28th September 2012

Dear Stakeholders:

Re: Standards and Application Framework for the use of Internal Capital Models for Regulatory Capital Purposes (Revised).

The Bermuda Monetary Authority (the Authority) wishes to thank stakeholders for their continued support of our key initiatives. In June, 2012, the Authority published for comment revisions to the guidance note entitled *Standards and Application Framework for the use of Internal Capital Models for Regulatory Capital Purposes*. The Authority is committed to a regulatory framework that permits the use of internal capital models in assessing regulatory capital requirements and appreciates the interest of stakeholders in commenting on the initiative.

The Authority's responses to the key comments that were received are outlined below:

I. Board and senior management training

The Authority had proposed in section B.50 that the insurer's Board must formally approve the model for use within the business. Section B.51 proposed that the Board should have a sufficient understanding of the model's key elements, and evidence regarding the nature and extent of training given to Board members and senior executives was proposed as part of the application process for model approval.

Commenters supported the engagement of the Board in approving the model for use within the business, but suggested that the requirement to provide evidence with respect to Board and senior executive training was unnecessary; citing that fitness and proprietary of Board members is already reviewed in general terms by the Authority relating to corporate governance matters and rules and to isolate "training" with respect to one element of the role and responsibilities is unreasonable and does not reflect the collective nature of Board members and their contributions

The Authority views the role of the Board and senior management as critical in ensuring the effective use of an internal model for regulatory capital purposes, and is mindful of the additional responsibilities for an insurer's Board and senior executives that arise from section B.50. As a result, the Authority expects insurers will conduct specific training for Board members and executives in this emerging area of business practice. Accordingly, the Authority does not view the requirement to provide evidence with respect to the nature and extent of training given as unduly burdensome for insurers.

Commenters raised a concern that section B.51 may suggest that the evidence of training given could be used by the Authority in order to adjudicate on the competency of individual Board members or executives. The requirement will be adopted as proposed, however, in response to comments the Authority has modified the Guidance Note, replacing the term '*Board members*' with '*the Board*' in section B.51. The Authority wishes to reassure stakeholders that the intended purpose of this section is not to adjudicate on the fitness and proprietary of Board members or senior executives.

On a related point, the Authority wishes to remind stakeholders that section 39 *(*The model *review process will involve both on-site and off-site examinations and discussions with the insurer's staff or representative)* may involve discussion with the Board and senior executives of the insurer with respect to the model.

II. Liquidity risk modelling

The Authority had proposed that liquidity risk will be considered during the model review to the extent that this risk is captured by the insurer's internal model. Commenters noted that a capital model may not measure liquidity risk explicitly, and that alternative methods/models can be relevant and appropriate.

The Guidance Note published for comment in June 2012 acknowledges this issue: *To the extent liquidity risk is considered in the ICM, the Authority will aim to confirm that it is done so appropriately during the ICM review process* (see section B.125). In response to comments received, the Authority has revised the Guidance Note in order to ensure this is clarified throughout the document - in particular a footnote has been added in section A.11.

In addition to responding to comments from stakeholders, the Authority has reviewed the Guidance Note for internal consistency and clarity. As a result, The Authority has included minor amendments to the Guidance Note, in the following sections[1]: 29, 50, A.11, A.17, B.6.6, B.102, C.44, C.63, C.91 and C.108. The Authority believes that these amendments clarify the requirements published for comment in June 2012, and there is no impact on the requirements as a result of these changes.

Again, the Authority would like to thank stakeholders for their comments on the Guidance Note. The Authority remains committed to working with the industry and other interested parties to ensure that results achieved are in the best interests of the Bermuda market.

Yours sincerely,

The Bermuda Monetary Authority

[1] Note: where changes are applied consistently throughout the document only the reference for the first occurrence is given here.