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Consultation Paper on

EIOPA Advice to the European Commission

Equivalence assessment of the Bermudian supervisory system in relation to articles 172, 227 and 260 of the Solvency II Directive

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Responding to this paper

EIOPA welcomes comments on the EIOPA Advice to the European Commission - Equivalence assessment of the Bermudian supervisory system in relation to articles 172, 227 and 260 of the Solvency II Directive.

Comments are most helpful if they:

- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email CP-14-042@eiopa.europa.eu, by 23 January 2015.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents[1].

Contributions will be made available at the end of the public consultation period.

Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied.

EIOPA, as a European Authority, will process any personal data in line with Regulation (EC) No 45/2001 on the protection of the individuals with regards to the processing of personal data by the Community institutions and bodies and on the free movement of such data. More information on data protection can be found at https://eiopa.europa.eu under the heading 'Legal notice'.

[1] Public Access to Documents

Consultation Paper Overview & Next Steps

By letter of 25th of February 2014, the European Commission requested EIOPA to update the equivalence advices for Switzerland and Bermuda (under articles 172, 227 and 260 of the Solvency II Directive) and Japan (under article 172 of the Solvency II Directive) that EIOPA provided in October 2011[2].

Like in 2011, EIOPA publicly consults on the three reports. As it concerns updates from reports already consulted upon in 2011, and also due to the external legislative timetable (i.e. intended European Commission determinations in relation to the equivalence of these countries), the public consultation will only be for a period of 5 weeks.

This Consultation Paper presents the draft 'EIOPA Advice to the European Commission - Equivalence assessment of the Bermudian supervisory system in relation to articles 172, 227 and 260 of the Solvency II Directive'.

Next steps

EIOPA will consider the feedback received and expects to publish a Final Report on the consultation. The 'EIOPA Advice to the European Commission - Equivalence assessment of the Bermudian supervisory system in relation to articles 172, 227 and 260 of the Solvency II Directive' will subsequently be submitted for adoption by the Board of Supervisors of EIOPA before it is sent to the European Commission.

[2] https://eiopa.europa.eu/Publications/Consultations/EIOPA-BoS-11-029-Bermuda-Equivalence-advice.pdf#search=equivalence%20assessment%20bermuda

Chapter I: Introduction

Section 1 - Equivalence assessments under Solvency II – a brief summary:

1. Under the Solvency II directive the European Commission may determine whether the solvency regime of a third country is equivalent to that laid down in Solvency II in relation to three areas of focus. Article 172 relates to equivalence of the solvency regime applied to the reinsurance activities of insurers[3] with their head office in the third country concerned, where a positive determination would allow reinsurance contracts with insurers in that third country to be treated in the same way as reinsurance contracts with EEA insurers. Article 227 relates to third-country insurers which are part of EEA groups, where equivalence would allow groups to take into account the local calculation of capital requirements and available capital rather than calculating on a Solvency II basis for the purposes of the deduction and aggregation method. Article 260 relates to group supervision of EEA insurers with parents outside the EEA, where equivalence would mean EEA supervisors would rely on the group supervision of that third country.

2. The European Commission's Call for Advice of 11th June 2010 asked CEIOPS (EIOPA's predecessor organisation) to provide advice on whether the supervisory regimes of certain third countries satisfy the general criteria for assessing third country equivalence. In its letter of 29th October 2010 the European Commission indicated that Bermuda should be assessed for equivalence under articles 172, 227 and 260. Following full consultation, EIOPA provided its advice to the European Commission in October 2011.

3. By letter of 25th of February 2014 the European Commission requested EIOPA to update the equivalence advice for Bermuda. The updated report is intended to allow the European Commission to take fully-informed decisions in relation to the equivalence of Bermuda under each of the three articles.

4. In revising its report EIOPA has again consulted the Bermuda Monetary Authority (BMA) who provided an update on relevant legislative changes that have taken place since 2011, and on developments in their supervisory approach. Following receipt of the BMA's input, EIOPA commenced a desk-based review of its previous advice, and following some further written queries which the BMA cooperated fully in answering, completed its deliberations.

5. Equivalence assessments are expected to take into account the principles contained in the Solvency II Directive, as well as the general criteria for assessing third country equivalence to be found in articles 378, 379 and 380 of Implementing Measures (in the form of a Delegated Act). The assessment against the criteria (principles and objectives) set out in this report reflects these provisions.

6. EIOPA's advice on equivalence refers only to the regulatory regime applying to those insurers which would, by virtue of their size and the nature of their activities, fall within the scope of the Solvency II Directive. The assessment in this report relates specifically to the supervision of commercial insurers in Bermuda, and not to captives (sees section 3).

Section 2 - EIOPA methodology:

7. There are a number of over-arching principles under-pinning the assessment:

[3] Please note that throughout this report, where reference is made to "insurers" or "insurance" this includes reinsurers and reinsurance, unless otherwise specified.

- Equivalence assessments aim to determine whether the third country supervisory system provides a similar level of **policyholder and beneficiary protection**.
- Supervisory cooperation under conditions of **professional secrecy** is a key, determinative element of a positive equivalence finding. When assessing the criteria relating to professional secrecy, the principle of proportionality will not apply.
- The equivalence assessment is a **flexible process** based on principles and objectives (embedded in the general criteria for assessing third country equivalence). All the applicable criteria (the principles and objectives) need to be met for a positive equivalence assessment; there are a number of indicators associated with these principles to help to guide the assessment, but a positive equivalence assessment does not require that every indicator be fulfilled.
- When pursuing an equivalence assessment, proper consideration should be given to the adequacy of third country practice in applying the **proportionality** principle. This is further developed below.
- An equivalence judgement can only be made in respect of the **regime in existence** and applied by a third country supervisory authority at the time of the assessment. Plans and on-going initiatives for changing the national supervisory regime should not be considered an adequate support for a positive equivalence finding until the day of their actual implementation. Nevertheless, these initiatives should be taken into account, with due consideration given to their expected timing and the degree of commitment to them, when performing an equivalence assessment and providing advice to the Commission.
- Assessments will be **kept under review** and take into account any developments that might lead to relevant changes in the third country supervisory regime. EIOPA will review its advice at least every 3 years or upon learning of significant developments within jurisdictions already found equivalent.

8. For a criterion to be considered equivalent, the third country supervisory authority must provide evidence that the relevant national provisions exist and are applied in practice. The process of assessing each principle and objective requires a judgmental weighting of numerous factors.

Proportionality

9. The proportionality principle is embedded in the Solvency II Directive, Article 29 (4) of which states that: "[…] Implementing measures [should ensure] the proportionate application of this Directive, in particular to small insurance undertakings". Consistently with this, the Directive:
    - Recognises that the principle of proportionality should apply to captives, given that they only cover risks associated with the group to which they belong (Article 13 (2) and Recital 21 Solvency II Directive);
    - Introduces a requirement for the system of governance to be proportionate to the nature, scale and complexity of the (re)insurance undertaking's operations (Article 41 (2) Solvency II Directive);
    - Allows, where necessary, for simplified methods and techniques to be developed to calculate technical provisions in order to ensure that methods are proportionate to the nature, scale and complexity of the risk supported

by the (re)insurance undertaking, including captive (re)insurance undertakings. (Article 86(2) (b) Solvency II Directive);

- Allows for simplified calculations for specific risk modules and sub-modules where this is justified taking into account the nature, scale and complexity of the risks faced by insurers, including captives (Articles 109 and 111 (1)(l) Solvency II Directive);
- Establishes an absolute floor for the MCR (Minimum Capital Requirement) of €1.2m for captive reinsurers, as opposed to €3.6m for other reinsurers (Article 129 (1d) (iii) Solvency II Directive); and
- Introduces a requirement for supervisory powers in deteriorating financial conditions to be proportionate and reflect the level and duration of the deterioration of the solvency position of the (re)insurance undertaking concerned.

10. In line with this, in its 1st April 2010 cover letter to the EC, EIOPA stated that equivalence was "a proportionate process. […] As such, under each of the Chapters, [EIOPA] has advised that the existence of a proportionality principle in the application of regulatory provisions in 3rd country jurisdictions (contingent upon the nature, scale and complexity of the risks inherent in the business) should not be in itself and obstacle […] to the recognition of equivalence."
11. EIOPA has taken the principle of proportionality into account in its equivalence assessments in a manner consistent with the above. Under this approach application of the proportionality principle could include discretion for the supervisory authority to apply the requirements in different ways as proportionate, but would not include discretion for the supervisory authority to exempt insurers from certain requirements. For instance, a proportionate application of a requirement for all insurers to have certain function holders could include the supervisory authority being comfortable with a small insurer having one person who holds, for example, the risk management function and actuarial function at the same time; it would not include a small insurer not having one or other of these functions at all.

EIOPA's advice

12. In undertaking the assessment, the finding for each Principle will be given using five categories: equivalent, largely equivalent, partly equivalent, not equivalent and not applicable.
13. EIOPA's overall advice to the European Commission on the country's equivalence for each article will be given as one of the following:
    - Country A meets the criteria set out by the Commission.
    - Country A meets the criteria but with certain caveats.
    - Country A needs to undertake changes in the following areas (…) in order to meet the Commission criteria for equivalence.

Section 3 - The Bermudian insurance sector – an overview:

Bermuda's Insurance Class System

14. In 1995, the BMA established a multi-licence system to categorise non-life insurers into four classes. In 2008, the Insurance Act was amended to allow for further segregation of Class 3 into small commercial (Class 3A), large commercial (Class 3B) and other insurers (Class 3). This class system is an important specificity of the Bermudian insurance sector. Classes of non-life business are defined as follows:

- Class 1: Single-parent captive insuring the risks of its owners or affiliates of the owners.

- Class 2: a) A multi-owner captive insuring the risks of its owners or affiliates of the owners; or (b) A single parent or multi-owner captive: (i) insuring the risks arising out of the business or operations of the owners or affiliates, and/or (ii) deriving up to 20% of its net premiums from unrelated risks.

- Class 3: Captive insurers underwriting more than 20% and less than 50% unrelated business.

- Class 3A: Small commercial insurers whose percentage of unrelated business represents 50% or more of net premiums written or loss and loss expense provisions and where the unrelated business net premiums are less than $50 million.

- Class 3B: Large commercial insurers whose percentage of unrelated business represents 50% or more of net premiums written or loss and loss expense provisions and where the unrelated business net premiums are more than $50 million.

- Class 4: Insurers and reinsurers capitalised at a minimum of $100 million underwriting direct excess liability and/or property catastrophe reinsurance risk.[4]

- Special Purpose Insurer ("SPI") class: A SPI assumes insurance or (re)insurance risks and fully funds its exposure to such risks, typically through a debt issuance or some other financing.

15. Further amendments to the Insurance Act in 2010 provided for a reclassification of long term insurers both to recognise existing captive insurance arrangements and facilitate the introduction of new capital and solvency reporting standards. The classes of long term insurers are:

- Class A: A single-parent Long-Term captive insurance company underwriting only the Long-Term business risks of the owners of the insurance company and affiliates of the owners.

- Class B: Multi-owner Long-Term captives owned by unrelated entities, underwriting only the Long-Term business risks of the owners and affiliates of the owners and/or risks related to or arising out of the business or operations of their owners and affiliates. A single-parent and multi-owner Long-Term captives writing no more than 20% of net premiums from unrelated risks.

- Class C: Long-Term insurers and reinsurers with total assets of less than $250 million; and not registrable as a Class A or Class B insurer.

- Class D: Long-Term insurers and reinsurers with total assets of $250 million or more, but less than $500 million; and not registrable as a Class A or Class B insurer.

[4] "Capital and surplus" roughly equates to own funds in Solvency II terminology

- Class E: Long-Term insurers and reinsurers with total assets of more than $500 million; and not registrable as a Class A or Class B insurer.

16. The Insurance Act also provides for Dual Licence insurers; i.e. insurers writing a combination of long term (or life) business and non-life business. Dual licences can be held by both captive and commercial insurers, but the great majority of dual licence holders – to date 44 out of the total of 52 (down from 72 in 2013) – have at least one commercial licence with 22 holding both life and non-life commercial insurance licences. No new dual licences are being issued except where one of the licences is confined purely to reinsurance business[5]. Dual licence holders have to maintain separate balance sheets and meet the capital requirements in respect of both their life and non-life business.

17. The above classifications provide the standard requirements for categorisation, however the BMA may at its discretion license an insurer in a different class from that suggested by the standard categorisation. In particular, the BMA anticipates that some long term insurers writing business from their parent or affiliates only may nonetheless be licensed in Class C.

18. The provisions for long term insurers (Classes A to E) have been in force since the beginning of 2011, and the reclassification of long term insurers into these classes was completed by end of 2011.

19. Further developments to the Bermudian legislation are intended:

    - The BMA is proposing to amend the Insurance Act to introduce notification of disposals of qualifying holdings; to require material change approval for insurance operations, to require submission of the declaration of compliance; and to require public disclosure of a declaration of compliance which provides an attestation that commercial insurers comply with the regulatory capital requirements, and the Minimum Criteria for Registration which would incorporate the Insurance Code of Conduct. The amendments proposed in relation to the first three points are intended to come into effect in Q4 2014; that relating to public disclosure in Q1 2015 for Class 4, Class 3B, Class 3A and Class E insurers, and Q1 2016 for Class C and Class D insurers.
    - The BMA is consulting upon a comprehensive review of the Code of Conduct Governance and Control, to reflect inter alia the issue of the independence of the internal audit function.
    - The BMA has developed a schedule for testing and embedding in legislation the economic balance sheet (EBS) approach. This is covered in detail under the section dealing with Principle 6, 7 and 12.
    - Finally, the BMA is proposing to work on modifications to the Bermuda Solvency Capital Requirement in 2015, and publish legislation to become effective in Q4 2015.

Overview of the Bermudian insurance market

20. Bermuda plays an important role in the global and European insurance markets, in particular for reinsurance. It is home to 15 of the top 40 reinsurance groups in the world, and Bermudian groups write 14% of the aggregate global reinsurance premium including 20% of the broker-placed European property catastrophe reinsurance. Bermuda's insurance market is predominantly focused

[5] According to the latest figures provided by BMA.

on wholesale business, with the local retail market making up only around 0.01% of the total.

21. Bermuda's insurance market also has a strong focus on **captive insurers**, which make up 66% of the 1206 insurers registered at the end of 2013. Market statistics for 2012[6] show that the domicile of the beneficial owners of two thirds of the captive companies registered in Bermuda is in North America, with European domiciled owners accounting for 14%. In terms of gross premiums written, the gap is narrower with 53% of the $46 billion premiums written being by captives with owners domiciled in North America compared to 36% by captives with owners domiciled in Europe. Looking at net premiums the balance shifts further, with 47% of the $33 billion net written premiums associated with captives with owners domiciled in Europe compared to 43% with captives with owners domiciled in North America. It is clear that Bermudian captives with owners domiciled in Europe retain much more of the business compared to those with owners domiciled in North America.

22. Bermuda is also a rapidly growing jurisdiction for **insurance-linked securities** (ILS). For the year end 2012, out of the $21.0 billion in global ILS issuance, $9.2 billion (41%) was sponsored by Bermuda-based special purpose insurers (SPI)[7]. Of the 91 new registrations in 2013, 51 were SPI, and a further 24 captives (21 non-life and 3 life).

Non-life & Special Purpose Insurers

Class of insurer	No of insurers	% of total (NL +L)	2013 new registrations
1	249	20.6	8
2	300	24.9	6
3	242	20.1	7
Total captive classes	791	65.6	21
3A	104	8.6	9
3B	17	1.4	3
4	27	2.2	1
Total commercial classes	148	12.2	13
Total non-life classes	939	77.8	34
Special Purpose Insurers	101	8.4	51

Life and dual licence holders

Class of insurer	No of insurers	% of total (NL +L)	2013 new registrations
A	3	0.2	1
B	1	0.1	2
Total captive	4	0.3	3

[6] Based on statistics derived from statutory financial returns and modified filings for 2012 submitted by reporting entities,

[7] BMA Annual Report 2013

classes			
C	71	6.0	3
D	4	0.3	0
E	15	1.2	0
Total commercial classes	90	7.5	3
Total life classes	94	7.8	6
Dual licence holders	72	6.0	0
Total all classes	1206	100	91

Commercial insurers

23. The assessment in this report relates specifically to the supervision of commercial insurers, of which there were 306 registered at year end 2013. Of these 148 held non-life registrations (classes 3A, 3B and 4); 90 life (classes C, D, and E); and 68 dual licences (out of the 72 registered). There were 13 new registrations of commercial non-life insurers in 2013, and 3 life.

24. As it can be seen in the table below, derived from the statutory financial returns and modified filings for 2012 submitted by reporting entities (and thus the numbers of insurers do not correspond), the non-life commercial sector wrote 44% of total gross written premium (54% on non-life premium) despite only comprising 15% of the total number of insurers. On the life side, commercial insurers wrote 16% of total gross written premiums. Captive life insurers currently play a very minor role in Bermudian business.

Class of insurer	**No of insurers**	**Gross premiums ($bn)**	**Net premiums ($bn)**	**Total assets ($bn)**	**Capital & surplus ($bn)**
3A	108	13.2	10.3	35.1	16.9
3B	15	9.9	7.3	17.5	14.0
4	36	30.3	26.8	150.0	70.9
Commercial classes (NL)	159 15%	53.4 44%	44.4 45%	202.6 40%	101.8 53%
Captive classes (NL)	*730* *70%*	*46.0* *38%*	*32.7* *33%*	*144.9* *30%*	*56.8* *29%*
Total (NL)	889 85%	99.4 82%	77.1 79%	347.5 69%	158.6 82%
C	93	12.5	12.5	100.2	14.1
D	8	0.6	0.6	6.6	1.2
E	11	6.7	6.7	44.1	17.0
Commercial classes (L)	112 11%	19.8 16%	19.8 20%	150.9 30%	32.3 17%
Captive classes (L)	*11* *1%*	*0.1* *0%*	*0.1* *0%*	*0.6* *0%*	*0.2* *0%*
Total (L)	123 12%	19.9 17%	19.9 20%	151.5 30%	32.5 17%
SPI	*34* *3%*	*1.1* *1%*	*1.0* *1%*	*6.4* *1%*	*1.8* *1%*
Total	1046 100%	120.5 100%	98.1 100%	505.5 100%	193.0 100%

25. Financial information on composites (dual licence holders) is included under Class

1 to Class 4 data, e.g. Class 1 to 4 gross written premiums includes USD 5.198 billion of long term business mainly in classes 3, 3A and 3B in 2013.

