BMA
BERMUDA MONETARY AUTHORITY

Bermuda's Insurance Solvency Framework
The Roadmap to Regulatory Equivalence

September
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Executive Summary

The Bermuda Monetary Authority has made considerable progress in its multi-year regulatory change programme. Our programme seeks to enhance Bermuda's framework for insurance regulation in line with evolving global standards. The objective underpinning this on going effort remains to apply risk-based regulations and supervision that:

- *meet or exceed international standards;*
- *enhance our ability to monitor and regulate insurers and our insurance market;*
- *are proportional, reflecting the differing constituents in our market; and*
- *are recognised as being equivalent by other leading regulators around the world.*

Committed to International Standards and Regulatory Equivalence

Our regulatory changes are consistent with similar changes being developed by other leading insurance regulators worldwide. Similarly, our focus for these changes is aligned with the core priorities of global regulatory reforms currently in progress: capital adequacy, governance, risk management and transparency and disclosure.

In addition, our strategic goal for making these changes in recent years has been to ensure that, given Bermuda's position as a leading insurance market with internationally active insurers, the Authority is well equipped to fulfill our mandate to protect policyholders with highly effective supervision. Part of that effort is to prepare Bermuda's insurance framework for achieving regulatory equivalence, in particular with Europe's Solvency II, the most imminent of global regulatory initiatives on insurer solvency. Equivalence is an important objective that will bring tangible benefits to firms and the broader Bermuda economy. It will also support the Authority's status as a leading risk-based financial regulator and our commitment to maintaining high standards.

We recognise that as regulatory changes continue to take place internationally there will still be more work required to keep pace with global expectations. However, the significant progress we have already achieved, with the goal of equivalency in mind, and our on going changes, are reinforcing and expanding the risk-based supervisory regimes we apply to Bermuda's insurance market.

Regulatory Re-engineering

When we first published this document, our aim was to set out the Authority's equivalence work plan or roadmap, discussing progress achieved to date as well as future changes planned. Since that time, our comprehensive work plan to enhance our regulations and supervisory regimes has both driven change nationally and allowed us to contribute to the process of reforms in financial regulation currently underway internationally. We have been pleased to share our long-standing experience in insurance regulation and the changes we are making to our frameworks to provide input to such reforms, which overall could be regarded as a global regulatory re-engineering process, particularly regarding the work of the International Association of Insurance Supervisors (IAIS).

We have also accelerated our regulatory framework enhancements as the momentum around Solvency II has gathered pace and timelines have become clearer for the programme of equivalence assessments for non-EU 'third countries' under the Directive. In addition, it has been proposed for consultation that Bermuda should be among the first wave of jurisdictions to be assessed for Solvency II equivalence.

The progress we have made to date in our enhancement programme for Bermuda’s solvency regime for insurers means that Bermuda remains among the leading group of jurisdictions preparing for Solvency II equivalence. We are ahead of schedule in work for some key elements within our programme of changes, such as establishing a group supervision framework.

Over the past two years in particular, the substantial policy work and framework implementation we have completed is consistent with Pillars 1, 2 and 3 of the Directive, covering quantitative requirements, the supervisory review process and disclosure:

Completed Framework Developments

- Implementing the **Bermuda Solvency Capital Requirement** (BSCR), a risk-based solvency standard and capital adequacy model for large commercial insurers, in use since 2008
- Establishing the standards to permit use of insurers’ **internal capital models** to determine regulatory capital, and launching a pilot application and review process with firms
- Developing the framework for **group-wide supervision** of Bermuda’s insurers, with supporting legislation that enables the Authority to be appointed as Group Supervisor
- Hosting and participating in **supervisory colleges** as one precursor to establishing the full supervisory framework for groups
- Introducing an **Insurance Code of Conduct** that establishes strong governance and risk management standards proportional to the nature, scale, and complexity of a firm’s business
- Requiring **public filing of general purpose financial statements** by the largest Bermuda insurers

These achievements represent the first phase of our regime development for equivalence, and provide a sound basis for moving forward. They have also been supported by an extensive consultation process with the market, to ensure our regimes remain pragmatic as well as internationally compliant, and to make sure firms are fully apprised of the enhanced standards that are being applied to them.

Looking ahead, the additional enhancements planned for further development and implementation by the end of 2011 will continue to extend the Authority’s supervisory capabilities and build on our regulatory frameworks:

Planned 2010/2011 Developments

- Launching our formal **group supervision** process, which will include new rules for a range of regulatory requirements such as group solvency and capital, reporting, group Code of Conduct
- Conducting broader roll-out of the **internal capital models** evaluation process
- Establishing the **Commercial Insurers' Solvency Self-Assessment** (CISSA) requirement, a Bermuda-specific ORSA (Own Risk and Solvency Assessment)
- Developing an **Economic Balance Sheet policy and framework**
- Implementing an **enhanced supervisory framework for the Long-Term (life) insurance** sector
- Reviewing the **Schedule of Risk Management** and **Catastrophe Return** submissions
- Establishing an **enhanced disclosure and transparency regime** by introducing a number of additional qualitative and quantitative public and regulatory disclosure requirements

Solvency II Equivalence

The Authority made a commitment to seek Solvency II equivalence recognising the important relationship that exists between the Bermuda market and the insurance sector in Europe. Creating regulatory efficiencies by gaining equivalence under the Directive will support continued conduct of business between Bermuda and Europe. In addition, the two overriding principles of the Directive —policyholder protection and improving the quality of insurance regulation worldwide—have long been embedded in Bermuda's regulatory legislation; therefore we are philosophically aligned with the aims of Solvency II. However, our approach to seeking equivalence remains pragmatic. The goal is to achieve broad equivalence with Solvency II, recognising that simply replicating its provisions may not be practical for all jurisdictions, including Bermuda.

