BERMUDA MONETARY AUTHORITY

13th November 2012

Dear Stakeholders:

Re: <u>The Insurance (Group Supervision) Rules 2012, the Insurance (Prudential Standards)(Insurance Group Solvency Requirement) Amendment Rules 2012, Amendments to Prudential rules for Class 4 and 3B, Class E and Class 3A solo entities</u>

The Bermuda Monetary Authority (the "Authority") wishes to thank stakeholders for their continued support of our key initiatives. In June 2012, the Authority published draft amendment rules with respect to insurance group supervision and the group solvency requirement, and a number of comments and requests for clarification were received. As well, the Authority published draft amendments to prudential rules which apply to solo entities. The Authority is committed to engaging stakeholders in such initiatives, as we strive to achieve our supervisory objectives and retain Bermuda's role as a leading international regulator.

With respect to the delay being experienced in the implementation of Solvency II in Europe, the Authority continues to consider the impact this will have on global efforts to achieve effective group supervision. We will delay the legal enforceability of the group enhanced capital requirement ("ECR"), until a date to be determined after a meeting at which industry views will be heard. The Authority previously communicated a deferral of the ECR and the eligible capital rules for the Long-Term companies until 1st January 2014. In the coming weeks prior to year end, the Authority will provide further communication on the timing of the group ECR and on any other transitional arrangements to be undertaken.

The Authority's responses to the key comments received and other substantive changes are outlined below.

The Insurance (Group Supervision) Rules 2012

Internal Audit

Summary of Comments: Concern was raised over the inclusion of language that would limit performance-based compensation of persons responsible for the group internal audit function that related solely to the performance objectives of the internal audit function. Commenters noted the absence of similar constraints on compensation in the rules of other major insurance regulators or international standard setters, and concerns that such an approach could increase the cost of the internal audit function by making companies rely on fixed bonuses not tied to performance.

Resolution: The wording will be revised as follows to focus on the needed independence of the internal audit function and the importance of board-level attention to internal audit compensation:

> ***The compensation of persons responsible for the group internal audit function should not compromise their independence, and at a minimum, the parent board or an appropriate committee thereof should establish and periodically review the compensation of the head of internal audit and establish guidelines for the compensation of other internal audit staff.***

Responsibilities of Board of Directors

Summary of Comments: Concern was raised over the use of language requiring the board of directors to "ensure" that certain activities are undertaken by a group because this could be interpreted in a manner that could give rise to legal liability.

Resolution: Additional revisions to the Group Rules have been made to address this point. In most cases, references have been changed to reflect that certain matters are the responsibility of the board. Industry stakeholders are advised that there has been added a requirement for the board to review annually the group solvency self-assessment and any changes.

Transitional Provision for Eligible Capital

Summary of Comments: The Authority was requested to extend the 1st January 2024, transitional provision for the inclusion of instruments in eligible capital to those that otherwise comply with the Group Rules but for the requirement that the instrument be non-redeemable or settled only with the issuance of an instrument of equal or higher quality upon a breach (or if redemption would cause a breach) of the enhanced capital requirement. The request noted that the absence of a transitional provision could require companies to amend the terms of existing instruments or refinance those instruments.

Resolution: The eligible capital provisions of the Group Rules have been revised to include the requested transitional provision.

Other Substantive Changes

Consistent with the proposal in the consultation paper regarding enhancements to the regulatory and supervisory regime for commercial insurers published in January 2012, the rules are amended to require the submission of an unaudited statement for public disclosure with respect to the group's compliance with the minimum margin of solvency and the ECR.

Consistent with the draft Guidance Note, Chief Actuary's Opinion, the references to the Group Actuary's certificate in Schedule 2 have been changed to refer to an opinion.

The Insurance (Prudential Standards) (Insurance Group Solvency Requirement) Amendment Rules 2012

Bermuda Dollar Accounts

The rules are amended to make clear that accounts must be stated in Bermuda dollars. The rate of exchange for U.S. dollars to Bermuda dollars is 1:1 and, thus, no adjustment need be made.

Insurance (Prudential Supervision) (Class 4 and 3B Solvency Requirements) Amendment Rules 2012
Insurance (Prudential Supervision) (Class E Solvency Requirements) Amendment Rules 2012
Insurance (Prudential Supervision) (Class 3A Solvency Requirements) Amendment Rules 2012
Insurance (Eligible Capital) Amendment Rules 2012

In addition to comments received in relation to the Group Supervision and Solvency Requirement Prudential Rules, feedback was sought from industry stakeholders on the proposed amendments to the insurance prudential supervision rules which apply to solo insurers. There were limited comments received on the amendments which were proposed. However, the Authority advises industry of the following additional amendments that the Authority proposes to make. These changes primarily clarify requirements and are housekeeping in nature:

a. **Insurance (Prudential Supervision) (Class 4 and 3B Solvency Requirements) Amendment Rules 2012**

These rules have been amended to eliminate the requirement for a director to sign the CISSA. However, as set out in the Code of Conduct and reflected in Schedule VII, the Board must review the CISSA annually and any material changes.

While the CISSA does not require a signature, the statutory declaration required to be submitted by the regulated insurer must be signed by two directors of the insurer, one of which may be the chief executive, and either the chief risk officer of the insurer, or the chief financial officer of the insurer.

Finally, the schedules have been adjusted to mirror the electronic filings.

b. **Insurance (Prudential Supervision) (Class E Solvency Requirements) Amendment Rules 2012**

The ECR for the Long-Term classes has been repealed and will not take effect until 1st January 2014, and will be phased in over a period of 3 years. As well, these rules have been amended to eliminate the requirement for a director to sign the CISSA. However, as set out in the Code of Conduct and reflected in Schedule IX, the Board must review the CISSA annually and any material changes.

Finally, the schedules have been adjusted to mirror the electronic filings.

c. **Insurance (Prudential Supervision) (Class 3A Solvency Requirements) Amendment Rules 2012**

These rules have been amended to eliminate the requirement for a director to sign the CISSA. However, as set out in the Code of Conduct and reflected in Schedule VII, the Board must review the CISSA annually and any material changes. As well, the requirement for a declaration of capital and solvency returns has been included and must be signed by two directors of the insurer and by the insurer's principal representative.

Finally, the schedules have been adjusted to mirror the electronic filings.

d. **Insurance (Eligible Capital) Amendment Rules 2012**

These rules have been amended to provide a transition until 1st January 2024, for the inclusion of instruments in eligible capital that otherwise comply with the rules but for the requirement that the instrument be non-redeemable or settled only with the issuance of an instrument of equal or higher quality upon a breach (or if redemption would cause a breach) of the enhanced capital requirement. This mirrors a similar approach taken under prudential rules for Solvency II.

In addition, the eligible capital rules for the Long-Term classes do not take effect until 1st January 2014.

The Authority thanks stakeholders for their comments and remains committed to working with industry and other stakeholders to take action in the best interests of the Bermuda market.

Any final comments on the revised Rules should be submitted to policy@bma.bm by Friday, 7th December 2012.

Yours sincerely,

Bermuda Monetary Authority