26. In terms of the beneficial ownership of commercial insurers, the domicile of the owners of 133 (44%) of the total of 306 commercial insurers and SPIs was North America. These insurers accounted for half of the relevant gross written premium. The domicile of a further 80 (26%) was Bermuda itself, with Europe being the domicile of 61 (20%).

Overview of the institutional and legal framework for the financial sector of Bermuda

27. Bermuda is a British Overseas Territory; it is self-governing and has its own legal framework. Following a 1966 Constitutional Conference between the UK Government and Bermuda representatives, the Bermuda Constitution Order 1968 (the "Constitution") was enacted as a UK Order in Council. It included provisions relating to the Bermudian Governor, Legislature, Executive, Judiciary, Public Service and Ombudsman.

28. More recently the Secretary of State of the United Kingdom revised the entrustment to the Government of Bermuda, by letter of entrustment which took effect in December 2009. Under this entrustment the Government is authorised to negotiate and conclude trade agreements related to treatment of goods and services, as well as agreements for technical assistance or of a cultural or scientific nature.

29. **Primary Acts**. Primary acts are laws which are enacted by Bermuda's Parliament and which set down the legislative framework for a regulatory regime. These laws, commonly referred to as statutes, set out the basic regulatory requirements, the regulatory authority, the enforcement powers and offences and penalties which are applicable. Accordingly, the Insurance Act 1978 (IA) is primary legislation and sets out the framework for regulating persons carrying on insurance business in and from Bermuda. For purposes of the Insurance Act, the definition of insurance business includes the reinsurance business.

30. Parliament may in some instances delegate to a Government Minister or a regulatory body such as the BMA the power to make secondary (subsidiary) legislation such as rules or regulations which will supplement the primary acts and the scope of such rules or regulations, as well as other ancillary regulatory directives such as a statement of principles and codes.

31. **Secondary (subsidiary/delegated) legislation**. Subsidiary legislation may include regulations, rules or orders which may be made under the authority of the primary legislation. The primary legislation would clearly set out the scope of the subsidiary legislation. The person making the subsidiary legislation must ensure that it is within scope of the enabling provision. Secondary legislation is usually reviewed by the Parliament. However, the Parliament may expressly direct that specific secondary legislation is not subject to Parliamentary scrutiny. Therefore BMA has the power to adopt rules without Parliamentary review.

32. These mechanisms are used to address technical details which may need to be frequently amended. For example the BMA is enabled to make rules as set out under Articles 6 and 27B IA. These regulations and rules being statutory provisions are similar to provisions of a primary statute in that they are binding and a penalty may be imposed.

33. Subsidiary legislation made under the IA includes the:
    - Insurance Returns and Solvency Regulations 1980
    - Insurance Accounts Regulations 1980

- Insurance (Prudential Standards)(Class 4 and Class 3B Solvency Requirement) Rules 2008
- Insurance (Prudential Standards)(Class 3A Solvency Requirement) Rules 2011
- Insurance (Prudential Standards)(Class C, Class D and Class E Solvency Requirement) 2011
- Insurance (Group Supervision) Rules 2011
- Insurance (Prudential Standards) (Insurance Group Solvency Requirement) Rules 2011
- Insurance (Eligible Capital) Rules 2011

Amendments to the solvency requirement rules for commercial insurers, the group supervision and eligible capital rules were made in 2013:

- Insurance (Prudential Standards)(Class 3A Solvency Requirement) Amendment Rules 2013
- Insurance (Prudential Standards)(Class 4 and Class 3B Solvency Requirement) Amendment Rules 2013
- Insurance (Prudential Standards)(Class C, Class D and Class E Solvency Requirement) Amendment Rules 2013
- Insurance (Prudential Standards)(Insurance Group Solvency Requirement) Amendment Rules 2013
- Insurance (Group Supervision) Amendment Rules 2013
- Insurance (Eligible Capital) Amendment Rules 2013

34. Statement of Principles. A Statement of Principles is an instrument made in accordance with an Act of Parliament which details how a regulator will apply certain provisions of the Act. Under Article 2A IA there is a duty imposed on the BMA to issue a Statement of Principle dealing with the following:

    - Interpreting the minimum criteria imposed on all licensees
    - Exercising powers to register or cancel the registration of a licensed person
    - Exercising power to impose or grant a condition on a licensed person
    - Exercising power to require and obtain information, reports
    - Exercising power to adjust of a licensed person’s available statutory capital and surplus or enhanced capital requirements
    - Exercising powers to give directions under Article 32 or 32A
    - Exercising discretion under Article 27B to determine whether to be group supervisor

35. The BMA issued a Statement of Principles in June 2007 relating to insurer registration, and has more recently (December 2012) issued a Statement of Principles on the Use of Enforcement Powers.

36. **Codes of Conduct**. Codes of Conduct are made in accordance with an act of Parliament however they are not defined as secondary legislation. They are an instrument which establishes certain standards – industry standards or otherwise which insurers are expected to apply and which are enforceable, but which do not have the same weight as a rule or a regulation, in that failure to comply does not usually give rise to a direct penalty.

37. The BMA issued the Insurance Code of Conduct in February 2010. This Code of Conduct is enforceable in that the BMA will take into consideration failure to comply with the Code as part of its assessment of the insurer’s compliance with provisions of the Act or the Minimum Criteria. The BMA may issue directions to comply with the Code and, if the entity does not respond, the BMA may take

other enforcement actions. Failure to comply with a direction is an offense. BMA applies the Code to all insurers and monitors compliance.

38. **Guidance**. Guidance may be issued from time to time by the BMA. It is not a legislative instrument, but rather is intended to convey expectations regarding the prudent conduct of the insurance business. It is not binding and has no legal effect.

39. Under Article 2B IA the BMA may issue guidance at its discretion. The BMA has issued over 20 guidance notes dealing with various aspects of the IA.

Chapter II: Overall assessment

EIOPA advice on Bermuda's equivalence under Article 172

40. EIOPA's advice is that Bermuda meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II for insurers of Classes 3A, 3B, 4, C, D and E, but with certain caveats set out below.

41. We find the BMA largely equivalent with regard to its powers and responsibilities as a supervisory authority for Class 3A, 3B and 4 insurers and Class E insurers and to be partly equivalent for Class C and D under Principle 1. Although the BMA has at its disposal a series of powers and reporting obligations, some of the obligations vary according to the insurer's class.

42. We find the BMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2.

43. We find the BMA largely equivalent with regard to its authorisation of insurers under Principle 3. The BMA is empowered to obtain all the information necessary for licensing, however there is no legal requirement to ensure that an insurer has its head office situated in the same country as its registered office.

44. We find the BMA largely equivalent for Classes 3A, 3B, 4, C, D and E with regard to its governance and public disclosure requirements under Principle 4. EIOPA has identified the following areas where the BMA regime would have to be strengthened or addressed in order to be considered equivalent to Solvency II: outsourcing and public disclosure.

45. We find the BMA largely equivalent with regard to its requirements around changes in business, management and qualifying holdings under Principle 5. We note that further changes to the IA that are proposed for Q4 2014 are likely to address the residual concern over the lack of any requirements covering disposals of qualifying holdings.

46. With regard to their solvency regime for reinsurance undertakings under Principle 6:

    a. We find the BMA's supervision of Class 3B and 4 insurers largely equivalent under the currently applicable rules. For these and other classes EIOPA cannot positively conclude on the present valuation framework, since it is possible for insurers to adopt a variety of different valuation standards. Consequently, there is no comparability between insurers.

    We note that the valuation issue is intended to be addressed if the proposed revision of the valuation standards are implemented and enter into force on the 1st of January 2016. For dual licence insurers in Classes 3B and 4 there is an additional dependency that Solvency II rules are adopted for their life business. The BMA has also indicated that it intends to make further enhancements to BSCR in 2015 to include currency and concentration risks.

    b. We find the BMA's supervision of Class 3A largely equivalent under the currently applicable rules.

    We note that the BMA is working on the extension of the EBS to Class 3A with appropriate simplifications, but this will not be implemented until 1 January 2017.

    c. We find the BMA's supervision of Class E life insurers partly equivalent under currently applicable rules. EIOPA is unable to conclude on the equivalence of the BMA's proposed valuation standards for assets and liabilities in respect of all

commercial life classes given the material uncertainties which remain around the EBS framework being developed. The MSM is not currently risk-based.

We note that the BMA will apply the floor of 25% of the ECR to all commercial life insurers with effect from 1 January 2017.

d. We find the BMA's supervision of Class C and Class D life insurers under the currently applicable rules is partly equivalent. In addition to the caveats noted for Class E, Class C and D insurers are not currently required to provide GAAP financial statements. There are no provisions requiring Class C and D insurers to maintain available statutory capital and surplus of a particular quality that equals or exceeds the value of the MSM.

We note that the BMA has stated that statutory capital and surplus requirements will be in place from year-end 2015.

EIOPA advice on Bermuda's equivalence under Article 227

47. EIOPA's advice is that Bermuda meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II for insurers of Classes 3A, 3B, 4, C, D and E, but with certain caveats set out below.

48. We find the BMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2.

49. With regard to their solvency regime for insurance undertakings under Principle 7:

a. We find the BMA's supervision of Class 3B and 4 insurers largely equivalent under the currently applicable rules. For these and other classes EIOPA cannot positively conclude on the present valuation framework, since it is possible for insurers to adopt a variety of different valuation standards. Consequently, there is no comparability between insurers.

We note that the valuation issue is intended to be addressed if the proposed revision of the valuation standards are implemented and enter into force on the 1st of January 2016. For dual licence insurers in Classes 3B and 4 there is an additional dependency that Solvency II rules are adopted for their life business. The BMA has also indicated that it intends to make further enhancements to BSCR in 2015 to include currency and concentration risks.

b. We find the BMA's supervision of Class 3A largely equivalent under the currently applicable rules.

We note that the BMA is working on the extension of the EBS to Class 3A with appropriate simplifications, but this will not be implemented until 1 January 2017.

c. We find the BMA's supervision of Class E life insurers partly equivalent under currently applicable rules. EIOPA is unable to conclude on the equivalence of the BMA's proposed valuation standards for assets and liabilities in respect of all commercial life classes given the material uncertainties which remain around the EBS framework being developed. The MSM is not currently risk-based.

We note that the BMA will apply the floor of 25% of the ECR to all commercial life insurers with effect from 1 January 2017.

d. We find the BMA's supervision of Class C and Class D life insurers under the currently applicable rules is partly equivalent. In addition to the caveats noted for Class E, Class C and D insurers are not currently required to provide GAAP financial statements. There are no provisions requiring Class C and D insurers to

maintain available statutory capital and surplus of a particular quality that equals or exceeds the value of the MSM.

We note that the BMA has stated that the statutory capital and surplus requirements will be in place from year-end 2015.

EIOPA advice on Bermuda's equivalence under Article 260

50. EIOPA's advice is that Bermuda meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II for group supervision but with certain caveats set out below.

51. We find the BMA equivalent with regard to its powers and responsibilities as a supervisory authority under Principle 1.

52. We find the BMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2.

53. We find the BMA's regulatory framework equivalent with regard to the scope of its group supervision under Principle 8.

54. We find BMA equivalent with regard to its co-operation and exchange of information with other supervisory authorities under Principle 9.

55. We find the BMA largely equivalent for group supervision with regard to its governance and public disclosure requirements under Principle 10. EIOPA has identified the key area where the BMA regime would have to be strengthened or addressed in order to be considered equivalent to Solvency II as public disclosure.

56. We find the BMA largely equivalent with regard to its requirements around changes in business, management and qualifying holdings under Principle 11. We note that further changes to the IA that are proposed for Q4 2014 are likely to address the residual concern over the lack of any requirements covering disposals of qualifying holdings.

57. We find the BMA's supervision of groups largely equivalent under the currently applicable rules, with regard to their solvency regime for groups under Principle 12. We note that the valuation issue is intended to be addressed if the proposed revision of the valuation standards are implemented and enter into force on the 1st of January 2016. For groups including life insurers there is an additional dependency that Solvency II rules are adopted for their life business. The BMA has also indicated that it intends to make further enhancements to BSCR in 2015 to include currency and concentration risks.

Chapter III: Assessment of each principle

Principle 1 - Powers and responsibilities of third country supervisory authorities

Objective - *The supervisory authorities of the third country have the necessary means, and the relevant expertise, capacity, and mandate to achieve the main objective of supervision, namely the protection of policyholders and beneficiaries regardless of their nationality or place of residence. In particular, the supervisory authorities in that third country shall have the necessary capacities, including financial and human resources.*

For reinsurance assessments:

The supervisory authorities of the third country are empowered by law or regulation to effectively supervise domestic insurance or reinsurance undertakings carrying out reinsurance activities and to undertake a range of actions, including the ability to impose sanctions or take enforcement action in relation to the domestic insurance or reinsurance undertakings carrying out reinsurance activities that it supervises.

For group supervision assessments:

The supervisory authorities of the third country shall be empowered by law or regulation to supervise insurance and reinsurance undertakings which are part of a group.

The supervision of insurance and reinsurance undertakings which are part of a group shall be carried out effectively and the supervisory authorities of the third country shall be empowered by law or regulation to undertake a range of actions, including the ability to impose sanctions or to take enforcement action in relation to the group that it supervises.

The supervisory authorities of insurance and reinsurance undertakings which are part of a group shall be able to assess the risk profile and solvency and financial position of that group as well as its business strategy.

The supervisory authority

The BMA's responsibilities and enforcement powers

58. Article 2 IA provides that the BMA is responsible for the supervision of insurers, insurance managers (see further details on insurance managers under Principle 3) and intermediaries. Failure to comply with specific provisions of the IA is a criminal offence. Failure to comply with subsidiary regulations and rules is an indictable or summary offence.

59. The IA provides the BMA with a wide range of powers, including, if the insurer appears to be at risk of becoming insolvent, the powers to restrict its activities, to restrict investments, to remove the management, to prohibit the payment of dividends, and to freeze its assets (Article 32). If the insurer "has failed to satisfy an obligation to which it was subject by virtue of this Act" (Article 35 (1b)) or if "any of the minimum criteria is not or has not been fulfilled (Article 41(1b vii)), the BMA may present a petition for the winding up of the insurer, or cancel its registration.

60. The enforcement regime in the IA was enhanced in 2012 and additional empowerments include:

i. Power to impose civil penalties (Section 32D);

ii. Power to publicly censure (Section 32F);

iii. Power to make prohibition orders (Section 32H);

iv. Power to issue an injunction (Section 32L);

v. Power to publish matters related to enforcement decisions (Section 44I); and

vi. Fines that may be imposed for summary offences increased from $50,000 to $150,000 (Section 55).

61. In December 2012 the Authority issued a Statement of Principles on the use of Enforcement Powers[8] which sets out how the Authority will exercise its enforcement powers.

62. Furthermore, the following changes were made between 2011-2013:

- The definition of an insurance group was amended to clarify that any group that carries on an element of insurance business, including financial/mixed conglomerates (regulated and non-regulated entities), may fall within scope for group supervision. The framework may extend up to the ultimate parent, even in the case of a conglomerate and capture all entities that are members of the group (both regulated and unregulated). The group supervision regime has been extended to include Class 3A, Class C, Class D and Class E insurers, and the group's framework also applies to captives that are part of the group.
- The Insurance Accounts Regulations 1980 were amended requiring commercial General and all Long-term insurers to report on gross and net technical provisions.

Freedom from undue political, governmental and industry interference in the performance of supervisory responsibilities

63. The BMA is an independent authority established by its own Act of Parliament, the Bermuda Monetary Authority Act 1969 (BMA Act). The BMA Act established the BMA as a body corporate which is allowed to create its own rules, operating procedures and organisational structures separate from those that exist in Government.

64. The Minister of Finance appoints the BMA's non-executive board members, including the Chairman of the Board, but does not appoint the CEO or other senior management. Executive directors of the BMA are appointed by a committee of non-executive members of the Board who are responsible for determining the remuneration and other terms of service of the executive members of the Board. It is the responsibility of the CEO (subject to the authority of the Board) to administer the affairs and to execute the functions of the BMA.

65. In the IMF's 2008 Assessment of Financial Sector Supervision and Regulation, it was recommended that, in relation to insurance, "the BMA should periodically review its relationship with industry to preserve regulatory independence". In this context we note that active industry practitioners make up for 4 out of 10 of the BMA's Board of Directors. Although the BMA's Board Code of Conduct and, more specifically, Board of Directors Conflict of Interest Code set out guidance on ethical issues, and directors are required under Article 13 (5) and (6) BMA Act to disclose conflicts and excuse themselves where necessary, this arrangement

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[8] http://www.bma.bm/document-centre/policy-and-guidance/TRUST%20II/Statement%20of%20Principles%20on%20the%20Use%20of%20Enforcement%20Powers.pdf

nevertheless poses risks, in particular in relation to access to firm-specific information or cases where a specific supervisory action is being decided upon.

Transparency of supervisory processes/procedures

66. The BMA usually undergoes a wide consultation process before adopting any new regulation. The BMA's annual reports are posted on its website.

