ENSURING THE HEALTH OF THE UNITED KINGDOM INSURANCE SECTOR

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Executive Summary

The United Kingdom (UK) insurance sector employs 315,000 people, contributes £35 billion to the UK Gross Domestic Product, pays almost £12 billion in taxes to the UK Government and is the largest insurance sector in Europe (TheCityUK, 2017; Abi, 2017, 2018). As such the sector is vitally important to the health of the UK economy.

In 2017, the UK exported approximately £6.9 billion in insurance and pension services to the European Union (ONS, 2017). However, the future relationship between the UK and the European Union (EU) remains unclear. Recognising that if the UK leaves the EU with 'no deal' or with a deal that does not secure the UK insurance sector's access to the EU market through adequate service provisions the sector will be impacted severely if action is not taken.

To mitigate any damage to the insurance sector and provide it with future growth opportunities the UK Government should look to expand insurance provider access to the Indian market. Overall insurance penetration in India is relatively low at a rate of 3.69% (IBEF, 2018) when compared to the global average of 6.3% (EY, 2018), meaning there is ample room for expansion.

Currently, however, there are restrictions on inflows of Foreign Direct Investment (FDI) into India that implies limited access to the market. Additionally, insurance companies investing in India are at risk of changes to regulation. Further still, India's history with investment treaties has made it a particularly difficult partner and combined with the difficulties associated with liberalising service sector regulation through treaties, there are a plethora of challenges.

The purpose of this paper is to provide a realistic proposal to improve access to the Indian insurance market for UK providers. This proposal will be based on India's current treaty practices and will take into consideration the historical context for these positions. Additionally, as negotiations are an exercise in compromise and understanding between all parties involved, this paper will also consider the political feasibility of the options available for the UK government based on Indian and the UK's political preferences. As such, this policy proposal contains the following sections: Section 2.1 provides a summary of current Indian restrictions that impact the UK's insurance sector. Section 2.2 contains a historical overview of India's treaty practice. Section 3.1 reviews the India-EU Broad Based Investment Agreement (BTIA) negotiations and then proceeds to highlight three political challenges from the negotiations that could also hinder future agreements between the UK and India. Finally, Section 3.2 argues that the UK government should consider the following two-part strategy based on lessons drawn from the previous sections.

1) Negotiating a Bilateral Investment Treaty (BIT) with India in order to bind currently applied regulations. To improve the feasibility of such an agreement it should contain the following clauses:

- A statement of the government's rights and obligations to regulate with a provision that clarifies that foreign investors have the same level of protection as domestic investors, not more.
- A clear definition for the application of the Most Favoured Nation (MFN) clause and a clear definition of what constitutes as an investment in the form of a closed list.

2) Long-term regulatory cooperation with the Indian Government in order to develop service standard harmonisation and thereby make future liberalisation more feasible.

Background

Section 2.1 provides an outline of the current restrictions that limit access to the Indian insurance market and compares these restrictions to India's General Agreement on Trade in Services (GATS) commitments. Whilst, 2.2 covers India's treaty practices and a brief background of their interactions with BITs and the Investor-state Dispute Settlement (ISDS) mechanism. This section concludes with a summary of the implications that these factors have on future negotiations.

2.1. Indian Insurance Market Restrictions

UK insurance providers have access to the Indian insurance market restricted in two ways. Firstly, the insurance sector is subject to a limit on foreign direct investment (FDI) of 49% (DIPP GOI, 2017) which increased from 26% after the Insurance Act 2015. This limit affects insurance companies, insurance brokers, third party administrators, surveyors and loss administrators. Despite the relative liberalisation, this restriction means that investors are limited to controlling only 49% of a company which thereby restricts access to the market for UK insurance providers.

Secondly, the Indian government has mandated that insurance companies must retain Indian management and control (DIPP GOI, 2017). Consequently, the aggregate investment by foreign investors cannot exceed 49%. This thereby forces foreign investors to compete with each other for stakes in Indian insurance companies as the total fixed amount of investment within the sector will be tied and limited to Indian investments.

