



BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

POLICYHOLDER PROTECTION

June 2017

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I. Executive Summary

1. In June 2014 the Bermuda Monetary Authority (BMA or Authority) issued a [Discussion Paper \(DP\)](#)¹ that explored various policy options for implementing a policyholder protection mechanism for Bermuda's insurance market. While the Authority continues to review and strengthen its regulatory and supervisory frameworks to encourage growth while supporting a stable insurance market, it was recognised that there are occasions where failures may occur, and policyholders need to be protected under such circumstances. Failure to provide such protection may undermine policyholder confidence in the insurance market.
2. Consequently, the Authority proposes an arrangement for the preferential treatment of policyholders' liabilities ahead of general creditors and Bermuda Government in the event of the liquidation or winding up of a Bermuda insurer.² This preferential treatment would come into force for insurance contracts as of the date enabling legislation is passed. In terms of scope of coverage, this preferential treatment would include a simple priority in the payment of claims for policyholders expressed in a new "liquidation waterfall" to be incorporated into insurance legislation that encompasses the broad spectrum of insurance contracts issued in the Bermuda market. The revised waterfall allows for payment of claims of employees, and provides a high priority for long-term and general insurance policyholders.
3. The views of the insurance industry and of other interested persons on the proposals set out in this paper are invited. Comments should be sent to the Authority, addressed to policy@bma.bm not later than **14th July 2017**.

¹ <http://www.bma.bm/document-centre/consultation-papers/INSURANCE%20II/Discussion%20Paper%20on%20Policyholder%20Protection.pdf>

² References in this paper to insurers are intended to apply equally to reinsurers unless noted otherwise.

II. Background

4. Regardless of how robust a jurisdiction's supervisory and regulatory regime is, it cannot prevent all insurance failures. In the event of an insurer failure, policyholders may be disadvantaged socially and economically if the insurer is unable to satisfy its obligations. Ultimately such failures can undermine confidence in the insurance industry and potentially have adverse effects on the wider financial system. The failure and winding up of a significant Bermuda insurer without adequate protection for policyholders could damage the jurisdiction's reputation and undermine the supervisory regime.
5. International standards cite policyholder protection as one of the core objectives of an effective regulatory and supervisory infrastructure. The International Association of Insurance Supervisors (IAIS) issued Insurance Core Principles (ICPs³) setting out the essential components that "must be present in the supervisory regime in order to promote a financially sound insurance sector and provide an adequate level of policyholder protection."⁴
6. In its consultation regarding the Assessment Methodology, the IAIS defined the term policyholder as "... a person (natural or legal) who holds an insurance policy, and includes, where relevant, other beneficiaries and claimants with a legitimate interest in the policy."⁵ An insurance policy is a contract of "insurance business" which is defined in the Insurance Act 1978.⁶
7. The current ICP 12 entitled, 'Winding-up and Exit from the Market' states, "*the legal framework gives priority to the protection of policyholders and aims at minimising disruption to the timely provision of benefits to policyholders.*"⁷ The IAIS recently published for consultation a revised ICP 12⁸, which includes Principle 12.9: "*Legislation provides a high legal priority to policyholders' claims within the hierarchy of claims in liquidation.*"⁹

³ <https://www.iaisweb.org/page/supervisory-material/insurance-core-principles//file/58067/insurance-core-principles-updated-november-2015>

⁴ IAIS Insurance Core Principles, Standards, Guidance and Assessment Methodology 1 October 2011

⁵ IAIS Insurance Core Principles, Standards, Guidance and Assessment Methodology (Version for Public Consultation) March 2017, Page 4

⁶ <http://www.bermudalaws.bm/laws/Consolidated%20Laws/Insurance%20Act%201978.pdf>

⁷ ICP 12: Winding-up and Exit from the Market, page 109, IAIS Insurance Core Principles, November 2015

⁸ <https://www.iaisweb.org/page/consultations/current-consultations/revision-of-icps-and-comframe//file/65311/revised-icp-12-and-comframe-in-icp-12-for-consultation>

⁹ "Policyholders should receive high legal priority in the liquidation of an insurance legal entity (or branch) so that policyholders rank above ordinary unsecured creditors." Guidance 12.9.1, page 16, IAIS Insurance Core Principles, Standards, Guidance and Assessment Methodology Mar. 2017

