



BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

ON

THE BERMUDA MONETARY AUTHORITY'S PROPOSED INSURANCE GROUPS REGULATORY FRAMEWORK

FEBRUARY 2010

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This paper outlines the Authority's proposal for the implementation of a group-wide supervisory regime. The views of the insurance industry and other interested persons on the proposals set out in this paper are invited. Comments should be sent to the Authority addressed to policy@bma.bm not later than March 5th 2010.

1 Executive Summary

1. The recent financial crisis has highlighted the need for regulators to give greater attention to overseeing the operation of financial groups, both insurance groups and financial conglomerates. A significant number of Bermuda licensed insurers¹ currently operate within a group structure. The financial position and risk profile of an insurer may be affected by its belonging to a group, with the possibility of both positive and negative effects on its prudential position.² The Bermuda Monetary Authority (“the Authority”) is developing its group-wide supervisory regime to address the needs of the Bermuda jurisdiction.
2. Many internationally active groups are controlled centrally with policies and procedures being developed in one jurisdiction and disseminated to the individual offices in other jurisdictions. Generally, regulation of parts of the group is carried out on a solo basis, and emphasis is placed on ensuring that each insurer in the group is adequately managed and financially sound. Under such circumstances, it was felt that this would ensure that the group as a whole would also be financially sound. Today it is widely accepted that the complexities of risks presented by the group require greater analysis and attention. The recent financial crisis has emphasised the need for effective group-wide supervision of internationally active insurance groups (“IAIGs”).
3. It is important for the Authority to be able to form a comprehensive view of the overall risk exposure of a group through group-wide supervision. To this end, the Authority’s group-wide supervisory regime will apply to insurance groups and insurance subgroups that form part of a financial group or mixed conglomerate. More specifically, it will initially apply to Class 4 and Class 3B insurers because of their higher risk profile; however the Authority will be extending this regime to the rest of the commercial insurance sector in the future. ,
4. The Authority has taken into account the key global debates and issues surrounding group-wide supervision as it strives to implement its own regime. Specific options have been put forward throughout this paper; however, the Authority also recognises that its group-wide supervisory framework will necessitate flexibility in order to accommodate a rapidly changing global financial environment.

¹ In this paper, the term “Insurer” is used synonymously with the term “Reinsurer” and the term “Insurance” includes “Reinsurance”.

² IAIS Principles on group-wide supervision October 2008.

5. As a result of the work done on the Authority’s Discussion Paper on Implementing Group-wide Supervision (“the Discussion Paper”), and feedback from various stakeholders, the Authority is issuing this consultation paper (“the CP” or “the paper”) on its proposed group-wide supervision regime. The CP describes the scope of the Authority’s group-wide supervisory regime and outlines the conditions under which the Authority would seek to be considered the Group-wide Supervisor. Since any group-wide supervisory regime hinges on the precepts of cooperation and equivalence, the paper also seeks to explain the Authority’s proposed equivalence framework, the use of supervisory colleges, and other forms of cooperation to facilitate effective and efficient group-wide supervision.
6. The paper also describes other features of the Authority’s proposed regulatory framework including the assessment of group corporate governance and risk management, eligible capital for the purposes of satisfying available statutory capital and surplus, and group-wide solvency assessment which includes a discussion of the treatment of intra-group transactions and risk concentrations. Additionally, it explores the efficacy of group support as an important factor in determining group-wide solvency, and the treatment of unregulated entities that are part of the group. The paper concludes with the Authority’s statutory reporting requirements for groups. It is noted that some of the topics set forth in this CP, are currently being addressed in greater detail in supporting consultation papers that are scheduled to be issued in the near future.

2 Background

2.1 The Road to Group-wide Supervision

7. The globalisation of financial markets created a catalyst for the development of financial groups³, which have increased in numbers, complexity and size. These groups provide a range of services, including insurance, banking and investment services. They operate simultaneously across financial sectors against a backdrop of slowly evolving legislation and regulatory framework(s) which, generally speaking, have not kept pace.
8. Failures in supervision have highlighted the deficiencies in traditional supervisory frameworks, where oversight was restricted to the legal entity. This is particularly important for groups that operate in multiple jurisdictions and conduct cross-sectoral activities where the home supervisor may have been unable to efficiently supervise the legal entity because of operational influences from other parts of the group, often outside the home supervisor's remit.
9. The credit crisis has accentuated just how embedded groups are within financial and economic systems. Governments and central banks in a number of jurisdictions had to implement emergency financial measures to stabilise and mitigate the potentially damaging effects on their respective economies. The adoption of group-wide supervision has emerged as a critical tool needed to help ensure that groups are effectively regulated and conduct their operations in both a prudent and financially sound manner.
10. It is important to note that the Tripartite Group of Bank, Securities and Insurance Regulators ("the Tripartite Group") identified a number of supervisory issues⁴ in their 1995 publication, which are relevant today. These issues have underscored the need for group-wide supervision which include:

³ In this paper, the term Financial Group is used synonymously with the term Financial Conglomerate. Financial Conglomerates contain companies that operate across various financial sectors; however, the group can also be limited to a single financial sector.

⁴ The Supervision of Financial Conglomerates – A report by the Tripartite Group of Bank, Securities and Insurance Regulators July 1995.

- a. developing a group-wide supervisory framework which regulates the legal entities within the group and also assesses the group as a whole;
- b. mitigating group contagion effects which can prompt potential insolvency or contravene regulatory requirements in relevant jurisdictions;
- c. identifying risk concentration and intra-group transactions, which present substantial credit risk;
- d. determining group capital adequacy;
- e. determining the fitness and propriety of the group's board of directors ("the board or group board"), shareholders and senior management;
- f. ensuring that the group has appropriate risk management and internal controls suited for its nature, size and complexity;
- g. accessing prudential information on the group so as to effectively supervise the legal entities and the group as a whole; and
- h. eliminating supervisory arbitrage.

11. The International Association of Insurance Supervisors ("the IAIS") published its Issues Paper on group-wide solvency assessment and supervision in March 2009, which reiterated the concerns identified by the Tripartite Group in its 1995 publication. While there are many benefits for an insurer to be part of a group, the negative effects present a compelling argument supporting the need for group-wide supervision.

12. Consequently, the IAIS supports a group-wide assessment⁵ by regulators in order to adequately supervise the insurer. It has stated that an insurer, which is part of a group, is affected by exposures arising from within its group and that the requisite legal provisions should be in place to support effective supervision of group entities.

13. The IAIS has advanced a definition of group-wide supervision as follows: "*A supervisory approach to a financial group which considers the group structure, the constituent licensed entities, and all the interrelationships within that financial group.*"⁶ The Authority, in developing its group-wide supervisory regime, has taken into account views advanced by the IAIS and other international bodies.

⁵ IAIS Insurance Core Principle 17: Group-wide Supervision October 2003.

⁶ IAIS Principles on group-wide supervision October 2008.

14. While there is broad acceptance for the need for group-wide supervision, there is also a divergence of opinions on how it should be executed. Consequently the appropriateness of any approach can only be properly considered in the context of the unique circumstances of a particular group and the jurisdiction(s) in which it operates. This is especially important when considering the equivalency of a jurisdiction against desired supervisory and regulatory outcomes.
15. The Authority has undertaken a review of its own policy and legislative environment against internationally expected outcomes. This review resulted in a number of workstreams described in the Bermuda's Insurance Solvency Framework Roadmap to Mutual Recognition ("the Roadmap") and recent publications such as:
- a. Discussion Paper on Implementing Group-wide Supervision
 - b. Consultation Paper on the Insurance Code of Conduct ("Code")
 - c. Consultation Paper on Eligible Capital ("Eligible Capital Paper")
 - d. Consultation Paper on Disclosures and Transparency ("Disclosures Paper");
 - e. Discussion Paper on Own Risk and Solvency Assessment ("ORSA Paper");
 - f. Discussion Paper on a Capital and Solvency Framework for Long-Term Insurance ("Long-Term Insurance Paper"); and
 - g. Guidance Notes for Standards and Application Framework for the Use of Internal Capital Models for Regulatory Capital Purposes ("Internal Models Standards").
16. This work outlines the Authority's views regarding specific components of an effective group-wide supervisory regime suitable for the Bermuda market. Despite the complexities surrounding group-wide supervision, it is important for the Authority to form a comprehensive view of the overall risk exposure of these groups, especially as they affect the regulated entities operating within Bermuda. Additionally, this view will enable the Authority to better assess the prudential situation of its insurers, and assist in mitigating any potentially adverse impact on the Bermuda financial market system, and the wider Bermuda economy.

17. Unique factors influencing the nature of the proposed group-wide supervisory regime in Bermuda include:⁷

- a. the jurisdictions within which the group operates, the similarities and differences between their legal, regulatory and solvency regimes, including supervisory powers and authorities;
- b. the complexity of the group structure and the relative significance of the particular insurer within that group, e.g. regulated and unregulated entities, insurance and non-insurance companies;
- c. the management structure of the group, and the extent to which it operates as a single integrated entity or as a group of separate entities; and
- d. the relative solvency position of entities within the group, when compared on a consistent basis taking into account the triggers for supervisory intervention in each jurisdiction.

18. It should be noted that the Authority currently applies group-wide supervision to Bermuda licensed non-insurance financial entities, specifically, banking and investment entities where the main activities are directed from Bermuda. In this regime, where risk exposures emanate from parts of the group located outside of Bermuda, the Authority seeks to satisfy itself that the entity is maintaining appropriate oversight and control of these risk exposures by communicating and coordinating with other supervisors.

19. Although the Authority does not currently apply group-wide supervision to insurance groups, the supervisory review process does help it to understand the influences that the group may have upon the Bermuda insurance legal entity. The Authority's on-site and risk assessment tools assist it in evaluating the inherent risk exposures affecting the insurer arising from it being part of a group. Additionally, the Authority considers its importance to the group, particularly where the insurer provides support to the group and its activities. Intra-group exposures are examined carefully, especially where the Bermuda legal entity:

- has material investments in/or loans to affiliated companies;
- engages in significant intra-group transactions; or
- provides guarantees or support to affiliated companies.

⁷ IAIS Issues Paper on group-wide solvency assessment and supervision March 2009.

20. The Authority is extremely active in the international regulatory debate on the appropriate designs for group-wide regulatory regimes. This includes active participation in the work of the IAIS, especially that relating to group-wide supervision and solvency issues, and frequently engaging in dialogue with and making presentations to international regulators and associations on the issue of equivalence.

