

December 8, 2010

Dear Insurers,

Re: Consultation Paper on Commercial Insurer's Solvency Self Assessment ("CISSA CP")

The Bermuda Monetary Authority ("the Authority") wishes to thank the stakeholders for their continued support of our key initiatives. Recently, the Authority published a Consultation Paper on CISSA and a number of comments were received. The Authority is committed to engaging our stakeholders in such initiatives as we strive to achieve our supervisory objectives, while retaining Bermuda's role as a key player in international fora.

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

1. The following concerns were raised regarding the CISSA return:

a) CISSA reporting template

Concerns were expressed regarding various aspects of the CISSA reporting template.

The Authority seeks to ensure that the CISSA requirements are not onerous on insurers, while at the same time ensuring that they meet its supervisory objectives and is aligned to international standards. Accordingly, the Authority has made significant format revisions to the CISSA return, which is benchmarked to the Own Risk and Solvency Assessment (ORSA) requirements of IAIS¹ and Solvency II frameworks. The revised CISSA format will allow insurers to describe how they individually assess their risks and consequently determine their required capital resources. The Authority believes that this level of flexibility should be left to insurers to ensure that the CISSA reflects the individual circumstances. The Authority believes that the revised CISSA return is aligned to Solvency II and IAIS principles with regard to the information that should be contained in, and standards of, the ORSA.

¹ International Association of Insurance Supervisors ("IAIS")

b) Regulatory capital computation at 99.0% Tail Value at Risk (TVaR)

Concerns were raised regarding the computation of capital at 99% TVaR.

The Authority requires insurers to submit the regulatory capital computation at 99%TVaR from an internal model approved by the Authority or from the Bermuda Solvency Capital Requirement (BSCR) where an insurer does not use an approved internal model for regulatory reporting. This is in addition to an insurer's submission of its own CISSA capital² arising from its self assessment. The regulatory capital is an input that facilitates reconciliation between CISSA capital and regulatory capital requirements.

c) Concerns on the name CISSA

Concerns were raised on using the name 'CISSA' instead of the name 'ORSA'.

The nomenclature 'CISSA' is familiar to CEIOPS, key EU regulators and other jurisdictions. The Authority has presented the CISSA to the CEIOPS Committee responsible for the Solvency II assessment, and other key EU regulators, and there was no ambiguity regarding the name or purpose of this tool. The Authority has in fact been the recipient of encouraging comments from the NAIC³ and other jurisdictions for its CISSA regime. Further, from the NAIC's recently published consultation paper on the ORSA the term "ORSA" as the official name of a regulatory tool does not exist in some reputable regimes (more specifically OSFI⁴ and FINMA⁵). ORSA in IAIS literature describes a process that is well understood by regulators, but there is no requirement to use that name for the actual tool which facilitates that process.

d) CISSA process vs. CISSA return

It was suggested that the Authority should consider using a different name for CISSA process and CISSA return.

The Authority uses both Own Risk and Solvency Assessment (ORSA) and solvency self assessment interchangeably to describe the process. The term 'self assessment' is embedded in the Authority's supervisory framework, through the Insurance Code of Conduct. This nomenclature is well understood by other regulators such as the United States and European supervisors on account of the numerous presentations made by the Authority on the topic.

² CISSA Capital is the amount of capital the insurer has determined that is required to achieve its strategic goals upon undertaking an assessment of all material (reasonably foreseeable) risks arising from its operations or operational environment.

³ National Association of Insurance Commissioners

⁴ Canadian regulator, the Office of the Superintendent of Financial Institutions (OSFI)

⁵ Swiss regulator, the Financial Market Supervisory Authority (FINMA)

e) Internal models and CISSA

Concerns were expressed on possible duplication of information submitted on internal models for CISSA purposes where an insurer has an approved internal model for regulatory purposes.

The Authority is in the process of determining the internal models filing requirements and documentation. However, in instances where the information submitted is duplicative, that information will not be required to be filed twice when both are annually filed.

f) Paragraph 2: materiality

Comments were expressed on the definition of ‘material’ and whether this definition is consistent across the Authority.

Consideration of materiality largely depends upon the subject matter. Materiality may be either quantitative, qualitative, or a combination of both. Going forward, when using a qualitative measure, the Authority plans to apply consistently the definition on material risks specified within the CISSA CP, or one that embodies the risk profile or compliance status of an insurer that may alter the Authority’s assessment of the required level of supervisory oversight.

g) Paragraph 15: proportionality principle

Comments were expressed on whether the proportionality principle would be assessed by the Authority or the insurer.

The Authority requires an insurer to have processes that are commensurate to the nature, scale and complexity of the risks inherent in its business. Accordingly, the Authority will assess and evaluate whether the insurer’s CISSA is proportionate to its nature, scale and complexity. While the Authority expects an insurer in good faith to make the initial determination, the Authority is the prudential standard setter that an insurer has to satisfy. Therefore, the Authority reserves the right to advise when it believes that an insurer is not meeting an appropriate standard. This could occur through on-site inspections or other interactions with insurers.

h) Paragraph 32: independent review

Concerns were raised on the requirement to have an oversight process/independent review of the CISSA.