Adequate financial and non-financial (e.g. sufficient numbers of appropriately skilled staff) resources

67. The BMA is funded through fees charged to regulated entities.

68. As of 2014, the BMA comprised 172 staff, with the following breakdown:

Supervision	87	(51%)
Regulation	38	(22%)
Support	47	(27%)

69. In 2014 the Actuarial Department is made up of an internal models specialist and six qualified actuaries. The BMA informed us that actuaries must have at least 10 years of industry experience of which at least 5 years must be in a senior position in the industry before being considered for hire.

70. The BMA has taken steps to change the way the actuarial resource is used within the Authority. They have expanded the duties of their supervisors who must be conversant on financial and actuarial models in order to competently conduct their supervisory reviews, interface with industry technical staff and conduct onsite examinations.

71. According to BMA, their supervisors can be considered the equivalent to "actuaries in training" found in other regulatory authorities and as such, they are satisfied with the sufficiency of their actuarial resources.

72. Given the nature of the Bermudian market and the potential demand for approval of internal models, there is a risk that the actuarial resources will nonetheless be stretched.

Appropriate protection from being liable for actions taken in good faith

73. Article 4B of the BMA Act provides that no action can be brought against agents of the BMA that have acted in good faith in the execution of their missions.

Powers to take preventative and corrective measures

74. IA provides the BMA with various actions. The BMA is empowered to authorise insurers (Article 3 IA), to investigate them (Article 30 IA), to object to a change in control (Article 30F, see further details under Principle 5). See above under "The BMA's responsibilities and enforcement powers" the actions it is empowered to take when solvency requirements are not met.

Financial supervision

75. The IA and the related Code of Conduct establish the general framework as to the requirements for the system of governance. The BMA has a general power to assess and ensure insurers' compliance with these requirements, although in practice, the scope and intensity of the BMA's supervisory activity reflects the application of the proportionality principle. Further to this, we note that the framework for group supervision also include governance arrangements at group level, including the BMA's powers in relation to supervising this aspect.

76. Bermudian legislation also includes provisions as to undertakings' reporting

obligations as to solvency conditions and provides the BMA with general powers for supervision in this area. The BMA exerts its powers by verifying both off and on-site the financial condition and technical provisions of an insurer. The table below provides the breakdown by class of the supervisory reports issued by the BMA during the period 2011-2013. These numbers represent the onsite inspections completed for insurance groups and commercial insurers:

	2011	2012	2013[9]	Number of groups/insurers as of 31.12.2013
Groups	5	6	8	21
Class 4		5	4	27
Class 3B	2	4	1	17
Class 3A	5			104
Class 3A&B	1			
Class E		1	1	15
Class D	2	1	1	4
Class C	6		1	71
Total	**21**	**17**	**16**	

77. Over the last two years no on-site inspections have taken place in Class 3A, despite the fact that there are 104 Class 3A-insurers. The BMA noted that prudential meetings with the management did take place. The BMA estimate that 20-30 Class 3A insurers would have had bi-annual meetings in 2013 and the majority would have least had 1 meeting in a year.

78. As part of the 2011 assessment, EIOPA reviewed some supervisory reports, and in particular examined how the BMA ensured that the financial position of the insurer was sound and that TP were calculated prudently. BMA has noted that since the 2011 assessment it has enhanced the documentation of its review process and resultant findings

79. As to general reporting requirements, for the purpose of this chapter we note that the IA and the Insurance Returns and Solvency Regulations, as well as the Insurance Group Supervision Rules establish a general framework for reporting to be submitted to the BMA.

Qualifying holdings

80. Any person proposing to acquire 10%, 20%, 33% or 50% of an insurer should notify the BMA of their intentions. The BMA will assess the fitness and propriety of the prospective acquirer and may object to the acquisition (Article 30F IA). The BMA has the authority to place a restriction on the sale or transfer of the shares of such persons pursuant to Article 30I IA.

[9] On-sites conducted in 2013 included 2 for dual licence holders

Specificities for 172

Type and frequency of accounting, prudential, statistical information obtainable by the supervisory authority from an undertaking

81. Article 15 IA provides that all insurers should file statutory financial statements with the BMA, by a date that depends on the class of the insurer[10]. The penalty for late filing of these statements also depends on the insurer's class: the fine is $1000 per week for Class 3A, Class C, or Class D insurer; and $5,000, in the case of a breach by a Class 3B, Class 4 or Class E insurer[11]. If an insurer fails to provide the BMA with statutory financial statements within 3 months of the filing date the BMA "may appoint an inspector to investigate the affairs of [the] insurer"[12].

82. The contents of other reporting obligations also depend on the class of the insurer, making it difficult to have a global picture of the Bermudian reporting obligations, even though they are publicly available. The opinion of a loss reserve specialist has to be provided every year for a Class 3A, Class 3B, or Class 4 insurer (Article 18B IA). The long-term insurers have to submit an opinion from the approved actuary. Additional GAAP financial statements are compulsory for Classes 3A, 3B, 4 or Class E insurers. There are no equivalent requirements for Classes C and D, though BMA state that the plan to introduce these in effect from year-end 2016.

83. When the solvency margin is breached, the Principal Representative[13] must notify the Authority forthwith[14]. Section 31A requires all insurers to report immediately to the Authority breaches to the minimum margin of solvency. The insurer must submit an action plan to rectify the breach within 14 days.[15]

84. Similarly, insurers who breach the enhanced capital requirement must submit an action plan to rectify the breach within 14 days (Section 31AA). Long-term insurers are also required to submit a solvency certificate and an actuarial opinion along with other documents set out in Section 31AA(1)(b) within 45 days after reporting a failure to meet the enhanced capital requirement. The Authority has the power to require an insurer to change any plan it has submitted.

Specificities for 260

Type and frequency of accounting, prudential, statistical information obtainable by the supervisory authority from the parent undertaking

85. Under Article 27F IA, the BMA is able to make rules regarding supervisory reporting in respect of insurance groups, which apply to designated insurers within the group. Their reporting requirements for groups are in line with the solo requirements outlined above. In addition, the Group Supervision rules also set out reporting requirements for groups.

EIOPA advice

Articles 172/260

86. The BMA has at its disposal a series of powers, including, in the event the insurer becomes insolvent, the powers to restrict the insurer's activities, to restrict its

[10] 6 months extensible to 9 months for class 3; 4 months extensible to 7 months for classes in the case of a Class 3A, Class 3B, Special Purpose Insurer, or Class 4 insurer or a Class C, Class D or Class E insurer(Article 17(4) IA).
[11] Article 18A (2) IA
[12] Article 18A (5) IA.
[13] The role of the '*Principal Representative'* is further detailed under Principle 3.
[14] Article 8A IA
[15] This is further developed under Principle 6.

investments, to freeze its assets, to remove its management and to prohibit the payment of dividends. Reporting obligations vary according to the insurer's class.

87. In respect of the Solvency II Directive, Principle 1 is considered to be largely equivalent for Classes 3A, 3B and 4 insurers and Class E insurers, including in group supervision, and to be partly equivalent for Classes C and D.

Principle 2 - Professional secrecy, exchange of information and promotion of supervisory convergence

Objective – *The supervisory authorities of the third country and supervisory authorities of Member States involved in the supervision of domestic insurance and reinsurance undertakings shall cooperate and, where relevant, ensure the effective exchange of information.*

The supervisory authorities of the third country shall provide that all persons who are working or who have worked for the supervisory authorities, as well as auditors and experts acting on behalf of those authorities, are bound by obligations of professional secrecy.

The above mentioned obligations of professional secrecy shall extend to information received from the supervisory authorities of Member States.

88. The BMA has developed a framework establishing the preconditions necessary for effective and efficient information exchange. This framework is applicable to information exchange in solo and group contexts.

89. All persons who receive information under the IA shall not disclose such information, except with the prior consent of the person to whom it relates or from whom it was received. "All persons" can include directors, board members, employees or contractors, as well as persons who have previously occupied one of those roles. This ensures that the concept of confidentiality is broad and will be applied across all operations possible in the field of supervisory information exchange. Violations of the confidentiality regime may lead to criminal investigations and may result in a fine of up to $100,000 or imprisonment for up to five years.

90. The BMA is only allowed to pass on such confidential information in a few cases. There are information gateways for information to be provided to the Minister of Finance or other authority where this would assist them in discharging regulatory functions. However, information can only be provided to these authorities for well-defined purposes, including supervisory purposes, as well as criminal proceedings and enabling inspectors to carry out investigations for the BMA.

91. Furthermore we note that the Minister does not actually have any regulatory functions with respect to insurance supervision. The registrar of companies is the only other authority which could be a possible recipient of information. The scope of information to be included on the register will be limited, though. As such the information gateways would have limited application.

92. If supervisory authorities from outside Bermuda provide information to the BMA, it will not be passed on except with the prior consent of the authority which provided the information (Articles 52B (4) and 52 (1) IA). The only possible circumstance where the BMA would disclose confidential information without such prior consent would be if a subpoena were served and the (civil) Court issued a direct order on the BMA to provide the desired information. While the IA (and also the Solvency II Directive) do not provide for such disclosure of confidential information and remain silent in this respect, the concept of assigning the final decision with respect to disclosure to the Court rather than to the supervisory authority is also applicable to some European countries. With respect to equivalence, it also has to be noted that the risk of such a circumstance arising is relatively remote and has never materialised to date.

93. The BMA has developed tools for group supervision. To this end, it has drafted guidance notes on *Supervisory Cooperation and Information Exchange* and on

Determination and Responsibilities of a Group-Wide Supervisor, and Principles of Group-Wide Supervision. The BMA hosted eighteen supervisory college meetings in 2013 covering groups for which it is the group supervisor[16], accompanied by numerous bilateral meetings with other relevant supervisors. These colleges were attended by supervisors from North America, Europe, and Asia. In preparation for these colleges, the BMA's Legal Services performed any necessary further analyses of the participating supervisors' legal frameworks. During the 2011 on-site visit the BMA explained in detail the arrangements and planning for an upcoming supervisory college. These details included the conditions for participation, including a sufficiently detailed framework for the protection of confidential information. Our discussions covered the timeline, format, and agenda of this particular college.

94. In addition to hosting college meetings, the BMA participated in other colleges in 2013. Information exchange within these meetings and otherwise as part of college cooperation included the communication of concerns regarding insurance groups active in Bermuda. The BMA has engaged in coordinating supervisory plans with relevant regulators from other countries.

95. International information exchange is also needed for the successful assessment of director and shareholder suitability. In this respect, research is performed by a specialised unit within the Licensing and Authorization Department. Background checks include using commercial services for compliance solutions, and information requests to other supervisors. In practice information flows both ways, as long as the aforementioned preconditions for information exchange are in place.

96. The BMA has entered into various cooperation agreements with, at the current time, twenty-three supervisors from North America, Europe, and elsewhere. Furthermore, it is a member of the IAIS and IOSCO MMoUs, and participates actively in the work of these bodies. However, the existence of such an agreement is not seen by the BMA as a precondition to information exchange.

EIOPA advice

Articles 172/227/260

97. Under the Bermudian legal framework, and under the provisions established by the BMA, confidential supervisory information is protected from unwarranted access as well as disclosure and transmission. Overall the level of protection is equivalent to that built into the Solvency II Directive.

98. Information obtained by the BMA, be it by means of research, reporting, or information sharing by other (supervisory) authorities, is strictly protected under the IA. All persons who are working for the BMA, or have previously done so, must comply with these provisions, breach of which would be prosecuted as a criminal offence. Voluntary disclosure of information to third parties needs prior explicit consent of the party which provided the information.

99. The BMA may be compelled to disclose information in criminal matters or if a direct subpoena were served on it for the purposes of court proceedings, in cases other than those covered by Articles 68 to 70 Solvency II Directive. Since the latter has not been of practical relevance so far, and is not expected to be in the foreseeable future, it does not have a negative bearing on the assessment. As to information sharing in practice, the BMA has a proven track record of information

[16] BMA Annual Report 2013

sharing through the numerous agreements it has entered into, and through supervisory colleges they have hosted or participated in. Therefore, Principle 2 is in respect of the Solvency II Directive considered to be equivalent.

Principle 3 - Taking-up of business

***Objective –** The taking-up of the business of reinsurance in the third country shall be subject to prior authorisation. Authorisation for the taking-up of business shall be conditional on the undertaking meeting a clear, objective and publicly available set of written standards on a continuous basis. Insurance business in Bermuda is subject to prior authorisation ("registration"). Insurers may take on the legal form of an incorporated entity under the Companies Act 1981, a company incorporated overseas with a special permit under said Act, or a Non-Resident Insurance Undertaking.*

Head office requirements

100. Article 20 Solvency II Directive requires that insurers' head offices be situated in the same Member State as their registered office. In Bermuda under Article 8 IA the only requirement is that every insurer must maintain a principal office in Bermuda, and appoint and maintain a principal representative approved by the BMA.

101. Under Guidance Note (GN) 1 on the Role of the Principal Representative (PR) it is further explained that "the principal office can be the office of the [PR], or the office of the [insurance] management company". The management company referred to is the Insurance Manager (IM) that an insurer may have – although it is not a requirement (Article 8.2.b of the IA). The duties of the IM are described in GN 8.

102. The following paragraphs set out in more detail the roles of the PR and the IM, to clarify the nature of the principal office.

103. GN1 (7) indicates that the PR "would generally be either a director, senior financial officer or manager normally resident in Bermuda, or a Bermuda registered insurance management company"; they may therefore be internal or external to the insurer. The role of the PR is defined in the IA, in particular under Article 8A IA, and in GN1 and they are subject to a number of regulatory requirements: in particular, they are required to immediately notify the BMA of any likelihood of the insurer becoming insolvent (Article 8A (1a) IA), or of other events listed under Article 8A (2) IA) and in certain cases they are also required to provide the BMA with further information and materials such as interim financial statements (see Article 8A (2a and b) IA). They act as a link between the insurer and the BMA, and indeed the PRs visited described their role as acting as a regulatory advisor.

104. In most cases the PR is a member of the insurer's board; if not, they request to attend board meetings. Under GN1 (17), insurers are required to ensure the PR has access to the necessary information to fulfil its role; GN1 (19) states that "Where the [PR] does not have access to sufficient information about the insurer […], the [PR] should contact the [BMA]." Article 12 states that "while the Board of Directors and the Senior Management have the primary responsibility for the conduct and performance of the insurer, the [PR] acts in an 'early warning' role and monitors the insurer's compliance with the [IA] on a continuous basis." They are also responsible for the filing of financial returns and statements and for the maintenance and custody of statutory accounting records (GN1(7)).

105. There are 130 Bermudian commercial insurers that have an IM. The role of the IM is outlined in Article 1(1) of the IA, which states that the IM is "a person who, not being an employee of any insurer, holds himself out as a manager in relation to one or more insurers, whether or not the functions performed by him as such go beyond the keeping of insurance business accounts and records". GN8 deals

with the appointment and duties of the IM. It is a requirement that there should be a formal agreement between the IM and the insurer that sets out the respective functions, duties and responsibilities. IMs are subject to registration and supervision by the BMA. Furthermore, as allowed for in GN1 (7), where an insurer has an IM they would often also be appointed to be the PR.

106. An IM is in practice an external company to which an insurer's functions, up to and including the responsibilities of the chief and senior executives (Paragraph 15 of the Insurance Code of Conduct), may be outsourced (see Article 1 (1) IA for a legal definition). In the context that some of these insurers may have very low volumes of business, a single IM may be responsible for the management of (and may act as PR for) tens to hundreds of insurers giving rise to potential for conflicts of interest.

107. Although in practice some principal offices may constitute the central administration of the insurer, and could be regarded as head offices[17], the current legal framework does not ensure that this is the case, as the formal requirements for a principal office relate to a narrower range of functions than those of a head office. Since no distinction is made between classes in this regard, it remains theoretically possible for even a large commercial insurer not to have a substantive head office in Bermuda.

108. In practice the BMA does not see nor has experience demonstrated that the Bermudian legal framework has hampered its ability to effectively supervise insurers under its regulatory control. The BMA supervision and licencing processes are also designed to apply appropriate regimes to ensure policyholder protection. Nevertheless the Bermudian legal framework does not have any equivalent requirement to Article 20 Solvency II Directive to ensure that insurers' head offices are situated in the same country as their registered office. This has the potential to impede effective supervision, though the BMA has stated that in their experience this has not been the case in practice.

Licensing process

109. According to the IA, undertakings can obtain licences for general insurance, for long-term insurance (see paragraphs 14, 15 and 21 above), or for both ("dual license"). There are currently (31 December 2013) 68 commercial insurers who are dual-licence holders. The BMA informed EIOPA that they don't longer licence insurers to write both general (non-life) and long-term (life) insurance business in the same entity. Dual licence is still possible for reinsurance business in combination with direct insurance business (e.g. direct general insurance business plus general and long-term reinsurance business). Dual licence holders have to maintain separate balance sheets and meet the capital requirements in respect of both their life and non-life business. Insurance managers and other intermediaries are also subject to authorisation.

110. The BMA may issue a licence for a different class than that applied for (Articles 4 (6) and 4EA IA). Besides this, applicants can also be licensed as a Special Purpose Insurer (SPI). During the past three years (2012 – October 2014), 28 licences were issued for Classes 3A, 3B and 4, 20 for long-term-business C, D and E, and 18 for insurance managers.

111. Applications are handled by the Assessment and Licensing Committee (ALC), which also makes the decisions on them. Its seven members are to be drawn

[17] With reference to the Judgment of the ECJ in Case 81/87 (Daily Mail) that equates the "real head office" with the "central administration of the company".

from senior staff in each of the relevant departments (Insurance, Banking, Policy, and Legal Services and others). The Unit is able to draw on the support of a Risk Committee.

112. The Solvency II authorisation requirements are defined in the Directive and are publicly available (e.g. Articles 18, 23, 100 et seq. and 128 et seq. Solvency II Directive). The fundamental elements are: defined own funds, a defined solvency level, and a scheme of operations (including the nature of risks, reinsurance arrangements, cost-estimates, forecast balance sheets, and estimates of the MCR/SCR (Minimum Capital Requirement and Solvency Capital Requirement)). The BMA, on the other hand, relies on minimum criteria set out in the law and has the right to impose further conditions for licensing as it deems necessary. In determining any further conditions, the BMA attaches much importance to the proportionality principle.