8. In June 2014 the Authority issued a DP to explore the importance of policyholder protection to developing and sustaining an economy and the various ways policyholder protection can be advanced. In order to support consumer confidence and be in line with international standards, the Authority proposed that Bermuda should adopt a formal policyholder protection mechanism for the insurance sector. Options that were considered in that paper included tied or segregated assets, policyholder protection schemes (insurance guarantee funds) and preferential payments of policyholders.
9. The DP sought comments on the Authority's proposals for adoption of a mechanism that would involve the implementation of a prospective arrangement for the preferential treatment of policyholders' claims ahead of general creditors in the event of the liquidation or winding up of a Bermuda insurer. This preference would apply prospectively only to insurance contracts entered into or renewed on or after the date enabling legislation is passed, so as to preserve the contractual rights of counterparties and investors on existing contracts.
10. The DP raised a number of important issues and asked stakeholders to respond to a series of questions. The DP feedback received was predominantly in support of a simple priority of payments in the event of liquidation as the policyholder protection mechanism to be implemented in Bermuda.
11. The DP argued that the scope of a policyholder protection mechanism needs to address:
 - a. the type of policyholders to which coverage is extended (e.g. retail or wholesale);
 - b. whether coverage (and the same type and extent of coverage) extends to both resident and non-resident policyholders;
 - c. the contracts to which policyholder protection extends (e.g. General Business, Long-Term, reinsurance contracts); and
 - d. cross-border insurance activity (e.g. whether policyholders are national or non-national).
12. The Authority seeks to ensure that its approach to implementing a policyholder protection mechanism is appropriate for all sectors of Bermuda's insurance industry, which includes both its wholesale market and an important retail market. The purpose of this Consultation Paper (CP) is to describe the Authority's revised proposal.

13. Resolution is a very broad and complex topic. The Authority has therefore decided to address this in stages beginning with the “liquidation waterfall” to effect more immediate change. Other issues will be examined in future consultations.

III. Preferential Treatment of Policyholders for the Bermuda Market

14. In this CP, the Authority is issuing a revised proposal for the preferential treatment of policyholders’ claims ahead of general creditors and Bermuda Government in the event of the liquidation or winding up of a Bermuda insurer. This preferential treatment would come into force for insurance contracts as of the date enabling legislation is passed. The policyholder protection framework would include a simple priority in the payment of claims for policyholders including long-term and general business, insurance and reinsurance contracts for both domestic and overseas policyholders and would include retail and commercial insurance coverages.
15. The proposed preferential treatment would also have regard to funds legally established for certain insurance products, such as the “long-term business fund” under Section 24 of the Insurance Act, which could be only used to satisfy the insurance obligations for those policies that are part of the fund. This approach is aligned with other jurisdictions who have similar such funds for their long-term business¹⁰.
16. The DP initially considered an amendment to the payment waterfall in the Companies Act 1981 (Companies Act), however, upon further deliberation, the Authority believes that the policyholder protection mechanism only affects insurers. Consequently, the Authority is of the view the best way forward is to leave the waterfall as is in the Companies Act and create a new liquidation waterfall of payment priorities in the Insurance Act 1978 as follows:
- a. The claims of employees for contributions to Pensions under section 44 of the National Pension Scheme (Occupational Pensions) Act 1998 (only if the pension plan is in liquidation);
 - b. The claims of employees under section 33 of the Employment Act 2000, unpaid health insurance premiums under section 20 of the Health Insurance Act 1970 or any other employee insurance obligation;

¹⁰ The following jurisdictions have similar wording to Section 24 of Bermuda’s Insurance Act, 1978 in their respective legislation: i) Cayman Islands, Insurance Law 2010, sections 16 and 17; ii) Isle of Man, Insurance Act 2008, sections 19 and 20; iii) Jersey, Insurance Business (Jersey) Law 1996, section 26; iv) Guernsey, the Insurance Business (Bailiwick of Guernsey) Law 2002, Section 42.

- c. The claims of long-term policyholders (including the savings or investment component of long-term contracts) as funded under section 24 of the Insurance Act 1978 and the claims of policyholders with respect to outstanding claims on General Business contracts;
- d. The claims of policyholders with respect to prepaid premiums;
- e. The claims of Bermuda Government for taxes under section 236(1) of the Companies Act 1981;
- f. The claims of employees for Workmen's Compensation under section 236(1) of the Companies Act 1981.

17. The rationale for the revised liquidation waterfall in paragraph 16 is as follows:

- a. Pensions: In line with the National Pension Scheme (Occupational Pensions) Act 1998 (NPS Act) in Bermuda, the Authority retains the high priority made to pensions. The Authority is cognisant of the significant dependence of pensioners on pension payments for normal living expenses, and therefore seeks a high level of priority for pensions if the pension plan is in liquidation.
- b. Employees: Consistent with existing law, employees' claims for payment of wages, salary and accrued holidays, would have precedence over the policyholders' claims, as well as general creditors. This is consistent with international practice. However, the Authority proposes that any unpaid employee (mandatory) health insurance premiums under section 20 of the Health Insurance Act 1970 for Bermuda employees is explicitly listed to fully reflect employer obligations to employees.
- c. Policyholders: The Authority's proposal includes both general business and long-term insurance contracts, and the savings or investment component of long-term contracts.
- d. Prepaid Premiums: The priority of payments would also place policyholders with outstanding insurance claims ahead of policyholders seeking to recover prepaid premiums. This recognises that unpaid claimants (e.g. the homeowner or small business owner needing insurance claim payments to rebuild a damaged property) may suffer economic loss far in excess of policyholders seeking to recoup premium payments.
- e. Government Taxes: The Authority proposes that policyholders be placed ahead of the Bermuda Government for taxes. The lack of payment of Government taxes does not have the equivalent detrimental effect on the Bermuda Government as it does on employees and policyholders. This has also been recognised in other jurisdictions, for example in England since 2002.