The Authority believes that CISSA should include an appropriate oversight process that involves independent review. The independent review will apply to the CISSA process as well as the CISSA return. As noted in the footnote on page 12 of the CISSA CP, the independent review should be conducted in accordance with the proportionality principle. The independent review may be conducted by an internal or external auditor or any other skilled internal or external function, as long as they have not been responsible for the part of the CISSA process they review, or there should be a suitable process for managing conflicts of interest effectively. Similarly, the Solvency II consultation paper on ORSA⁶

⁶ Issues Paper on Own Risk and Solvency Assessment (ORSA) May 2008, paragraph 89

requires that the administrative or management body shall ensure that a regular assessment of the ORSA process is performed by persons that have not been responsible for the part of the ORSA process. The assessment may be conducted by an internal or external auditor or any other skilled internal or external function, as long as they are independent in their assessment task.

i) Paragraph 33/41: formal board declaration

Clarity was requested on what the Board is required to sign-off vs. review.

The board should declare that it believes that the CISSA is appropriate and is aligned with the plans of the insurer. We would envision the same to occur in other international regulatory frameworks.

j) Paragraph 35: quantification of risks

Clarity was requested on the Authority's expectation of insurers that do not quantify certain risks such as reputational, liquidity, group and strategic risk.

The Authority does recognise that certain risks are difficult to quantify such as reputational, liquidity, group and strategic risk. Where an insurer does not quantify these risks, they should include a nil amount in the CISSA return. However, the Authority will expect that insurers have some mechanisms of managing/addressing these risks.

k) Paragraph 41: CISSA should be forward looking

Clarity was requested on the time horizon to be applied in the forward looking aspect of CISSA.

The CISSA is particular to an insurer's own assessment of its risk and solvency and should ideally be aligned with how an insurer manages its business. Although the Authority would expect the insurer to plan into the future, generally speaking selection of the horizon should be left to the insurer; otherwise, the CISSA would fail the 'use test'.

l) Paragraph 44: CISSA Use test

Concerns were raised on the requirement for CISSA to be integrated into the decision making process of an insurer 'use test'.

The CISSA is not necessarily an internal model, and is to satisfy the "Use test". The CISSA is an output of an insurer's overall risk management framework, to be reviewed regularly and updated accordingly so that it remains aligned with the risk management framework in accordance with the requirements of paragraph 53 of the Insurance Code of Conduct. This being the case, stating that "An insurer should be able to describe how strategic decisions are made in the context of the firm's overall risk management framework" is consistent with, and would yield a similar result as, stating that the same be done for the CISSA.

m) Paragraph 45: board responsibility

Concerns were raised on the role and responsibilities of the board with regards to monitoring of the CISSA process.

The ultimate responsibility for CISSA, as an integral part of an insurer's risk management framework, rests with the board. Although the board may delegate certain responsibilities and functions to board committees, senior management or external parties, it does not absolve the board of its ultimate responsibilities (in accordance with paragraph 12 of the Insurance Code of Conduct). The Authority accepts that such demonstration would likely be delegated and performed by senior management.

n) Paragraph 52: legal entity and/or group CISSA where the Authority is Group-wide Supervisor (GWS)

Clarity was requested on whether insurers will be required to file a legal entity CISSA in addition to the group CISSA where the Authority is the GWS.

Where the Authority is the GWS, insurers will be required to file a legal entity CISSA in addition to the group CISSA. However, insurers may apply for exemptions or modifications in accordance with Section 6A of the Act. An example of circumstances where an application for an abbreviated CISSA would be considered includes instances where centralised risk management exists so that the qualitative content of the legal entity and group CISSAs are largely duplicative. For instance, the Authority would consider an exemption entirely from a legal entity CISSA, where the scale of the legal entity comprises almost that of the entire group, so that no material difference exists in relation to the quantification of CISSA capital and the qualitative description of risk management in respect of the legal entity and group.

o) Paragraph 54: legal entity and/or group CISSA where the Authority is not the GWS

Clarity was requested on the approach to be applied by the Authority to allocate capital to a legal entity where modeling and capital assessment are not carried out at legal entity level; where the Authority is not the GWS.

The statement⁷ should be re-phrased. Where the Authority is not the GWS, the Authority still requires an insurer to submit a legal entity CISSA. Where the group CISSA submitted to the GWS is of a broadly equivalent nature and the results for the Bermuda legal entity are discernable, then the Authority may accept the group CISSA submission and require no separate legal entity CISSA.

p) Paragraph 61 Consolidating CISSA within the Capital and Solvency Return

Concerns were raised regarding the consolidation of CISSA return within the Capital and Solvency Return and the timing of the CISSA annual filing.

⁷ Paragraph 54 of CP – “The Authority will work with insurers to determine an appropriate approach for allocating capital to a legal entity, where modelling and capital assessment is not carried out at the legal entity level”.

The Authority's proposal to consolidate CISSA within the Capital and Solvency Return is in line with Solvency II, which requires that the ORSA form part of the Solvency and Financial Condition Report⁸ that is to be filed annually. The Authority envisages the importance of filing the CISSA submission together with the annual filings since the information contained in the CISSA (risk management, governance, etc.) complements the solvency analysis. The Authority does not view this as being inconsistent with an insurer's planning process since the Authority has not prescribed that the substantive CISSA work occur immediately preceding the filing. This work may be performed at any time during the preceding year and submitted with the annual filing. However, as noted above, paragraph 53 of the Insurance Code of Conduct requires regular review for appropriateness so that Authority would expect that the CISSA filing reasonably reflects an insurer's current view. The Authority plans to extend the mandatory trial runs for CISSA and other documents to June 2011.

The Authority again thanks stakeholders for their comments on the CISSA CP. We are committed to working with the Industry and other stakeholders to ensure a result that is in the best interest of the Bermuda market, taking into account the costs to the Industry.

Please feel free to contact the Authority if you have any questions.

Yours sincerely,

Bermuda Monetary Authority

⁸ CEIOPS CP 58- Supervisory Reporting and Public Disclosure Requirements, pg 30