113. Minimum criteria (as set out in the Schedule to the IA) are inter alia:
    - Every controller and officer has to be a fit and proper person.
    - Body corporates must be directed by at least two individuals, and have non-executive directors on their board as the nature of the business requires.
    - The entity must conduct its business in a prudent manner, must have sufficient capital, and must maintain adequate accounting and business records as well as adequate control systems to comply with all applicable provisions.

    In addition, the Insurance Code of Conduct provides further directions, predominantly around governance and risk management.

114. These criteria provide a broad framework and are further elaborated upon in an ALC information bulletin which has recently been updated (October 2014) and is publicly available. Every application must include a detailed scheme of operation; income statements and balance sheets on a 5-year basis; information on shareholders, owners and directors; and information on insurers the applicant plans to do business with.

115. Assessments include fitness and propriety checks for key individuals who are performed on the basis of personal declarations and CVs submitted by applicants. Background checks are also common (see Principle 2).

116. Under Article 4 (1c) IA, as noted above, insurers may obtain a dual licence for non-life and long-term business classes to be conducted together. Although this differs from Article 73 (1) Solvency II Directive, this difference is of limited relevance for the licensing of insurance undertakings carrying out reinsurance activities, which are not required to separate their portfolios into life and non-life insurance for that business, and does not influence our advice for this principle. Article 73 Solvency II Directive also in some cases allows a single company to pursue both life and non-life business - for certain non-life insurance activities (new-style composites) or under a permit to pursue rights arising from an old licence (old-style composites).

117. In 2012, Section 19 of the Insurance Act was amended prohibiting commercial insurers from engaging in non-insurance business unless such business is ancillary to its operations. Before this date, insurers were allowed to conduct non-insurance business. On that point, prior to the amendment, the legal regime differed considerably from that set out in Solvency II.

118. Article 18(1)(a) Solvency II Directive provides that an insurance undertaking

must limit its objects to insurance business and "operations arising directly therefrom to the exclusion of all other commercial business". In Bermuda "ancillary business" is defined as activities associated with or supporting the insurer's insurance business such as managing the own investment activities (not for third parties), risk management activities, ALM activities and risk transfer activities.

119. The situation of the ancillary business can be largely considered as equivalent to what is required by the directive Solvency II.

EIOPA advice

Article 172

120. Principle 3 is largely equivalent. The BMA is empowered to obtain all the information necessary for licensing, however there is no legal requirement to ensure that an insurer has its head office situated in the same country as its registered office.

Principles 4 and 10 - System of Governance and Public Disclosure

Objective - *The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings carrying out reinsurance activities to have in place an effective system of governance which provides for sound and prudent management of the business, and require groups to have in place such a system at the level of the group. That system shall at least include an adequate transparent organisational structure with a clear allocation and appropriate segregation of responsibilities, requirements for ensuring that persons managing the undertaking are fit and proper and effective processes to ensure the timely transmission of information both within the undertaking or group and to the relevant supervisory authorities.*

The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings carrying out reinsurance activities to have in place an effective risk-management system comprising the strategies, processes and internal and supervisory reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis and at an individual and an aggregated level, the risks to which the undertaking is or could be exposed, and their interdependencies, as well as an effective internal control system. It shall require groups to have in place such a system at the level of the group.

The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings carrying out reinsurance activities to establish and maintain risk-management, compliance, internal audit and actuarial functions. Groups shall be required to establish and maintain these functions at group level.

The solvency/prudential regime of the third country shall require groups and domestic insurance and reinsurance undertakings carrying out reinsurance activities to disclose publicly, on at least an annual basis, a report on their solvency and financial condition.

For group supervision assessments:

The prudential regime of the third country shall require the group to have sound reporting and accounting procedures to monitor and manage its intra-group transactions and risk concentrations and to report at least annually significant risk concentration at the level of the group and significant intra-group transactions.

Governance

121. The BMA's 'Insurance Code of Conduct' (the 'Code') became effective from July 2010 with a deadline for compliance set for July 2011. The Code applies to all insurers and the BMA must be satisfied that a company is conducting its business in a sound and prudent manner, as evidenced by compliance with the Code. The BMA verifies compliance with the Code in on-site reviews and off-site analysis. In the event that the BMA finds an insurer's compliance with the Code to be deficient, it notifies the company (or its insurance manager, as appropriate) of the need for corrective action and agrees a timeline for action. The BMA has stated that it will be amending the Insurance Act to require insurers to submit a declaration of compliance with, inter alia, the Minimum Criteria for Registration, which embodies the Code. This declaration will be published for commercial insurers (Refer to paragraph 148 below).

122. The BMA considers that the Code brings together in a codified form and updates much of its earlier governance requirements and guidance for insurers. The BMA states that the Code largely represents existing practice for the market with some updates to reflect recent changes in international standards.

123. The Code is principles-based and its application in the market depends on the nature, scale and complexity of the insurer, which the BMA determines on a case by case basis. The BMA will have regard for the appropriateness of provisions of the Code in relation to their application to a particular insurer taking into account the BMA's prudential objective underpinning the provisions being effectively met.

124. The BMA published the draft text of proposed amendments to the Code (the 'draft Code') at end August 2014, and the consultation period was closed at end October 2014. The proposed amendments address some of the differences from Solvency II raised in EIOPA's 2011 advice, assuming the draft Code is adopted in its current form. It is intended that the Code will come into effect in January 2015, with a deadline for compliance of July 2015.

125. In addition to the Code, which applies to all insurers, the BMA has also published its 'Insurance (Group Supervision) Rules 2011' (the 'Group Rules'), which establish governance and other requirements in relation to groups. The Group Rules came into operation in stages between January 2012 and January 2014; all are now in effect.

Fit & proper

126. An underpinning principle of an effective governance system is the fitness and propriety of the key individuals operating in the market. It is therefore essential that the supervisory authority and the firms in the market have appropriate processes to make this assessment. In Bermuda paragraph 12 of the existing Code, gives insurers' boards responsibility for ensuring the fitness and propriety of key individuals and having in place appropriate processes to assess this. The roles requiring assessment are 'board members, controllers, officers and third-party service providers, including insurance managers, auditors, actuaries and the principal representative'. These BMA requirements are equivalent to Article 42 Solvency II Directive which requires assessment of those who "effectively run the undertaking".

127. Requirements regarding fitness and propriety also appear in paragraph 5 (6) of the Group Rules, which determines that membership of the parent's board and its committees must be reviewed at least every three years to ensure that members of the board and the executives:

- Continue to be fit and proper;
- Individually and collectively have the requisite knowledge skills, expertise and resources given the nature, scale and complexity of the group's operations; and
- Individually and collectively remain effective in discharging the respective roles and responsibilities assigned to them.

128. This triennial assessment is forward-looking, in that the Board will have to be satisfied that these conditions will continue to be met. The three-yearly frequency presents a slight difference from the Solvency II fitness and propriety requirements, which apply continuously. However in practice the BMA's expectation is that the fitness and propriety requirements will be met on an on-going basis.

Risk management

129. The requirement for a risk management function is established in paragraph 45 of the existing Code and paragraph 8 of the Group Rules. Paragraphs 11 to 17 of the Group Rules and paragraphs 22 to 43 of the existing Code describe in detail the risk management framework and its essential features, establishing a

comprehensive set of requirements similar to those of Articles 44 (1-4) Solvency II Directive.

130. The BMA has developed a framework for Commercial Insurers Solvency Self Assessments (CISSA) and Group Solvency Self Assessments (GSSA), similar in concept to the Solvency II Own Risk and Solvency Assessment (ORSA) requirement. Under paragraph 53 of the existing Code, insurers are required to develop procedures to assess their material risks and capital requirements; relevant insurers must follow the CISSA standards in place of this self-assessment. The Insurance Prudential Standards for the commercial insurance classes establish in paragraph 6 that insurers in classes C, D, E, 3A, 3B and 4 must annually submit details of their CISSA to the BMA.

131. Paragraph 18 of the Group Rules requires that groups establish GSSA procedures which are an integral part of the group's risk management framework. They are to be conducted annually (or after a significant change in the group's business or risk profile). Under paragraph 6 of the Insurance Prudential Standards for Groups, every insurance group must provide the BMA with details of its GSSA.

Internal audit function

132. Article 47 Solvency II Directive requires that insurers falling under the scope of the Directive shall provide for an effective internal audit function. This internal audit function must be objective and independent from the operational functions (except in certain circumstances described in Article 271 (2) of the Solvency II Delegated Acts). For the BMA, the internal audit function is dealt with in paragraph 48 of the existing Code and in paragraphs 4 and 7 of the Group Rules. There is currently no requirement at solo level for the function to be independent from other functions, however the draft Code which was consulted on would establish the independence of the internal audit function (in paragraph 50).

Effective controls and contingency plans

133. Paragraphs 40-43 of the existing Code articulate requirements for insurers to have effective processes and controls. Paragraph 12 of the existing Code requires the Board to ensure the existence of 'contingency plans, including those surrounding natural disasters and information recovery, to ensure continual operation of the insurer'. It is considered that this is equivalent with the requirements of Solvency II.

134. Anti-money laundering is an important area of an effective control framework, which the Directive picks up by reference to other legislation in article 59. In this area we note that there is a difference in that under the BMA regulations there is no definite cash payment threshold that would trigger specific obligations.

Actuarial function

135. Paragraph 51 of the existing Code specifies the role of the actuary, which appears largely equivalent with Article 48 Solvency II Directive. For groups, an actuarial function is required under paragraph 4 of the Group Rules and details of its responsibilities are set out in paragraph 10.

136. One area of difference is that the Directive requires the actuarial function to 'express an opinion' on underwriting policy and adequacy of reinsurance, whereas the BMA's Code only suggests that they 'assist' with the process. This is a difference because 'expressing an opinion' implies a degree of oversight over the effective underwriting of the insurer whereas the latter does not.

Outsourcing

137. In respect of outsourcing, a key requirement under article 49 of the Directive is

that insurers remain responsible for all of the activities that they outsource. Paragraph 56 of the BMA's existing Code requires that "the insurer should have oversight and clear accountability for all outsourced functions as if these functions were performed internally and subject to the insurer's own standards on corporate governance and internal controls", which is equivalent to Solvency II requirements. This part of the Code goes on to require transparency of information as similarly required by Article 38 Solvency II Directive.

138. Article 49 Solvency II Directive requires that insurers "notify the supervisory authorities prior to the outsourcing of critical or important functions or activities". Since the 2011 EIOPA's advice the Insurance Act has been amended, such that Sections 30JA and 30JB now require insurers to notify the BMA prior to outsourcing all or a material part of their underwriting activity, or all or substantially all of their actuarial, risk management, compliance and internal audit functions.

139. The Directive imposes restrictions on outsourcing, in that when it is of "critical or important operational functions", account needs to be taken of factors such as whether this will impair the system of governance or increase operational risk. In Bermuda, when the BMA is notified of a proposed outsourcing arrangement in line with Sections 30JA and 30JB of the Insurance Act, it will object to the arrangement if the interests of policyholders may be threatened by it in any manner. Provisions in the Code place responsibility on the insurer to have oversight and clear accountability for all outsourced functions as if these functions were performed internally and subject to the insurer's own standards on corporate governance and internal controls.

140. Outsourcing is common place in the Bermudian market among commercial insurers, primarily Class 3A, with 130 having insurance managers - some of whom may act for multiple insurers. Insurance managers perform a broad range of functions and can act as an insurer's principal representative in Bermuda. Although paragraph 15 of the Code would appear to allow commercial insurers to outsource all core activities, including Chief and Senior executives responsibilities, BMA has confirmed that it is not their policy to allow commercial insurers to outsource the CEO and senior executive functions, and that no commercial insurers have outsourced these functions.

Compliance function

141. Paragraph 49 of the existing Code establishes that insurers should have a compliance function. Paragraph 52 of the draft Code elaborates on the function's responsibilities, stating that among other things this should include establishing compliance policies, procedures and process and a system of compliance monitoring. For groups, a compliance function is required under paragraph 4 of the Group Rules and details of its role are given in paragraph 9.

Deteriorating financial conditions

142. Article 36 Solvency II Directive requires that the regulatory authorities have in place appropriate monitoring to enable them to identify deteriorating financial conditions in insurance or reinsurance undertakings, and the firms themselves are required to have these processes in place per Article 136 Solvency II Directive.

143. The BMA has in place an annual filing process to identify issues with minimum solvency requirements. The Authority has quarterly filings for insurance groups, Class 4 and Class 3B insurers. The BMA does not have a quarterly process for other insurers, although in practice it receives information from commercial

insurers on a quarterly basis that would allow it to check for a breach in the Minimum Solvency Margin as the items needed for its calculation are included.

144. In paragraph 18 of the existing Code the BMA has a requirement that the Principal Representative[18] "acts in an "early warning" role and monitors the insurer's compliance in accordance with Article 8A IA on a continuous basis". Article 8A IA refers to the insolvency of the insurer and to "failure by the insurer to comply with a condition imposed upon the insurer by the Authority relating to a solvency margin or liquidity or other ratio".

Auditor's responsibilities

145. Under Article 72 Solvency II Directive, auditors have a responsibility to report material breach of laws, impairment of functions, refusal to certify accounts and non-compliance with MCR/SCR, and generally to respond to relevant information requests from the supervisory authorities. In Bermuda, under Article 16A IA, auditors are required to report issues to the BMA related to the accounts and "any fact or matter which is likely to be of material significance for the discharge, in relation to the insurer, of the Authority's functions under this act". Provided exercised appropriately this is equivalent to the requirements of the Directive.

Public disclosure

146. Articles 51 and 256 Solvency II Directive detail the public disclosure requirements for insurers and insurance groups respectively. Specifically, insurers and insurance groups are required to disclose publicly, on an annual basis, a report on their solvency and financial condition. This report should include, but is not limited to, information on the insurer's business, external environment and performance, system of governance, risk profile, valuation for solvency purposes and capital management.

147. Since EIOPA's 2011 advice, public disclosure requirements for Bermudian insurers have been developed. According to Section 17A Insurance Act Bermudian insurers in Classes 3A, 3B, 4 and E are obliged to prepare additional financial statements in accordance with International Financial Reporting Standards (IFRS), or any generally accepted accounting principles (GAAP) recognized by the BMA, mainly Bermudian, Canadian, US or UK GAAP. The different bases mean there may be some variation in the information disclosed.

148. These additional financial statements generally provide some information on: business and performance, assets, technical provisions and capital management. However, this is more limited than the information which will be included in the Solvency and Financial Condition Report under Solvency II, in particular in relation to:

- **System of governance** – under Solvency II, insurers and groups must provide a fairly comprehensive description covering the Board and committee structures, all of the key functions, outsourcing and remuneration – the additional financial statements required in Bermuda do not cover any of these areas (barring some narrow requirements in relation to remuneration), although IFRS does require some description of the framework for managing insurance risks.
- **Risk profile** - under Solvency II, insurers and groups must provide a description, separately for each category of risk, of the risk exposure, concentration, mitigation and sensitivity – with the exception of some

[18] The role of the *Principal Representative* is described under Principle 3.

points relating to credit risk, this is not required in the additional financial statements.

- **Capital management** – under Solvency II, insurers and groups must disclose the SCR and MCR, details about their calculation, any significant non-compliance with them during the reporting period, and details about the composition of own funds – under the Bermudian regime, practice varies, but in general only the amounts of the actual and required statutory capital and surplus are disclosed.

  EIOPA is advised that the BMA will amend Section 17A Insurance Act to make it a regulatory obligation that commercial insurers state their compliance with regulatory capital requirements and the Minimum Criteria for registration. The latter creates an attestation of compliance with the Code which constitutes a public disclosure on an insurer's compliance with the system of governance regime in Bermuda. As no details of the insurers' capital positions or governance arrangements will be provided beyond the fact that they meet the minimal standard, gaps will remain in relation to the capital management and system of governance elements mentioned above.

149. In the current environment:

- Classes 3B, 4 and groups are required to submit additional financial statements which are published on BMA's website.
- Classes 3A and E are required to submit additional financial statements but these are not disclosed.
- Classes C and D are not required to submit additional financial statements.

  EIOPA is advised that from year-end 2016 the additional financial statements for classes 3A, C, D and E will also be published according to Section 17A (6) IA.

150. There are limited instances where the Authority may consider exemptions or modifications to the preparation and/or publication of these additional financial statements. BMA has issued an Information Bulletin (Information Bulletin on Waivers and Modifications to Section 17A of the Insurance Act 1978) in which these instances are stipulated. These cover a wider range of circumstances than those where Solvency II envisages exemptions.

151. For example, the BMA bulletin envisages considering waiving disclosure requirements where disclosure may create a competitive disadvantage. Under Solvency II such disadvantage would have to be certain, significant and undue for disclosure to be waived. Other circumstances where waivers are possible under the BMA regime but not under Solvency II are where the insurer's parent is in administration, or for run-off insurers where "it is not expected that public disclosures are necessary" or where disclosures may prejudice the insurer's commercial position. Where the BMA supervises both the group and the legal entity, the legal entity's disclosures might be waived where they would not materially differ from the group's or where accounting conventions do not appropriately reflect the economic characteristics of the legal entity.

152. In addition, under Solvency II the disclosure of capital management information may never be covered by such an exemption (Article 53 (4) of the Solvency II Directive), whereas under the Bermudian regime it may be.

153. The BMA has stated that even when a waiver has been granted this would be

conditional on policyholders still being able to obtain a certificate of compliance and financial information from the insurer or from the BMA.

154. Since the 2011 EIOPA's advice the Insurance Accounts Regulation 1980 was amended requiring commercial general and all long-term insurers to report on gross and net technical provisions.