3 Scope of Group-wide Supervision Regime

3.1 Definition of a Group

21. To date, the IAIS' publications on group-wide supervision have focused on groups "whose main activity is insurance, including reinsurance groups, and an insurance subgroup within a financial conglomerate."⁸ The Authority has adopted the same focus proposing a group-wide supervisory regime for groups and subgroups whose primary activity is insurance (hereafter, the term insurance group or insurance subgroup will be used to identify the type of group under scope for group-wide supervision, unless otherwise stated).

22. **Appendix I** illustrates the entities and business activities within the scope of the proposed group-wide supervisory regime. For the purposes of group-wide supervision the parent, whether the parent is an insurer or a holding company, along with its insurance entities will be subject to group-wide supervision. Where the insurance group has entities that conduct non-insurance activities, (both regulated and unregulated) or has participating shareholdings in other entities, the Authority will consider the risk exposures presented by these entities in its overall assessment of the insurance group.

23. Where the insurance group forms part of a financial group then the Authority will apply group-wide supervision to the insurance subgroup and will liaise with the other sectoral supervisors to assess the overall group effects on the insurance subgroup.

24. The Authority will initially apply its group-wide supervisory framework specifically to the Class 4 and Class 3B insurers with the view of extending this regime to the rest of the commercial insurance sector in the future.. These classes of insurers that are part of an

⁸IAIS Guidance Paper on the Role and Responsibilities of a group-wide supervisor October 2008.

insurance group will be supervised by a Group-wide Supervisor. This role will either be filled by the Authority or another supervisor from an equivalent regime that is willing and able to assume this role. Where there is no such supervisor in place, the Authority will consider itself as the Group-wide Supervisor for the Bermuda insurance subgroup, including foreign subsidiaries of the subgroup. The objective is to ensure that all Class 4 and Class 3B insurers that belong to an insurance group are subject to group-wide supervision, or minimally their Bermuda operations (including foreign subsidiaries). The Authority proposes to implement group-wide supervision for insurance groups by Q3 2010 and will provide a transition period for these groups to comply with certain standards.

3.2 Proportionality

25. The proposed group-wide supervisory regime is risk-based and as such it will be fit for purpose to reflect the nature, scale, and complexity of the risk to which an insurance group is exposed. In applying this regime, every effort will be made to identify all reasonably foreseeable risks and to analyse the impact they might have on the insurance group.

4 Role of and Determination of the Group-Wide Supervisor

26. In order for group-wide supervision to be effective, the responsibility for comprehensive risk assessment should rest with at least one supervisor. This would be greatly facilitated if supervisors cooperate and assist one another with sharing information required to ensure the insurance group is adequately supervised. The cooperative process could be enhanced by the appointment of a Group-wide Supervisor whose responsibility would include the comprehensive assessment of the risks presented by the insurance group, and ensuring that it operates in a sound and prudent manner.
27. Further, the Group-wide Supervisor is additionally responsible for the coordination of the input from solo supervisors.⁹ This would be assisted through a program of supervisory recognition, which yields appropriate reliance upon the work performed by the relevant solo supervisors.

⁹ Ibid

28. It should be noted that the work undertaken by the Group-wide Supervisor does not negate or diminish the supervisory responsibilities of the solo supervisors; rather, effective group-wide supervision is dependent on the work conducted by these supervisors.
29. Where an insurer is subject to group-wide supervision, then the insurance group's legal entities and intermediate parent companies, whether regulated or not, and whether based in Bermuda or not, must be included in the assessment of group risks and the calculation of group solvency. It should be noted that group-wide supervision is focused only at the group level and does not extend the Group-wide Supervisor's remit into the supervision of each and every entity within a group.
30. The IAIS' *Guidance Paper on the Role and Responsibilities of a Group-wide Supervisor* discusses certain considerations that may be taken into account when identifying who should be the Group-wide Supervisor. The Authority is supportive of these considerations and will employ these conditions as it seeks to ascertain whether it, or another supervisor, should be considered the Group-wide Supervisor.
31. The IAIS paper states that first consideration should be given to the supervisor who has "statutory responsibility to supervise the head of the [insurance] group."¹⁰ Other factors¹¹ to be considered would include:
- a. where the [insurance] group's head office¹² is located;
 - b. where the [insurance] group's registered head office is not located in the same jurisdiction as the operational head of the [insurance] group, then the location of:
 - i. the main business activities of the [insurance] group are undertaken;
 - ii. the main business decisions are taken;
 - iii. the main risks are underwritten and/or;
 - iv. the [insurance] group has its largest balance sheet total

¹⁰ Ibid

¹¹ Ibid

¹² The Guidance Paper further explains the IAIS' position of what it regards as the insurance group's head office.

32. The Authority proposes to adopt the following considerations in assessing who should be the Group-wide Supervisor for those insurance groups which contain a Class 4 and Class 3B insurer:
- a. the supervisory authority of the jurisdiction where the parent of the insurance group is located;
 - b. the supervisory authority of the jurisdiction where the head office of the parent of the insurance group is located;
 - c. the supervisory authority of the jurisdiction where the insurance group directs its business; or
 - d. the supervisory authority of the jurisdiction where the insurance group has the largest gross liabilities.
33. Notwithstanding the afore-mentioned factors, the appointment and acceptance of the Group-wide Supervisor is one of consensus between the supervisors of the relevant insurance group.
34. Where there is an appointed Group-wide Supervisor, the Authority may determine if the group-wide supervisory arrangements are equivalent; and, where it is not, it may undertake the role of Group-wide Supervisor for those insurance entities located within Bermuda (including their foreign subsidiaries).
35. The Authority believes that utilising a principles-based approach will allow for a flexible regime that can be adapted to the particular circumstances of each insurer. It will use its discretion when making a determination as to when it can become the Group-wide Supervisor.
36. The Authority proposes to perform its functions as Group-wide Supervisor guided by the principles identified by the IAIS’ *“Guidance paper on the role and responsibilities of the group-wide supervisor”*. This paper identifies the following key responsibilities of the Group-wide Supervisor:
- a. to assess the fitness and propriety of the significant owners and managers at the [insurance] group level;
 - b. to assess the overall standard and compliance of the [insurance] group’s corporate governance;

- c. to assess the [insurance] group's risk management and internal control systems;
- d. to identify and measure all material risks of the [insurance] group and to ensure that sufficient capital is allocated to those risks;
- e. to undertake a group-wide risk analysis including risk concentration and group contagion effects;
- f. to assess the adequacy of the [insurance] group's capital and solvency position; and
- g. to evaluate intra-group transactions as they affect the [insurance] group's capital adequacy position.

5 Equivalence and Supervisory Recognition

5.1 Equivalence

37. The effectiveness of the Group-wide Supervisor is dependent in part on the level of confidence that the relevant solo supervisors have in the Group-wide Supervisor's ability to appropriately supervise the group, and the confidence that the Group-wide Supervisor has in the work of the solo supervisors. This necessitates mutual dependence on each other's supervisory work, reducing both duplication of supervisory efforts, and the cost of regulatory compliance for the insurance group.
38. Hence, group-wide supervision requires that the relevant solo supervisors assess whether the Group-wide Supervisor's supervisory regime is broadly equivalent when compared to their own supervisory frameworks in terms of achieving supervisory outcomes. To engender confidence and achieve recognition as an acceptable Group-wide Supervisor, the Authority will deploy its group-wide supervisory regime in accordance with international standards.
39. The Authority will conduct its equivalence evaluation using a principles-based approach when assessing the foreign jurisdiction's insurance, legislative, and supervisory regimes. This broad equivalence test would enable the Authority to be satisfied that the jurisdiction being assessed has the requisite framework and expertise to achieve supervisory outcomes acceptable to the Authority.

40. Some of the areas that will be considered include:

- a. Does the supervisor have sufficient legal authority to supervise insurance groups and/or insurance entities?
- b. Does the supervisor have legal authority over the head of the insurance group?
- c. Does the supervisor have the necessary supervisory skills and resources to supervise insurance groups and/or insurance entities effectively?
- d. Does the jurisdiction encourage fair treatment and good market conduct?
- e. Does the jurisdiction have specific regimes for winding up and licensing requirements?
- f. Does the jurisdiction have adequate ongoing supervisory requirements of an insurance group and/or insurance entity?
- g. Does the supervisor have the ability to effectively assess the insurance group and/or insurance entity's corporate governance and risk management?
- h. Does the jurisdiction have the requisite enforcement provisions over insurers and/or insurance groups?
- i. Does the jurisdiction have adequate group solvency requirements?
- j. Does the jurisdiction have solvency or financial protection legislation that would not potentially hinder the transfer of capital?
- k. Does the jurisdiction adequately account for insurance reserves?
- l. Does the jurisdiction have adequate regulatory and public reporting requirements for the insurance group and/or insurance entity?
- m. Does the jurisdiction analyse intra-group transactions and risk concentrations?
- n. Does the jurisdiction have the ability to share information with other supervisors, and have adequate confidentiality provisions within legislation?

41. The presence of all the necessary regulatory and supervisory provisions will not automatically result in equivalence. Consideration must be given to the outcomes of the actual practice and enforcement of the jurisdiction as compared to the expected supervisory outcomes of the Authority's own regime.

42. Before entering into a formal supervisory recognition agreement¹³ with other jurisdictions, the Authority may take into consideration some specific issues including:
- a. the scope of the agreement and any associated limitations of what is covered;
 - b. requirement to inform each other of any significant changes in the respective legislative and supervisory regimes;
 - c. the contribution of each supervisor towards effective group-wide supervision;
 - d. protocol when determining enforcement actions;
 - e. a formal information sharing agreement; and
 - f. arrangements for dispute resolution and/or termination of the agreement.
43. In addition to using IAIS' Insurance Core Principles as part of its jurisdictional assessment, the Authority would have due regard for work conducted by international bodies such as the International Monetary Fund under the Financial Sector Assessment Programme. Due regard would also be given to work done by other regulators such as that contemplated by the European Union ("EU") and the United States National Association of Insurance Commissioners ("NAIC"). Consideration of these assessment programmes could reduce duplication of effort and facilitate convergence of the assessment process.
44. On completion of an assessment the Authority may conclude that a given jurisdiction has achieved one of three possible designations: is equivalent, is largely equivalent or is not equivalent. In this regard:
- a. if the home¹⁴ jurisdiction is considered equivalent, the Authority may accept the home jurisdiction as the Group-wide Supervisor;
 - b. if the home jurisdiction is largely equivalent but there are aspects within the supervisory regime the Authority regards as not equivalent vis-à-vis the Bermuda supervisory regime, then the Authority may still accept the home jurisdiction as the Group-wide Supervisor. The Authority may, however, introduce additional requirements that would

¹³ This can be accomplished using a memorandum of understanding. See section on "Supervisory Co-operation and Information Exchange".