It is important to recognise the current Indian FDI policy in relation to its General Agreements on Trade in Services (GATS). The GATS commitments represent the regulatory guarantees that a nation abides by. This means that nation would not regulate past the level they have made commitments to. Typically, when comparing applied policies to GATS commitments, the latter is much more restrictive (Hoekman and Mattoo, 2013). Understanding the difference between the two is important as a country could choose to restrict its current policy down to its GATS commitments without breaking the World Trade Organisation (WTO) rules. Furthermore, without the protection of some sort of agreement, an investor could be at risk of any domestic changes in rules.

The difference between the current Indian applied policy and that in its GATS commitments are quite substantial. The restrictions on FDI mentioned above all relate to the mode of supply regarding commercial presence (mode 3). In India's GATS schedule its limitations to market access and national treatment on mode 3 within the insurance sector are unbound (WTO, 1998). Therefore, India chose to remain free within this sector and is not bound to any commitment. As a result, India could decide to increase restrictions to any degree without breaking its commitments.

2.2. Negotiation Challenges: India, BITs and the ISDS mechanism

In order to ensure access for UK insurance companies to the Indian insurance market, it is also essential to understand India's current treaty practices and the context in which they have developed. As shall be shown below India's treaty practices have changed substantially since signing their first BIT in 1994 with the UK.

During this earlier period, most developing countries were open to signing BITs with the aim of increasing inflows of direct investment into their countries (Bonnitcha et al, 2017). India was no exception and between 1994 and 2003 signed a total of 56 BITs (Rajput, 2016). However, as with most developing countries, these agreements were signed whilst entirely overlooking the potential ramifications and costs (Bonnitcha et al, 2017).

In 2011, India experienced the now very contentious Investor-state dispute settlement (ISDS) mechanism. An Australian investor, White Industries, filed a claim against India for failing to provide 'effective means'. This claim was brought under the India – Australia BIT. Perhaps surprisingly, the claim was successful despite the 'effective means' clause not being present in this BIT. However, like most BITs, the treaty contained a Most Favoured Nation (MFN) clause which allowed the company to borrow the 'effective means' standard from the India – Kuwait BIT. White Industries was granted over AUD4million in awards by the arbitrators (White Industries Vs India, 2011). After this successful claim, foreign companies began making much more use of the ISDS against India (Ranjan et al., 2018).

Unfortunately, obtaining access to more favourable standards is not limited to the use of an MFN clause. Despite BITs at first, appearing to provide preferential advantage simply to companies in the partnering country, the reality is that multinational corporations can structure themselves to benefit from BIT coverage of a different nation (Poulsen, 2010). This is primarily due to the broad definitions used in treaties to describe investments. The impact of both of these issues is evident in India's response and its current treaty practices.

In 2016, as a result of the factors highlighted above, India responded in two ways. Firstly, by giving notice on all existing BITs or by asking for clarification on vague and broad terms. Secondly, by adopting a new Model BIT which aimed to strike a balance between protecting the rights of investors and the obligations of the government. Whether or not the new Model BIT, in fact, delivers on these aims is debatable (see. Ranjan, Anand, 2017). However, the main changes have important implications for any future agreement between India and the UK. The two main changes that the Indian Model BIT make are as follows:

- The MFN clause is exempt from the Model BIT
- It redefines the definition of investor/ investments in an attempt to limit 'treaty shopping'

These major changes to India's Model BIT are a direct result of their experience of investment treaties. This context also allows us a better understanding of the difficulties negotiators have

had in making new treaties with India as will be seen in the following section.
In summary, there are three key lessons to be taken from this section. Firstly, in order to grant better access to the Indian insurance market, India's FDI restrictions must be relaxed or removed. Secondly, as a minimum the UK should seek to bind India's applied policies removing the risk of tightening restrictions, thereby protecting access to the market. Thirdly, India has become sceptical of the fairness of BITs, in particular, the ISDS mechanism, and therefore any negotiations should aim to balance the rights of investors with government obligations.