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155. The BMA framework, made up of its Code of Conduct, rules, and guidelines, requires insurers to have in place an effective system of governance which provides for sound and prudent management of the business and an effective risk management system. It is considered that the framework applied to groups and insurers in classes 3A, 3B, 4, C, D and E is largely equivalent to that under Solvency II.

156. EIOPA has identified outsourcing and public disclosure as the key areas where the BMA regime would have to be strengthened or addressed in order to be considered equivalent to Solvency II.

157. The BMA's current regulation and plans for public disclosure are different from Solvency II in terms of (intended) scope and market reach. There are currently no public disclosure requirements applicable to insurers in Classes 3A, C, D and E; those which apply to groups and Classes 3B and 4, and which are intended to apply to the other commercial classes in due course, are not as extensive as under Solvency II and exemptions may be considered in a wider range of circumstances. Solvency II is based on a three pillar approach with significant emphasis placed on Pillar 3 disclosure requirements.

158. Consequently the supervisory regime should be deemed to be largely equivalent with Solvency II.

Principles 5 and 11 - Changes in business, management or qualifying holdings

Objective – *The solvency/prudential regime of the third country shall require that proposed changes to the business or management of domestic insurance or reinsurance undertakings carrying out reinsurance activities or of groups, or to qualifying holdings in such undertakings and groups are consistent with maintaining the sound and prudent management of the domestic insurance or reinsurance undertaking or group.*

Acquisitions of insurers

159. According to Article 30D (1) IA persons with the intention of becoming a shareholder controller (Article 1A (3) to (5) IA) in a registered private insurer in Bermuda must notify the BMA. After the notification the BMA has 45 days in which to serve any notice of objection. In addition, the BMA must be notified within 45 days of a person becoming a shareholder controller of a public insurance company, in accordance with Article 30E IA. The thresholds for notification are 10%, 20%, 33% or 50% of the capital or voting rights. Failure to give the required notification is an offence (Article 30G IA). Under Article 30J IA commercial insurers are required to notify the BMA no later than 45 days after becoming aware of any person who has become or has ceased to be a controller of the insurer. Articles 30JA and 30JB consider amalgamations and acquisitions as material changes that require the Authority's approval.

160. In this process the BMA is empowered to object to a new or increased controller if it is not satisfied that they are fit and proper, if the interests of clients or potential clients of the insurer are threatened or if the insurer will no longer meet minimum supervisory requirements under Article 30F IA. In September 2014 the BMA issued public guidance on the supervisory process for carrying out assessments of shareholder controllers, and the criteria for establishing the fitness and propriety of shareholder controllers/controllers.

161. Furthermore the BMA has the power to impose restrictions on shareholders' voting rights or to void share transfer agreements according to Article 30I(2) IA.

Existence of provisions in relation to disposals

162. There is currently no legal requirement to notify the BMA of disposals of qualifying holdings. The BMA intend to address this in amendments to the IA scheduled for Q4 2014.

Information obtainable from an undertaking regarding acquisitions and disposals

163. According to Article 30J IA all insurers have to notify the BMA in writing when any person becomes or ceases to be one of their controllers. The notification shall be served within 45 days of the day on which the insurer became aware of the relevant facts.

Existence of provisions in relation to outsourcing

164. Under Articles 30JA-C IA proposals for the outsourcing of all, or substantially all, of specified key functions, or of a material part of an insurer's underwriting activity, need to be notified to the BMA 14 days in advance of their taking effect. The BMA is required to serve a notice of objection to the change unless it is satisfied that the interests of policyholders and potential policyholders are not

threatened and that the requirements of the IA would continue to be complied with. In the case of outsourcing of underwriting activity, where the decision making function is outsourced the BMA would consider this a material change to which Article 30JA would apply.

165. According to paragraph 56 of the Code, the insurer should have oversight and clear accountability for all outsourced functions as if these functions were performed internally and subject to the insurer's own standards on corporate governance and internal controls. The insurer should also ensure that the service agreement includes terms on compliance with jurisdictional laws and regulations, cooperation with the BMA, and access to data and records in a timely manner.

166. The status of the Code is not directly comparable to law (see introduction). It elaborates a standard set by the BMA and that the BMA expects to be met by market participants. The BMA considers the Code of Conduct is an indicator of compliance with the Minimum Criteria set forth in the Insurance Act, and that failure to comply with the Minimum Criteria would give rise to enforceable actions by the BMA.

Ongoing assessment, approval and disclosure of relevant information (including portfolio transfers, changes to board and senior management and scheme of operation)

167. The IA requires that the BMA be notified of and approve all long term business portfolio transfers (Article 25 IA). Under Article 25 (7) IA, these requirements do not apply to the transfer of long-term business that is reinsurance business. However, article 30JA broadens the approval process for risk transfers to cover non-life and life business, except covering purchase of reinsurance.

168. Under Article 30J IA an insurer must notify the BMA of changes to its Officers. 'Officers' in this context means directors, chief executives and senior executives exercising functions in relation to underwriting, actuarial, risk management, compliance, internal audit, finance and investment matters.

169. Articles 30JA to 30JC IA pertain to material changes to business operations which need to be notified to the BMA. Material changes are defined as:
    - Acquisition or transfer of insurance business being part of a scheme falling within Article 25 IA or section 99 of the Companies Act 1981;
    - Amalgamation with or acquisition of another firm;
    - Engaging in unrelated business that is retail business;
    - Acquisition of controlling interest (50% or more of the voting shares) in an undertaking that is engaged in non-insurance business which offers services and products to persons who are not affiliates of the insurer
    - outsourcing all or substantially all of the functions of actuarial, risk management, compliance and internal audit;
    - outsourcing of all or a material part of an insurer's underwriting activity;
    - transfer other than by way of reinsurance of all or substantially all of a line of business; and
    - expansion into a material new line of business.

170. As noted above in relation to outsourcing, the BMA is required to serve a notice of objection to the material change unless it is satisfied that the interests of policyholders and potential policyholders are not threatened and that the requirements of the IA would continue to be complied with. Contravention of the requirements is subject to civil penalties, and registered persons may be subject to public censure. Other changes to the scheme of operation do not legally require approval.

171. In the case of an expansion into a material new line of business the BMA assesses whether the proposed change would adversely affect the insurer's ability to meet its regulatory and supervisory requirements. Such a change would not necessarily require a change in the insurer's class of licence unless it involved a substantial growth in premium volume and/or insurance reserves. However, reclassification, or the imposition of conditions on the licence, could result if the insurer's risk profile altered.

172. Further to the IA, the BMA stated that under standard industry practice a material change would be understood to include any change which significantly impacts the insurer's risk profile, solvency, liquidity, regulatory compliance or reputation. From the BMA's perspective material changes would therefore encompass:

- Portfolio transfers;
- Changes in key personnel or shareholder controllers;
- Mergers, acquisitions and divestitures;
- Change in business plan including new products and territories;
- Significant reduction of statutory capital and surplus; and
- Expansion and contraction.

173. In effect, insurers making such changes have to obtain approval from the BMA and refile their BSCR and/or business plan and pro forma financials if the change will affect their capitalisation.

Specificities for 172

Details as to the existence and content of standards in respect of the undertaking's obligation to provide information on assessment of the reputation and financial soundness of the acquirer

174. In addition to the notification requirements for shareholder controllers, insurers are also required under Bermudian law to seek permission for transfers of shares under the Exchange Control Act 1972, including transfers to foreign owned Bermuda registered entities. This requirement indirectly imposes a duty on the insurer to assess the soundness of new shareholders. The BMA provides an opinion on share transfers by issuing a 'no objection' notice. Share transfers or allotments between 1% and 4.9% are considered minor and the BMA does not necessarily require prior review of personal declaration forms. Between 5% and 49%, personal declaration forms with net worth statements are required for review, including review by the BMA's Insurance Department.

175. Where there is a majority change in beneficial ownership to an unrelated new owner of 51% or greater, this purchase is reviewed by the ALC, which means that the following items will have to be provided to the BMA:

- Information on the principals (parent company):
    - Audited financial statements of the parent
    - Regulatory filings, if applicable
    - Background information

- Information on the individuals involved with the insurer:
    - Personal declaration forms
    - Bank references
    - Net worth statements
    - Curriculum vitae

176. If the overseas parent of the Bermudian insurer amalgamates with another

overseas company, the BMA explains that it only notes the change, as it has no control over the overseas company. However, if the overseas parent wishes to sell all or part of the Bermudian insurer to an unrelated entity, the BMA's Authorisation and Compliance Department, with the input of the Insurance Department, must indicate whether they will approve the change in control.

177. Finally, should the overseas parent place an intermediate company between the Bermudian insurer and themselves, or remove an intermediate company, the ultimate beneficial owner does not change and there is no impact on the class of the company, and consequently the BMA would give its approval.

Specificities for 260

Existence of provisions regarding the information obtainable from an undertaking relative to thresholds prompting notification of acquisitions/disposals and regular notification of qualifying holdings, including size

178. For groups, the insurer must notify the BMA of changes in shareholders and controllers within 45 days of the person becoming or ceasing to be a shareholder or controller, following the same rules as solo insurers under Articles 30D to 30JD IA.

179. The legal basis is equivalent.

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180. Following changes to the IA effective from 1 January 2013, principles 5 and 11 are largely equivalent. We note that further changes to the IA that are proposed for Q4 2014 are likely to address the residual concern over the lack of any requirements covering disposals of qualifying holdings.

Principles 6, 7 and 12 – Solvency Assessment

Objective *- The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings and groups to hold adequate financial resources.*

The assessment of the financial position of domestic insurance and reinsurance undertakings and groups in the third country shall rely on sound economic principles and solvency requirements shall be based on an economic valuation of all assets and liabilities.

The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings and groups to establish technical provisions with respect to all of their insurance and reinsurance obligations towards policyholders and beneficiaries of insurance and reinsurance contracts.

The solvency/prudential regime of the third country shall require that assets held to cover technical provisions are invested in the best interests of all policyholders and beneficiaries taking into account any disclosed policy objective and that domestic insurance and reinsurance undertakings and groups only invest in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report.

The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings and groups to meet capital requirements that are set at a level which ensures that in the event of significant losses policyholders and beneficiaries are adequately protected and continue to receive payments as they fall due to a level of confidence at least equivalent to that achieved by Article 101 of Directive 2009/138/EC. Those capital requirements shall be risk-based with the objective of capturing quantifiable risks. Where a significant risk is not captured in the capital requirements, then that risk shall be addressed through another supervisory mechanism. The calculation of capital requirements shall ensure accurate and timely intervention by supervisory authorities of the third country.

The solvency regime of the third country shall require domestic insurance and reinsurance undertakings and those which are part of a group to maintain a minimum level of capital, non-compliance with which shall trigger immediate and ultimate supervisory intervention.

The solvency regime of the third country shall require domestic insurance and reinsurance undertakings to meet the capital requirements referred to above with own funds that are of a sufficient quality and which are able to absorb significant losses. Own-fund items considered by the supervisory authorities to be of the highest quality shall absorb losses both in a going concern and in case of a winding up.

For group supervision assessments:

The calculation of group solvency in the third country's prudential regime shall produce a result that is at least equivalent to the result achieved by either one of the calculation methods set out in Articles 230 and 233 of Directive 2009/138/EC. The calculation shall ensure that there is no double use of own funds to meet the group capital requirement and that the intra-group creation of capital through reciprocal financing is eliminated.

Financial supervision

181. Section 31A IA requires that, within 14 days of its notification, an insurer failing to meet its Minimum Solvency Margin (MSM) send to the BMA a written report covering the causes of the failure and the actions the insurer intends to take to rectify it, including the time frame. The insurer shall not declare or pay any dividends until the failure is rectified. Similar provisions apply under section 31AA in the case of failure to comply with the enhanced capital requirement applicable to an insurer. In addition, within 45 days the insurer is under a duty to furnish the BMA with, amongst other things, an unaudited financial statement covering such period the Authority may require; solvency certificates for the life and non-life business (as applicable); a capital and solvency return reflecting an enhanced capital requirement prepared using post failure data where applicable.

182. Section 31B IA states that a Class 3B and Class 4 insurer shall not in any financial year pay dividends which would exceed 25% of its total statutory capital and surplus unless it has provided to the BMA 7 days in advance of payment an affidavit signed by at least two directors and by the insurers principal representative which states that in the opinion of those signing the declaration of those dividend has not caused the insurer to fail to meet its relevant margins. The BMA issued a Consultation Paper in October 2014 proposing to extend this requirement to all commercial insurer classes, and the Insurance Amendment that is presently before Parliament extends this provision to all commercial (re)insurers.

183. Section 31C IA requires BMA approval for any reduction of 15% or more of an insurer's statutory capital as set out in the previous year's financial statements in the case of all commercial classes of insurer.

Valuation

184. BMA legislation on the valuation of assets and liabilities for commercial insurers is under revision. BMA issued consultation papers for both life and non-life (general) insurers in August 2012, putting forward proposals for an Economic Balance Sheet (EBS) framework. The proposals, amongst other things, included that:

- assets & liabilities should be valued on a consistent economic basis
- financial assets should be reported on an economic basis
- liabilities other than TPs should be valued on an economic basis, consistent with international accounting standards [19].

185. The BMA conducted two quantitative impact assessments (trial runs – one in 2012 and the other in 2014), the latest being an assessment on Class 3B and 4 insurers and those groups where the Authority is the group supervisor. It used as a starting point the financial statements prepared according to IFRS or generally accepted accounting principles that apply in the USA, Canada or the UK to create an EBS. The BMA has concluded that the results demonstrated that the broad principles were feasible for non-life insurers, and the Authority proposes that Class 3A should also be covered by the approach with appropriate simplifications. A further trial run, including Class 3A insurers, is proposed for 2015.

186. For life insurers the EBS framework is less developed and no trial runs have yet been undertaken. The issues under consideration include how to allow for

[19] Main characteristics of this framework are listed under § 31 of BMA 02.05.2014 update.

adjustments to discount rates to reflect the risk characteristics of business written in Bermuda. The BMA has noted that in looking at the appropriate risk free discount rate it will consider approaches used elsewhere, including Europe, with particular attention to the adjustments adopted under Solvency II (matching adjustment, volatility adjustment).

187. BMA's proposals to its industry appear to be by and large Solvency II consistent, but they are still subject to further development in respect of Class 3A insurers (simplifications) and the commercial life classes (C, D and E). The following table covers the timeline towards full implementation of EBS.

188.

	Further proposals	**Trial runs (QIS)**	**Implementation**
Classes 3B, 4 and insurance groups	Consultation Paper and draft prudential rules December 2014 Finalised rules published 1 July 2015	April 2015 (best efforts basis)	1 January 2016
Class 3A	Simplifications to be worked on in 2015-16	April 2015 (best efforts basis)	1 January 2017
Classes C, D and E	Consultation Paper and draft prudential rules December 2014 Finalised rules published 1 October 2015	May 2015 (best efforts basis) Minimum two further tests in 2016 and 2017	1 January 2016 with transitional provisions for TP elements (TP on current valuation basis in 2016 and 2017) Full implementation 1 January 2018

189. In the interim period between 1 January 2016 and the implementation of the EBS for life insurers, the BMA has informed EIOPA that it will use the Solvency II rules in respect of the life business of groups and dual licence insurers in Classes 3B and 4. It is proposed that the relevant implementing rules will be introduced before the summer 2015.

190. The BMA intend to embed the EBS for non-life and life insurers as additional schedules in the Capital and Solvency Return, retaining the existing statutory financial statements in their current form as part of the statutory financial return. The new EBS schedules will be used as the source from which the Bermuda Solvency Capital Requirement Model would extract information to calculate the enhanced capital requirement (ECR), defined as the greater of the BSCR or the MSM (see below).

Technical provisions

191. Under Section 17A IA, commercial class non-life insurers and Class E life insurers are required to prepare GAAP financial statements in addition to audited statutory financial statements under Section 15 IA. Since insurers may prepare financial statements according to various accounting standards, TP are not assessed consistently across the market, preventing comparison between

undertakings. This will remain the case until the EBS is implemented.

192. Bermuda's regulatory framework requires that an appropriately qualified and experienced actuary express an opinion on the adequacy of reported TP, and the BMA places reliance on this and the supporting actuarial standards. It also places reliance on the independent auditing of financial statements to ensure that the Approved Actuary has used high quality data in calculating technical provisions.

193. Under the proposed EBS approach, the TP valuation instructions will include that:

- TP will be valued at an economic value using best estimate of probability weighted cash flows with an additional risk margin;
- Assumptions underlying the calculation of TPs will be based on current expected experience, using expert judgment where necessary, and reflect expected policyholder behaviours and future management actions;
- Valuation of liabilities must reflect the time value of money using the risk free discount rate which may be adjusted to suit the nature of the liability;
- The risk margin will be calculated using the cost of capital method.

194. Insurers and insurance groups will be able to apply to the BMA to elect to produce some or all of their EBS components using Solvency II principles or other economic valuation principles as approved by the Authority. Guidance will be provided on the standards expected to ensure consistency, and on a range of possible simplifications which may be considered appropriate. The required Approved Loss Reserve Specialist and Approved Actuary Opinions on the TPs will be based on EBS values[20].

Own funds

195. The Insurance (Eligible Capital) Rules 2012 (hereafter IECR) provide a 3 tiered system. Within each tier, a distinction is made between basic & ancillary[21] capital. In order to determine the eligibility of off-balance sheet instruments as ancillary capital, the insurer must receive approval for each instrument from the BMA[22].

196. **Tier 1 basic capital** (hereafter T1BC) comprises statutory surplus, capital stock, common shares and contributed surplus.

T1BC also comprises capital stock preferred shares (hereafter PS), provided they are paid-up *or called*[23], are undated or have an estimated maturity of not less than 10 years from date of issuance[24], etc. The BMA has stated that it proposes to amend the IECR in Q2 2015 to remove the word "called" in relevant paragraphs dealing with PS and hybrids since it is inconsistent with current practice. The underlying form for Eligible Capital requires PS to be paid up, and all hybrids instruments must be approved by the BMA before being considered for ancillary capital. The BMA only approves instruments that are paid up.[25]

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20 BMA update, 29 October 2014

21 It should be noted that in BMA legislation, the phrase 'ancillary capital' has a different meaning from that under Solvency II, since in BMA legislation T1 ancillary items would generally be paid-up .

