

22nd November, 2011

Dear insurers,

Re: Response to Key Comments on Eligible Capital

The Bermuda Monetary Authority (the “Authority”) wishes to thank the stakeholders for their continued support of our key initiatives. The Authority published the draft of Eligible Capital Rules 2010 (the “Rules”) and a number of comments were received pertaining to the Rules.

The Authority’s responses to the comments that were received are outlined below.

- 1. A request was made for an exception to the proposed rule that would reduce the amount of statutory surplus includable in tier 1 capital by the amount of collateral posted to ceding companies net of associated loss reserves.**

With respect to the reduction of statutory surplus includable in tier 1 capital, the Group Rules reflect that collateral that is freely available to all policyholders would not be deducted from statutory surplus for purposes of calculating tier 1 capital.

- 2. Clarification was sought that subordinated debt that is non-redeemable or repayable for so long as the insurer fails to meet its ECR would continue to be tier 1 capital even if the stated maturity is less than 10 years.**

The Authority does not agree with this request. In order to qualify as tier 1 capital, the subordinated debt must have a stated maturity of 10 years or longer. The Authority reserves the right to approve otherwise non-conforming instruments on a case-by-case basis.

- 3. Clarification was sought as to the meaning of the term “incentive to redeem.”**

In general, incentives to redeem include contractual increases in the interest rate or dividend payment combined with a call option (i.e. step-ups). Instruments with incentives to redeem are classified as Tier 3 eligible capital.

- 4. Clarification was sought as to the proper capital tier for certain instruments, including:**

- **Letters of credit and trust account assets held in support of surety and workers' compensation business**
- **Letters of credit and trust account assets held to support reinsured losses**
- **Letters of credit issued by banks to support obligations to reinsureds**
- **Letters of credit issued by banks to provide funds for Lloyds operations**
- **Junior subordinated trust preferred debt where coupons are deferrable but not cancellable**

In general, the letter of credit instruments are encumbered assets for policyholder obligations that are deducted from tier 1 capital. The appropriate tier for the junior subordinated trust preferred debt would depend on the particular terms and conditions of the instrument, including its maturity. The Authority encourages companies to seek a determination as to the appropriate capital tier for particular instruments.

5. Clarification was sought as to the treatment of pooled guarantees where the potential obligation is unknown.

The liability would be reflected on the balance sheet in an amount equal to the present value of the amount expected to be drawn down, discounted to take into consideration the time value of money at an appropriate rate disclosed to the Authority. If this is not feasible, the entire amount of the obligation would be reflected as an on balance sheet liability.

6. Clarification was sought regarding the impact of prior arrangements to grandfather the tier 1 capital treatment of certain capital instruments.

Approval of hybrid instruments and their grandfathered status will continue to be considered on a case-by-case basis.

A revised version of the Rules have been posted on 14th November, 2011 and are to take effect on 31st December, 2011. Any additional comments on the Rules are invited by 13th December, 2011.