¹⁴ Home Jurisdiction: a home jurisdiction is one in which the parent insurer is incorporated, or in which the head office of a branch is incorporated. Host jurisdictions/supervisors must be aware of the distinctions between immediate and higher level home jurisdictions supervisors, taking account of the hierarchical corporate structures of many international insurers and insurance groups. – IAIS Glossary

address supervisory gaps, as they pertain to the insurance group's impact on the Bermuda legal entities.

- c. if the home jurisdiction is not considered equivalent, the Authority may consider requesting that the insurance group establish a locally incorporated parent over the Bermuda legal entities or, in the case of Bermuda branch operations, require that the branch be incorporated. In this way, the Authority will be able to exercise group-wide supervisory control over the insurance subgroup.

45. The Authority is reviewing its position on branch operations, both existing and future, within Bermuda. Branch operations present a number of supervisory challenges including:

- a. the fungibility and transferability of funds to support the business written by the branch operation;
- b. the fact that the management and direction of the branch's operations reside elsewhere;
- c. the treatment of policyholders during winding up phase; and
- d. overall the appropriateness of the regulation of the parent operations in another jurisdiction.

In recognising these issues, the Authority will be working on enhancing its regulatory and supervisory treatment of branches, including appropriate prudential requirements, and will advise the industry in due course.

5.2 Supervisory Co-operation and Information Exchange

46. An important component of a well structured group-wide supervision regime is the ability and authority to share key information between regulators. The Authority has within its legislative framework the ability to cooperate and share information with regulators from other jurisdictions through its established information gateways. Additional mechanisms available to the Authority include Memoranda of Understanding ("MoUs"), Multilateral Memorandum of Understanding ("MMoU") and supervisory colleges. The Authority is signatory to a number of MoUs with other supervisory authorities, and is a signatory to the IAIS MMoU, whose objective is to facilitate the "formal basis for cooperation and information exchange between

the Signatory Authorities regarding the supervision of insurance companies where cross-border aspects arise.”¹⁵

47. A supervisory college is an excellent mechanism for facilitating the exchange of information and cooperation between the solo supervisors of insurance entities. It accomplishes this by providing a permanent forum for cooperation and communication between the involved supervisors. It can assist the Group-wide Supervisor in its job of assessing the group’s operations as well as provide information to the solo supervisors, enabling them to better supervise the legal entities of the group within their jurisdictions.

48. “Through the sharing of information and discussion of supervisory issues, involved supervisors gain an improved mutual understanding of supervisory practices, which may contribute to enhanced convergence of supervisory practice on a global basis”.¹⁶

49. The IAIS views supervisory cooperation and information exchange as necessary inputs to achieving effective group-wide supervision. They have identified several key features as necessary for the efficient operation of a supervisory college. These include:

- a. It must be flexible and appropriate, reflecting the scale and complexity of the group;
- b. It should be a permanent feature of a group supervision regime;
- c. It should promote common understanding and agreement in its decision-making;
- d. It should facilitate mutual trust and confidence amongst its members;
- e. It should have in place formal information sharing and confidentiality agreements; and
- f. It should be self-reviewing with a view to continuous improvement.

50. Both the Financial Stability Board (“FSB”), and the Committee of European Insurance and Occupational Pensions Supervisors (“CEIOPS”) have issued their own guidance which concurs with the previously stated IAIS key features. Further, they agree that supervisory cooperation and information exchange would assist in addressing cross-border issues, which were brought to the forefront during the global credit crisis.

¹⁵ IAIS Multilateral Memorandum of Understanding on Cooperation and Information Exchange (IAIS MMoU) February 2007

¹⁶ IAIS Guidance paper on the use of supervisory colleges in group-wide supervision, October 2009

51. The Authority has hosted supervisory colleges for certain of its insurance groups, where it assumed the role of the lead supervisor for these groups. The Authority benefited from hosting these colleges in several ways. Specific gains included developing mutual trust and confidence in each supervisor's regulatory regimes, and attaining a greater understanding of the insurance entities and the insurance group as a whole. Additionally, the Authority believes that enhancing its relationships with other supervisors will be a critical asset that will assist in resolving cross-border issues, as and when they do arise.

52. As Group-wide Supervisor, the Authority will continue to hold and be responsible for coordinating supervisory colleges, and fostering supervisory cooperation and information sharing amongst the relevant supervisors. Principles surrounding the organisation and operation of its colleges will include:

- a. the terms of reference of each meeting will be agreed in advance;
- b. formal information sharing agreements will be agreed in advance of any college;
- c. the size and scope of the issues to be dealt with within a college will determine the involvement required;
- d. supervisory colleges will continue to be a permanent feature of the Bermuda Group-Supervisory regime;
- e. key functions of a supervisory college will include, but not be limited to: review of group solvency assessment, consolidated risk assessment, group capital adequacy and other areas of supervisory interest; and
- f. the meeting schedule for each college will be commensurate with the scale and complexity of the issues to be addressed.

6 Regulatory Framework for Group-wide Supervision

53. A number of factors require careful consideration for the group-wide supervisory regime to be effective. These considerations include:

- a. group corporate governance and risk management;
- b. group solvency – including the solvency approach, group support, intra-group transactions and risk concentrations;

- c. treatment of unregulated and non-financial entities; and
- d. group statutory reporting and filing requirements.

6.1 Group Corporate Governance and Risk Management Framework

54. “Corporate governance refers to the rules and procedures put in place within a corporation for the management and control of its business and affairs. What makes structures and policies work in practice is a knowledgeable and competent board, with a clear understanding of its role and strong commitment to carrying it out.”¹⁷ The IAIS and the Organisation for Economic Co-operation and Development (“OECD”) published their Issues paper on corporate governance which highlighted that “weak insurer corporate governance is seen by supervisors as a key reason for insurer failures.”¹⁸
55. There is no one standard model of corporate governance. “Corporate governance encompasses the means by which directors and senior management of an [insurance group] are held accountable for their actions and for the establishment and implementation of oversight functions and processes. The value of good corporate governance lies in its contribution to both the prosperity and accountability of the insurer. A corporate governance framework specifies the distribution of rights and responsibilities among different participants in the management of the company and sets out the rules and procedures [practices] for making decisions, and for the management and control of the insurer’s business and affairs. Corporate governance also includes corporate discipline, transparency, independence, accountability, and responsibility, as well as compliance with legal and regulatory requirements.”¹⁹
56. Insurance groups generally adopt a centralised approach to corporate governance and risk management where the board determines the corporate governance and risk management structures for the entire group. It is usually the responsibility of the parent to provide direction to the legal entities on implementing and harmonising these processes throughout the group. The Authority’s position is that “the prime responsibility for the sound and prudent management of [an insurance group] rests with the board of the [parent]”.²⁰

¹⁷ Bermuda Monetary Authority Guidance Note #12 Corporate Governance, March 2005

¹⁸ IAIS OECD Issues Paper on Corporate Governance July 2009

¹⁹ Bermuda Monetary Authority Guidance Note #12 Corporate Governance, March 2005

²⁰ Ibid

57. The Authority recognises that the insurance group may face risks that cannot be mitigated by capital alone. These risks also require sound governance and effective risk management. As part of its supervisory process the Authority will look for indications that overall, processes or procedures for effective corporate governance for the insurance group are in place, that they are appropriate, and that they are operating effectively. The Authority will formulate its overall judgment on the effectiveness of an insurance group's corporate governance based on a variety of indicators including findings from on-site examinations and off-site assessments.
58. "The board is ultimately accountable and responsible for the performance and conduct of the [insurance group]. It should have a balance of appropriately skilled, experienced and qualified individuals who can apply informed and independent judgment to the governance of the [insurance group]."²¹ It should ensure that the insurance group is effectively directed and managed, and its business is conducted in a sound and prudent manner with integrity, due care and professional skills appropriate to the nature and scale of its activities. The board of an [insurance group] must exercise its judgement in determining an effective approach to corporate governance, taking into account the nature, scope, complexity, and risk profile of its organisation, and also having regard to the cost effectiveness of the rules and procedures."²²
59. Accordingly, the Authority views the board along with senior management as being responsible for developing suitable corporate governance, prudential oversight, risk management and internal control systems, as well as strategies and policies. While the implementation of an adequate and sound system of internal controls is normally the responsibility of senior management, the board is ultimately responsible for ensuring that such a system is established and maintained.²³
60. The Authority previously issued its draft Code of Conduct which outlines the principles, duties and responsibilities governing the insurer's corporate governance, risk management and internal controls infrastructure. The Authority intends to adopt the provisions contained in the Code for insurance groups, and as such, will publish a Code for insurance groups in Q3 2010, which will be enforced in Q4 2010.

²¹ Ibid

²² Ibid

²³ Bermuda Monetary Authority Guidance Note #13 Risk Management and Internal Controls March 2005

61. Risk management and internal controls systems are integral parts of a corporate governance framework. Risk management and internal control systems and practices may also differ depending on the size and complexity of the group, and the nature of the group's risk exposures. The board and senior management should, based on their judgment, adopt a sound risk management and internal controls system, having regard for international best practice. This includes ensuring the fitness and propriety of individuals responsible for the management and ongoing operation of the system.
62. The risk management process is not static and should be reviewed regularly to fully appreciate the risks faced by the insurance group, and it should be an integral part in the "implementation of the [insurance] group's overall strategy and should allow an appropriate understanding of the nature and significance of the risks to which the group and its individual [insurers] are exposed to."²⁴
63. A sound risk management system requires each insurance group to identify all material risks, including financial and non-financial, on and off-balance sheet, and current and contingent exposures. Additionally it should measure the potential impact of all material risks affecting capital requirements and capital management, as well as short-term and long-term liquidity requirements, policyholder obligations, and operational strategies. Effectively it should report all material risks to the board and have strategies to mitigate them.²⁵
64. Material risks to be considered and addressed by the risk management system include: insurance underwriting risk; market risk; credit risk; operational risk; group risk; strategic risk; legal/litigation risk; reputational risk; and investment, liquidity, and concentration risk.²⁶
65. Specifically, the insurance group should assess its group risk exposures by reviewing its structure and interrelationships, assessing material intra-group transactions and exposures, and implementing strategies to mitigate these risk exposures so that the insurance group is operating according to its risk appetite, as established by the board and senior management.²⁷

²⁴ CEIOPS – Consultation Paper No. 66 – Supervision of Groups with Centralised Risk Management November 2009

²⁵ BMA Consultation paper on the Insurance Code of Conduct, September 2009

²⁶ Ibid

²⁷ Ibid

66. The Authority will assess the insurance group's internal control structures to determine whether they are appropriate and form an integral part of the insurance group's operating framework. Additionally the review should ensure that:

- a. the insurance group's business activities are conducted in a prudent manner in accordance with the policies and strategies established by the board;
- b. clear delegation of responsibilities are being adhered to;
- c. assets are safeguarded;
- d. accounting and other records provide complete, accurate, verifiable and timely information;
- e. management is able to identify, assess, manage and control material risks of the business and hold sufficient capital for these risks; and
- f. appropriate reporting mechanisms are in place to assist management in controlling material risks affecting the insurance group.