This is in line with our overall approach to framework development, which successfully ensures our regulations maintain consistency with international standards, while we adapt those standards appropriately for the nature and associated risks of the Bermuda market.

Expanding Supervisory Resources

As these framework enhancements continue, we recognise that the Authority will require appropriate resources to implement the expanding supervisory regimes we are building. This is true in terms of both short-term developmental work currently in progress to establish new policy and processes, and the long-term resource needs of our supervisory teams. Therefore, in common with regulators around the world, increased resourcing and technical training are key elements of our supervisory strategy.

We are currently building on the existing senior-level technical expertise and skills in our supervisory, policy, risk analytics, actuarial and enforcement teams via an aggressive resourcing plan. Under this two-year plan the Authority is recruiting highly experienced staff for senior positions to support and execute our new regulatory frameworks and processes. These additional staff will also provide specialisation and expertise for implementing key regimes, such as our group supervision framework. Building these resources will help to ensure, as we roll out our expanded regimes from now and through 2011, that the Authority maintains its effectiveness and an appropriate level of challenge, rigor and integrity within our assessments and decision-making.

Parallel to the resourcing effort, we are providing our existing employees with on going opportunities to expand their knowledge and technical capabilities. The Authority's targeted use of expert Senior Advisors and consultants for technical and analytical support has proved to be highly effective in the learning and development of our team. This has also been beneficial for addressing short-term resourcing needs with targeted technical expertise as we have developed our framework enhancements.

Having the benefit of this high-level input to support our preparations for equivalence is significant and contributes to our overall goal of developing a leading insurance regulatory framework for the Bermuda market.

Technology to Extend Supervisory Effectiveness

We are also taking steps to use technology to improve our supervisory effectiveness by introducing enhanced reporting and analytic tools into our processes. Our objective is to use electronic processes strategically to create greater efficiencies, richer data analysis and improved reporting capability from the Authority's systems.

This initiative involves improving workflow and efficiencies for the Authority and the market by facilitating greater levels of automated filing by firms, and standardised data reporting. Standardisation of data will also enable us to enhance our capabilities for intra- and cross-sectoral analysis for supervisory purposes. This will support analysis and key processes related to matters including macro-prudential supervision, such as identification of outliers, producing peer rankings, either within an industry category or across a market sector.

We also intend to leverage standardised data reporting to enhance further collaboration between the Authority and other regulators, in particular to facilitate group-wide analysis and solvency calculations under our group supervision framework. We will be using the XBRL format to automatically standardise, classify and describe the information the Authority receives as part of the supervisory process. To make the most of the opportunity this initiative presents, we are active in leading development of a broad Solvency II-based XBRL taxonomy. Our intention is to share this work with fellow regulators as an additional contribution to our support of fostering greater supervisory cooperation globally.

Active International Cooperation

Solvency II still remains one of the most advanced among regulatory initiatives internationally in terms of its phase of development, and therefore our efforts are concentrated on the Directive. However, we remain actively involved in work related to other major international advancements, particularly with initiatives driven by the IAIS.

We also continue to monitor on going developments in relation to the US Solvency Modernisation Initiative via on going contact with the NAIC. Ensuring that the Authority actively supports international supervisory cooperation also remains a priority. Our active dialogue with other regulators around the world is supplemented by a series of Memoranda of Understanding, most recently signed with insurance regulators in various US States (New York and Florida), as well as with the Swiss Financial Market Supervisory Authority (FINMA).

The following sections provide further details about the progress achieved to date and planned initiatives, in the regulatory change work plan for our insurance framework. The extensive consultation process that we have conducted with the market as we make these changes will continue. We appreciate the time and input that the market has provided as we have progressed our framework developments. It remains clear from the commitment demonstrated throughout this process that firms understand the importance of this development for Bermuda and are supportive of our proposals. We have identified throughout the document where we will require further input from the market moving forward. The sections cover seven key areas:

- **Scope** This sets out our commitment to ensuring we operate an appropriate regulatory regime across the whole of the Bermuda market place, and sets out how we intend to continue implementing proportionate regulatory change for the various classes of insurers;
- **Economic Balance Sheet** This section discusses the potential impact on our regime of wider international regulatory and accounting developments, and how we propose to incorporate this as we develop our approach;
- **Capital Adequacy** This sets out our proposals for introducing tiered eligible capital requirements reflecting the quality of capital, and provides an overview of extended application of the Bermuda Solvency Capital Requirement (BSCR), our standard capital model, and further developments regarding the roll out of our internal models framework and our introduction of a Bermuda-specific Own Risk and Solvency Assessment (ORSA) regime;
- **Governance and Internal Control** This section describes the Insurance Code of Conduct that we have introduced, which establishes enhanced standards for firms regarding their approach to risk management and governance, as well as in relation to prudent person investment principles;
- **Disclosure** This section sets out the work that has been completed to date to consider approaches for additional disclosure requirements and proposals for phasing the timing of their implementation;
- **Groups** This section provides details of our group supervision framework, and describes how we will request further information from firms as regards existing group exposures, as well as our intentions to introduce a group solvency capital requirement;
- **Long-Term Business** This section considers how we propose to enhance solvency and reporting standards that will be specific to Long-Term Insurers.

Scope

The development of our framework will impact each class of insurer (both general insurers and Long-Term Insurers); however, our overarching aim remains to ensure that the final regime reflects the regulatory risk presented by the various classes of licence holder.