Policy Options

Section 3.1 reviews the BTIA negotiations and describes three areas that may prove problematic in formulating an agreement with between India and the UK. Section 3.2. Then proceeds to provide policy recommendations incorporating lessons learnt from both the background section and the BTIA negotiations.

3.1. The BTIA and Current Policies

Since 2007 India and the EU have been in the process of trying to negotiate a bilateral trade and investment agreement. Unfortunately, there have been various issues that hindered the progress of the deal. Although not all of these issues would apply to a potential future UK – India negotiation[1], in order to successfully navigate negotiations with the Indian Government it will be vital to understand the problems that the EU and India have had in negotiating a trade agreement.
The first issue area, which relates to the previous section, has been the terms for investments. There have been disagreements between India and the EU relating to the ISDS mechanisms. At India's request, revisions were made by the EU, however, these changes went "against the spirit of the Make in India" movement (Dhingra, 2016). The revision stated that companies would need to pursue domestic cases before getting access to international arbitration. Yet, Indian firms would not have access to this mechanism. Thus, giving foreign firms an advantage over domestic companies as it would allow for potential discriminatory application of regulation – in this case, exemption. This, along with the issues discussed in the previous section would need to be resolved in order to negotiate a successful agreement.
The second issue area, without reciprocal liberalisation of sectors, such as information technology (IT), India will not liberalise access to areas such as the insurance sector (Dhingra, Datta, 2017). During the BTIA negotiations, there have been discussions about deregulation of the insurance sector, however, this has been a particularly complex issue (D'ambrogio, 2017). India has made it clear that part of striking any deal liberalising the insurance sector would require the inclusion of terms that liberalise the IT sector. This has been a problem within the negotiations as the EU does not recognise India as a data-secure country (ibid). As such, this means that if the UK wanted to negotiate the liberalisation of the insurance sector, it would either have to accept current Indian IT sector standards or work with the Indian government to develop its IT sector with the hope of then being able to liberalise in the future.
The third issue, the immovability of the UK regarding visas for Indian students and professionals (Dhingra, Datta, 2017 & Asthana, 2016). One of the major issues for India has been to secure a more liberal visa system for its professions and students (D'ambrogio, 2017). Politically this is a particularly problematic area as Theresa May has made it clear on multiple occasions that the UK visa policy for India will not be changed. Additionally, as of April 2018, 39% of the British public think that immigration levels are too high (Wells, 2018). This is down from 44% in 2016, nevertheless, even when taking a more nuanced look at public opinion, 42% of the public agree with current levels of access for people with high levels of education and 46% agree with current access for foreign students (ibid). May's statements and these statistics indicate that there is likely little political feasibility in providing a more liberal visa system which, for the time being, essentially blocks this avenue of negotiation.

3.2. Recommendations

In light of the points raised in the previous sections, the UK government, to ensure the health of the insurance sector, should aim to do the following:

1. Bind India's currently applied policies to ensure fewer risks to the UK insurance sector by guaranteeing current rates.
2. Increase access to the Indian insurance market by reducing FDI barriers.

In order to achieve these goals, this policy brief recommends the following two-part strategy.

[1] Some of the issues have revolved around tariff reductions, in particular that of wine, automobiles and agriculture. However, none of these are expected to hinder an agreement between India and the UK.

Firstly, the UK Government should negotiate a BIT with India in order to bind currently applied policies and thereby secure continued access for the UK insurance sector. To secure this deal, the BIT should provide a balance between investors' and the government's rights. Secondly, the UK Government should develop a long-term regulatory partnership with India in order to create regulatory harmonisation and thereby allow for greater liberalisation in the future.

