BERMUDA MONETARY AUTHORITY

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CONSULTATION PAPER

Minimum Margin of Solvency

20th September 2012

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I. INTRODUCTION AND EXECUTIVE SUMMARY

1. In January 2012, the Bermuda Monetary Authority (the Authority) published for comment a consultation paper that proposed enhancements to the regulatory and supervisory regime for Bermuda commercial insurers (that is, Class 4, 3B and 3A general business insurers and Class E, D and C Long-Term insurers). One of the matters on which public comment was sought related to the imposition of a minimum, or floor, for the minimum margin of solvency (MSM) that would be equal to 25 percent of the enhanced capital requirement (ECR). The MSM floor would apply only at the legal entity level.

2. In response to the January 2012 consultation, a number of issues were raised with respect to the MSM floor including whether the imposition of a floor would raise issues from an audit perspective. The Authority agreed to study the matter further before proceeding.

3. After further study and consultation with the industry, the Authority believes that the proper course of action would be to impose a floor on the MSM equal to 25 percent of the ECR as originally proposed. A MSM floor would enhance the risk sensitivity of the MSM and align Bermuda requirements more closely to international standards.

4. In order to address the audit concerns expressed by industry, the Authority proposes to remove the calculation of the MSM and MSM floor from the scope of audit at the legal entity level.

5. The Authority proposes to implement the MSM floor effective 1st January 2014 for general business insurers (Classes 4, 3B and 3A) and effective 1st January 2017 for Long-Term insurers (Classes E, D and C).

6. The insurance industry and other interested parties are invited to submit their views on the proposal set forth in this paper. Comment is particularly requested on the timing aspects of this proposal. Comments should be sent to the Authority and addressed to policy@bma.bm no later than 31st October 2012.

II. BACKGROUND

7. The MSM is the capital level, the breach of which represents an unacceptable level of risk and triggers the strongest supervisory actions.

8. While the MSM is an important prudential measure, it is not necessarily reflective of the risk profile of an insurer. For general business insurers, the MSM is based upon the volume of premiums and reserves. For Long-Term insurers, the MSM is based on a percentage of total assets. Neither measure reflects differences in the risk among various types of business that can be underwritten by a general business or Long-Term insurer.

9. Capital standards in other leading insurance jurisdictions have been enhanced by the introduction of a more risk-sensitive MSM calculation through the introduction of a MSM floor.

III. CALCULATION OF MSM FLOOR

10. The Authority would implement a MSM floor equal to 25 percent of the ECR according to the implementation schedule outlined in Section IV of this Consultation Paper. The calculation of the MSM currently is performed by insurers pursuant to Schedule I (for general business insurers) or Schedule III (for Long-Term insurers) to the Insurance Returns and Solvency Regulations 1980 and this calculation would remain unchanged. The Authority would add to these Schedules a simple calculation of the MSM floor.

11. In order to remain mindful of the burden on the industry and to reflect the Authority's improved capability to receive and process data, the Authority proposes to remove the calculation of the MSM and the MSM floor from the scope of items that are subject to audit.

12. The MSM and MSM floor can be readily calculated by Authority staff and, thus, the need to have this amount subject to audit is diminished greatly. The electronic filing platforms that the Authority is implementing will add to the efficiency of this process and allow for timely review of companies' MSM calculations.

13. The Authority will advise companies in writing of any need to enhance its capital levels promptly upon review of the Schedules referenced in paragraph 10, above. In the event an insurer fails to meet the MSM floor, the Authority will endeavor to work with the insurer to establish a timetable for prompt enhancement of its capital levels so that the MSM floor is met.

IV. TIMETABLE FOR IMPLEMENTATION OF MSM FLOOR

14. The Authority proposes to implement the MSM floor effective 1st January 2014 for general business insurers.

15. The Authority proposes to implement the MSM floor effective 1st January 2017 for Long-Term insurers.

16. The different implementation dates reflect the different timing of introduction of the BSCR for Long-Term insurers and the fact that, for Long-Term insurers, the results of trial runs may give rise to the need for not insubstantial modifications to the model.

17. Moreover, the Authority is advised that a number of Long-Term insurers are modifying their capital structures in order to accommodate enhanced prudential requirements. An extended implementation schedule for Long-Term insurers would facilitate those efforts.

18. Comment is requested on all aspects of this proposal, but particularly with respect to timing.