol>

Were compliance costs estimated for all options mentioned in the RIA?	Yes.
Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?	Yes. Costs were shown for large, medium and small life insurance providers.
Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?	Yes – subject to the learning points in section 6.2 below.
Was there sufficient time to produce a robust assessment of compliance costs?	There is some doubt whether businesses were given enough time to produce reliable compliance cost estimates. This wasn't identified particularly at the time, but hindsight indicates that more time would have been helpful.
Were any assumptions reasonable, given the circumstances at the time?	Yes – subject to the learning points and commentary discussed elsewhere in this review.
Were any estimates of compliance costs caveated appropriately?	Yes – this was not a problem.
Were any risks correctly identified, addressed and explained?	No significant risks were identified.
Were any disagreements identified and reflected appropriately (e.g. if the figures were disputed by businesses, or if more than one set of figures was available)?	There is no record of any disagreement, although it is not clear from the surviving documentation exactly how the business analysis was fed into the final RIA, and whether the Inland Revenue added any additional analysis to fill any gaps.
Would HMRC do anything differently if the exercise were repeated, and hence could the RIA process have been improved?	Not in essence. This RIA was completed effectively and with consultation beforehand. More time for that consultation, and a better appreciation of the complexity of the change, and how businesses would adapt to it, would have helped. The learning points follow below.

## **6. Learning points arising from the review**

### **6.1 Learning points for future work in this policy area**

- If compliance cost estimates are requested from insurers in future, the consultation period should be extended if possible, to give them time to fully consider the impact. Obviously, if trade bodies are asked or volunteer to coordinate / collate analysis then that will take extra time too.
- Future RIAs should recognise that insurers need to maintain good customer service for their own clients. This may have an impact on the timing or way in which changes are handled.
- Additional written guidance, in advance of implementation, would have been welcomed.

### **6.2 Learning points for the RIA and compliance cost process in general**

- Where trade figures are used in an RIA, the text should make clear whether they have been used directly, or modified / extrapolated in some way. It is accepted that the source may have provided data confidentially, but some kind of commentary would always be helpful.
- Similarly, if data have been provided by a small sample, or a particular part of the industry, that should be noted in the RIA.
- Consultation will inevitably be biased towards those firms who are familiar with the issues and/or who have trade body membership. Specific targeting of other key stakeholders may be valuable.
- Better record keeping is essential, particularly covering the use of data provided by the trade.

## **7. The way forward**

Comments are invited on any aspect of this report or the wider compliance cost review programme.

The learning points are being fed into the policy development process directly if particular to one RIA or policy area. More generic recommendations are being collated across the review programme overall, and will be used to create an action plan for HMRC to take forward to improve the RIA process and development.

## **8. Contact points for further information**

For issues relating to life insurance tax policy specifically:

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For issues relating to the compliance cost review programme generally:

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**ANNEX : THE PUBLISHED REGULATORY IMPACT ASSESSMENT**