67. As Group-wide Supervisor, the Authority will assess the following:

- a. the fitness and propriety of the insurance group's board, senior management and significant shareholders;
- b. the fitness and propriety of the insurance group's actuary and external auditor;
- c. the appropriateness of the corporate governance of the insurance group;
- d. the insurance group's adherence to the Authority's Code for insurance groups (when published). The Authority places the responsibility on the board to ensure compliance, and in the event the insurance group and/or any of its subsidiaries are unable to comply, the matter should be reported to the Authority for consideration;
- e. the insurance group's internal controls and risk management systems;
- f. the risk management surrounding the insurance group's intra-group transactions and risk concentrations;
- g. the risk management structure pertaining to off-balance sheet exposures; and
- h. whether the insurance group's risk management framework is reviewed regularly by the board.

68. The Authority will request that the relevant solo supervisors of the group's overseas entities, or the insurance group itself provide, inter alia, the following information²⁸ as is necessary so that the Authority will be able to conduct a group-wide assessment:

- a. the legal structure of the insurers belonging to the [insurance] group;
- b. any granting and withdrawal of license for a company forming part of the [insurance] group;
- c. changes in the board or senior management of **any** insurance company forming part of the [insurance] group;
- d. significant changes in risk management and internal control systems;
- e. significant developments in the financial position of the [insurance] group or insurers belonging to the [insurance] group;
- f. location of significant business;
- g. significant investments in group entities;
- h. significant financial links;
- i. transfer of risks to unregulated entities;
- j. significant operational risk;
- k. potential high risk factors for contagion; and
- l. other events that may endanger the going concern of the [insurance] group or major insurers belonging to the [insurance] group.

69. As Group-wide Supervisor, the Authority will need to have in place appropriate powers to take supervisory or enforcement actions if the group is not conducting its business activities in a sound and prudent manner. Where the matter pertains to a legal entity subject to another jurisdiction's regulatory provisions, the Authority will confer with the relevant supervisor(s) to ensure a collaborative approach is taken to appropriately address the issue.

²⁸ Ibid

6.2 Proposed Group Solvency Framework

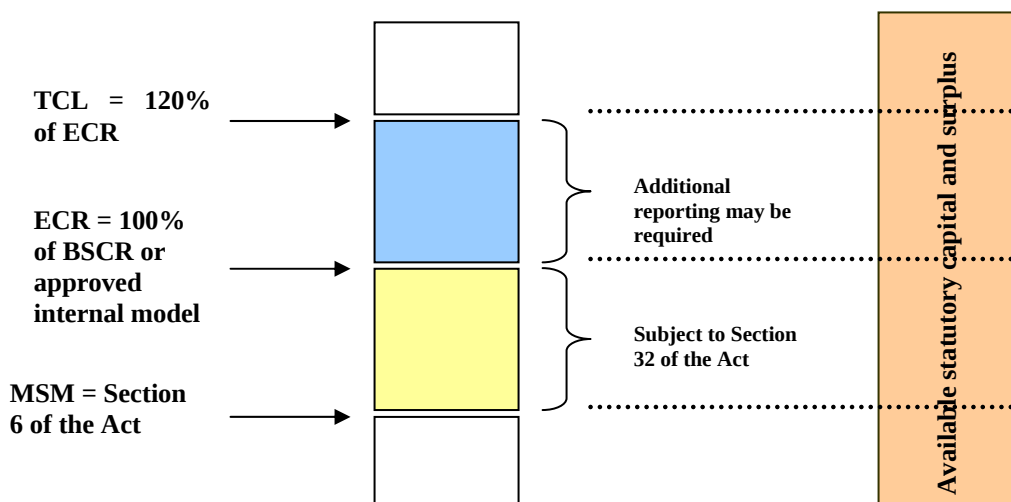
6.2.1 Current Solvency Regime

70. The Authority's current solvency regime is restricted to the legal entity level where the solvency requirement depends on the registered class of insurer under section 4 of the Insurance Act 1978 ("the Act"). Class 4 (and shortly Class 3B) insurers are subject to a risk-sensitive statutory capital and surplus requirement.
71. The Bermuda Solvency Capital Requirement ("BSCR") applies capital factor charges to fixed income investment risk, equity investment risk, credit risk, premium risk and reserve risk. The capital factor charges are calibrated at 99% Tail Value-at-Risk ("TVaR")²⁹ over a one year time horizon, with full run-off of insurance liabilities. The BSCR also contains both a built-in stress test for interest rate/liquidity risk (factoring in asset/liability matching), and an insurer modelled catastrophe risk charge calibrated at 99% TVaR over a one year time horizon.
72. The BSCR also contains an operational risk charge calibrated to the quality of an insurer's risk management policies and procedures. This charge ranges from 1% to 10% of the pre-operational risk BSCR. The Authority has developed a self-assessment tool to assist insurers in evaluating the quality of their risk management and determining the appropriate operational risk capital charge. The results of the self-assessment are verified during on-site assessments and capital add-ons may be applied.
73. Class 4 insurers use the BSCR along with the supplementary schedules³⁰ to determine their statutory capital and surplus. While the capital and solvency return is restricted to the legal entity, the Authority's analysis takes into account group risks within the determination of the capital charge, as well as provides a qualitative assessment of intra-group transactions.

²⁹ 99% TVaR is approximately equivalent to a 1 in 250 return period.

³⁰ Collectively the Capital and Solvency Return – section 6 of the Insurance (Prudential Standards) (Class 4 Solvency Requirement) Order 2008 ("the Order")

74. Line 4 and Line 37 of the Statutory Balance Sheet (Form 1A of the Insurance Accounts Regulations 1980) allows the Authority to examine the effects of certain intra-group transactions and apply the relevant capital charge associated with these disclosures. Further analysis is performed for off balance sheet intra-group transactions, which includes counterparty credit risk exposure and the extent to which group support exists within the insurance group.
75. In 2008, the Insurance (Prudential Standards) (Class 4 Solvency Requirement) Order was introduced with the provision for Class 4 insurers to make application to have their internal models approved for the purposes of determining regulatory capital and surplus. Additionally, the Internal Models Standards was issued in 2009, and the Authority plans to conduct pilots on internal models in 2010 before accepting applications. It is planned that approval will be subject to stringent criteria surrounding use, statistical quality and calibration examinations.
76. It should be noted that the Authority has the ability to impose capital add-ons where the insurer's risk profile differs materially from the underlying assumptions of the BSCR. A capital add-on may also apply where the Authority has determined that circumstances have changed, for example where an approved internal model no longer captures all applicable risks (i.e. a temporary misalignment between an approved internal model and the risk characteristics of the insurer).
77. The existing solvency regime has three regulatory action levels: Minimum Margin of Solvency ("MSM"), Enhanced Capital Requirement ("ECR"), and Target Capital Level ("TCL"), as indicated in the diagram below.



78. The MSM is prescribed in the Act and serves as the floor or minimum level of capital an insurer is required to hold. An insurer that has a capital and surplus level below the MSM is considered insolvent from a statutory perspective, and this will trigger certain intervention powers under the Act.
79. The ECR is equal to the capital requirement yielded by the BSCR model or the approved internal model subject to the MSM floor. While the insurer would not be considered insolvent from a statutory perspective, capital levels between the ECR and the MSM may prompt the Authority to issue directions under Section 32 of the Act, which may include restrictions on transacting new insurance business, or payment of dividends until the required capital level has been restored. Although the ECR is the statutory capital requirement, the Authority expects insurers to hold capital equal to, or above, the TCL (120% of the ECR). The Authority considers the level between the ECR and TCL to be a safety buffer, and an early warning trigger for increased prudential oversight.
80. Class 3B insurers will be submitting their BSCR filing on a trial basis for the period ending December 31st, 2009. It is planned that BSCR filings will become a statutory requirement from the period ending December 31st, 2010 and onwards.

6.2.2 Proposed Group Solvency Approach

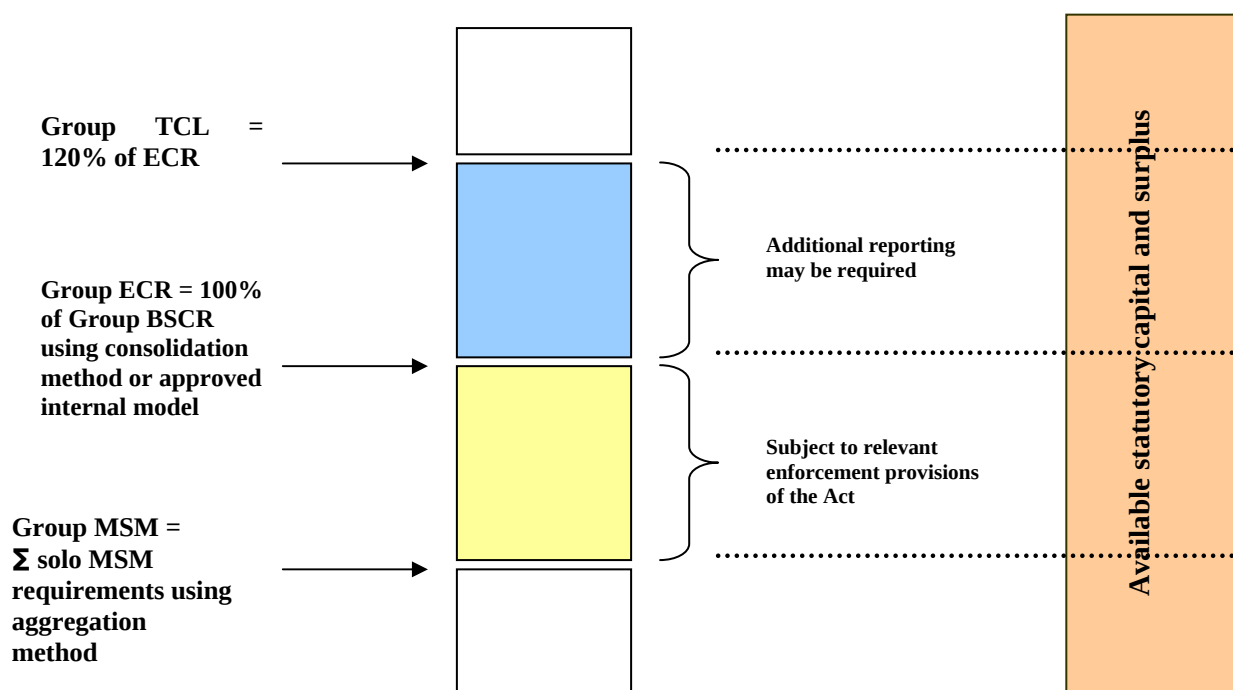
81. The status of an insurance group's solvency position remains a key supervisory concern for the Authority. As a solo supervisor, the Authority is keenly aware that Bermuda insurers are affected by the financial position of the insurance group, especially where the Bermuda insurers either supports or are supported by the parent. As Group-wide Supervisor, the Authority's remit will include ensuring that the insurance group's capital and solvency position is adequate given the insurance group's overall risk profile.
82. Establishing the insurance group solvency requirement is not intended to replace the solvency requirements of the solo entities in the respective jurisdictions; however, it does assist in evaluating whether the required amount and quality of capital instruments used are appropriate given the level of risks present within the insurance group.