3.2.1. Bilateral Investment Treaty

A BIT with India would bind currently applied regulations ensuring continued access to the Indian insurance market. As previously mentioned, India has become sceptical of BITs and the ISDS mechanism. In order to secure such an agreement, it would need to ensure a balance between the rights of investors and the rights of governments the investment treaty and therefore should contain the following provisions.

3.2.1.1. Statement of the government's obligations and rights to regulate

Vital to negotiating a treaty with India will involve ensuring not only the rights of investors but also the rights of the government. As such, the agreement should include a clause that clearly states the government's rights and obligations to regulate. For example, the Australia – Korea FTA contains a public interest provision which reserves the right of the government to deploy measures that will protect areas such as human health and the environment (DFAT, 2018). Of course, this provision should apply to domestic and foreign investors as to not discriminate. The clause should therefore also include a provision which clarifies that foreign investors have the same levels of protection as domestic investors but not higher levels (Kleinheisterkamp and Poulsen, 2014).

3.2.1.2. Clear definitions for MFN application and investments

Clearly defining these two areas will provide a limitation on the scope of unintended and expansive interpretations of foreign investor's rights.

Firstly, rather than excluding the MFN clause from the BIT like India has done in its Model BIT, a UK – India agreement should instead clearly define limits on its application. For example, the EU-Canada CETA has a provision that states that the MFN clause does not apply to procedures for the resolution of investment disputes (CETA, 2014). This would prevent cases like the aforementioned White Industries Vs India case. Thereby, improving the feasibility of an agreement.

Secondly, clearly defining what is meant by investments will also assist in preventing 'treaty shopping'. The Indian BIT Model does not provide a clear definition (Ranjan et al, 2018). The provision which states that to be an investment it must be significant for development makes the definition vague, as to how does one measure developmental significance? Instead, a definition should follow the Canadian Model FIPA (2004), which provides a closed list of assets that are included under the definition. An agreement between the UK and India should include a similarly structured list, however, it should not limit itself to the types of investments within the Canadian Model but instead construct a list based on its understanding of the term (Malik, 2009).

3.2.2. A framework to deliver future liberalisation through long-term regulatory cooperation

The current likelihood of forming an agreement that liberalises the insurance sector is very improbable. Most investment agreements simply lock in current levels of regulation and do not lead to liberalisation (Hoekman and Mattoo, 2013). This is mainly due to the cost of liberalising sectors being too high. In this instance, there are two negotiation avenues that the UK could take, highlighted in section 3.1. As previously mentioned, granting increased visa access to Indian professionals and students does not seem to be politically viable – the cost is politically too high. This leaves the option of the liberalisation of a sector that India is interested in such as the IT sector. As stated, this is problematic as the sector does not meet the current EU data security standards and therefore could pose as a danger for the UK.

This policy brief recognises these political concerns and therefore recommends that the UK begins long-term regulatory cooperation with the Indian Government. Processes that allow for the improvement of service regulations and cooperation are vital to market access negotiations (Hoekman and Mattoo, 2013). By cooperating with countries in service regulation the UK would help solve some of the concerns of regulatory quality (Adams, Capparelli, 2016). Therefore, the UK, by working with India, would over time develop a regulatory framework that would not raise standards concerns of the UK or India. This would then allow for the liberalisation of the IT sector and in turn, the liberalisation of the insurance sector. Thereby, providing a boost to the UK insurance.

Conclusion

With the future relationship between the UK and the EU beset with uncertainty, it is more important than ever to secure vital sectors like the insurance industry and ensure their ability to provide services abroad. As such pursuing agreements with countries like India will help provide security from de-liberalisation and thereby prevent further uncertainty. Although, trade agreements may not provide direct liberalisation of services it will still provide a better benchmark than a country's GATs commitments. Furthermore, understanding the context of a country's treaty practice can be useful realising impediments to an agreement. Additionally, providing regulatory cooperation with countries like India will allow for long-term liberalisation of sectors as governments can work together to improve regulatory processes.

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