In particular, we continue to recognise the significantly different risks inherent in the commercial and captive sectors. Accordingly, we continue to give regard to the proportionality principles that underlie a number of overseas regimes, including Solvency II. Consistent with this approach we are cascading the roll out and application of our enhanced supervisory regimes on a phased basis across the different classes making up the various sectors of the Bermuda insurance market, beginning with Class 4 firms and working through the Class 3B and Class 3A companies, based on their respective risk profiles. This approach recognises the disparate nature of these firms and hence the different risks posed by the classes.

Using this risk-based regulatory approach, we apply progressively robust supervisory regimes and enhanced monitoring to firms, in accordance with their risk profiles. We have already implemented changes to the Class 4 sector, insurers with the highest risk exposures, which include our standard risk-based capital model (BSCR) and filing of public GAAP financial statements. Incentive for the implementation of appropriate risk and governance has been introduced through our Commercial Insurer Risk Assessment framework where an Operational Risk Charge is assigned to the standard capital model in accordance with the quality of an insurer's risk management and governance. Risk and governance requirements have been implemented through our Code of Conduct, which became effective on 1st July 2010, although more will be required here as other areas of our regime develop (e.g. in relation to own internal models). Our overall approach will be to apply our standards proportionately across the Class 3B and Class 3A sectors. Generally we expect implementation for the Class 3B sector to be one year after Class 4 implementation, and implementation for the Class 3A sector to be a year after 3Bs. Therefore, the BSCR and requirement to file public GAAP financial statements will be applied to Class 3B firms during 2010.

As regards captives, we will also use our depth of regulatory experience in relation to this market, as well as our on going gathering of data and information on the sector, to build greater understanding about any changes that might be appropriate for the supervision of such firms. We remain committed to achieving the right result for Bermuda from this analysis, and will ensure robust application of the proportionality principles to ensure an appropriately measured response to any international developments that are relevant to the captive sector.

Developments in our regime to date have been focused on the general insurance sector rather than the Long-Term market. We have however recognised the need to address the Long-Term insurance sector and issued a discussion paper in December 2009 to begin the process to develop an enhanced supervisory framework for Long-Term Insurers. Further development on the proposed framework enhancements for Long-Term business is in progress and we intend to conduct a second round of consultation on our proposals in the third quarter of 2010.

Capital Adequacy

The changes we have made to our solvency framework for insurance ensures that we have a process in place for determining capital adequacy for firms that can be applied proportionately to the entire Bermuda market.

The goal of our framework enhancements is to ensure that firms not only hold sufficient levels of capital, but also that the quality of that capital is appropriate and effectively takes into consideration the risks associated with their business.

Our standard capital model (BSCR), which we have applied to Class 4 firms since 2008 and will be extended to Class 3B companies in 2010, was specifically developed and calibrated to recognise elements that are unique to the Bermuda market (e.g. the heavy property catastrophe exposures and high proportion of reinsurance business). In addition, the stress-testing requirements that we have implemented include:

- Realistic disaster scenarios for both manmade and natural catastrophes;
- Severe shocks to the financial markets;
- Impact of rating downgrades on liquidity and capital adequacy; and
- Company-specific loss simulations and worst-case scenarios.

Determining adequate capital requires firms to properly identify, assess, manage and measure their risks. Further, supervisors must both understand the risk management systems and processes used by the firm and effectively challenge both models and assumptions, including the use made of these models within an organisation. Where we identify weaknesses that we judge to be material, the Authority has the power to require the firm to hold additional capital to help mitigate the perceived weaknesses.

We have also now established the standards and applications framework for permitting the use of insurers' own internal models, as approved by the Authority, for determining regulatory capital. This recognises that standard models may not fully represent the specific risk profiles of some firms, and also that sophisticated modelling techniques are currently used within companies across the Bermuda market. As we transition towards implementing the framework, we are conducting pilot assessments through to the end of this year; further details on this initiative are provided below.

Moving forward, we plan further developments focused on what we regard as the core components of an equivalent capital adequacy regime, as follows:

- Determination of eligible capital requirements (based on an economic assessment of the assets and liabilities of the firm)
- Requirements relating to quantum of capital required (to be assessed using either a standard model through the BSCR or pre-approved internal capital model)
- Requirements relating to the need for firms to demonstrate clearly the link between their capital model, risk governance and decision making (this will be effected through the Commercial Insurers' Solvency Self-Assessment, our proposed Bermuda-specific Own Risk Solvency Assessment (ORSA)).

The actual detail of the requirements in these areas will vary across different classes of insurer based on their risk profile and in accordance with the general principle of proportionality. We will also develop our own authorisation, supervisory processes and enforcement actions around these elements and additional information about those proposals are provided below.

Eligible Capital

There are a number of elements that need to be brought into the eligible capital (or Own Funds using the terminology of

Solvency II) rules. We have developed rules regarding the following:

- **Classification Criteria** – This will include tiered capital requirements. Recognising that there are many different capital instruments in use in our market, we conducted a desktop survey to assist with our policy development to establish eligible capital rules. Capital elements that are less certain to crystallise or have lower loss absorbency characteristics will only be available to cover capital requirements to a limited extent. We have therefore developed rules regarding coverage of policyholder liabilities and the various capital requirements.
- **Off Balance Sheet Items** – We will continue to consider off balance sheet items (e.g. Letters of Credit, contingent capital) as sources of regulatory capital, to differing extents. We already have in place within our regime an approval process for off balance sheet items and will review this in line with developments in classification criteria.
- **Economic Balance Sheet** – In our view, there is a need for the starting point for capital to be based on an economic view of the balance sheet. Therefore, for solvency purposes we believe that assets and liabilities should be valued on a consistent economic basis to more faithfully represent the solvency position of an insurer.
- **Commercial Insurers' Solvency Self-Assessment (CISSA)** – Comparable to the Own Risk and Solvency Assessment (ORSA) being developed by the IAIS and under Solvency II, the CISSA will facilitate capital assessment for regulatory purposes to be harmonised with firms' own assessments of their capital needs
- **Catastrophe Risk Return** – Given that the Bermuda insurance market is one of the world's largest reinsurance centres, assessing the assumptions and methodologies firms use to determine their catastrophe risk exposure is important to the Authority due to its significant contribution to the regulatory capital requirement. The proposed Catastrophe Return (Cat Return) will assist us in assessing the reasonableness of inputs into the catastrophe component of the regulatory capital requirement, and whether market practices are consistent with the Authority's standards. It will also provide information on the extent of firms' reliance on vendor models and the quality of catastrophe modelling. It also introduces new stress/scenarios for terrorism risks. We published a Consultation Paper on this proposal in Q3 2010. The Cat Return will apply to Class 4 and Class 3B insurers, Class 3A insurers writing property catastrophe business, and insurance groups.