83. In its Discussion Paper, the Authority explored a number of options to derive solvency for an insurance group. These include:

- a. *The consolidation approach* - which presumes that the insurance group is a single economic unit and group solvency is determined using the group consolidated financials as the base for either a standard model or an approved internal model. This method also assumes that the assets supporting intra-group transactions within the insurance group are both fungible and transferable.
- b. *The risk-based aggregation* - approach which postulates that group solvency is derived by summing the solo capital requirements and making relevant adjustments to avoid double or multiple gearing of capital.
- c. *The legal entity approach* - views the group as a “set of interdependent legal entities, and not one single entity.”³¹ Capital requirement for each legal entity is computed, taking into account intra-group exposures. These intra-group transactions are modelled to derive the appropriate capital required to address these risks, and that capital forms part of determining the overall group solvency requirement.

84. Insurance groups will be required to hold capital equal to the Group ECR. The Authority proposes to use the consolidation method to calculate the insurance group’s ECR supplemented by elements of the legal entity approach where certain intra-group transactions and investments in unregulated entities will be treated conservatively. Due to the recognition of diversification effects in the consolidation method, the insurance group’s ECR may be lower than the sum total of the solo entities’ regulatory capital requirements. The insurance group’s ECR should not, however, be lower than the sum of the solo entities’ MSMs, which will serve as the insurance group’s ECR floor. The Authority proposes a MSM for the insurance group by using the aggregation method to calculate the floor by which the insurance group’s regulatory capital should not be breached.

³¹ IAIS Issues paper on group-wide solvency assessment and supervision March 2009



85. Where the aggregation method is used to determine the insurance group's MSM, the issue of equivalence plays a key role. The aggregation method postulates that the solo entities' solvency requirements would be based on the solvency rules of the relevant jurisdictions. As Group-wide Supervisor, the Authority would rely on the solvency calculations of the various jurisdictions, provided the Authority recognises them as equivalent. If a jurisdiction is not recognised as being equivalent, the Authority will use its own solvency rules to assess the solvency requirement of the legal entity.
86. The Authority is presently enhancing its regulatory regime for long-term insurers. The Authority issued its Long-Term Insurance Paper at the end of Q4 2009. This paper discussed the Authority's proposed approach to determining regulatory capital for life insurers. The Authority will produce a factor-based model to calculate regulatory capital for long-term insurers, or rely on the results of the insurer's approved internal model. The Authority will be issuing a consultation paper on its long-term insurance regime in Q3 2010 and will further explore the mechanics of deriving long-term insurer's regulatory capital. Once the solvency regime for long-term insurers has been established, the Authority's proposed solvency regime for insurance groups would be modified to take account of the risk exposures presented by these insurers.

87. The Authority proposes to provide insurance groups with sufficient time to capitalise and meet group solvency requirements. The Authority proposes to begin its first assessment of capital requirements when insurance groups submit their regulatory filings for the 2010 year-end. The Authority will provide insurance groups twelve months from that date to meet the group regulatory capital requirements.

Components of Insurance Group Solvency

Group BSCR

88. The Authority will enhance its existing solvency regime to make it apply to insurance groups. The Authority proposes to use the BSCR to determine regulatory group capital, although it recognises that the BSCR framework may require some modification to make it applicable at the insurance group level.

$$GroupBSCR = \sqrt{C_{g\,fi}^2 + C_{g\,eq}^2 + C_{g\,int}^2 + C_{gb\,prem}^2 + C_{gl\,prem}^2 \left[\frac{1}{2} C_{g\,cred} + C_{gbrsvs} + C_{gl\,rsvs} \right]^2 + \left[\frac{1}{2} C_{g\,cred} \right]^2 + C_{gb\,cat}^2 + C_{gl\,cat}^2 + C_{g\,op}^2}$$

89. The Group BSCR Model³² would apply capital risk charges using a combination of information contained within the insurance group's financial statements and accompanying schedules (collectively "the Insurance Group Capital and Solvency Return") to assess the following risk areas:

- a. Fixed Income Investment Risk ($C_{g\,fi}$)
- b. Equity Investment Risk ($C_{g\,eq}$)
- c. Interest Rate/Liquidity Risk (with a built in stress test) ($C_{g\,int}$)
- d. Premium and Reserve Risks (general business and long-term business) ($C_{gb\,prem}$; $C_{gl\,prem}$)
- e. Credit Risk ($C_{g\,cred}$)
- f. Catastrophe Risk (general business and long-term business) ($C_{gb\,cat}$; $C_{gl\,cat}$)
- g. Operational Risk (applied after the covariance adjustment) ($C_{g\,op}$)

³² The group component of long-term insurance business is presently being developed.

90. The Group BSCR Model would be calibrated at 99% Tail Value-at-Risk with a one year time horizon. The model would provide for diversification along the lines of business written by the insurance group as a whole as well as recognising correlation under the square root of the sum of squares methodology.
91. The schedules that form part of the Insurance Group Capital and Solvency Return would be the same schedules used in the BSCR reflected in section 6 of the Order with the addition of schedules specific to long-term business when revised capital requirements for the business are determined. The insurance group would also submit a self-assessment of its operational risk exposure, at the group level, using a framework similar to the Commercial Insurer Risk Assessment.

Approved Group Internal Model

92. Insurance groups would have the ability to make application for their internal models to be approved for the purposes of determining their regulatory capital requirement: similar to the process that will exist under the solo solvency regime. The principles of the Internal Models Standards will also be used to approve the insurance group's internal model. As previously noted model approval will be subject to stringent criteria surrounding use, statistical quality and calibration examinations.
93. There may be instances where the insurance group's internal model was approved by a solo supervisor as the basis to determine the insurer's regulatory capital in that jurisdiction. The Authority may rely on another supervisor's review and approval of the insurance group's internal model provided that the necessary information can be extracted and the jurisdiction is deemed equivalent. "The degree of reliance placed upon these reviews will be guided by the extent to which their approach is comparable to that of the Authority's, the sufficiency of documentation available, and any other factors that the Authority may consider appropriate."³³ Where the Authority is the solo supervisor, the Authority may accept the Group-wide Supervisor's assessment of a group's internal model, provided the Bermuda legal entity's results could be extracted to confirm compliance with the Act.

Economic Balance Sheet

94. The issue of an economic balance sheet is being widely debated internationally and the Authority has already established a working group to discuss the implications of producing an economic balance sheet and its impact on the Bermuda market. The Authority recognises any proposals to adopt an economic balance sheet would affect the insurance group's solvency and the corresponding eligible capital instruments suitable to meet its regulatory capital requirement. The Authority intends to issue its discussion paper on economic balance sheet in Q2 2010.

Own Risk and Solvency Assessment ("ORSA")

95. The Authority issued its ORSA Paper in Q3 2009. An ORSA is defined as "the entirety of the processes and procedures employed to identify, assess, monitor, manage, and report the short and long-term risks an [insurer] faces or may face and to determine the own funds necessary to ensure that the [insurer's] overall solvency needs are met at all times."³⁴

96. The ORSA will provide the Authority with the group's perspective of the capital resources necessary, and the risk management and governance in place, to achieve its business goals.

97. The ORSA Paper recognises that the use of either the BSCR or an internal model may not adequately capture all the risks an insurer faces; hence the requisite capital derived from the capital models may not be commensurate with the insurer's risk exposures. The ORSA process will complement these tools, along with a supervisory review process, in order to determine the insurer's regulatory capital requirement. Generally speaking, the Authority's view is that capital add-ons should be exceptional, and the supervisory review will focus on the extent to which the insurance group considers, and how it responds to, risks that could materially impact the insurance group.

³³ BMA guidance note on standards and application framework for the use of Internal capital models for regulatory capital Purposes June 2009

³⁴ CEIOPS Issues Paper : Own Risk and Solvency Assessment May 2008

98. Some key points from the ORSA Paper are as follows:

- a. The ORSA process will be a fundamental component in the supervisory review process and on-site programme.
- b. The ORSA is a forward looking assessment, taking into account the insurer's plans and projections. The insurer should hold adequate capital to support these forward looking plans.
- c. The Board and Senior Management should formally endorse the ORSA and have the ability to review and challenge the results of the ORSA.
- d. The ORSA must be embedded in the insurer's corporate governance and risk management frameworks, and should be central to its decision-making process. The ORSA should be performed, at a minimum, on an annual basis.
- e. The ORSA captures risks not appropriately accounted for in the BSCR or the internal model. Some of these risks include strategic risk, reputational risk, capital-raising risk and group risks. The Authority will consider how the insurance group addresses (manages/mitigates etc.) these risks.
- f. The supervisory review process will include an assessment of the insurer's:
 - i. system of governance and controls;
 - ii. insurance reserves;
 - iii. capital requirements, including quality and quantity of capital;
 - iv. investment guidelines;
 - v. underwriting guidelines; and
 - vi. where the insurer uses an internal capital model to determine regulatory capital, ongoing compliance with the requirements for internal models.
- g. The supervisory review process may conclude that a capital add-on is necessary in finalising the insurer's required regulatory capital.

