30th November 2017

Dear Stakeholders:

Re: Findings of the Trial Run Exercise – Bermuda Solvency Capital Requirement Update Proposal, March 2017

The Bermuda Monetary Authority (the Authority) would like to thank stakeholders for their continued support of our key initiatives. The Authority appreciates the feedback received and is committed to working closely with its stakeholders to ensure that Bermuda's regulatory regime is effective and aligned with international standards.

On 30th November 2016, the Authority issued a consultation paper on a series of potential adjustments to the Bermuda Solvency Capital Requirement (BSCR) standard formula. Responses to industry comments were provided in our "Response to Industry Comments – Bermuda Solvency Capital Requirement Update Proposal, November 2016" posted 15th March 2017.

On 15th March 2017 the Authority issued a revised version of the consultation paper taking into account market feedback and conducted a field testing exercise of the proposals therein contained alongside the regular annual statutory filing .

This letter provides a summary of the main findings of the trial run exercise and resulting actions.

I. Level of participation

The Authority received over sixty trial-run submissions across different classes of insurers and business models. The quality of the submissions was generally good which meant Industry understood the main aspects of proposals being tested. Overall, the representative sample received has enabled the Authority to extract meaningful conclusions from the exercise.

II. Main results

Results were broadly in line with *a priori* expectations namely in terms of main drivers albeit resulting in a somewhat higher impact than initially anticipated. Ultimately, the effect of the proposals varied based on specifics of the risk profile and business model, nevertheless the Authority has concluded the following:

- The proposed changes are unlikely to cause significant market solvency issues although they will cause Enhanced Capital Requirement (ECR) ratios to decrease and may cause solvency issues on a very limited number of already thinly capitalized insurers.
- The main driver of the results was the changes to dependencies followed by equity risk and operational risk.
- The impact of the proposed changes on multi-year insurance contracts and concentration risk charge was also noticeable for a few selected insurers.

III. Actions taken based on the trial-run exercise and industry discussion

Having in due regard the feedback received from stakeholders on the proposed changes and the results from the trial run exercise, the Authority has decided to issue a revised Consultation Paper on 30th November 2017. This consultation paper further updates the referred March 2017 Consultation Paper and introduces additional adjustments with the ultimate goal of further increasing the risk sensitivity of the BSCR standard formula and better reflecting how insurers manage risks. The Authority would like to conduct two rounds of field testing on the proposed adjustments to the BSCR standard formula, one in the fall of 2017 using financial figures as of 31/12/2016 and another in the spring of 2018 using financial figures as of 31/12/2017. The new rules will enter into force in 1st January 2019 notwithstanding grade-in provisions.

The areas considered in this revised paper are equity risk, premium risk, credit risk, dependencies within premium and reserve risks, the overall risk aggregation process, operational risk, other BSCR adjustments, treatment of run-off insurers, currency risk, interest rate and liquidity risk, risk mitigation, use of management actions, the use of look through, treatment of derivatives, and grade-in arrangements as well as other provisions. The proposals went through extensive pre-consultation discussions with Industry and already incorporate their feedback to the extent the Authority considered appropriate.

The main changes from the March 2017 version of the Consultation Paper are:

- The revision of certain correlation assumptions, the operational risk charges, the premium risk charges for multi-year P&C contracts and the charges for sundry assets and liabilities.
- The introduction of an alternative approach for interest rate and liquidity risk, criteria under which the risk mitigation effect of risk mitigating techniques and the use of certain management actions are allowed in the calculation of the ECR, criteria under which the use of look through is allowed, and a new treatment for derivative instruments.
- Extension of the grade-in period from three years to 10 years for Long Term insurers.
- Grandfathering of equity risk capital charges for equities backing existing insurance liabilities as of 31/12/2018 for Long Term business.
- Delay implementation date of the proposed changes by one year.

The Authority would like to thank stakeholders for their participation on the trial run exercise of the BSCR Update Proposal, March 2017, and we remain committed to working with the Industry and other interested parties to ensure that results achieved are in the best interest of the Bermuda market.

Yours sincerely,

Bermuda Monetary Authority