Our goal remains to ensure that the capital rules we develop are practical, minimally disruptive to firms and not unduly burdensome on the market, whilst achieving the objective of policyholder protection. Therefore, we will continue dialogue and consultation with the market in various areas as we develop this regime, in particular as regards the tiering of capital and the potential use of an economic balance sheet.

Key milestones

• Consultation Paper–Cat Return	Q3 2010
• Test run for Cat Return	Q4 2010
• Eligible Capital Rules	Q4 2010
• Transition and implementation	2011

Standard Capital Model (BSCR)

The process to roll out the BSCR to the market using a phased approach continues. Analysis from a trial run of the BSCR for Class 3B firms is in progress, based on voluntary filings from companies for the 2009 year-end. Full implementation of the BSCR for Class 3B firms is scheduled for Q4 2010. We are also in the process of gathering information from Class 3A firms to assist in refinement and calibration of the BSCR model for small/medium-sized entities

(BSCR SME). This exercise and a related impact analysis study will enable us to apply the BSCR SME appropriately to Class 3A firms. The Authority is also working on a parallel project to develop a BSCR (BSCR-LT) for selected Long-Term Insurers, based on their risk profile. Further consultation with the market on the BSCR SME and BSCR-LT will take place throughout 2010. Our goal is to conduct a trial run of the BSCR SME using test submissions from Class 3A firms early in 2011, with a view to facilitating full implementation by the end of that year. A similar phased approach will be taken in relation to the BSCR-LT.

Policy on BSCR SME version will be developed once approach and BMA's position for Class 3A is determined.

Key milestones

- BSCR Class 4 2008 ✔
- BSCR Class 3B Test submission 2009 ✔
- Implementation Class 3B 2010
- BSCR SME Class 3A 2010
- BSCR-LT Selected Long -Term 2010
- Implementation Class 3A and selected Long-Term 2011

Internal Models

The Authority has recognised that standard capital models may not adequately represent the specific risk profile of a given firm. Bearing in mind that firms may be using internal capital models (ICM) in relation to their strategic risk management and capital assessment decisions, we have established our ICM framework.

After extensive market consultation, the Authority formally established model review standards and an application process for permitting the use of insurers' internal capital models in June 2009. The guidance notes that we issued in relation to putting this process in place outlined the various components of the ICM framework. These components include detailed pre-application conditions insurers must meet prior to submitting their models for review; the application review procedures the Authority will follow; and the monitoring and control activities we will undertake once a model has been approved. The elements of the framework are in line with emerging international best practice and standards for reviewing internal models being set by bodies such as the IAIS. They are also consistent with the provisions of Solvency II.

This development represented the first phase of transitioning towards implementation of the framework. The Authority remains cognizant of the need to ensure that we only place reliance on internal models that can demonstrate the highest degree of robustness and reliability, and only once the framework is fully implemented. As the next phase of the ICM framework transition, we have launched a pilot of our internal capital model review and assessment process. The ICM assessment includes evaluating the adequacy of the design, statistical quality and calibration of the models submitted, and, importantly, the governance structure, controls and documentation surrounding them. It is heavily focused on determining the extent to which the models are used effectively and fully integrated into the strategic decisions, underwriting and risk mitigation strategies of firms.

We will conduct the pilot assessments through to the end of 2010 with selected Class 4 companies. The pilot will enable us to test our review process, allowing us to make refinements to the framework as required. This includes validation of our pre-application process and information request for data from firms about their internal models, as well as the procedural details of the application review process, that will help with further development of the analytical tools that will be an integral part of the reviews. The pilot will also assist in our resource planning to support the process.

Early results from the pilot have led to us making further enhancements to the proposed pre-application process, which will require additional background information on the internal model to ascertain whether it should be submitted for application and review. We will be documenting the overall results of the pilot reviews internally and will refine our procedures accordingly. We also continue to monitor other regulatory developments internationally in relation to internal models to ensure our framework remains consistent with global standards and best practice.

Once the framework is implemented the Authority will provide approval for a model for regulatory purposes only if it is that all relevant minimum standards are met, and that an insurer has established an effective and suitable track record of reliable risk management. We will be applying rigorous scrutiny to the internal models submitted for review, given that application of approved internal models may result in reduced capital requirements for some insurers. We are also continuing to build on our technical resources to conduct the analysis that this initiative will require moving forward, currently adding further experienced resources to our existing in-house Actuarial Services team. We will also make provision for internal models within our regime for the Long-Term sector, and intend to conduct pilot ICM assessments for such firms in 2011.