22 BMA response on p6,7 and 12 of 2 May

23 IECR, Art. 2(3)(c)(iii)

24 IECR, Art. 2(3)(c)(iv). In comparison, Art. 71.1.f.ii of July 2014 Draft S2 DA provides that the item should be undated, with the first contractual opportunity to repay or redeem not occurring before 5 years from issuance.

25 BMA additional response on eligible capital – 14 October 2014

It is not specified that repayment is subject to supervisory approval[26], even though repayment is possible only if instrument of greater than or equal quality is issued[27]. It is specified that the coupon payment is cancellable or deferrable indefinitely in case of breach of ECR[28] but it isn't explicitly specified that PS should absorb losses once there is non-compliance with ECR[29]. PS are subordinated to general creditors and policyholders under winding up conditions.

197. **Deduction to T1BC.** Art. 2(3)(a)(ii) of IECR provides that excess of encumbered assets over the sum of
– the relevant "policyholder obligations" (hereafter POs),
– capital requirement (hereafter CR) applicable to the relevant POs,
– CR applicable to the encumbered assets[30],
may be deducted from statutory surplus, *"to the extent that [the] encumbered assets would not be available to meet the obligations of [PHs] in a going concern."*

198. As of now, such deduction is not explicitly provided for in Solvency II[31], where BMA rules may appear more prudent. However, a distinction is made in the Eligible Capital Regime between "encumbered assets" and "encumbered assets for policyholder obligations". Encumbered assets are generally not admissible under Eligible Capital, whereas encumbered assets for policyholder obligations are normally recognised as tier 2 with some adjustments.[32]

"Encumbered assets" are required to be deducted from tier 1 capital under the IECR paragraph 2(3)(iii).

199. Regulation does not provide for the deduction of any other item. The BMA notes that under the legal entity supervision assets such as goodwill and deferred tax assets are considered to be non-admitted assets which are factored during the preparation of the legal entity statutory financial statements, therefore no further treatment or consideration is needed with respect to the Eligible Capital regime. For groups, goodwill is not an admitted asset, but the portion of a deferred tax asset that is readily realisable is not deducted.[33]

200. **Tier 1 ancillary capital** comprises *"any other fixed capital"* such as *"(i) hybrid capital instruments"* and *"(ii) Guarantees and others"*[34], which obey to the same characteristics as T1 basic capital. In practice guarantees could not be considered because of their contingent nature.

201. **Tier 2 basic capital** (hereunder T2BC) comprises capital stock PS that are not T1BC items. These PS should be *"capable of absorbing moderate levels of losses on a going-concern, including suspension of coupon payment if ECR is breached"*[35], should be undated or have an estimated maturity of 5 years at

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[26] EU rules: see July 2014 Draft S2 DA, art.71.1.h.
[27] IECR, Art. 2(3)(c)(v)
[28] IECR, Art. 2(3)(c)(vii)
[29] EU rules: see July 2014 Draft S2 DA, art.71.1.d, e, j, l.ii.
[30] "[CR] applicable to the encumbered assets for [PH] obligations" and "[CR] applicable to [PH] obligations", are defined as follows:
– IECR Art. 2(8)(a) provides that these CR equate the contributions of pledged assets and PH obligations of the ECR, multiplied by the ratio MMS/ECR, when determining whether an insurer meets the MMS.
– IECR Art. 2(8)(b) provides that these CR equate the contributions of pledged assets and PH obligations of the ECR, when determining whether an insurer meets the ECR.
[31] It is provided for in IAIS Draft ComFrame: see IAIS 17.10.2013 Consultation Paper, Parameter M2E5.7.8.
[32] BMA additional response on eligible capital – 14 October 2014
[33] Ibid
[34] IECR, Art. 2(2)(a) , and line 1.c of Form 8 of IAR 1980, p. 36.
[35] IECR, Art. 2(5)(a)(i)

least[36], should be non-redeemable if ECR is breached or be settled only with issuance of greater or equal quality instrument[37], should have a coupon payment indefinitely deferrable if ECR is breached[38]. It is not fully clear whether T2BC PS should be paid-up[39] or what is meant by *"moderate levels of losses"*.

202. T2BC also includes the above-mentioned amount (excess of collateral over guaranteed insurance debt and associated capital requirements, cf. § 184.b) deducted from T1[40].

203. **Tier 2 ancillary capital** comprises of:
- unpaid instruments which are callable on demand and which, when paid, would qualify for T1 instruments[41], and
– *"other fixed capital"* such as *"(i) hybrid capital instruments"* and *"(ii) Guarantees and others"*[42], that are undated or have an estimated maturity of 5 years at least[43], are not redeemable if ECR breached or are settled only with issuance of instrument of greater or equal quality, have a coupon payment indefinitely deferrable if ECR is breached[44].

204. **Tier 3 basic capital** (hereunder T3BC) comprises PS which are undated or have a maturity of 3 years at least, are non-redeemable if ECR is breached or are settled only with issuance of greater or equal quality instrument[45], have a coupon payment cancellable or indefinitely deferrable if MSM is breached[46].

205. **Tier 3 ancillary capital** (hereunder T3BC) comprises *"any other fixed capital"* such as *"(i) hybrid capital instruments"* and *"(ii) Guarantees and others"*[47], which are undated or have a maturity of 3 years at least, are non-redeemable if ECR is breached or are settled only with issuance of greater or equal quality instrument, have a coupon payment cancellable or indefinitely deferrable if MSM is breached[48].

Minimum Solvency Margin (MSM) coverage

206. The IECR requires that every commercial non-life insurer and Class E life insurer maintain available statutory capital and surplus that equals or exceeds the value of its MSM comprising:

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36 IECR, art.2(5)(a)(iii). Reference in the IECR to "estimated" maturities are to be removed for the sake of clarity. The BMA and Bermuda market interpret and apply the rules to mean actual maturity not estimated.

37 IECR, art. 2(5)(a)(iv). As a comparison, Art.73.1.c, d, and e of S2DA provides that T2BOF must have an original maturity of at least 10 years, the first contractual opportunity to repay may not occur before 5 years, incentives to repay may not occur before 10 years, repayment is subject to supervisory approval.

38 IECR, art. 2(5)(a)(vi).

39 IECR, art. 2(5)(a), is so drafted: *"capital instruments as set out in Form 8, line 1.a.ii not requiring an approval to be admitted for the purpose of calculation an insurer's total statutory capital and surplus"*.
Line 1.a.ii is so denominated: *"[PS]: authorized shares of par value each issued and fully paid shares"*.

40 IECR, art. 2(5)(b). As a comparison, IAIS Draft ComFrame does not provide for such re-integration.

41 IECR, art.2(4)(a).

42 IECR, art.2(4)(b), and line 1.c of Form 8 of IAR 1980, p. 36.

43 IECR, art. 2(4)(b)(ii)

44 IECR, art. 2(4)(b)(v)

45 IECR, art.2(7)(a)(iii) and (iv). As a comparison, Art.77.1.c, d, and e of July 2014 Draft S2DA provides that T3BOF must have an original maturity of at least 5 years, the first contractual opportunity to repay may not occur before 5 years, T3BOF may include "limited" incentives to repay, T3BOF must provide for suspension of repayment if SCR not complied, repayment is subject to supervisory approval.

46 IECR, art. 2(7)(.a)(vii). MSM: *Minimum margin of solvency*, see hereunder section on Capital requirements. Similar provision under Art.77.1.g of July 2014 Draft S2DA.

47 IECR, art.2(6)(a) and line 1.c of Form 8 of IAR 1980, p. 36.

48 IECR, art.2(7)(a)(iii), (vi) and (vii), respectively. Comparison with EU rules here is difficult to undertake, insofar as Art.78 of July 2014 Draft S2DA simply states that T3AOF are items approved by supervisor "which do not display all of the features set out [for T2AOF]". It is understood that T3AOF should eventually be defined as elements which, when paid up, would qualify as T2BOF; this would be consistent with definition of T2AOF, which are elements that, when called, qualify for T1BOF (art. 75 of DA). However, such definition doesn't seem so far to have been explicitly provided for.

(i) an amount of tier 1 capital not less than 80% of the value of the MSM; and

(ii) an amount of tier 2 capital which is not more than 25% of the tier 1 figure calculated under (i)[49].

There are currently no similar provisions in the IECR covering Class C and D life insurers. However, the BMA is in the process of implementing rules which will extend the provisions to Classes C and D. These rules will take effect from 31 December 2015.

Enhanced Capital Requirement (ECR) coverage

207. Every commercial non-life insurer and Class E life insurers is required to maintain available statutory capital and surplus that equals or exceeds the value of its ECR (the greater of the BSCR or the MSM). In the case of Class 3B and 4 insurers, not less than 60% of the value of the insurer's ECR must comprise tier 1 capital. For Class 3A insurers and Class E life the figure must not be less than 50%. Provisions relating to tier 2 and 3 capital also apply in both cases.[50] There are no similar provisions in the IECR governing Class C and D insurers. The BMA has stated that this will be addressed from year-end 2015.

208. The IECR came into operation on 1 January 2013. Capital held over and above that required to meet the MSM and ECR may be held in any combination of tiers 1, 2 and 3.

Capital requirements

The existence of two risk-based capital requirements

209. BMA regulation defines two capital requirements: the Minimum Solvency Margin (MSM) and the Enhanced Capital Requirement (ECR), applicable to both commercial life and non-life insurers. The ECR is determined from the relevant BSCR model or the insurer's approved internal capital model provided that the ECR is at least equal to the insurer's MSM. The BMA also uses a Target Capital Level of 120% of the ECR as an early warning solvency threshold. Though this is not defined in regulation, it is incorporated in both the General and Long-term BSCR Model Instruction Manuals.

Capital add-ons

210. Capital add-ons/reductions may be assessed where the BMA believes that an insurer's risk profile deviates significantly from the risk assumptions underlying the ECR or from the insurer's assessment of its risk management policies and practices. These include, but are not limited to, items such as: provisions for reserve deficiencies, significant growth in premiums (or premium inadequacies for non-life insurers), and quality of risk management surrounding operational risk.

Risk sensitivity of the lower capital requirement

211. The MSM is defined in the *Insurance Returns and Solvency Regulations 1980*, hereunder IRSR 1980.

212. The non-life MSM is defined as the maximum of four figures[51]: 'Figure A' is an

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[49] IECR art 3(1) and (2)

[50] IECR art 3.(3)-(5) For class 3B and 4 insurers, tier 2 shall be no more than 40% of the available capital and surplus, and tier 3 shall not be more than 17.65% of the aggregate sum of tier 1 and tier 2 (provided that tier 2+3 does not exceed 40%). For Class 3A and Class E insurers tier 2 shall be no more than 50% of the available capital and surplus and tier 3 no more that 17.65% of the aggregate sum of tier 1 and tier 2 (provided that tier 2+3 does not exceed 50%)

[51] IRSR 1980, art.10, p. 11.

absolute floor, 'Figure B' is based on net premiums, 'Figure C' is based on technical provisions, and Figure D is based on "ECR", that is, the required capital derived from the "standard" formula BSCR or from an approved internal capital model.

Non-life MSM:

	Figure A (m)	Figure B (% of premiums)	Figure C (% of TP)	Figure D[52] (% of ECR / BSCR)
Class 3A	1	1st tranche: 20% 2nd tranche: 15%	15%	25%
Class 3B	1	1st tranche: 20% 2nd tranche: 15%	15%	25%
Class 4	100	50%[53]	15%	25%

213. Under Solvency II the MCR is the lower control level, the breach of which would trigger the strongest supervisory actions. It corresponds to an amount of own funds "below which policyholders are exposed to an unacceptable level of risk"[54] and is calibrated using a VaR (Value-at-Risk) measure with an 85% confidence level over a one-year period[55]. Since only a breach of the lower capital requirement allows the supervisor to invoke its strongest actions, it follows that the lower capital requirement should not be too low in relation to the risk profile of the insurer or in comparison with the higher requirement, and should remain sufficiently risk-based. Under Solvency II it is therefore floored at 25% of the SCR.

214. Figures B and C on the basis of which MSM is calculated are insufficiently risk-sensitive. In particular, for an insurer ceding a great part of this business, this resulting in low volumes of net premiums & claims, the absence of any requirement based on counterparty risk leads to low Figures B & C[56].

215. In order to increase the risk sensitivity of MSM, Art. 10 of IRSR 1980 was thus amended, introducing a 25% linkage between the MSM and the higher capital requirement, the ECR (cf. right column in the above table). This requirement became effective for Classes 4, 3B and 3A insurers on 1 January 2014 [57]. Under Solvency II the absolute floor of the MCR is €2.5m for non-life insurance undertakings and €3.6m for reinsurers (except for captive reinsurers where it is €1.2m)[58]. The Bermudian absolute floor (Figure A) is lower than this for classes 3A and 3B.

216. For commercial life insurers the relevant MSMs are the following:

Class C – the greater of $500,000 or 1.5% of assets

Class D – the greater of $4 million or 2% of the first $250 million of assets plus 1.5% of assets above $250 million

Class E - the greater of $8 million or 2% of the first $500 million of assets plus 1.5% of assets above $500 million

[52] IRSR 1980, Schedule 1, pp. 16-18.
[53] With limit on ceded premiums at 25% of gross premiums
[54] Art. 129.1.b S2 Directive.
[55] Art. 129.1.c S2 Directive.
[56] One Class 3A reinsurer supervisory file that was examined by EIOPA during its on-site visit provided an illustration of this. The reinsurer was a 'top-layer' that had incurred no loss during the past 5 years. As a consequence, Figures B and Figures C were very low for this high risk-profile reinsurer.
[57] BMA's 02.05.2014 update, § 36.
[58] Art. 129.1.d S2 Directive.

Where assets are the total assets reported on the balance sheet in the relevant year less the amount held in a segregated account. The absolute floor under Solvency II for life insurers is €3.7 million. The Bermudian absolute floor for Class C insurers is lower, but it may be exceeded by the required asset calculation.

A floor of 25% of the ECR will be applied to commercial life insurers with effect from 1 January 2017.

The higher capital requirement: BSCR and BSCR–SME

217. The higher capital requirement for non-life is called the ECR which, in the absence of an approved internal capital model, is derived from the BSCR for Classes 3B & 4, and BSCR-SME for Class 3A. The BSCR and BSCR–SME, which are used to derive the ECR, are defined in Insurance (Prudential Standards) (Classes 4 & 3B Solvency Requirement) Rules 2008[59] (hereunder IPS 43B), and in Insurance (Prudential Standards) (Classes 3A Solvency Requirement) Rules 2011 (hereunder IPS 3A). The higher capital requirement for commercial life insurers is also derived from the BSCR, in the absence of an approved internal capital model, and is defined in the Insurance (Prudential Standards) (Class C, Class D and Class E Solvency Requirement) Rules 2011 (hereunder IPS L). A transitional clause has meant that all commercial life insurers have only been required to comply fully with these rules from 1 January 2014.

Calibration of the BSCR

218. The BSCR is calculated to cover unexpected losses arising from existing business that correspond to the Tail VaR subject to a confidence level of 99% over a one-year period. A 99% Tail-VaR confidence level represents the probability-weighted average amount of all losses in the 1% tail of the probability distribution function of changes in ECR which could be greater than (or, if there is no probability mass beyond the 1% quantile, equal to) a 1% VaR of the profit and loss distribution. Assuming the changes in ECR have a normal distribution, then a Tail-VaR subject to a confidence level of 99% over a one-year period is at least as strong as a VaR subject to a confidence level of 99.5% over a one-year period and as such, provides equivalent policyholder and beneficiary protection to the Solvency II Directive requirement.

219. The main risk mitigation technique allowed for in the BSCR is the purchase of outward insurance. Normally the BSCR does not make allowance in the standard factors for hedging arrangements in an insurer's asset portfolio. One exception to this position is for variable annuity business where the insurer has opted to use an internal capital model approach rather than the standard factors.

220. Management actions are typically not allowed for within the BSCR except for certain long-term products (mortality business, critical illness business), where the BSCR applies lower charges where the insurer has the ability to make material adjustments to the cost of insurance based on recent experience.[60]

EIOPA's approach to assessing the equivalence of the BSCR

221. In assessing whether the BSCR is equivalent to the SCR, EIOPA's approach has been to assess whether the BSCR and the SCR provided a similar overall level of safety and risk-sensitivity, not to look for an exact match between the formulae. The following two paragraphs illustrate this approach.

[59] The solvency requirement rules for all commercial classes and groups were all subject to amendment in 2013. References to the rules should be read as meaning to the rules as amended.
[60] Additional response 12 September 2014

222. In the non-life BSCR formula, the correlation factor between equity and property risks is **1**; in the SCR standard formula, it is **0.75**. The SCR formula thus provides a slight incentive for an insurer to diversify its investments between equities and property; the BSCR formula does not provide such an incentive. However, the difference in capital charge is very small, and so this difference could not reasonably be a basis for a finding that the two capital requirements are not equivalent.

223. In the BSCR formula, the correlation between credit risk on the one hand and fixed income, equity and interest rate risks on the other hand is **0**. In Solvency II, the correlation between counterparty default risk (which corresponds to the BSCR credit risk) and market risk (which corresponds to the BSCR fixed income, equity and interest rate risks), is **0.25**. A similar example is the correlation between premium and reserve risks: the BSCR assumes that it is **0** — which might seem counter-intuitive — whereas in the SCR, the proposed correlation has been set as **0.5** in each line of business[61]. These differences per se do not mean that the BSCR is less "prudent" than the SCR: the overall prudence of the BSCR and SCR also crucially depends on the calibrations of the individual modules and sub–modules.

