BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

FUNDING AGREEMENTS

JULY 2015

I. Introduction

1. As global insurance markets evolve, so do international regulatory and supervisory standards. The Bermuda Monetary Authority (the Authority) continues to review its current framework and make adjustments where needed. The Authority is proposing to amend its regulatory and supervisory regimes for Long-Term (life) insurers, that is, Class A, Class B, Class C, Class D and Class E insurers.

2. The proposed amendments aim to expand Bermuda's insurance regulation regime by incorporating the notion of 'funding agreement', an arrangement underwritten by life insurance companies as part of their business activities. Funding agreements – or capital redemption contracts – have a long history, in particular in continental Europe; they are common among life insurers in both the United States and EEA.

3. In the European Union, "capital redemption operations" are governed by the Solvency II Directive, which absorbed the concept from the Life Assurance Directive 2002. Although Solvency II does not define them as an insurance activity, capital redemption operations are included in the scope of the Directive (Article 2(3)(b)(ii)).

   Capital redemption operations are given regulatory and supervisory treatment as if they were an insurance activity. In the UK, capital redemption operations are treated as 'contracts of insurance' by the Prudential Regulatory Authority.

4. In the US, funding agreements are also treated as insurance business. Further, counter-parties to funding agreements are treated *pari passu* with policy holders in case of an insurer's insolvency (this is the case, for example, under NY law).

5. This segment of business has been experiencing a steady increase of the past years. In this respect, the Authority aims to equip those life insurers willing to issue funding agreements with the regulatory tools necessary to do so.

6. The proposed amendments aim to ensure that the regulatory and supervisory framework continues to offer a balance between robustness and flexibility that enables innovation to take place within a sound prudential supervisory environment.

7. The proposed amendments are intended to be effected in 2015. These are:

   a. Introduce the notion of 'funding agreement'
   b. Clarify that funding agreements shall be deemed to be Long-Term business

8. 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 no later than 8th September 2015.

II. Amendments to the Insurance Act (1978)

Introduction of the definition of funding agreement

9. The Authority proposes to insert a new definition of 'funding agreement' in Section 1 of the Insurance Act (1978). The proposed definition is as follows:

   "capital redemption contract" or "funding agreement" means an agreement for an insurer to receive and accumulate money and to make one or more payments of money or render money's worth on dates and in amounts that are not based on life contingencies of any person, which by its terms is expressed to be a capital redemption contract or funding agreement.

Funding Agreements to be deemed to be long-term business

10. The Authority proposes to clarify that Funding Agreements or Capital Redemption Contracts shall be deemed to be Long-Term business

11. For this purpose, the Authority proposes to insert in Section 1 of the Insurance Act (1978) a new point 6 as follows:

    i. *(6) For all purposes under this Act capital redemption contracts or funding agreements shall be deemed to be long-term business.*

12. By deeming capital redemption contracts or funding agreements to be Long-Term business the Authority is of the view that it not necessary to amend Section 19 of the Insurance Act.

III. Funding Agreements to follow the regulatory treatment given to equivalent life insurance activities

13. For regulatory and supervisory purposes, the Authority proposes to take in respect of funding agreements the approach taken in respect of equivalent life insurance activities, that is, activities with a substantial investment element in them.

14. The Authority proposes to apply this approach to the solvency, risk management and governance, and reporting and disclosure dimensions of the regulation and supervision of funding agreements.

15. The Authority proposes to amend the Insurance Act to reflect this provision, which will take effect by 31st December 2015.

IV. Conclusion

16. The Authority continues to monitor international developments and ongoing discussions that are affecting the playing field in which the Bermuda insurance industry operates.

17. As these developments require dedicated policy attention by the Authority, discussions with industry and other stakeholders become more formalised. This consultation aims to update Bermuda's insurance regulation regime in a manner that is robust as it is suitable for the characteristics of the Bermuda insurance market, ensuring that it remains both credible and appropriate.