Key milestones

• Standards and applications	Q2 2009
• Assessment Pilot completed	Q4 2010
• Own Models (Class 4, Class 3B and Class 3A)	2011
• Long-Term assessment pilots	2011
• Own models Long-Term	2012

Commercial Insurers Solvency Self-Assessment (CISSA)

Ensuring firms maintain prudent capital levels based on their risk profiles, and that the capital adequacy requirements in place for them are rigorous and effective, remains at the core of Bermuda's regulatory framework for insurers. Our on going programme of framework enhancements has resulted in additional supervisory regimes and solvency assessment tools that are risk-sensitive and in line with international standards and best practice. These include the BSCR and internal models regime, both introduced over the past two years and designed to assist in determining regulatory capital for Bermuda's insurers, as well as the Insurance Code of Conduct, which requires all firms to conduct solvency self-assessments for risk and capital management purposes. Our proposals to augment these tools with an Own Risk and Solvency Assessment (ORSA) requirement within our framework have resulted in the Commercial Insurers' Solvency Self-Assessment (CISSA). We began the second round of market consultation on our proposals for CISSA requirements via a Consultation Paper issued in Q2 2010.

The CISSA is a Bermuda-specific ORSA process, consistent with the existing high-level guidance on ORSA from the IAIS and developing Solvency II requirements, but taking into account the unique characteristics of the Bermuda market. The CISSA will provide us with the insurer's perspective of the capital resources necessary to achieve its business strategies and remain solvent given its risk profile, and we will also gain insights on the risk management, governance procedures and documentation surrounding this process. Our expectation will be that firms will be able to demonstrate via the CISSA that strong links exist between their management of risk assessment, governance and capital. It will provide an opportunity for insurers to demonstrate that their capital levels, quality of capital and risk management procedures and policies are commensurate with their risk profile. It also includes a forward looking perspective, which augments an insurer's ability to deal with the impact of future external changes in its risk and solvency position.

The CISSA will therefore become a critical tool within our supervisory review process. We will expect insurers to have processes that are proportionate to the nature, scale and complexity of the risks inherent to their business in order to conduct the CISSA. We will apply the use test, as well as qualitative assessments and quantitative analysis of a firm's CISSA process, as part of our review. This will require insurers to explain and justify their CISSA assessment in its entirety (e.g. the methodology used, the use and effectiveness of the capital model applied, key assumptions, results of the assessment, sources of data used, etc.), and to demonstrate that they have appropriately considered and accounted for all material risks that should be reasonably known. The CISSA process, following the overall principles of the ORSA, should be an integral aspect of a firm's capital management and as such would link closely to the disclosures it makes to the market. In addition, the CISSA will augment the self-assessment that will be required by the Insurance Code of Conduct, which became effective on 1st July 2010. Therefore, we will also use CISSA as a tool in the supervisory review process to assist in monitoring compliance with the Insurance Code of Conduct.

Based on our initial research and first round consultation conducted in 2009, although this is a new concept to the Bermuda market, it is apparent that many insurers already have in place systems that, to a great extent, will meet the requirements of a CISSA regime. We intend to apply the regime to commercial Long-Term Insurers, and it will also be applicable to insurance groups, using the proportionality principle.

Key milestones

• Discussion paper	Q3 2009
• Consultation paper	Q2 2010
• Test run	2010 (reporting year-end)
• Implementation	2011

Economic Balance Sheet

To provide greater transparency into the economic position of regulated entities and enhance our risk-based supervision, we are moving towards the implementation of an economic balance sheet. International accounting standards, including the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) in the USA, are similarly moving towards a fair value accounting regime, or at minimum, to more fair value disclosures. We consider an economic balance sheet to be a cornerstone to developing a leading risk-based regulatory regime as it will serve as the foundation for other key regulatory activities including capital requirements and disclosures. The Authority's view is that for solvency purposes assets and liabilities should be valued on a consistent economic basis, since this reflects more faithfully a firm's solvency position. Taking this approach is also in the best interests of policyholders.

In Q3 2010, we will release a discussion paper indicating our intention to implement an economic accounting regime and economic balance sheet reporting requirement by 2012. The discussion paper highlights the principles, and approaches to, the development of an economic balance sheet.

Some of the important principles described in the paper include:

- Valuation of assets and liabilities on a consistent basis to eliminate accounting

mismatches where no economic mismatches exist
- Utilisation of standard general purpose financial accounting (e.g. US GAAP, IFRS, etc.) accompanied by prudential filters and fair value disclosures as an accounting basis
- Statutory reserves reflecting the probability weighted discounted cash flows plus a discount margin, replicating portfolios and other reserving methodologies.

The discussion paper also highlights several key issues expected to be raised in the implementation of an economic balance sheet. We have sought feedback from key stakeholders on these issues and will explore them in further detail in the consultation paper. Examples of such issues include:

- Procyclicality and valuation during market dislocations
- Choice of discount rate and use of illiquidity premium
- Scenario projection and embedded optionality
- Determination of risk margin

Consideration will be given to methodologies used in other jurisdictions.

Key Milestones

• Discussion Paper	Q3 2010
• Consultation Paper	Q1 2011
• Enactment of legislation	Q4 2011
• Implementation of economic value disclosures	Q4 2011
• Implementation of an economic balance framework	Q3 2012

Corporate Governance - Code of Conduct

The Authority has successfully completed framework enhancements designed to reinforce and communicate our expectations of firms regarding their approach to risk management and governance.

Using feedback from the market subsequent to an extensive round of consultation that we completed at the end of 2009, we have developed and issued a formal Code of Conduct for insurers, which came into effect on 1st July 2010.

The Code establishes sound principles for the conduct of insurers and is based on international standards. It builds upon and codifies the governance standards and expectations already established within our regulatory framework, in particular the Minimum Criteria and Guidance Notes for Bermuda's insurance sector. It establishes duties, requirements, and standards with which (re)insurers must comply, including the governance procedures and sound principles to be observed by firms. Pertinent issues addressed in the Code include corporate governance, risk management, governance mechanisms, outsourcing and market discipline and disclosure. Overall, it requires informed Boards, effective delegation of authority, clear policies, safeguards on information and sound risk controls.