99. The principles in the ORSA Paper will be applicable to insurance groups. Where the Authority is the Group-wide Supervisor the insurance group will submit a group ORSA which will be used to assess the insurance group and its subsidiaries. As a solo supervisor the Authority may accept the group ORSA as long as the insurer could extract its legal entity capital requirements. Where the group or solo ORSA has been accepted by another supervisor, the Authority may rely on the work of that supervisor, as long as the jurisdiction has been assessed as equivalent. The Authority will be issuing its consultation paper on the ORSA in Q2 2010.

Deriving Insurance Group Solvency

100. The determination of the insurance group's solvency can be seen in the process workflow in **Appendix II:**

- a. The insurance group will be required to submit audited consolidated financial statements³⁵, which will form the basis for the Authority to apply various prudential filters to derive financials that reflect the level of conservatism that the Authority deems necessary to achieve its supervisory outcomes.
- b. The Authority will deduct non-admitted assets that would not be considered suitable to determine the insurance group's solvency for the purposes of meeting their financial obligations. The Authority will also deduct the full value³⁶ of investments in unregulated affiliated entities. Further, the Authority will review certain intra-group transactions such as contingent liabilities and other off-balance sheet obligations and, initially take a conservative default position by requiring the full value of the obligations to be recorded as liabilities on the balance sheet. The insurance group will be able to apply to the Authority for reconsideration of its treatment of these liabilities by providing a modelled assessment of the risks posed by these exposures.³⁷

³⁵ Audited consolidated financials will be prepared according to US, UK or Canadian GAAP or IFRS.

³⁶ This deduction of the value of investments in unregulated entities can potentially result in a deduction greater than 100%, if the impact of these investments warrant such a treatment.

³⁷ Legal entity approach used along with the consolidation method.

- c. Once the prudential filters³⁸ have been applied, the modified consolidated financials (**Appendix III**) will form part of the Insurance Group Capital and Solvency Return to be applied to the Group BSCR Model.
- d. The insurance group's ECR may be derived from the Group BSCR (**Appendix IV**) or from an approved group internal model.
- e. The Authority will review the output from the Group BSCR or approved group internal model, along with the ORSA filings to compute the Group ECR.

101. Where the insurance group is a subgroup within a wider group such as a financial conglomerate, the Authority will assess the risk exposures posed by the non-insurance activities of the wider group. It is critical that the solvency assessment of the insurance subgroup addresses areas such as double and/or multiple gearing of capital between itself and the wider group; the impact of intra-group transactions and other off-balance sheet commitments, pooling of invested assets in different parts of the group, and the risks associated with transferability of assets. As the Group-wide Supervisor, the Authority will work with the other supervisors of the non-insurance financial entities to ascertain the risk exposures. The Authority may require additional capital at the level of the insurance subgroup to compensate for the additional risk exposures emanating from the wider group.

102. Where the insurance group or the insurance subgroup has shareholdings in financial regulated entities, the Authority proposes the following modifications to supplement the consolidation approach:

- a. where the shareholding is in a regulated non-insurance financial entity (such as a bank), the consolidation approach used to calculate the group ECR should be supplemented by the proportionate share of regulatory capital calculated using the relevant sector's solvency rules. The Group BSCR model would normally require a capital charge for investments in affiliates. However, in order to avoid double charging to investment in regulated non-insurance financial entities, the model would apply a zero capital charge and the proportionate share of the entity's regulatory capital requirement would form

³⁸ Certain prudential filters will be applied to items on the GAAP balance sheet - for example, Goodwill, DAC and own credit standing for insurance liabilities.

part of the overall insurance group's solvency calculation by using the aggregation method, provided that the Authority believes that these sectoral rules are appropriate.

- b. a similar approach would be taken where the insurance group has a significant influence³⁹ in insurance entities. These investments would be given a zero capital charge and the proportionate share of the insurer's regulatory capital requirement would be included in the insurance group's solvency capital requirement using the aggregation method. Where the insurer's regulatory capital is determined using another jurisdiction's solvency rules, the Authority will accept the solvency calculation once those solvency rules are deemed equivalent. If the jurisdiction's solvency requirements are not deemed equivalent, the Authority will apply its own solvency rules to determine the proportionate share of the insurer's regulatory capital, which will then be aggregated to the insurance group's regulatory capital requirement.

103. The insurance group will be required to hold regulatory capital at least equal to the ECR. If the group's available statutory capital approaches or falls below the ECR amount, this will trigger a "ladder of intervention"⁴⁰ which will be suited to the degree to which the capital level has fallen. As Group-wide Supervisor the Authority will exercise its supervisory powers to request further information, impose additional reporting requirements, and apply other monitoring mechanisms to assess the insurance group's financial position, including potentially issuing certain directions to the parent. The Authority may also require additional capital to be raised and be placed at the level of the insurance group.

104. Where the Authority believes, through its investigations, that the solvency position of the insurance group has been compromised by one of its legal entities, the Authority will contact the relevant solo supervisor on the matter and seek to work with that supervisor to resolve the issue. It may be necessary to contact the other supervisors as well, as the financial viability of the insurance entities in their jurisdictions may be impaired by the financial situation affecting the insurance group.

105. If the insurance group breaches its MSM level, it is probable that a number of solo entities have breached their MSM levels, which may indicate that the entire group may be experiencing

³⁹ Information is retrieved from <http://asc.fasb.org/link&sourceid=SL2216515-111957&objid=6525388>.

⁴⁰ IAIS Draft Guidance Paper on Group-wide capital adequacy assessment for insurance groups - August 2009

financial distress. As Group-wide Supervisor, the Authority will confer with the other supervisors on the matter to agree a course of action to be taken with the insurance group. While a breach in the MSM may usually signal winding up proceedings for the respective legal entity or entities, the Authority will not automatically select this option, but would try to work with the insurance group, along with the co-operation of the other supervisors, to rehabilitate the insurance group, and where necessary, facilitate its reorganisation.

6.3 Group Support

106. In its Discussion Paper, the Authority explored the idea of group support within group-wide supervision. Group support potentially facilitates the efficient allocation of capital and the recognition of diversification benefits for the purposes of calculating group regulatory capital.⁴¹ It presumes that capital will flow freely within the insurance group wherever it is needed.

107. Group support becomes complicated when the insurance group operates in multiple jurisdictions. The effectiveness of a group support regime would be hindered if the solo supervisors present any impediments to the transferability of capital, especially under conditions of financial distress. Supervisors are concerned that free movement of capital may in fact be restricted under these conditions, and result in a legal entity's, and potentially, the group's financial impairment.

108. The Authority is a proponent of group support; however, until the concept of group support becomes ensconced within legislation internationally, and there is an established protocol facilitating group support, especially for IAIGs, the Authority may not be able to allow group support within its group-wide supervision regime.

109. The Authority will continue to monitor international developments in this area and will adjust its regime accordingly. If group support is accepted internationally, the Authority will develop detailed criteria governing the acceptance of group support as both a Group-wide Supervisor and solo supervisor. At a high level, the criteria may include, inter alia:

⁴¹ The issue of groups in the insurance industry: Diversification effects and group supervisor concept – Michaela Koller, CEA Director General April 2008

- a. the parent must provide a declaration of group support;
- b. group support must be backed by a legally binding document approved by the Authority;
- c. the group must provide information to the Authority on the existence of any issues or requirements that may hinder or otherwise compromise the transferability of capital;
- d. capital must be fungible and transferable within the group, even under stressed conditions;
- e. capital must in fact be available; and
- f. the minimum criteria for group support has been met by other jurisdictions.

6.4 Proposed treatment of Intra-group Transactions and Risk Concentration

110. Intra-group transactions occur where subsidiaries within the group depend on the parent and/or other subsidiaries to perform a particular obligation. Intra-group transactions allow the insurance group and its subsidiaries to maximise efficiencies in capital utilisation, and meet funding performance obligations. These transactions can also give rise to a number of complex issues, and supervisors need to have a clear understanding of the structure of these transactions, the links between different parts of the insurance group, and the resultant effects upon the insurance group's solvency.

111. Intra-group transactions can present very serious implications for the insurance group, especially where the insurance group uses these transactions to generate internal creation of capital or to inflate its solvency position through double gearing. Instances can arise where the insurance group internalises its risks (such as through reinsurance and retrocession arrangements) causing a spiralling effect of increased insurance risks within the insurance group.

112. The proposed consolidation approach to calculate insurance group solvency assumes that capital will flow, as and when needed, throughout the insurance group. In reality this may not be the case, especially where capital support⁴² (either from the parent or from a subsidiary) comes from an entity in another jurisdiction. The insurer and/or the parent that is providing the

⁴² This is not to be confused with group support as noted in the previous section.

obligation may be in financial distress or may be restricted from providing the necessary flow of capital to support another entity. The insurance group should take into account the risks associated with potential impediments to the flow of capital.

113. As a solo supervisor, the Authority must take into account the impact on the Bermuda insurers where the non-performance (or even the performance) of an obligation could potentially yield negative results. As a Group-wide Supervisor the Authority would assess the effects of these transactions, including any foreseeable hindrances that may occur, that could adversely affect the insurance group as a whole.

114. Where the insurance group is a subgroup and/or forms part of a financial conglomerate, the Authority would review the intra-group transactions that occur between the insurance subgroup and the wider group, especially if the subgroup is dependent on capital flowing from other financial sectors. The Authority would be in close communication with other sectoral supervisors to ensure that there is no double/multiple gearing of capital and that there are no legal or supervisory impediments to capital.

115. Disclosures on intra-group transactions allow supervisors “to evaluate the channels through which the holding company, subsidiaries and affiliates of a regulated legal entity can influence the financial health of that legal entity.”⁴³ Such disclosures, supplemented by discussions with the insurance group’s senior management, provide valuable information regarding how intra-group exposures are monitored to ensure that limits are not breached. They also give insight into the risks associated with these transactions which assist in assuring that they do not adversely affect the financial health of the insurer and/or insurance group.

116. The Authority proposes that the insurance group should disclose material intra-group transactions along with its group statutory filing. These disclosures along with the ORSA filings, would allow the Authority to assess the concentrations and the impact of these transactions on the insurance group. The Authority’s assessment may generate a capital add-on where the Authority determines that risks are not properly assessed and managed.

⁴³ Supervision of Financial Conglomerates – Papers prepared by the Joint Forum on Financial Conglomerates February 1999

117. The Authority has set out its proposed criteria to define materiality for disclosures of intra-group transactions. Consideration must be given to both the quantitative and qualitative effects of the transaction. Quantitatively a material intra-group transaction has been defined as follows:

- a. an intra-group transaction whose impact can cause a reduction in the insurer's statutory capital and surplus by 5% or more;
- b. a series of linked intra-group transactions that can cumulatively reduce an insurer's capital and surplus by 10% or more;

Qualitative aspects include the risk characteristics of the issue: for example, it may be known that a certain transaction has high risk attached to it; however, the quantitative impact remains unknown.