Non-life calibrations

BSCR–SME Class 3A vs BSCR Classes 3B & 4

224. The rules covering Class 3A insurers are identical on most points to those covering Classes 3B and 4. The BMA has highlighted that the BSCR–SME differs from BSCR in two areas:

a) BSCR–SME does not require Class 3A which does not write property catastrophe to use a catastrophe model; and

b) BSCR–SME awards credit for underwriting mitigation strategy, which, beyond LoB diversification and reinsurance, BSCR does not[62].

225. It is expected that when BSCR is further amended to take a better account of geographical diversification[63], BSCR–SME will be aligned on BSCR[64].

Besides these two differences, there are other minor differences: for instance, in calculating the interest rate charge calculation, the duration factor when liabilities are longer than assets is capped to 3.5 for Class 3A insurers[65].

There are also differences in the formula determining the premium risk, the reserve risk capital charges, and the operational risk capital charge is based on a greater number of criteria for Classes 3B & 4.

The non-life BSCR is risk based

226. Formula of BSCR / BSCR–SME is reproduced in Annex 1[66]. Using different terminology to that of Solvency II for some modules, the formula covers the following risks: counterparty risk (BSCR: credit risk); spread risk (BSCR: fixed income risk); market risk (BSCR: equity risk); premium risk; reserve risk; interest risk; catastrophe risk; operational risk.

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[61] Cf. *QIS 5 Technical Specifications*, § SCR.9.31 p. 202.
[62] 02.05.2014 update, § 38.b.
[63] 02.05.2014 update, § 37.
[64] 02.05.2014 update, § 38.b.
[65] IPS 3A, page 15, Schedule 1, Art.4.c; vs IPS 43B, page 15, Schedule 1, Art.4.c.
[66] Art.1 of Schedule 1 of IPS 43B, and Art.1 of Schedule 1 of IPS 3°.

227. Correlation between credit risk and reserve risk is 70.7%[67]. Apart from this correlation, correlations between credit risk, spread risk, equity risk, premium risk, reserve risk, interest risk, and catastrophe risk, are deemed equal to 0. Correlation between the aggregation of these risks and Operational risk is 1.

228. The BSCR and BSCR–SME do not include currency and concentration risks. BMA has indicated that it intends to make further enhancements to BSCR in 2015 which will include currency and concentration risks[68].

Credit risk

229. The multiplying factor for credit risk in the BSCR formula is 0.707, rather than 1 as in the other risk modules. The credit risk capital charge C_{CRED} should be defined as $C_{CRED} = C_{CRED\ current\ formula} * 0{,}707$: this would increase transparency and make the formula more intelligible.

230. This unusual feature means it is not always obvious what the credit risk charge is. For instance, while the BSCR specification seems to indicate that the capital charge for one retrocession receivable of €100 is €10, in reality the effective capital charge is 0.707*€10 = €7.07.

231. This gives a misleading picture of the credit risk charge, and makes it difficult to compare it with the credit risk capital charge under other standard formulae, or with another risk capital charge under the BSCR.

232. Annex 1 sets out the BSCR formula and amendments to allow comparison. It should be underlined that the amendment does not change the value of any capital charge but only allows better readability, understanding and transparency.

233. Since EIOPA's 2011 report, Bermuda has amended the BSCR Model[69] to increase the risk sensitivity of the counterparty risk charge to differentiate more granularly between the credit standing of counterparties. The credit risk module was further enhanced to reflect diversification of an insurer's credit exposures, meaning that an insurer with a larger number of counterparties may have a lower credit risk charge compared to another insurer with a greater degree of risk concentration. The approach in this respect is now more convergent to that in Solvency II.

234. A residual concern relates to cash at bank. The BMA proposes to review this component when it revisits the BSCR model in 2015.

235. In the BSCR, cash at bank seems to be covered through the fixed income risk module. The capital charge is 0.3% of the amount, and does not vary according to the soundness of the bank. The BSCR does not take into account whether the exposure is to a single or multiple counterparties.

236. It is noted that Schedule V of the BSCR Model (Schedule of Risk Management) has been amended to include a description of the insurer's policy and strategy surrounding the use of derivatives and other hedging instruments.

Life calibrations

237. The BSCR model for commercial life insurers comprises both risk-based capital factors and stochastic elements. The model captures the following 12 risks:

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[67] See EIOPA 26.10.2011 advice, Annex 1 page 54.
[68] BMA's 02.05.2014 update, § 37.
[69] BMA update 02.05.2014 para 37. Amendments were made to the BSCR Models for general (non-life), life and insurance groups.

a) Fixed income investment risk;

b) Equity investment risk;

c) credit risk;

d) long-term interest rate/liquidity risk;

e) long-term insurance risk – mortality;

f) long-term insurance risk – non-proportional;

g) long-term insurance risk – riders;

h) long-term insurance risk – morbidity and disability;

i) long-term insurance risk – longevity;

j) long-term variable annuity guarantee risk;

k) long-term other insurance risk;

l) operational risk.

Annex 2 sets out the BSCR for commercial life insurers.

238. The BSCR life model (as the non-life model) uses a square root methodology to aggregate the various risks, under the assumption that the risks are at least partially independent from one another and therefore some diversification benefit is provided when combining risk charges.

239. The operational risk capital charge is the operational risk charge multiplied by the BSCR (after covariance adjustment). The risk charge ranges from 1-10% based on each insurer's self-assessment of the Commercial Insurer's Risk Assessment framework. The ultimate BSCR is the sum of the BSCR (after covariance adjustment), operational risk capital charge, and capital add-ons/reductions (if assessed).

Internal models

240. The Bermudian internal capital model (ICM) regime, which was initiated with Class 4 and 3B insurers in 2010, has been extended to all commercial insurers and insurance groups. The BMA has stated that it will not be pursuing a partial internal model regime at this time, although consideration will be given to insurers wanting to implement a partial internal model as part of a phased transition to a full model in due course.[70] The relevant guidance notes – see below – say that an application for a partial internal model can be entertained in exceptional circumstances where the insurer is able to demonstrate that development of a full internal model would be inappropriate, and that the standard formula does not adequately reflect the risk to which the insurer is exposed. The BMA requires evidence that the use of a partial internal model is not for the purpose of regulatory arbitrage (cherry picking).

241. The BMA has codified its criteria for evaluating internal models in its guidance note entitled "Standards and application framework for the use of internal capital models for regulatory capital purposes". The guidance notes have most recently been revised in September 2012 to incorporate additional considerations for long-term insurers and to clarify some items previously dealt with. The guidance notes establish the framework for the internal model application and review process and include provisions relating to pre-application conditions, application and review procedures, and post-approval monitoring and control activities. For

[70] BMA update of 02.05.2014, para 39

class 3A and C insurers the standards are applied on a proportionate basis. Although there are group ICM, the guidance notes do not explicitly formalise procedures and requirements for group ICM approval.

242. Following model approval, the insurer is subject to monitoring in respect of its ICM to ensure that it remains fit for purpose. Any major model changes require the written permission of the BMA before the insurer can use the change in the calculation of required regulatory capital.

Calibrations

243. According to point B.8 in the attachment to the guidance note dealing with affirmations that have to be provided in the pre-application process, ICM should be calibrated such that the ECR is determined using the Tail VaR metric subject to a confidence level of 99% with one year of new business and reserve development over a one year time horizon[71].

244. If another calibration metric is used, the insurer has to demonstrate that this metric is at least as effective as 99% Tail VaR over a one year period. In light of the above observations it can be concluded that the calibration standards codified in section B.8 of the guidance note on internal models are equivalent to the requirements of the Solvency II Directive.

Pre-approval

245. Article 5 of the each of the applicable sets of solvency requirement rules states that an ICM be approved before it can be used to calculate regulatory capital by the insurer. In considering an application, the BMA has regard to the appropriateness of the ICM for the determination of the insurer's capital requirement; the extent to which the ICM has been integrated into the insurer's risk management programme; and the appropriateness of the controls applicable to the creation and maintenance of the ICM.

246. A pre-application process applies before application and review. The formal application incorporates 7 tests: use; documentation, governance, controls, statistical, calibration and validation. The BMA will assess each insurer's ICM using the criteria set out in the guidance note, dividing its evaluation over the following four sections: use test; governance and controls; theoretical review; and analytical review.

247. Conditional approval of an ICM may be given where the BMA is satisfied that the applicant substantially complies with the requirements, and that any remaining areas of possible non-compliance are not material to the quantification of regulatory capital and can be realistically addressed in a time period specified by the BMA.[72] Conditional approval can be cancelled.

Adequate risk management system

248. An ICM will not be considered for approval unless the insurer can demonstrate a comprehensive and effective approach to risk management. A requirement for the insurer to demonstrate prudent capital management is also one of the application conditions for ICM[73].

249. The theoretical review considers whether an appropriate structure and statistical

[71] Output from the ICM used to determine regulatory capital is defined as the amount of capital required to meet all obligations using a TVaR metric subject to a confidence level of 99%, inclusive of existing business and business expected to be written over a one-year period with reserve development over a one year time horizon and losses due to market, credit and operational risks.
[72] MBA additional answers 12 September 2014
[73] Guidance notes paragraphs 26-7

methodologies are employed for modelling various risks and aggregation of risks.[74] The insurer/group has to affirm that the ICM adequately captures all the material risks facing it, including, but not limited to: insurance risk, market risk, credit risk, operational risk and liquidity risk, to the extent that this is modelled by the ICM.

Use test

250. The mandatory use test is prescribed by section paragraph 28 of the guidance note, which states that there will need to be evidence that the Board of Directors has formally approved the ICM for use within the insurer. Six of the 24 affirmation statements required in the pre-application process relate to the use test, including affirmations that the ICM is an essential component in the development and evaluation of an insurer's strategies; that it is relied upon for key management and tactical operating decisions; and that it is an integral part of the insurer's risk and capital management functions.

Statistical quality standards

251. The general approach is that the ICM should be based on rigorous actuarial and statistical techniques, be consistent with the methods used to calculate technical provisions and use current and credible data as well as realistic assumptions. In addition to stating that the insurer should be able to justify diversification benefits between risk categories, the guidance notes say an insurer should be able to demonstrate that the ICM adequately captures interactions and dependencies between risks in extreme scenarios, or tail events[75].

252. Risks associated with derivatives, guarantees and any contractual options should be reflected in the internal model, including any off-balance sheet exposures, which again is equivalent to the requirements of the Solvency II Directive. Given these observations, it can be concluded that the statistical quality standards prescribed by the BMA are broadly equivalent to those required by the Solvency II Directive.

Validation standards

253. According to the guidance note for internal models[76], a periodic validation process should exist and should include a review of the model's predictive performance, an on-going assessment of the appropriateness of material assumptions and methodologies, a review of model output for reasonableness and an examination of the sensitivity of results to changes in key underlying assumptions. This is equivalent to the requirements of the Directive.

Documentation standards

254. The documentation standards codified in the guidance note on internal models are equivalent to the requirements of the Solvency II Directive.

Profit and loss attribution

255. Profit and loss attribution is considered to be a part of the use test under the BMA regime, and the fact that the BMA will consider if the ICM is used for this purpose is reflected in B.16 of the guidance notes.

Investments

256. The Solvency II provisions on investments are set out in Articles 132 to 135

[74] Guidance notes paragraph 41
[75] Guidance notes B.27
[76] Guidance notes B.34-42

Solvency II Directive. The Bermudian investments provisions are set out in paragraph 4.1.2 of the Code.

257. Having this in mind, the provisions of paragraph 4.1.2 are, by and large, equivalent to those of Solvency II; in some aspects however, they seem to lack precision. For instance, paragraph 31 of the Code states that "The concentration risk component of the insurer's risk management framework should include [...] identifying, responding to, monitoring, mitigating, and reporting [...] credit risk arising from an individual risk exposure [...]." This absence of a precise obligation can be understood in light of the lack of a concentration risk module in the BSCR standard formula. Paragraph 32 and 33 of the Code provides additional requirements on the market and credit risk components that partially offset the above mentioned concern.

Specificities for 227

Sufficient information on the constitution of own funds

258. Insurers in Bermuda are required to report intra-group transactions on a quarterly basis. As laid out under Principle 8, it can be assumed that the BMA has a good overview over the scope of the group and any relevant subsidiaries. Hence it can be concluded that the BMA would have enough information to detect double gearing of capital.

Specificities for 260

259. The consolidated approach is used to address double gearing and intra-group creation of capital, since all such arrangements are removed from the calculation. The BMA requirements are therefore equivalent to Solvency II in this respect.

260. The assessment of fungibility and transferability of assets is conducted at entity level to avoid netting out the difference between the value of the encumbered assets for policyholder obligations and the higher of the values of the obligations or the capital requirements arising from those assets. Solo deficits are deducted from available statutory capital and surplus in the full amount where the group exercises control, and a proportional share of participation is deducted where the group exercises significant influence.

261. The group BSCR model applies a combination of risk-based capital factors, a stress test, and stochastic processes, addressing all material quantifiable risks, to arrive at a capital requirement. Where risks are not appropriately reflected in the capital requirement, adjustments can be made under Article 6D IA.

262. To ensure that the ECR addresses all risks applicable to the group, both asset charges and non-regulated surcharges are applied to non-regulated entities based upon the level of risk they pose to the group. Capital requirements for non-insurance financial entities are aggregated net of intra-group transactions to yield the overall ECR.

263. Under Article 6D IA, the BMA may make adjustments to either the ECR or the available capital and surplus, as it considers appropriate, for example where the BMA concludes that the risk profile of the group deviates significantly from the assumptions underlying its ECR or the group's assessment of its risk management policies and practices in calculating its ECR. It may also make adjustments to a group's ECR and available statutory capital and surplus when it concludes that the system of governance of the insurance group deviates significantly from the standards applicable to it.

264. The BMA also assesses intra-group impacts by closely reviewing investments in

affiliated companies, intra-group reinsurance and off-balance sheet transactions. The intra-group and off-balance sheet impacts will be considered in determining any capital add-ons for the group.

265. In addition, the designated insurer for an insurance group has an obligation to report certain events to the BMA, including significant losses that are reasonably likely to cause the group to be unable to comply with the applicable ECR. In the event of such losses, the designated insurer shall submit a BSCR model reflecting an ECR prepared using post-loss data within 45 days of notification of the loss event.

266. The BMA stated that it expects to consult and involve overseas supervisors in examining a group-wide internal model and in making the final assessment. Where the BMA is the group supervisor, it is required under Article 27E (a) IA to consult other involved authorities in matters of common concern. The BMA emphasised that it would consult and involve in advance the relevant supervisory authority prior to carrying out any inspections in the EEA.

267. Article 27 of the Group Rules requires insurance groups to maintain available statutory capital and surplus equal to or in excess of the group's ECR. Failure to do this would constitute a breach under the Act. The legislation does not prescribe the exact actions to be taken upon a breach of the ECR; rather, Section 32A (1) grants the BMA the powers to issue any remedial directions the BMA believes is "desirable for safeguarding the interests of policyholders and potential policyholders of the insurance group." Appreciating that any action taken by the BMA within a group's context may affect solo entities in other jurisdictions (e.g. where there are support agreements or other intra-group transactions, etc.), the BMA's position is that it would consult with host supervisors in determining the most appropriate direction having regard for the particulars of the group and views of host supervisors.

268. Under Article 3 of the Group Rules the ECR is based on the group BSCR or an approved internal model, subject to a requirement that it should "at all times be an amount equal to, or exceeding, the minimum margin of solvency within the meaning of paragraph 25 of the Group Rules."

EIOPA advice

Articles 172/227/260

269. EIOPA's overall advice on Principles 6, 7 and 12 is that:

a. The BMA's supervision of Class 3B and 4 insurers and groups is largely equivalent under the currently applicable rules. For these and other classes EIOPA cannot positively conclude on the present valuation framework, since it is possible for insurers to adopt a variety of different valuation standards. Consequently, there is no comparability between insurers.

We note that the valuation issue is intended to be addressed if the proposed revision of the valuation standards are implemented and enter into force on the 1st of January 2016. For dual licence insurers in Classes 3B and 4 and groups including life insurers there is an additional dependency that Solvency II rules are adopted for their life business. The BMA has indicated that it intends to make further enhancements to BSCR in 2015 to include currency and concentration risks.

b. The BMA's supervision of Class 3A is largely equivalent under the currently applicable rules.

We note that the BMA is working on the extension of the EBS to Class 3A with appropriate simplifications, but this will not be implemented until 1 January 2017.

c. The BMA's supervision of Class E life insurers is partly equivalent under currently applicable rules. EIOPA is unable to conclude on the equivalence of the BMA's proposed valuation standards for assets and liabilities in respect of all commercial life classes given the material uncertainties which remain around the EBS framework being developed. The MSM is not currently risk-based.

We note that the BMA will apply the floor of 25% of the ECR to all commercial life insurers with effect from 1 January 2017.

d. The BMA's supervision of Class C and Class D life insurers under the currently applicable rules is partly equivalent. In addition to the caveats noted for Class E, Class C and D insurers are not currently required to provide GAAP financial statements. There are no provisions requiring Class C and D insurers to maintain available statutory capital and surplus of a particular quality that equals or exceeds the value of the MSM.

We note that the BMA has stated that the statutory capital and surplus requirements will be in place from year-end 2015.

270. Own funds requirements can be considered equivalent to Solvency II.

271. The ECR (the higher BMA capital requirement, which will only be applicable to commercial insurers), incorporates a number of risks in a way that seems broadly equivalent to Solvency II. Currency and concentration risks are not currently included, but BMA has stated that it plans enhancements to the BSCR in 2015.

Articles 172/227

272. The BMA's proposed regulatory framework with regard to internal models, as discussed above, is equivalent to Solvency II. It is noted that for Class 3A and C insurers the standards are applied on a proportionate basis.

273. In some areas - including the definition of the BSCR formula and investments rules - BMA legislation could be clearer.

