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Current Issues in General Insurance

CP190: An Update
Wendy Hawes
26 April 2004



Agenda

- Main issues raised in CP190
- Feedback
- Policy Timetable
- Internal Timetable
- Discussion

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Main issues raised in CP190

- Current prudential regime in UK
- Proposed approach
- ECR/ICA/ICG????
- Definition of capital
- Key questions asked in the consultation paper

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Main issues raised in CP190: Current regime

- EU statutory minimum solvency margin
- Based on a proportion of premium or claims incurred
- No allowance for risks associated for different classes of business written
- No allowance for quality of capital
- No transparency of financial strength
- Rule of thumb: 2 x RMM although dependent on type of business written

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Main issues raised in CP190: Proposed approach

- Move to a more risk based capital approach
- Made up of formulaic based Enhanced Capital Requirement (ECR) and more subjective Individual Capital Guidance (ICG)

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Main issues raised in CP190: ECR/ICA/ICG???

- ECR=Enhanced Capital Requirement: a formula based approach
- ICA=Internal Capital Assessment: a company's own assessment of capital
- ICG=Individual Capital Guidance

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Main issues raised in CP190: Definition of capital

- Innovative tier 1 capital
- Disclosure of surplus capital
- Preference shares – limit 50% of tier 1 capital must comprise ordinary shares and retained earnings

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Main issues raised in CP190: Definition of capital

- Tier 2 (subordinated debt) – no distinction between perpetual securities and subordinated debt
- Tier 2: coupon deferral on breach of FSA requirements

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Main issues raised in CP190: Key questions

- Do you agree the introduction of a more risk-based capital approach is appropriate?
- When do you think ECR should be introduced as a prudential requirement?
- Have we struck the correct balance between practicality and sophistication?
- Is our approach to calibration reasonable?
- Is the scope of the ICAS regime appropriate?
- Is framework practical and appropriate?
- Comments on timetable

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Feedback

- Risk based approach welcomed by industry
- ECR calibration too crude (although data limitations acknowledged)
- Broad agreement of ICAS framework
- Concern over super equivalence
- ECR should not become a hard rule

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ECR: Misconceptions

- Calibration to BBB credit rating
- Penalising small firms

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ECR: A prudential requirement?

- *Feedback:* respondents in favour of a 'soft' test ahead of Solvency 2
- *FSA initial view:* sympathetic towards respondents' views

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Feedback: Calibration

- *Feedback:* respondents recognised the ECR was an imprecise measure and raised specific issues
- *FSA initial response:* no change to overall calibration of ECR, but investigating specific issues

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Feedback: Calibration – specific issues

- *Feedback:* respondents made comments on a range of specific issues
- *FSA initial response:* considering more granular capital charge factors for bonds and reinsurance debtors, class 8 business and look through for money market funds

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Feedback: ECR Reporting

- *Feedback:* respondents favoured private reporting of ECR until it became a prudential requirement
- *FSA initial response:* private reporting until ECR becomes a prudential requirement. Currently designing a standard form for consistent reporting

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Feedback: ICAS framework

- *Feedback:* respondents were supportive of the ICAS framework, but emphasised the need for it to be practical
- *FSA initial response:* developing our approach to ICAS, which will be integrated with RAF process

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ICAS process – firm submission

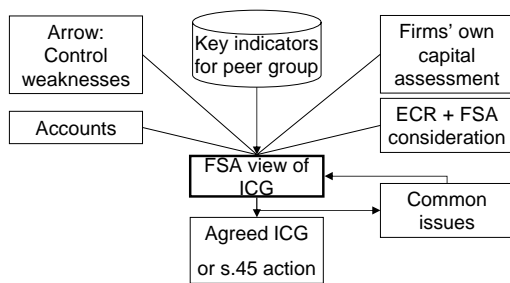
- Firm undertakes stress and scenario testing/capital modelling on its business plan
- Firm identifies issues not covered by modelling and qualitative issues
- Firm submits ICA to FSA summarising work above

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ICAS



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Feedback: ICAS

- *Feedback:* Guidance (PRU 2.4) on ICA's helpful. Unclear as to how FSA will approach capital models
- *FSA initial response:* Capital models will be tested for 'reasonableness' by FSA.

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Feedback: Group ICAS

- *Feedback:* Respondents believed that the approach to group ICA's was clear, but may not address possible diversification benefits
- *FSA initial response:* continue to consider issue of diversification benefits, but onus remains with firm to demonstrate such benefits

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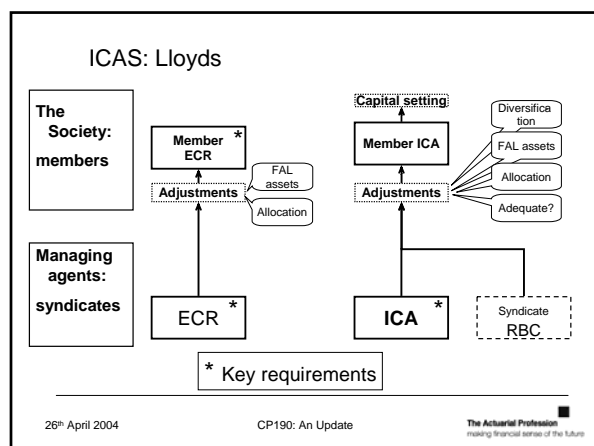
Feedback: Timetable

- *Feedback:* Many firms considered timetable reasonable, although some believed it was ambitious
- *FSA initial response:*

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Policy timetable

- ECR reporting (privately) very soon as at 31 December 2003 and will form part of the ICAS reviews from July 2004 (standard template / Excel spreadsheet) to be used
- And, ECR reporting (privately) with 31 December 2004 returns
- Also soon asking for questionnaire to be completed describing progress and approach to ICA assessments
- PRU rules in 'near final' form published mid-year 2004
- Revised reporting forms consulted on in 'miscellaneous' CP mid-year
- Later reviewed more fundamentally as part of FSA data needs project and incorporated in SUP rather than IPRU(INS)
- PRU rules come into force around November 2004
- New reporting forms used for year-ends ending thereafter

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Internal Timetable

- Internal training for supervisors supervising firms on Pilot exercise
- Pilot ICAS assessments
- Internal training for all other supervisors
- Rollout to whole market over 26 month period

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Discussion

Any questions?
