

Response from the Financial Services Consumer Panel to CP190: Minimum Capital Requirements for non-life insurers

1. The Consumer Panel generally supports the FSA's proposals to strengthen the capital regime for non-life insurers. We note the rate of failure amongst non-life insurers in London over the last twenty years and agree that it is sensible for the FSA to start implementing Solvency 2 and the reinsurance directive now rather than waiting for the conclusion of international discussions, which could inevitably take some time.
2. That said, we do have some comments on points of detail in the proposals outlined in CP190. Firstly, we note that it is proposed to derive the new risk based minimum regulatory capital requirement from a formula that best fits larger well-diversified firms, thereby running the risk that smaller less well-diversified firms will hold too little capital. We understand that, if the risk-based capital calculation is to be kept simple, the alternative formula – one that best befits the smaller less well-diversified firms – would result in the larger firms being required to hold an onerous amount of capital (or having to apply to the FSA for waivers from the rule).
3. We note that it is proposed to address the risk that the smaller less diversified firms will initially hold inadequate capital by giving them individual capital guidance where necessary. However, we assume that, under the FSA's risk-based ARROW regime, it could take some time for firms to be reviewed and for individual capital guidance to be given. Under the ARROW regime, we would think it more logical to set capital requirements that best befit the smaller firms who are not subjected to such intense supervision and to grant waivers from the rules for firms that are supervised more closely. The fact of the matter is that the FSA is better placed to grant waivers for the larger firms than it is to determine appropriate individual capital requirements for the smaller firms.
4. That said, we do not see why the formula cannot be calibrated so that it suits both large well-diversified firms and small less diversified firms alike. For example, the default could be the formula that best befitted small firms with the larger firms having the option to use the more sophisticated formula where they could justify a lower capital requirement. Alternatively, while we appreciate that it would make the calculation more complicated, we would support the development of a more sophisticated formula, one that produces a capital requirement which varies proportionately to the risk carried by the firm.
5. The Panel supports the proposal that non-life insurers will initially report privately to the FSA their capital position compared with their new risk-based minimum regulatory capital requirement. The Panel is generally in favour of openness and transparency. However, it accepts that, until holding capital at least equal to risk-based minimum regulatory capital requirements becomes a firm prudential rule, non-life insurers should not be required to include details of their individually determined capital requirements in regulatory returns available to the public. This, we understand, reflects the position in respect of banks. The Panel notes that insurers will still be required to show their Solvency 1 position on returns during this transitional period. No doubt the FSA will be monitoring firms' actual capital positions during this period and will intervene in the event that financial problems develop.

December 2003