- f. Workers' Compensation: The Authority's proposal maintains claims for workers' compensation beneath that of Government taxes, which is the current ranking.
- g. Pursuant to section 235 of the Companies Act, the aforementioned waterfall would not affect the rules with respect to the rights of secured creditors and unsecured creditors in an insolvent liquidation.

IV. Conclusion

- 18. The Authority believes that the above approach is appropriate given the relatively rare occurrence of insurer failure in Bermuda, and the longer time horizon for the payment of insurance liabilities compared to other financial services firms, for example banks. Additionally, the requirement to hold sufficient capital assets under the Insurance Act 1978 and the accompanying rules and regulations, along with the robust system of insurance supervision in Bermuda are additional factors supporting this approach.
- 19. No policyholder protection mechanism can guarantee that policyholders all get compensated in liquidation or winding up, however, the Authority is of the view that the proposed priority for creditors is sufficient. Accordingly, the Authority does not view the establishment of a waterfall of preferential payments for policyholders as unduly burdensome to the industry.

June 1, 2017

A BILL

entitled

INSURANCE AMENDMENT ACT 2017

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WHEREAS it is expedient to amend the Insurance Act 1978, and to make consequential amendments;

Be it enacted by The Queen's Most Excellent Majesty, by and with the advice and consent of the Senate and the House of Assembly of Bermuda, and by the authority of the same, as follows:

Citation

1 This Act, which amends the Insurance Act 1978 (the "principal Act"), may be cited as the Insurance Amendment Act 2017.

Inserts section 36A

2. The principal Act is amended by inserting the following after section 36—

"Preferential payments

36A (1) Section 236 (1) of the Companies Act 1981 does not apply in the case of a winding up of an insurer and instead, the provisions of subsection (2) have effect.

(2) In a winding up of an insurer there shall be paid in priority to all other debts—

- (a) unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation or of merger with another company, all amounts due in respect of contributions payable during the twelve months next before the relevant date by the company as the employer of any persons under the Contributory Pensions Act 1970 or any contract of insurance or any unpaid premiums due in respect of a contract of health insurance under the Health Insurance Act 1970;
- (b) all wages or salary, whether or not earned wholly or in part by way of commission or whether payable for time or piece work of any employee of a company in respect of services rendered to the company during four months next before the relevant date;
- (c) all accrued holiday remuneration becoming payable to any employee, or in the case of his death to any other person in his right, on the termination of his employment before or by the effect of the winding-up order or resolution;
- (d) all amounts due to policyholders of any contract of insurance, excluding those amounts due under subsection (e);
- (e) all prepaid premium amounts made by a policyholder prior to the inception of a contract of insurance;
- (f) all taxes owing to the Government and rates owing to a municipality at the relevant date;

- (g) unless the insurer is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation or of merger with another company, or unless the company has, at the commencement of the winding up, under a contract with insurers capable of being transferred to and vested in the workman, all amounts due in respect of any compensation or liability for compensation under the Workmen's Compensation Act 1965, being amounts which have accrued before the relevant date.

Amends section 40

3 Section 40 (2) (b) of the principal Act is amended by deleting the words "236 of the Companies Act 1981" and inserting "section 36A (2)".

Commencement

4 This Act shall come into operation on assent.

INSURANCE AMENDMENT BILL 2017

EXPLANATORY MEMORANDUM

This Bill seeks to amend the Insurance Act 1978 (the “principal Act”) by making a number of changes to the winding up of an insurance business.

It seeks to address matters relating to the protection of all policyholders during the winding up of an insurer.

Clause 1 provides a citation for the Bill and defines “principal Act” as the Insurance Act 1978.

Clause 2 proposes to insert a new provision as “section 36A” after section 36, to dis-apply the requirements of section 236 (1) of the Companies Act 1981 and instead, apply a new “waterfall” of preferential payments in order to embed a requirement under Bermuda law to protect the interests of policyholders. In this regard, policyholders shall now be paid in priority to all other debts in a wind up of an insurer *after*: (i) certain contributions to be made by an employer in accordance with the Contributory Pensions Act 1970 (or required in relation to any insurance contract or any unpaid premiums under a contract of health insurance); (ii) including but not limited to, all wages and salaries of the employees of a company and (iii), the payment of employee accrued holiday remuneration where applicable. The new requirements then seek to provide for the priority of payment to all other debts of an insurer in a wind up (i.e., *after payment to policyholders*) in relation to:

- (a) any prepaid premiums by a policyholder under any contract of insurance;
- (b) all taxes owing to the Government and rates owing to a municipality; and
- (c) where appropriate, certain amounts due in respect of any compensation or liability for compensation under the Workmen’s Compensation Act 1965.

Clause 3 seeks to amend section 40 (2) (b) to align such provisions with the new section 36A.

Clause 4 makes provision for the proposed requirements to come into operation on assent.