Insurance Regulatory Capital

MAIDEN HOLDINGS, LTD

New proposal threatens Tier 1 tax status in the Netherlands

The Dutch government is planning to eliminate tax deductions for coupons on the Tier 1 securities issued by banks and insurers, after the European Commission said that their tax treatment could raise state aid concerns. Last Friday (June 29th), the Dutch government put forward a proposal that would mean that coupon payments made on Additional Tier 1 (AT1) and Restricted Tier 1 (RT1) instruments would not be tax deductible beginning January 1st, 2019, thus mirroring the tax treatment of dividends paid rather than loan or regular bond coupons. In other jurisdictions, Tier 1 coupons are accounted for as a business expense and as such, are accounted for out of gross rather than net profits.

The proposal still needs approval by the Dutch parliament, but the planned tax changes signal a shift in thinking that would move the country away from the position of several other European member states, in which banks and insurers are still able to deduct tax from their Tier 1 coupon payments. The Dutch government said that it was looking to update the tax rules having received a letter from the European Commission on June 22nd. In the letter, the Commission said that Dutch rules on the tax treatment of Tier 1's were designed to give a specific benefit to the financial sector and could therefore be in breach of European rules on state aid.

The Netherlands is not the first country in Europe to have put forward a proposal to outlaw tax deductibility for Tier 1 coupons. In 2017, Sweden placed a ban on tax deductions for interest on regulatory capital instruments issued by financial institutions — which also included Tier two bonds. But banks and insurance companies in countries such as Denmark, Ireland, Italy and the UK still benefit from government rulings that free them from having to pay tax on interest payments for Tier 1 capital. There are no specific laws to this effect in countries like Belgium, Germany and France, where financial institutions benefit from tax deductibility for AT1's and RT1's because the structural features of the instruments align them with the domestic tax principles for debt rather than equity.

The planned changes to Dutch tax law would likely constitute a "tax event" as described in most Tier 1 bond contracts, meaning that issuers would have an opportunity to redeem outstanding AT1 and RT1 instruments (usually at par). This prospect has led to significant volatility in the pricing of outstanding Dutch AT1 and RT1 debt which had mostly been trading at a significant premium to par before the announcement. Soothing comments from issuers including ING, ASR and Vivat have calmed investors' worries about imminent par calls but we expect the landscape to remain volatile through the remainder of the year.

At Insurance Regulatory Capital (IRC) we continue to believe that insurance issuers should fully utilise their Tier 2 and 3 buckets before considering issuing more expensive and longer dated (less flexible) RT1 debt for now. If other European governments follow the Netherlands lead we could see a significant widening in the after-tax cost of issuing RT1 and Tier 2 debt.

Maiden and IRC uniquely offer a seamless Continuum of Capital solution demonstrated by our desire to invest in small and medium sized insurers.

Our vision is to offer tailored solutions for both subordinated debt and reinsurance with a single review process for both products. We seek to establish long term capital partnerships with medium sized insurers offering operating flexibility through the provision of just-in-time capital.