118. Some of the intra-group transaction disclosures the Authority will require include, inter alia, details on transactions such as loans and advances to affiliates and/or the parent, reinsurance and other risk transfer arrangements, investments in affiliates (regulated or unregulated), performance guarantees, off-balance sheet transactions, pooling arrangements to manage assets (asset management services within the insurance group), securities lending arrangements, encumbered assets to support obligations within the insurance group (such as assets to support letters of credit), transactions costs and fees, investment in corporate debt instruments issued by insurance group and/or its subsidiaries, and coupons and interest payments.

119. In determining the insurance group's solvency intra-group transactions such as investments in unregulated entities, and off-balance sheet transactions, would be treated conservatively. As previously mentioned, the full value of the asset would be deducted and/or the contingent obligation would be recorded as a liability on the insurance group's balance sheet.

120. When seeking to have intra-group exposures approved as admitted assets or reduced in value as liabilities the proposed approach would require firms to present a modelled risk assessment before such waivers or discretions are granted.

121. The Authority proposes initially to accept existing intra-group exposures (where prior approval was granted) and allow them to be grandfathered through amendments in legislation. However, the Authority would retain its power to review and revoke any such approval where necessary.

122. In order to make a proper assessment of the impact of these transactions, the Authority proposes the following:

- a. enhanced disclosures of intra-group transactions within the insurance group;
- b. enhanced disclosures of intra-group transactions between the insurance subgroup and the wider group;
- c. notification to the Authority, on a quarterly basis of any material intra-group transactions that occurred within the quarter;
- d. submission of any corresponding information from foreign supervisory authorities responsible for the supervision of other legal entities within the insurance group;
- e. credit standing of counterparties; and
- f. financial statements of counterparties, where deemed necessary.

123. Based on the additional information, the Authority's assessment may include:

- a. determining the adequacy of risk management processes in place, including those pertaining to intra-group transactions;
- b. requiring regular reporting to assist in understanding the impact of intra-group transactions;
- c. requiring additional capital commensurate with the incremental risk exposures;
- d. encouraging public disclosure; and
- e. liaising closely with other supervisors to ascertain their concerns and coordinating supervisory action where deemed appropriate.

124. In its Discussion Paper, the Authority examined the effects of risk concentrations on an insurance group. Risk concentration⁴⁴ was defined as exposures that possess the following characteristics:

- a. the potential to produce losses large enough to threaten a financial institution's health or ability to maintain its core operations; or
- b. the potential to produce a material change in an institution's risk profile.

⁴⁴ The Joint Forum Cross-sectoral review of group-wide identification and management of risk concentrations April 2008

125. The insurance group's risk management framework must include an assessment of its risk exposures in order to gauge the extent to which there is diversification, and to monitor the correlation of its risks. Such concentrations "may arise in relation to assets, liabilities, off-balance sheet items, and through processing transactions. They may arise within or across different risk categories (underwriting, credit, market, liquidity and operational risk) throughout the [insurance] group."⁴⁵ Insurance groups tend to view and manage risk concentrations separately within the various risk categories; however, these concentrations may "arise from (interrelated) exposures across the risk categories, rendering a silo-based approach insufficient as potential concentrations across risk categories may not be captured."⁴⁶

126. The Authority proposes to address risk concentrations by requiring that:

- a. the risk management framework surrounding such concentrations are adequate and approved by the board;
- b. the board monitors these concentrations at the group level; and
- c. where appropriate, the parent conducts stress and scenario tests on the group's risk concentrations to determine the impact of changes in the group's risk profile arising from market conditions.

127. The Authority will assess the governance framework surrounding the insurance group's assessment and management of its risk concentrations. The insurance group would be required to disclose its material⁴⁷ risk concentrations as part of its ORSA filings and this would form part of the Authority's supervisory review process. If the Authority believes that the risk exposures presented by these concentrations have not been adequately addressed, capital additions or other regulatory action may be applied.

⁴⁵ IAIS Issues paper on group-wide solvency assessment and supervision March 2009

⁴⁶ The Joint Forum Cross-sectoral review of group-wide identification and management of risk concentration April 2008

⁴⁷ The materiality definition would be aligned with that proposed for intra-group transactions.

6.5 Proposed Eligible Capital Structure

128. Subsequent to the Authority's proposals on eligible capital structure for insurance groups contained within its Discussion Paper, the Authority issued its Eligible Capital Paper at the end of Q3 2009. The proposals contained in the Eligible Capital Paper will be applied to insurance groups and as such this section seeks to reiterate the principles from that paper.

129. The Authority proposes to adopt a tiered capital structure for insurance groups⁴⁸ which would reflect the different characteristics of capital instruments, as well as how they behave during the phases of economic conditions affecting the insurance group. The Authority's proposed tier classification is aligned with its supervisory objectives of ensuring that the insurance group will be able to meet its obligations to both policyholders and creditors, as well as having sufficient quality resources to conduct its operations.

130. The proposed eligible capital tier structure for insurance groups must satisfy the following criteria⁴⁹:

- a. Tier 1 eligible capital must be:
 - able to fully absorb losses at all times (going concern, run-off, insolvency, and winding up);
 - subordinated to the rights of policyholders at all times (going concern, run-off, insolvency, and winding up);
 - permanent within the insurance group such that the instrument cannot be redeemed or is free from any requirements in that regard;
 - perpetual – must be available to the extent suitable to satisfy obligations under a going concern, run-off, insolvency, and/or winding up basis; and
 - free of any encumbrances or mandatory fixed charges.
- b. Tier 2 eligible capital would include capital instruments that possess some of the qualitative traits of Tier 1 capital but are able to meet policyholder obligations.

⁴⁸ Bermuda Monetary Authority Consultation Paper on Eligible Capital September 2009

⁴⁹ Ibid

- c. Tier 3 eligible capital would include capital instruments that possess some of the qualitative traits of Tier 1 and Tier 2 capital and are fully subordinated under insolvency or winding up conditions.

131. The Authority proposed a number of capital instruments that may qualify for Tier 1, Tier 2 and Tier 3 capital within its Eligible Capital Paper⁵⁰, however, the Authority reserves the right to assess and reclassify or limit these capital instruments if they do not meet the tier eligibility criteria. An example of where this may occur is where assets, that may be Tier 1 and/or Tier 2 capital, are held in trust to honour collateral requirements for certain policyholder obligations. Any surplus assets remaining in this structure are not available to the wider group of policyholders, therefore, do not meet the criteria mentioned above, and as such would be considered Tier 3 capital.⁵¹

132. Concurrently, the Authority will also review ancillary capital instruments such as off-balance sheet commitments to determine the extent of their inclusion as tier capital. The Eligible Capital Paper cites the Authority's considerations as follows:

- a. ability and willingness of the counterparty to honour their commitment;
- b. terms of the instrument (e.g. duration, subordination, etc.);
- c. credit risk of the counterparty (e.g. assets held in trust); and
- d. any supplementary information, such as past behaviour of the counterparty.

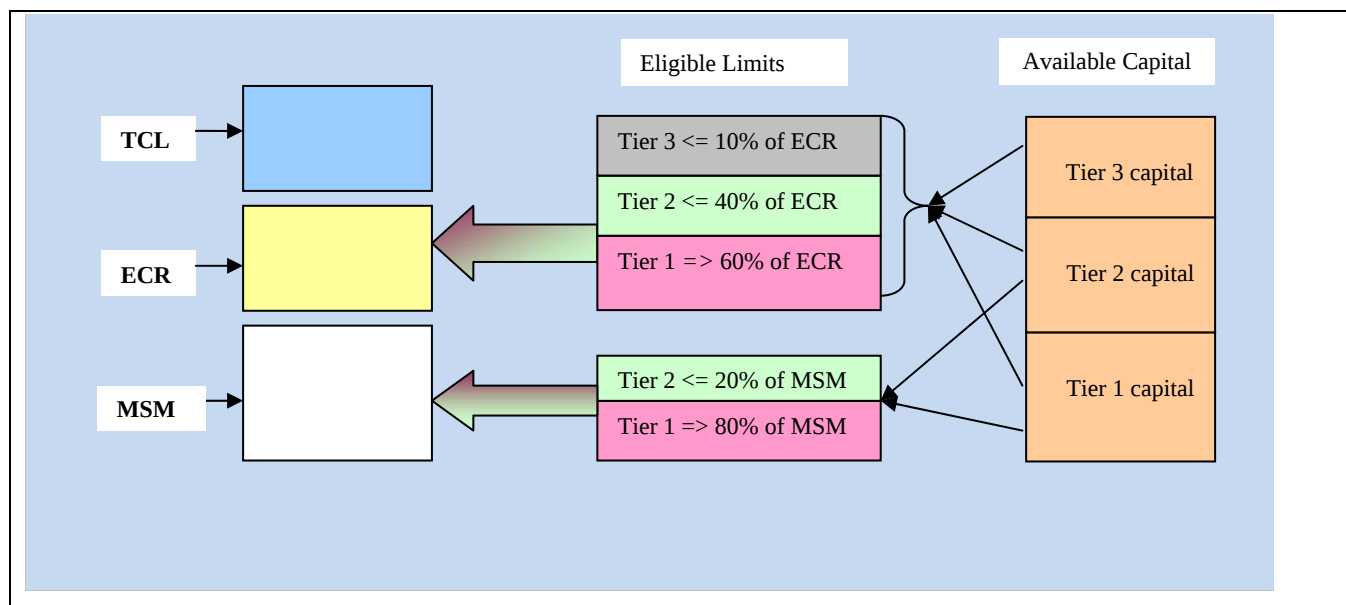
133. The Authority's proposed group-wide supervision regime will follow the principles outlined in the Eligible Capital Paper (*see Diagram 1 below*); therefore the insurance group's statutory solvency requirements would comprise the following:

- a. Insurance Group's MSM would consist of a minimum of 80% Tier 1 capital and a maximum of 20% Tier 2 capital;
- b. Insurance Group's ECR would consist of a minimum of 60% Tier 1 capital and a maximum 10% of Tier 3 capital respectively; and
- c. Insurance Group's TCL, subject to the MSM and ECR limits, any combination of Tiers 1 to 3 capital.

