28 June 2012

Dear Stakeholders:

Re: Insurance Amendment (No. 2) Act 2012

The Bermuda Monetary Authority (the Authority) wishes to thank stakeholders for their continued support of our key initiatives. On June 15th, 2012, the Authority published for consultation a Bill entitled *Insurance Amendment (No. 2) Act* (the Bill) which proposed amendments to the Insurance Act 1978 (the Act). The Authority recognises that the consultation period on these amendments was abbreviated and thanks stakeholders for their prompt review and response. We note that in addition to the June consultation period, prior consultations have been carried out with the Insurance Advisory Committee's Acts and Regulations Subcommittee as well as industry groups. The Authority is committed to pursuing passage of the Bill during the current sitting of Parliament to ensure that Bermuda's regulatory regime continues to meet the expectations of industry and external interested parties.

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

Approval of Group Actuary (Affected Clauses of the Bill: 1, 2 and 13; Affected Sections of the Act: 8B and 26). Clause 13 of the Bill would amend Section 26 of the Act to make provision for an actuary to be approved in order to assess the adequacy of long-term insurance reserves of insurers in Classes A, B, C, D and E. Comments indicated some confusion about the requirements of Sections 8B and new Section 26 of the Act as they relate to insurance groups and the suggestion was made to remove existing Section 8B(6) of the Act and proposed subsections 26(6) and (7) of the Act (as added by Clause 13 of the Bill) and replace the foregoing with a new section of the Act that addresses the requirements applicable to insurance groups.

The Authority agrees with this request and has determined to adopt a new Section 27G of the Act which would read as follows:

27G (1) A designated insurer shall ensure that the group of which it is a member appoints an actuary approved by the Authority to assess the adequacy of the insurance reserves of the group.

(2) Before making any such appointment, an insurer shall submit particulars of such person to the Authority for approval.

(3) The Authority, on being satisfied that a person is fit and proper to hold such an appointment shall approve the appointment as that insurer's approved actuary.

(4) Subject to subsection (5), the Authority may revoke an approval of an approved actuary in respect of any insurer if it is satisfied that he is no longer a fit and proper person to hold the appointment.

(5) The Authority shall not revoke its approval unless it has first notified the approved actuary and the insurer of its intention to do so.

Non-Insurance Business (Affected Clauses of the Bill: 2 and 12; Affected Sections of the Act: 1 and 19). Clause 12 of the Bill would repeal and replace Section 19 of the Act to require the conduct of non-insurance activities in a separately incorporated subsidiary or affiliate; that is, those activities could not be conducted directly by a Bermuda commercial insurer. Commenters requested confirmation that the definition of non-insurance business does not include derivatives entered into by insurers.

As noted in the Authority's response of 31 May 2012 to comments on the **Consultation Paper, Enhancements to the Regulatory and Supervisory Regime for Commercial Insurers** (the CP Response)**,** non-insurance activities do not include an insurer's own investments, including those in financial derivatives, insurance-linked securities or other forms of risk transfer. However, to the extent that an insurer's derivatives-related activities are conducted in the course of operating an investment fund that makes investments of a nature that are not ancillary to the business of the insurer or are in pursuit of investment banking business or other non-insurance business, they could not be conducted directly by a Bermuda commercial insurer.

Commenters raised questions regarding the definition and scope of ancillary business that would not be considered within the scope of non-insurance business. In general, the Authority views ancillary business as that which is in support of the primary activities of the insurer and is not a line of business separate from the core operations of the insurer. The Authority appreciates that there may be a need for further clarification of the definition and scope of this term and will entertain requests for clarification in the context of specific activities or, if necessary, through the issuance of guidance to industry.

It was also suggested that the Authority reserve the power to approve non-insurance business on a case-by-case basis. The Authority notes that the conduct of non-insurance business conducted as of December 31, 2012 is subject to a transition period until January 1, 2017 to allow insurers to restructure their business activities. Presently, the Authority is not minded to consider exemptions for new non-insurance business that is not ancillary to the insurer's core business.

Material Changes (Affected Clauses of the Bill: 15 and 16; Affected Sections of the Act: 30JA and 30JB). Clauses 15 of the Bill would amend Section 30JA of the Act to include within the scope of material changes requiring prior notification to the Authority the outsourcing of all or a "substantial part" of an insurer's underwriting activity. Commenters requested that this language track the language of other material change notification requirements which reference the outsourcing of "substantially all" of a key function or the transfer of "substantially all" of a line of business.

The Authority does not concur with the suggestions of stakeholders to refrain from reviewing the outsourcing of underwriting activity until it has reached the level of substantially all of the insurer's underwriting activity. We believe that a lower threshold is appropriate in light of the risks posed and, thus, have determined to require notification of the outsourcing of all or a "material part" of an insurer's underwriting activity. Materiality should be determined on the basis of the nature, scale and complexity of the risks underwritten and is not simply a quantitative analysis. The Authority will undertake to discuss with insurers specific outsourcing arrangements in order to provide further guidance.

Clause 15 of the Bill would also require prior notification of the transfer of all or substantially all of a line of business. Commenters requested the exclusion of transfers by means of reinsurance arrangements. The Authority is in agreement with this request and has rephrased Section 30JA(h) as follows:

(h) transfer other than by way of reinsurance of all or substantially all of a line of business;

Clarification was sought on the definition of a line of business. As noted in the CP Response, a line of business generally may be defined by reference to the BSCR; however, it may be more appropriate to delineate lines of business in a more granular manner based on materiality.

The Authority was asked to confirm that the inclusion of outsourcing arrangements as a material change would apply only prospectively to new arrangements and we confirm that this is in fact the case. Indeed, each of the new requirements for material change notifications to the Authority is to be applied prospectively.

The Authority was asked to consider the proportionality principle in connection with the outsourcing of functions and underwriting activities. Proportionality will be a factor in the review of material changes; however, the Authority intends to require notification of all such changes.

Definition of General Business (Affected Clauses of the Bill: 2; Affected Sections of the Act: 1). Clause 2 of the Bill would amend Section 1 of the Act to allow long-term insurers to write accident and disability contracts of any duration. It was suggested that this amendment be extended to permit the writing of short-term disability contracts. While the Authority does not, in principle, object to this suggestion, in the absence of a current definition of short-term disability in the Act, it would prefer to include this as an element of the broader consultation planned on the definition of general and long-term business. A reference to Section 1(4) of the Act is added to clarify the drafting.

General Comments: Application to Class C and D Insurers. The Authority was asked to apply the proportionality principle in its application of regulatory and reporting requirements to Class C and D insurers. We note that reporting requirements have been phased in for these insurers in a proportional manner. We do not believe that other phase-in provisions are warranted across the board but will consider appropriate requests for exemptions or modifications upon specific application.

General Comments: Effective Date. The Authority was asked to extend the effective date of the legislative changes to January 1, 2014. With the exception of the effective date for the separate and independent internal audit function (which is not reflected in the Bill but will be reflected in amendments to the Insurance Code of Conduct), the Authority does not believe that further delay in the effective date of these amendments is warranted. As noted above, a five-year transition period has been provided for the conduct of non-insurance business and modifications have been made to the original proposals contained in the Authority's January 2012 consultation in order to address key industry concerns.

Again, the Authority would like to thank stakeholders for their comments on the Bill. 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