Article 260

274. The BMA's requirements in relation to group-specific aspects of own funds are equivalent to Solvency II.

275. While there is provision for the approval of group ICM, the current guidance notes setting out the standards and application framework for the use of ICM for regulatory capital purposes do not explicitly formalise procedures and requirements for group ICM approval.

Principle 8 - Parent undertakings outside the Community: scope of group supervision

Objective - *The supervisory authorities of the third country shall have a legal or regulatory framework for determining which undertakings fall under the scope of supervision at group level.*

The scope of supervision at group level shall at least include all undertakings over which a participating undertaking, as defined by Article 212 of Directive 2009/138/EC, exercises dominant or significant influence. The scope may exclude undertakings where this would be inappropriate to the objectives of group supervision.

276. The primary legislation underpinning the Bermuda framework for group supervision is contained in Part IVA of the Act.

277. The Insurance (Group Supervision) Rules, that applies to insurance groups of which the Authority is the group supervisor, are:

- Insurance (Group Supervision) Rules 2011
- Insurance Group Supervision Statement of Principles (SoP), June 2012
- Insurance (Group Supervision) Amendment Rules 2013
- Insurance (Prudential Standards) (Insurance Group Solvency Requirement) Amendment Rules 2013
- Group Supervision User Manual, October 2013

278. The Statement of Principles sets forth how the Authority will act in exercising its power and discretion in these areas of group supervision. The Statement of Principles is made in accordance with section 2A of the Act, which requires the Authority to publish in such manner it sees fit a statement of principles in accordance with which the Authority will exercise the powers and discretion of group supervisor.

279. Under Part IVA of the Act, the Authority may determine whether it is appropriate for it to be the group supervisor of an insurance group.

280. The general definition of an insurance group under Article 1 IA is complemented by Article 25 IA which clarifies that it will include all entities under the control or significant influence of the parent undertaking. For this purpose the BMA bases its considerations on the accounting definition of dominant and significant influence according to the IASB. At the same time, the BMA has the power under Article 27C IA to include or exclude an entity from the scope of the group, if this is deemed appropriate to the objectives of group supervision. The BMA relies on the insurer's financial filings, as well as the report on intra-group transactions, to identify entities which may need to be included in the group. The BMA has clear criteria for determining whether it is the group supervisor, as laid out in Article 27B IA. The criteria under Article 27B (3b and c) IA mean that no Bermudian insurers of any size may is excluded from consideration as to whether BMA group supervision should apply. The practical consideration behind the criteria is the BMA's ability to exercise effective group supervision, for example in terms of access to the necessary information.

281. If even after negotiations no group supervisor can be identified, due to constraints or unwillingness on the part of the jurisdictions involved, the BMA will consider defining the part of the group in its own jurisdiction as a group for supervisory purposes and ensure that at least for that part of the group effective group supervision can be guaranteed. If other supervisors claim the role of group

supervisor as well as the BMA, the BMA will consult them and engage in discussions to determine the authority best suited to be group supervisor. If the group is already under group supervision that the BMA deems equivalent, the BMA will consider recognising another group-wide supervisor. The BMA emphasised during the 2011 on-site visit its willingness to build a relationship of trust with other supervisors. It should be noted that under the BMA approach, where it does not consider itself to be in a position to exercise effective group supervision it may conduct its own analysis regarding the suitability of other supervisors to take on this role, whom they may then approach. However, the BMA stated that its next step would be to consider the viewpoint of all the other regulators involved.

282. The BMA's duties as group supervisor are codified in Article 27E IA and require a similar level of supervisory activity to the Solvency II Directive. If the BMA is the group supervisor, under Article 27E (a) IA it is required to consult the other authorities involved in matters of common concern. The BMA emphasised that it would consult and involve in advance the relevant supervisory authority, prior to carrying out any inspections in the EEA.

283. Under Article 27C IA the BMA is required to notify the supervisory authorities concerned of any exclusions it makes from group supervision and the reasons they were undertaken. It may also make a determination pursuant to Section 27CA of the Act to add entities to the scope of the group.

284. When the Authority acts as group supervisor for an insurance group, the scope of its supervision generally includes the ultimate insurance parent, its direct subsidiaries, and lower-tier subsidiaries where control or significant influence exists. Lower-tier subsidiaries include, without limitation, subsidiaries, participations, affiliates, holdings and guaranteed or off-balance sheet entities.

285. In October 2013, BMA published a "Group Supervision User Manual" developed to provide supervisors with practical guidance for Group Supervisory activities, including the organisation and operation of Supervisory Colleges in cases where the BMA has assumed the role of Group-Wide Supervisor ("GWS").

EIOPA advice

Article 260

286. In light of these observations it can be concluded that the supervisory regime of Bermuda is equivalent in respect of Principle 8.

Principle 9 - Parent undertakings outside the Community: cooperation and exchange of information between supervisory authorities

***Objective** - Third country supervisory authorities shall be empowered by law or regulation to enter into coordination arrangements to ensure that the requirement in Article 261(2) of Directive 2009/138/EC can be met.*

Determination of the group supervisor

287. The BMA's procedure in relation to the identification of the group supervisor is dealt with under Principle 8 above. In respect of the rules and guidelines regarding the determination of a group supervisor, there will inevitably be differences in wording and possible interpretation between regimes. EIOPA will therefore recognise a broadly similar approach to determining group supervision as equivalent, providing this does not prejudice the proper exercise of supervisory responsibilities under Solvency II. Therefore where a third country has been assessed as equivalent, it is essential that there be cooperation between all supervisors concerned prior to decisions on group supervision being taken and communicated to insurers.

288. Section 27B establishes that the BMA may, in respect of an insurance group, determine whether it is appropriate for it to be the group supervisor of that group.

The BMA must take into consideration the following matters:

- whether the group is headed by a specified insurer;
- where the group is not headed by a specified insurer, whether the insurance group is headed by a parent incorporated in Bermuda;
- where the group is headed by a parent not incorporated in Bermuda, the authority must be satisfied that:
    - i. the insurance group is directed and managed from Bermuda; or
    - ii. the insurer in the insurance group with the largest balance sheet is a Bermuda registered insurer.

289. The Insurance Group Supervision Statement of Principles (SoP), June 2012, sets forth how the BMA will act in exercising its power and discretion in group supervision. This is in accordance with section 2A of the Act, which requires the BMA to publish in such manner it sees fit a statement of principles in accordance with which the BMA will exercise the powers and discretion of group supervisor. This Statement cannot be exhaustive and cover every circumstance in which the BMA would exercise its power or discretion.

290. The SoP states that in determining whether the BMA is the group supervisor the BMA should consider the materiality of business lines, products and markets in relation to insurers in other jurisdictions in which the group operates. The BMA will consider whether Bermuda is the jurisdiction in which the group control function and the direction and management of the group reside. The determination of whether the BMA should be the group supervisor necessarily involves both quantitative and qualitative factors and the weight to be assigned various factors necessarily depends on the facts and circumstances of each case and the nature and composition of the group. As part of the process of making a determination as to whether to act as a group supervisor the BMA will also take into consideration the views of other potential group supervisors.

Rights and duties of the group supervisor

291. Article 27 IA sets out the BMA's high level group supervision powers and responsibilities. Further to this the BMA has developed a document titled "Supervisory cooperation and information exchange" which sets out the BMA's approach to supervisory colleges, in particular the way it proposes to operate them in its capacity as a group-wide supervisor.

292. When BMA is GWS for a cross-border insurance group a Supervisory College is established. The main purpose of the Supervisory College is to ensure the group is appropriately supervised and that there are no material supervisory gaps so that policyholders are adequately protected. The manual determines the steps to be followed by BMA for establishing a college, its functioning, members, levels of participations, meetings, information exchange, decision making process, activities under crisis situations, etc.

293. The Group Supervision User Manual, section 4, establishes the importance of a supervisory college to facilitate group-wide supervision, to improve solo supervision, to act as a permanent forum for cooperation and to facilitate improved understanding of supervisory practices and effectiveness of supervision.

294. The Authority will assess a group's capital adequacy on a group basis, taking into consideration its nature, scope, complexity and risk profile.

Exchange of information and cooperation

295. Article 27E (a) IA makes the BMA responsible as group supervisor for "coordination of the gathering and dissemination of relevant or essential information for going concerns and emergency situations, including the dissemination of information which is of importance for the supervisory task of other competent authorities". Elaborating on this, point 4.3 of the aforementioned BMA document states that "The key areas that the Authority would be asking the Supervisory College to share information on would include the following:

    - information on major intra-group transactions (dividends, capital injections, etc.);
    - information on various risk areas;
    - the results of risk assessments conducted by each supervisor;
    - reports and letters drawn up by each authority on matters of major importance;
    - summaries of the findings of on-site investigations;
    - developments in markets that constitute the group's business areas;
    - important approvals granted by each authority, or in progress;
    - significant organisational changes in the group;
    - changes in management or ownership, or the establishment of a presence in another country."

296. The Guidance Note on Supervisory Colleges, June 2012, is designed to assist the Bermuda insurance industry and other stakeholders in understanding how the BMA intends to conduct its supervisory colleges when acting as the group supervisor for an insurance group or Bermuda group. It also discusses the Authority's responsibilities and obligations as a participant, or host supervisor, in a supervisory college. The Guidance Note provides operational guidance,

explanatory text, and differentiates among the duties and responsibilities of the Authority with respect to leadership or membership in a supervisory college.

297. For an effectively functioning of a supervisory college, participants must have the reassurance that information released, exchanged, and shared is being kept confidential.

298. Point 17 of the Guidance Note on Supervisory Colleges establishes that "The establishment and functioning of a supervisory college generally will be based on written agreements drafted by the Authority with input from an agreement by supervisory college members. These would include, inter alia, bilateral, multilateral, confidentiality, cooperation, and information sharing agreements, bilateral memorandum of understanding (MoU), multilateral memorandum of understanding (MMoU), and coordination arrangements."

299. The supervisory college process is captured in three documents as follows:
a) The College MMoU which includes coordination arrangements surrounding roles and responsibilities, co-operation under a going-concern and crisis situations, information sharing etc.
b) Supervisory Plan which is a document presented in the College that outlines the insurance group's material risks, and contains co-ordinated steps that the respective supervisors will need to take to address the risks until the next scheduled college meeting (refer to Section 3 of the BMA Group Supervision Manual).
c) Crisis document is a document that contains the key supervisory contacts as well as the process to be undertaken during the time of a crisis (refer to Section 5 of the BMA Group Supervision Manual).

Dispute solving mechanism

300. The coordination arrangements covered in the College MMoU should specify the approach to decision-making among the competent authorities.

301. Following the Manual, the BMA will take a consultative approach to decision-making and seek to make joint decisions where appropriate. The process for decision-making will need to be agreed with the other involved supervisors, in particular which issues require joint decision-making and in which instances the BMA will make its own decisions.

302. Chapter 6 of the Note establishes that the mediation and resolution of disputes among supervisory authorities within the supervisory college setting will presently form part of the coordination arrangements negotiated and agreed to among the college membership. The arrangements will specify effective procedures and processes for resolving disputes on both going concern and emergency or crisis situations.

303. In the light of experience a more formal approach and dispute resolution framework will be developed and applied across all the groups for which the Authority is the group supervisor.

General supervisory powers to require insurers to submit necessary information

304. The BMA will require groups to provide adequate and appropriate regulatory information and reports and may require the production of documents in order to facilitate monitoring of group financial condition, solvency, and risks. The Act and the Group Rules require certain mandatory filings by insurance groups. The standard reporting prescribed under the Act and attendant legislation may not be sufficient under certain circumstances for the Authority to appropriately assess and determine the group's risk profile. Consequently it could request for non-

standard information so that the Authority can effectively analyse the group's risk profile and ensure that the appropriate supervisory intensity is applied.

305. Under Article 27F IA, the BMA is empowered to make rules applying to "designated insurers" which take into account, in their case, the activity of the group to which they belong, including rules relating to supervisory reporting and disclosures in respect of the insurance group. Article 29 IA further sets out the BMA's ability to require information and reporting from such designated insurers (including "such information as the Authority may reasonably require with respect to matters that are likely to be material to the performance, in relation to [...] the relevant insurance group, of its functions under this Act").

306. When the Authority is not satisfied with information submitted and/or requires additional information, therefore the Authority usually approaches the designated insurer and, to date, has received the information without any hesitation.

307. An insurance group shall establish and maintain organizational, governance and communications structures at the group level that facilitate the fulfilment of the duties of the designated insurer. A designated insurer shall facilitate and maintain compliance by the group with the Act and the Rules.

The assessment of the application for a group internal model

308. There are 21 groups in Bermuda which use an internal model for their own purposes (asset management, underwriting and reserving). Some groups would use other standard models (or portions of those models) in conjunction with their internal models to manage their operations.

309. The BMA has informed EIOPA that it has only received one application since 2012 from a Bermuda group for internal model approval for regulatory purposes.. It expects 3 during 2015 and, perhaps, 2-3 during 2016.

310. When reviewing an insurance group's internal capital model, the Authority, as group supervisor, undertakes the responsibility to contact other relevant supervisors through the college network and invite those supervisors to collaborate on the review of the ICM. In those instances where there is a collaborative effort to review the ICM, as group supervisor, the Authority makes the final decision as to whether or not the group's ICM is approved.

311. The Guidance Note on Supervisory Colleges treats the approval of an internal model in the paragraph dedicated to the communication with the group. It will cover the joint decision on model validation: the requirements and standards of the application, the planning of the validation process, the joint decision on advanced methods for the calculation of capital requirements and key findings from model validation reviews. The Group Supervision User Manual refers to an internal model approval in the paragraph dedicated to the communication with the supervised institutions with the same sentence.

EIOPA advice

Article 260

312. On the basis of information provided, Bermuda is considered equivalent under Principle 9.

Annex 1: The non-life BSCR

The non-life BSCR formula is as follows:

$$\text{BSCR} = \sqrt{C_{fi}^2 + C_{eq}^2 + C_{int}^2 + C_{prem}^2 + (\tfrac{1}{2} C_{cred} + C_{rsvs})^2 + (\tfrac{1}{2} C_{cred})^2 + C_{cat}^2} + C_{op}$$

Where:

C_{fi}	=	Fixed income investment risk charge
C_{eq}	=	Equity investment risk charge
C_{int}	=	Interest rate / Liquidity risk charge
C_{prem}	=	Premium risk charge
C_{rsvs}	=	Reserve risk charge
C_{cred}	=	Credit risk charge
C_{cat}	=	Catastrophe risk charge
C_{op}	=	Operational risk charge

This formula utilises the square root rule to aggregate the various risks under the assumption that the risks are at least partially independent of one another, and therefore, some diversification benefit is provided when combining the risk charges. The credit risk and reserve risk are combined to reflect the assumption that part of credit risk is directly related to reserve risk. The end result is the BSCR (after covariance adjustment)

The operational risk capital charge is the operational risk charge multiplied by the BSCR (after covariance adjustment). The risk charge ranges from 1% to 10% based on each insurer's self-assessment of the Commercial Insurer's Risk Assessment ("CIRA") framework.

The BSCR is equal to the sum of the BSCR (after covariance adjustment), operational risk capital charge, and capital add-ons/reductions (if assessed).

A peculiarity of the BSCR overall formula is as follows: the multiplying factor of C_{cred} under the square root is 0.5 (= $0.5^2 + 0.5^2$); it is not 1. This unusual feature makes it difficult to understand how C_{cred} corresponds to the resulting capital charge. By defining $C'_{cred} = C_{cred} / \sqrt{2}$, the formula can be written in the following way:

$$\text{BSCR} = \sqrt{C_{fi}^2 + C_{eq}^2 + C_{int}^2 + C_{prem}^2 + C'^2_{cred} + C_{rsvs}^2 + 1.414 * C'_{cred} * C_{rsvs} + C_{cred}^2 + C_{cat}^2} + C_{op}$$

It thus seems more appropriate to set out that

- the credit risk charge is C'_{cred} (= $C_{cred} / \sqrt{2}$ or = C_{cred} * 0.707); and
- the correlation between credit risk and reserve risk is 0.707 (= $1/\sqrt{2}$).

Annex 2: The life BSCR

The life BSCR formula is as follows:

BSCR =

$$\sqrt{C_{fi}^2+C_{eq}^2+C_{LTcred}^2+C_{LTint}^2+(C_{LTmort}+C_{LTsl}+C_{LTr})^2+C_{LTmorb}^2+C_{LTlong}^2+-.5x((C_{LTmort}+C_{LTsl}+C_{LTr})xC_{LTlong})+C_{LTVA}^2+C_{LToth}^2}+C_{op}$$

Where:

C_{fi} = capital charge in respect of fixed income investment risk;

C_{eq} = capital charge in respect of equity investment risk capital;

C_{LTcred} = capital charge in respect of credit risk capital;

C_{LTint} = capital charge in respect of interest rate and liquidity risk;

C_{LTmort} = capital charge in respect of long-term insurance risk – mortality;

C_{LTsl} = capital charge in respect of long-term insurance risk – stop loss;

C_{LTr} = capital charge in respect of long-term insurance risk – riders;

C_{LTmorb} = capital charge in respect of long-term insurance risk – morbidity and disability;

C_{LTlong} = capital charge in respect of long-term insurance risk – longevity;

C_{LTVA} = capital charge in respect of long-term variable annuity guarantee risk;

C_{LToth} = capital charge in respect of long-term other insurance risk; and

C_{op} = capital charge in respect of operational risk.

This formula, as with the non-life formula, utilises the square root rule to aggregate the various risks under the assumption that the risks are at least partially independent of one another, and therefore, some diversification benefit is provided when combining the risk charges. The end result is the BSCR (after covariance adjustment)

The operational risk capital charge is the operational risk charge multiplied by the BSCR (after covariance adjustment). The risk charge ranges from 1% to 10% based on each insurer's self-assessment of the Commercial Insurer's Risk Assessment ("CIRA") framework.

The BSCR is equal to the sum of the BSCR (after covariance adjustment), operational risk capital charge, and capital add-ons/reductions (if assessed).