Specifically in terms of risk management, the Code requires firms to establish a sound and effective risk management framework, while also recognising that this should be achieved in a manner that is proportionate to the size and nature of the company. This includes developing policies, procedures, and internal controls promoting the identification, evaluation, mitigation, monitoring, and reporting of material risks. Importantly, it requires all firms to conduct a self-assessment of their material risks to determine their capital requirements, at least annually, again using the proportionality principle. The expectation is that this self-assessment should be an integral part of the insurer's risk management framework, and we will review the effectiveness of these assessments, via mechanisms such as use tests, as part of our enhanced supervisory review process. Consequently, any insurer that is not subject to the requirements of our Commercial Insurer Solvency Self-Assessment regime once it is in place will still be required to conduct a risk-based solvency self-assessment under the requirements of the Insurance Code of Conduct.

The Code also incorporates prudent investment principles, under which firms are obliged to take into account, and fully understand, the underlying risks of the assets they hold. The intention of these principles in particular relates ultimately to the protection of policyholders. They also seek to make sure that the firm monitors, manages and controls the overall risks in their entire portfolio. The Code has been drafted to ensure proportionality; therefore these requirements are commensurate with the size, nature, complexity and risk profile of the insurer.

Industry consultation is a critical component of the Authority's policy development process, and the feedback we received from the market on the Code was constructive and helpful. We are very grateful for the input from Bermuda market participants, and look forward to further consultation as the proposals for establishing a similar Code in relation to risk management and governance requirements for insurance groups are developed during 2010.

Key milestones:

- Consultation Paper Q3 2009 ✔
- Code of Conduct implementation July 2010 ✔
- Consultation Paper on Groups Code of Conduct Q3 2010

Disclosure and Transparency

Our work to build an appropriate level of additional transparency and disclosure into Bermuda's regulatory regime continues to progress steadily.

The Authority remains committed to providing open, transparent regulatory frameworks and requirements that are consistent with international standards, and to applying and enforcing those requirements consistently in a firm but fair manner. Our proposed disclosure regime includes both financial and qualitative risk and governance disclosures, using a risk-based, measured approach that will be applied using the proportionality principle. We regard transparency and disclosure as being core elements of an effective and well-functioning regulatory regime, and as international disclosure standards continue to evolve, we recognise that Bermuda must keep pace and maintain an active dialogue with other regulators. We have also taken into consideration the input we have received from the market regarding the form and content of disclosures industry should provide, to the regulator and the market overall, based on information firms currently provide for regulatory and financial reporting purposes. On that basis, and given the unique characteristics of the Bermuda market, we are taking a phased approach to the development of our enhanced disclosures regime:

Phase 1 began in 2009 and will extend to 2011; our goal during this period is to enhance and standardise regulatory disclosures on risk management, governance, and related financial information to provide a more complete understanding of insurers' risk characteristics or risk profiles. We are enhancing our disclosures regime based on existing public disclosure requirements internationally. Initially, this will comprise general purpose financial statements (US GAAP, IFRS), which already incorporate a comprehensive range of risk and other disclosures required by accounting standard setters. Since 2009 we have required Bermuda's Class 4 firms to produce publicly available GAAP financial statements. We are extending this requirement to Class 3B companies for the 2010 year-end, reflecting requirements already in place for Class 4 companies, thereby ensuring an enhanced level of public disclosure for Bermuda's largest commercial (re) insurers. This reporting period will also address disclosures for group-wide supervision; Commercial Insurer's Solvency Self Assessment (CISSA), our version of the IAIS's own risk and solvency assessment (ORSA); and the accompanying Catastrophe Risk Return (Cat Return), which will allow us to better assess the composition of the Probable Maximum Loss submissions we receive from firms and the quality of modelling generally in the Bermuda market. The second round of consultation with the market on these proposals is in progress, providing updated and more detailed information for discussion, and this will assist in our enhancement of the disclosures framework through 2011.

Phases 2 (reporting periods 2012 to 2014) and 3 (reporting periods 2015 and beyond) will be primarily dedicated to requiring public disclosures that are consistent with prevailing international standards and market consultation in place at that time. This approach takes into consideration the continuing pace and evolution of international developments on disclosures, and how they may be adopted appropriately for the Bermuda market. We will also review the effectiveness of our regulatory disclosures at Phases 2 and 3 and propose enhancements accordingly.

Key milestones

- Class 4 GAAP financial statements 2008 ✔
- Transparency Task Force recommendations 2008 ✔
- Consultation Paper Q2 2009 ✔
- Class 3B GAAP financial statements 2010 ✔
- Consultation Paper –update Q2 2010 ✔
- Phased implementation Present - 2015

Groups

The Authority has made significant progress in its work towards implementing a full group supervision regime.

We recognise that this remains a complex area of regulation, subject to continuing deliberations and development internationally. However, despite the complexities surrounding group-wide supervision we have advanced this work, since we also recognise the importance of the Authority having the ability to form a comprehensive view of the overall risk exposure of the notable number of Bermuda licensed insurers that operate within a group structure. The group supervision regime also builds on the work we already conduct within our on-site programme and advanced risk assessments of relevant solo entities, to obtain information on group risks and controls, as well as intra-group exposures and concentrations. In developing the regime we have taken a proportionate and risk-based approach, recognising the significant impact that group supervision could have on the different sectors of the Bermuda market.

