

31st March 2010

Dear Long-Term (Re) Insurers

The Bermuda Monetary Authority (“the Authority”) wishes to thank the stakeholders for their support on its initiatives. In December 2009, the Authority published a Discussion Paper on a Capital and Solvency Framework for Long-Term Insurance. A number of formal submissions were received by and subsequent to the close of the consultation period and a few others are anticipated shortly. For clarity, we have categorised the comments received into Process Issues, Application Issues, Technical Elements and Actuarial Standards. The Authority’s responses to the submissions received and the dialogue generated from meetings with various stakeholders are outlined below:

Process Issues

Comments were expressed regarding:

- a. The aggressive time frame proposed for development and implementation;
- b. Insufficient consultation for Life companies with respect to prior papers addressed to general insurers; and
- c. Time required for data gathering to gauge the impact of new capital standards.

The Authority’s goal is to have the new capital standards in place this fall, in time for consideration under Europe’s third country equivalence assessment. The Authority is mindful of the ambitious timeline this necessitates to develop and implement a risk-based framework for determining capital standards for Long-Term insurers. Of necessity, this abbreviated timeline dictates that prior work and development be used as much as possible. The Authority welcomes input on areas where previous proposals for general insurance may not be suitable for Long-Term insurers. In particular, the standards for eligible capital may warrant consideration and adjustments may be made where appropriate.

Application Issues

Additional clarity was requested regarding the treatment of Segregated Accounts and particularly whether the new capital standards will apply to the general account only or to each cell.

The Authority is aware that there are circumstances where the activities within one cell may create financial risks for participants in other cells. This is a complex area and the Authority wishes to take a deliberate and thoughtful approach to its application. For 2010, the Authority will focus its attention on the development of appropriate capital

standards framework. In 2011, the Authority will consider if and how the framework might best apply to Segregated Account arrangements.

Technical Elements

Numerous comments and recommendations were expressed in the feedback, including:

- a. Variations in balance sheet reporting methods create complex challenges for an industry wide uniform capital standard;
- b. Recommendations to use the Standard & Poors model which accommodates multi-jurisdictional reporting standards;
- c. Most Bermuda reinsurance arises from within a larger corporate entity and the capital requirements should recognise that the risk characteristics are different than direct insurance business;
- d. The 99% TVaR standard requires stochastic modelling of many scenarios. Use of 99.5% VaR can be determined by one scenario and greatly simplifies technical work;
- e. The 20% additional capital requirement should be eliminated since the basic capital requirement satisfies the 99% TVaR standard;
- f. The eligible capital requirements need to recognise the Section 56 Directions approved by the Authority allowing admissibility of intangible assets;
- g. The factor-based approach or the internal model approach should be permitted by line of business;
- h. Diversification benefits need to be recognised and accounted for; and
- i. The threshold for use of the proposed 5% capital requirement should be increased from \$25 million to \$50 million.

The Authority is engaging an actuarial consulting firm to assist with the development of the factor-based approach to determining the capital requirements. We also plan to work closely with the industry in this design phase. The above recommendations will be carefully considered as the work is performed.

Actuarial Standards

The comments received questioned the need for a Bermuda Actuarial Standards Board, citing that:

- a. Home jurisdiction standards are sufficient;
- b. Peer review is not universally accepted and has significant issues to implement effectively;
- c. Actuarial Opinions on capital are not required from P&C actuaries, and should not be imposed on Life actuaries; and
- d. Creation of an Actuarial Standards Board should be treated as a separate issue and not be part of the capital standard development process.

Recognising the urgency with which the long-term capital standards are needed and the aggressive timeline for its implementation, the Authority will defer further consideration of an Actuarial Standards Board to a later time.

Going Forward

The Authority is considering the following actions:

1. To ease the implementation process, the Authority anticipates that initially, the new standards will only apply to the larger companies representing the greatest business exposure. Data gathering from their reporting and feedback will assist in refining the process and in developing the understanding needed to function on a wider basis.
2. There is a need to create and maintain open dialogue on the long-term capital developments. The Authority is committed to working with industry representatives during the development of the new capital framework to ensure its appropriateness for the Bermuda market.
3. There is an emerging need to recognise the varying purposes, strategies and scales of operations among the Long-Term insurers. A single supervisory framework for all companies may no longer be suitable. The Authority is therefore considering the implementation of a licensing class structure for Long-Term insurers. While not necessarily the same as the current system for general insurance, it would recognise that a modified standard in line with the risk profile is appropriate for those businesses that are limited or restricted in their powers. Companies that engage in the assumption of greater and more complex risks would be subject to more stringent standards. In developing a class structure for Long-Term insurers, the Authority would address the appropriate application of the new capital standards and supervision requirements to segregated accounts.
4. With assistance from a consulting firm, the Authority is developing its proposal for a factor-based approach. The form itself and factors will of necessity be designed with simplicity and ease of use in mind. The Authority recognises that in so doing, the methodology will need refinement over time. Consequently, in addition to staging the application of the new reporting requirements to companies, the Authority anticipates a gradual movement towards the full compliance requirements over a number of years.
5. Where an insurer believes that it has been unduly penalised by the new capital requirements as a result of its risk profile deviating significantly from the assumptions underlying the capital requirements (ie. the new standards are too stringent given the risk characteristics of the insurer's operations), the insurer may make application to the Authority for a capital reduction. Particularly during the transition period to the new standards, the Authority will consider an insurer's representations.

The development and implementation of an appropriate risk-based capital standard will take time to cultivate into a robust framework. The Authority's initial steps in this process in 2010 are intended to establish a strong foothold from which further refinements are expected. The Authority looks forward to working closely with the long-term insurance industry to implement the initial framework over the course of this year.