Association of British Insurers

FSA Quarterly Consultation – CP 11/1

The ABI's Response to Chapter 2 of CP 11/1

Introduction

1. The ABI is the voice of insurance, representing the general insurance, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK. The ABI's role is to:

    - Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
    - Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation.
    - Advocate high standards of customer service within the industry and provide useful information to the public about insurance.
    - Promote the benefits of insurance to the government, regulators, policy makers and the public.

2. The ABI welcomes the opportunity to respond to Chapter 2 of the FSA's Quarterly Consultation Paper (CP 11/1). The ABI will respond to other chapters of this paper separately.

Overall comments

3. The ABI does not believe that the FSA has shown that its proposal for firms to pre-notify it of capital issues is necessary or delivers any significant regulatory benefits. We also believe that the FSA has not properly taken into account the significant potential costs to firms, not merely the compliance burden but in restricting their ability to manage their capital resources in response to changing market conditions and their business needs. Nor has the consultation paper provided any indication of what regulators wish to do with the information during the proposed pre-issuance notification period. We do not, therefore, believe that the FSA should proceed with its proposal in its current form.

4. We think that a post-notification regime is the right focus of any general regulatory requirement. To the extent that firms are issuing genuinely new types of instrument, where we accept that the regulatory authorities have a legitimate interest in properly

understanding the characteristics and suitability of different instruments, it would be reasonable to expect those firms developing such instruments to be prepared to discuss these with regulators. However, we believe that this requirement is already provided for under the existing requirements of SUP 15.3.8G(3).

5. As instititutional investors our members do have an interest in ensuring that the pattern and pace of equity and debt issuance takes place on a basis that can safeguards quality of markets and we would be interested in understanding the regulatory authorities' views in this regard. This is a subject, however, that is much wider than just financial sector issuance but is of relevance from a financial stability perspective.

6. More detailed comments on the proposal are in the attached annex.

ANNEX

Questions for Consultation

Q2.1: Do you have any comments on the proposal?

We disagree with the proposal.

None of the expected benefits to introducing a pre-notification regime (monitoring the amount and type of capital being issued, ensuring senior level sign-off and bringing the FSA into line with international practice) would appear to justify the proposal. The first could be fulfilled just as effectively under a post-notification system. Firms should already have systems in place to ensure senior management sign-off which could be checked as part of normal supervisory processes. In respect of bringing the FSA into line with best international practice there is nothing in the consultation to suggest that the FSA is under any requirement to do so nor is there information as to whether the FSA's proposal to apply the requirements to all forms of capital and require at least one month's notice is in line with international norms.

We would suggest that, if the FSA does wish to make additional rules requiring firms to inform it of capital issuance, it would meet the FSA's requirements at considerably less disruption to firms to do so through a post-issue notification requirement.

Q2.2: Do you agree with our description of the costs to firms?

We disagree with the FSA's estimate of the costs to firms of the proposal.

The FSA argue that the costs of the proposal will be minimal. And while the consultation paper accepts that the notification period will reduce firms' flexibility it asserts that this will have little impact. We do not believe that this is the case and are concerned that the FSA's proposals will substantially increase both the ability to raise capital and the cost of doing so.

Our members are concerned that the description of the issuance process in paragraphs 2.17-2.19 is not an accurate reflection of the reality and, in particular, underestimates the importance of timing. In general, timing is extremely important for the success of any issue in the capital markets, particularly of subordinated instruments. "Success" refers both to the ability to execute the issue and to the cost of execution. Markets are not static, so issuance opportunities change all the time and it is important to pick the right moment. It should be noted that an issuer's individual circumstances may impose further restrictions, for example through "black-out" periods created by disclosure obligations.

Whilst timing is important even in a benign market environment, it has been even more important during the last three years. During this period, market volatility has been at unprecedentedly high levels, both in terms of pricing and of the ability to issue. Issuance windows have occurred unpredictably and often only for short periods, and the market for hybrid issuance has been closed for long periods of time (often for several months in a row). These windows were dependent on general

market conditions, which are often uncorrelated to individual firms' ability to issue (e.g. "black-out" periods).

The experience of the past few years underlines the importance of being able to access markets when good opportunities arise to issue capital, even at relatively short notice. In this context, it should be noted that cost matters: even though market access may be possible, the cost of issuing can fluctuate dramatically, depending on the market environment at the time of issue.

Therefore, we consider that a 1-month pre-notification requirement for issues of hybrid capital instruments is not workable in practice, as it would prevent issuers from accessing the market as and when issuance windows open. This could jeopardise their ability to issue hybrid and/or increase the cost of issuing capital instruments significantly. As a result, the introduction of such a 1-month pre-notification requirement for issues of hybrid capital instruments would be unduly burdensome, particularly in view of the limited stated purpose of the requirement.

Q2.3: Are there any other costs, benefits or other barriers to capital issuance in relation to this proposal that we have not adequately represented?

The ABI believes that the proposals will cause firms a number of practical issues in relation to equity issues. We have the following specific concerns:

- Many routine equity issues (eg scrip dividends, share options) will be unknown as to the exact amount or timing until very close to the issuance date.
- Likewise conversion of convertible securities will often not be known until very close to the conversion date.

It would appear that in these circumstances the proposed requirement to provide one month's notice of all capital issues will be in direct conflict with other legal obligations that firms are under to issue equity within specific timeframes. We see no purpose served by pre-notification by financial sector firms to regulators of issuance of equity securities either in these circumstances or more generally. Companies will be accountable to, and be acting under authorisation from, their shareholders in respect of any issuance of equity securities.

We are also concerned by the proposal that the FSA should be informed of any capital issuance within an insurance group. Once again this gives rise to practical issues (for example, how is a firm meant to comply with the one month notification period if an overseas regulator requires issuance in a shorter timeframe?). However, we also have concerns as a matter of principle about whether it is appropriate for the FSA to put in place requirements that may simply not be enforceable on overseas headquartered firms, for example the management of the UK arm of an overseas firm may not be aware (indeed may not be legally entitled to be informed) of plans to issue capital at group level and so it is not possible for the FSA requirement to be met.

We believe that these issues would be resolved if the FSA replaced its current proposal with a post-issuance notification requirement.

Q2.4: Are there any other changes firms may make in response to this proposal?

We have no comments on this question.