Having completed preliminary consultation with the market on initial proposals for our proposed framework for group supervision during 2009, we were able to provide more details about our plans in this regard to the market via a Consultation Paper, ahead of schedule, in February 2010. We have since formally established the overall framework for group supervision for Bermuda's insurance market. In addition, enabling legislation was developed and enacted during the first quarter of 2010 that facilitated the Authority being a Group-wide Supervisor. This means we are now in a position to present the conditions and criteria under which the Authority can consider becoming a Group-wide Supervisor, and direction for home-host supervisor interaction and information exchange. We are basing our approach and functions in this regard on the principles and guidance set by the IAIS.

We are now establishing the supervisory process and procedures for applying the key components of our group supervision framework, taking into consideration on going international developments, the specific characteristics of the Bermuda market and input received from consultation with industry, including:

- Assessment of group corporate governance and risk management;
- Group-wide solvency assessments, which includes the treatment of intra-group transactions and risk concentrations;
- Statutory group financial reporting requirements; and
- Treatment of unregulated entities that are part of a group.

Our group supervision process will include new rules for a range of regulatory requirements covering these components, such as group solvency and financial reporting at the group level. We are also developing a group Code of Conduct, which will establish risk management and governance standards for Bermuda's insurance groups.

With respect to group solvency assessments, work to establish a standard solvency capital model for insurance groups is currently underway. We are determining how our BSCR model should be appropriately adapted for application at the group level. To support this initiative we will be conducting a data call during the third quarter of 2010 that will assist with testing the calibration of the group BSCR. This follows our previous information requests for the market to submit group solvency assessments that firms in the Bermuda market have conducted for other purposes, e.g. under the EU's Insurance Groups Directive, in order to obtain a baseline overview of the market's position while we develop our approach. The results of the baseline assessment will allow us to determine the effectiveness of the group BSCR model as well as the reasonableness of its output. The assessment will also incorporate an own model-based group solvency review.

We are currently developing group-specific on-site processes, adapted and enhanced from the policies and inspection procedures in place for solo entities. In parallel, we have developed requirements for group disclosures (including group-level CISSA and CIRA) and eligible capital that will become effective by the end of 2011. However, given the major change that implementation of the group supervision regime presents for the market, we will allow a transition period of 12 months for firms to comply with the group solvency and eligible capital requirements.

As part of our transition towards a full group supervision regime, we have continued our active participation in supervisory cooperation and information exchange with fellow regulators. We regard such cooperation, and the sharing of information appropriately among supervisors, as being key to the effectiveness of group supervision, in line with the standards set by the IAIS in this respect. The Authority became a first-round signatory to the IAIS Multilateral Memorandum of Understanding in 2009, as well as becoming a signatory to additional bilateral Memoranda of Understanding during the year. We also continue to share information with our regulatory counterparts overseas under the provisions within legislation that enable us to do so. We have also continued to host supervisory colleges for Bermuda's large insurance groups; further colleges are scheduled for 2010 and will take place in the future. We also intend to continue our support and contributions to the on going development of international standards for group supervision, particularly via our active participation in the IAIS's work on group supervision.

Key milestones:

- Discussion Paper — Q1 2009 ✔
- Supervisory Colleges — On going ✔
- Consultation Paper and legislation — Q1 2010 ✔
- Publication of Group Rules and Group Code of Conduct — Q3 2010
- Data call to assess group solvency — Q3 2010
- Trial Run for statutory filing 2010 year-end — Q3 2011
  (Groups with a Class 4 and Class 3B insurer)

Long-Term Business

As we have continued our programme of regulatory framework enhancements for general insurers we have recognised the need to ensure that supervisory regimes for Bermuda's growing Long-Term Insurers also remain effective and appropriate.

Our focus and the work completed to date in that regard, as for the general business market, has been on enhancing solvency and reporting standards for Long-Term Insurers. We began the review and enhancement process with a market survey, which provided useful baseline information that contributed over the past year to our development of initial proposals for an enhanced capital and solvency framework for the Long-Term business sector. Our goal will be to apply enhanced risk-based capital adequacy assessments tailored specifically to the nature and risk profile of Bermuda's Long-Term sector.

In December 2009 we published in a Discussion Paper providing preliminary direction on the enhanced Long-Term framework. The Paper set out the Authority's vision for a capital and solvency framework for Long-Term insurance companies that is both appropriate for the Bermuda market and recognised as meeting international regulatory standards. The proposed framework requires Long-Term Insurers to maintain regulatory capital to ensure, to a specified degree of confidence, that they have sufficient capital to withstand adversity emerging within a defined period. The goal is that firms' capital levels at the end of the period should result in a sufficient amount of assets to provide for the transfer (to another insurer) or run-off of remaining obligations.

Requirements under our broader framework enhancements, e.g. CISSA and group supervision regimes, will also be applied to the Long-Term sector. This will make the enhanced Long-Term framework consistent with the regulatory requirements applied to general insurers in Bermuda, using the proportionality principle.

We propose making available either a modelled approach or a standard approach to determine regulatory capital for Long-Term Insurers under the enhanced framework. This will accommodate the range of modelling capabilities that exists within companies in the market: some already employ sophisticated modelling tools and techniques, while others may not yet have the capacity to develop an approved internal model. For the modelled approach, we propose that the process and standards established in 2009 to review internal models of general insurers in Bermuda to assess their appropriateness to determine regulatory capital should also apply to Long-Term firms. The standard approach will use the same principles as our BSCR model for general insurers, as well as comparable international approaches that could be applicable, modified appropriately to take into account the nature and associated risks of Bermuda's Long-Term sector. This initiative will complement our implementation of the Bermuda Solvency Capital Requirement (BSCR) capital adequacy model for the property and casualty market in Bermuda and it builds on the effectiveness of our overall solvency regime for insurers.

As we continue the development process, we are now considering proposals to establish refined licensing classes for Long-Term Insurers. This will enhance alignment of solvency and reporting requirements within this sector based on the risk profile of firms within the refined classes.

These proposals still remain subject to further development and continued deliberations. In order to facilitate on going feedback from the market we have formed an industry task force to maintain communication with the insurers that will be most directly impacted by our proposed changes. We intend to issue a Consultation Paper with further details for the proposed solvency and capital framework enhancements for the Long-Term sector in Q3 2010.

Key milestones:

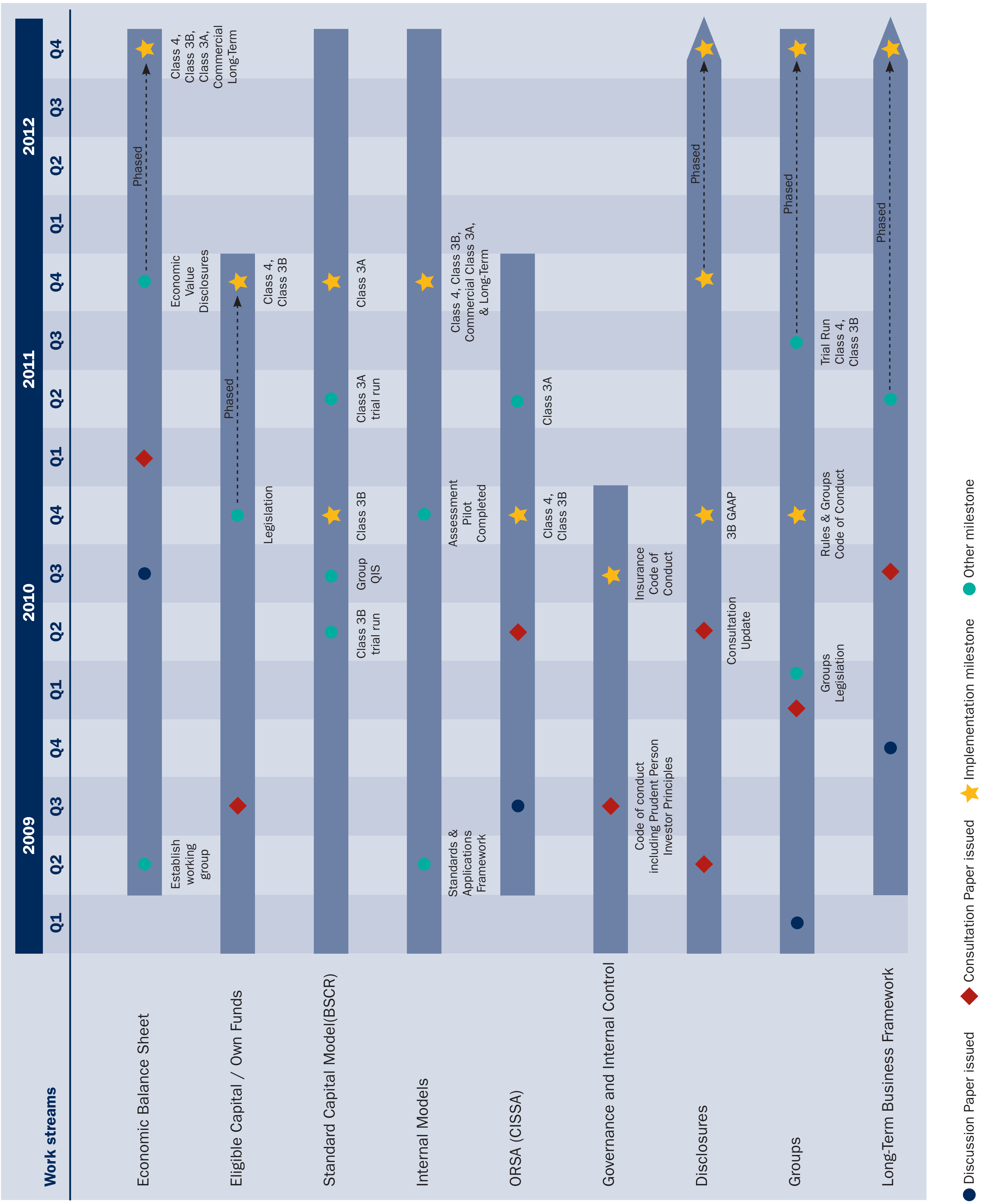
- Discussion Paper
  December 2009 ✔
- Consultation Paper
  - Long-Term licence classifications proposals, risk-based capital requirements and solvency regime Q3 2010
- Trial run for proposed higher Long-Term companies Q2 2011
- Long-Term licence classifications Q3 2011
- New capital requirements for Long-Term companies effective Q4 2011

Conclusion

We have made significant progress in our work to establish a leading risk-based supervisory framework that recognises both the differing constituents of the Bermuda market as well as developing international regulatory standards. While much has been achieved to date, we recognise that some key milestones still lie ahead.

We have fostered the engagement of the market during our framework development process and appreciate the support and input provided so far by the industry. Firms are preparing for this enhanced supervisory programme, and we encourage them to continue to do. The work completed to date places Bermuda among the leading group of jurisdictions preparing for regulatory equivalence. We intend to continue our programme of regulatory change, maintaining dialogue with the market and relevant authorities overseas, in order to put Bermuda in the best position to gain equivalence under Solvency II and other similar international initiatives. We remain determined to ensure that implementation of this programme should be achieved in a manner that demonstrates flexibility, adapts the emerging international regulatory framework to the characteristics of the Bermuda market, and adopts a risk-based and proportionate approach to the different classes of insurers operating in the Bermuda market.

Summary of BMA Programme Plan



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