⁵⁰ Ibid – Appendix A

⁵¹ Ibid

Diagram 1: Proposed Eligible Tier Capital Structure for Insurance Groups⁵²



134. The list of capital instruments identified in Appendix A of the Eligible Capital Paper is not exhaustive; therefore, in situations of doubt, the insurance group should contact the Authority regarding treatment of a particular capital instrument. Also, where the characteristics of the capital instruments have changed, the Authority would require notification from the insurance group and an assessment of the capital instrument for consideration. The Authority recommends that insurance groups retain the necessary documentation supporting their assessment of capital instruments within the proposed tiered eligible capital structure, which will be subject to supervisory inspection.

135. The Authority intends to supplement its regulatory disclosures for insurance groups to include disclosures on capital instruments eligible for tier capital within the insurance group.

⁵² Adaptation from Bermuda Monetary Authority Consultation Paper on Eligible Capital September 2009

136. The Authority recognises that the eligible tier capital structure is new for the Bermuda insurance market and wants to provide insurance groups sufficient time to assess their capital structure to ensure that they comply with the proposed eligible capital requirements. Therefore, the Authority will grant insurance groups a transitional provision of twelve months from the enactment of authorising legislation to adjust their capital structure in order to comply with the new provisions. The Authority will begin its first assessment of the eligible capital structure when insurance groups submit their regulatory filings for the 2010 year-end.

6.6 Proposed Treatment of Unregulated Entities

137. Group-wide supervision involves assessing all material risks within the insurance group, including those arising from unregulated entities. The presence of unregulated entities, which are not subject to prudential oversight, means that they may conduct activities that can threaten the insurance group's solvency or liquidity position. The Authority does not propose to regulate the business activities of these entities; however, the Authority plans to incorporate the risks arising from them into the scope of group-wide supervision.

138. The Authority proposes to address these risks by requiring additional disclosures on the nature of the business risks assumed by unregulated entities and reviewing both the insurance group's risk management framework and intra-group transactions that occur with unregulated entities. Where the unregulated entity is a subsidiary within the insurance group, the insurance group's ECR must reflect the risk exposures presented by these entities. As previously proposed, the Authority would deduct the value of these investments under the group solvency consolidated approach. If the insurance group wants the Authority to recognise the value of these investments for solvency purposes, the Authority would require that the insurance group submit a modelled assessment of this exposure for consideration and approval.

139. Where a non-financial entity is the parent of the insurance group, such as a holding company, the IAIS supports the notion that aspects of supervisory oversight should be extended to those entities, in areas such as corporate governance, internal controls and group-wide solvency assessments⁵³. In its paper, "Principles on group-wide supervision", the IAIS asserts that the

⁵³ IAIS Issues paper on group-wide solvency assessment and supervision March 2009

“supervisor should have appropriate power and authority to assess and ensure compliance with corporate governance requirements at the head of the group.”⁵⁴

140. Similarly, the Authority proposes to extend its supervisory remit to holding company parent operations located in Bermuda. The scope of the proposed supervisory oversight will be limited to the Authority being able to obtain information and prescribe requirements relating to corporate governance and risk management. These entities will also be included in the consolidated solvency assessment and the Authority proposes to exercise enforcement powers over the parent in these areas and the insurance group. Where the parent is not incorporated in Bermuda, the Authority will liaise with the supervisor where the parent is located to exercise those powers. The regulatory powers would pertain to the activities of the parent, as they affect the insurance group and/or any entities within the insurance group. Again, the Authority does not propose to regulate the holding company parent’s operations, nor would it be regarded as a “fully regulated [entity],”⁵⁵ but due regard will be taken into account where its activities can adversely affect entities within and/or the insurance group as a whole.

6.7 Proposed Group Statutory Reporting and Filing Requirements

141. Inherent in the proposals discussed in the various sections, is the requirement for the Authority to collect additional information to assist in conducting its group-wide assessment regime. This includes information that may come directly from the Group-wide Supervisor where the Authority does not hold this position.

142. The Authority issued its Disclosures Paper in June 2009 which endorsed some key guiding principles governing disclosures. These same guiding principles⁵⁶ that will be adopted for the group-wide regulatory framework are:

- a. Regulatory disclosures should be more timely and comprehensive than public disclosures, but limited to information applicable to the prudent supervision of [the insurance group]. In determining regulatory disclosures, due regard should be given to the necessary balance between the benefits of additional information and the cost

⁵⁴ IAIS Principles on group-wide supervision October 2008

⁵⁵ Ibid

⁵⁶ Bermuda Monetary Authority Consultation Paper on Disclosure and Transparency June 2009

incurred by [the insurance group], taking into account disclosures made to other regulators⁵⁷;

- b. Public disclosures should be reliable, clear, understandable, consistent, relevant, and material having due regard for information that would compromise competitive advantage and confidentiality; and
- c. Disclosures should be developed and implemented in tandem with international standards and be proportional to the size, business mix, complexity, and the risk profile of [the insurance group].

143. The Authority will place reliance on the parent's board and senior management to ensure that both regulatory and public disclosures, to the best of their knowledge and belief, fairly represent the financial condition of the insurance group's operations in all material respects.

144. The Disclosures Paper presented a three-phased approach, which the group-wide supervisory regime will adopt. Phase I will cover regulatory disclosures, where these disclosures would be streamlined and standardised for reporting purposes.

145. The Authority will be issuing consultation papers on ORSA and on Disclosures in 2010, which will elaborate further on the reporting requirements for insurers and insurance groups. The Authority will make a determination to accept the insurance group's reporting requirements as a replacement for the solo reporting in certain cases, only if the group disclosures are not materially different from what the Bermuda insurer would submit or if the Bermuda insurer's information can be extracted from the group reporting information.

Reporting Requirements

146. Reporting requirements for the insurance group would include the following broad areas⁵⁸:

- a. Financial
 - i. Annual audited consolidated financials
 - ii. Quarterly unaudited consolidated financials

⁵⁷ See Section 5 "Equivalence and Supervisory Recognition"

⁵⁸ The disclosure items under these broad areas are not meant to be exhaustive but rather examples of what these areas would cover.

- iii. Business projections
 - iv. Valuation analysis to determine economic values
- b. Corporate Governance
 - i. Due diligence documents for major shareholders, board and senior management
 - ii. Organisational structure
 - iii. Terms of reference for board sub-committees
- c. Risk Management
 - i. Risk management strategy
 - ii. Risk appetite and framework surrounding risk concentrations, intra-group transactions, off balance sheet exposures, unregulated entities, contagion effects etc.
 - iii. Stress tests and scenario tests
 - iv. Risk controls
 - v. Disaster Planning
- d. Solvency
 - i. Group Capital and Solvency Return – Group BSCR and related schedules
 - ii. Approved Group Internal Model
 - iii. Intra-group Transactions
 - iv. ORSA
 - v. Schedule of capital instruments eligible for the Group MSM
 - vi. Schedule of capital instruments eligible for the Group ECR
 - vii. Restrictions on the fungibility and transferability of assets
- e. Underwriting and Claims Performance
 - i. Underwriting parameters and strategy
 - ii. Reserving methodology for insurance reserves
- f. Investments and off-balance sheet transactions (including intra-group transactions and risk concentrations)
 - i. Investment strategy
 - ii. Asset management arrangements (intra-group)
 - iii. Effective duration for investment assets and insurance obligations
 - iv. Off-balance sheet commitments – exposure values of guarantees, contingent arrangements; loans, letters of credit, securities lending arrangements etc.
- g. Compliance – rating agency reports, any regulatory action taken by a solo supervisor, rating agency actions.

- h. Ad hoc – these may include those disclosures required for on-site reviews, actions prompted by any regulatory issues and/or additional information based on the Authority’s ongoing assessment of the insurance group.

147. In its role as solo supervisor, the Authority may recognise the statutory group reporting and filing information submitted to the Group-wide Supervisor as acceptable, and as such, may request and review the information along with the solo statutory reporting for the legal entities. The Authority reserves the right to request additional information and/or more frequent reporting as it may deem necessary in order to conduct its group-wide supervisory assessment.

148. Phases II and III pertain to public disclosures that would be required for insurance groups. The Authority is presently assessing stakeholders’ needs and what would be appropriate disclosures suited for a largely wholesale market such as the Bermuda insurance market. The Authority recognises that a number of Bermuda insurers and insurance groups already publicly disclose a substantial amount of information on their websites and to various stakeholders and any additional disclosures would be intended to enhance and complement their existing practices. Notwithstanding what information insurers and insurance groups presently publish on their websites, the Authority proposes to publish certain information on its website.

149. The Authority proposes transitional insurance group filing requirements for 2010 year-end. The Authority will place due regard to information that insurance groups submit as part of their public filings. However, to the extent where such information is not a part of these filings, we would require insurance groups to submit them for the period in question. The Authority proposes the following:

- a. Financial
 - i. Annual audited consolidated financials
 - ii. Business projections
- b. Corporate Governance
 - i. List of major shareholders, board and senior management
 - ii. Organisational structure
- c. Risk Management
 - i. Risk management strategy
- d. Solvency – filing due July 31, 2011

- i. Group Capital and Solvency Return – Group BSCR and related schedules –
- ii. Intra-group Transactions –
- iii. Schedule of capital instruments eligible for the Group MSM –
- iv. Schedule of capital instruments eligible for the Group ECR –
- e. Ad hoc – these may include those disclosures required for on-site reviews, actions prompted by any regulatory issues and/or additional information based on the Authority’s ongoing assessment of the insurance group.

7 Group Timetable

150. The Authority proposes the following timelines:

- | | |
|---|---------|
| • Enactment of insurance group legislation | Q1 2010 |
| • Publication of Code of Conduct | Q1 2010 |
| • Enforcement of insurance group legislation | Q1 2010 |
| • Enforcement of Code of Conduct | Q4 2010 |
| • Statutory filing for 2010 year-end (except Solvency filings) | Q2 2011 |
| • Trial run for solvency filing for 2010 year-end | Q3 2011 |
| • Transition period of 12 months to Q3 2012 for the insurance group to comply with the provisions for group solvency and eligible capital | |
| • Enforcement of Group Solvency and Group Eligible Capital requirements | Q3 2012 |

8 Conclusion

151. In its effort to ensure that its regulatory and supervisory regime is aligned with international standards, the Authority continues to monitor international developments. Additionally, it has a series of workstreams operating parallel to its development of its group-wide supervisory framework. This includes co-ordinating its efforts internally to ensure a consistent approach in both its solo and group-wide regime, taking into account the unique nature of the Bermuda insurance market.

152. Although the proposals advanced in this paper reflect the Authority’s thoughts towards implementing a group-wide supervisory regime, there are a number of issues that are still being

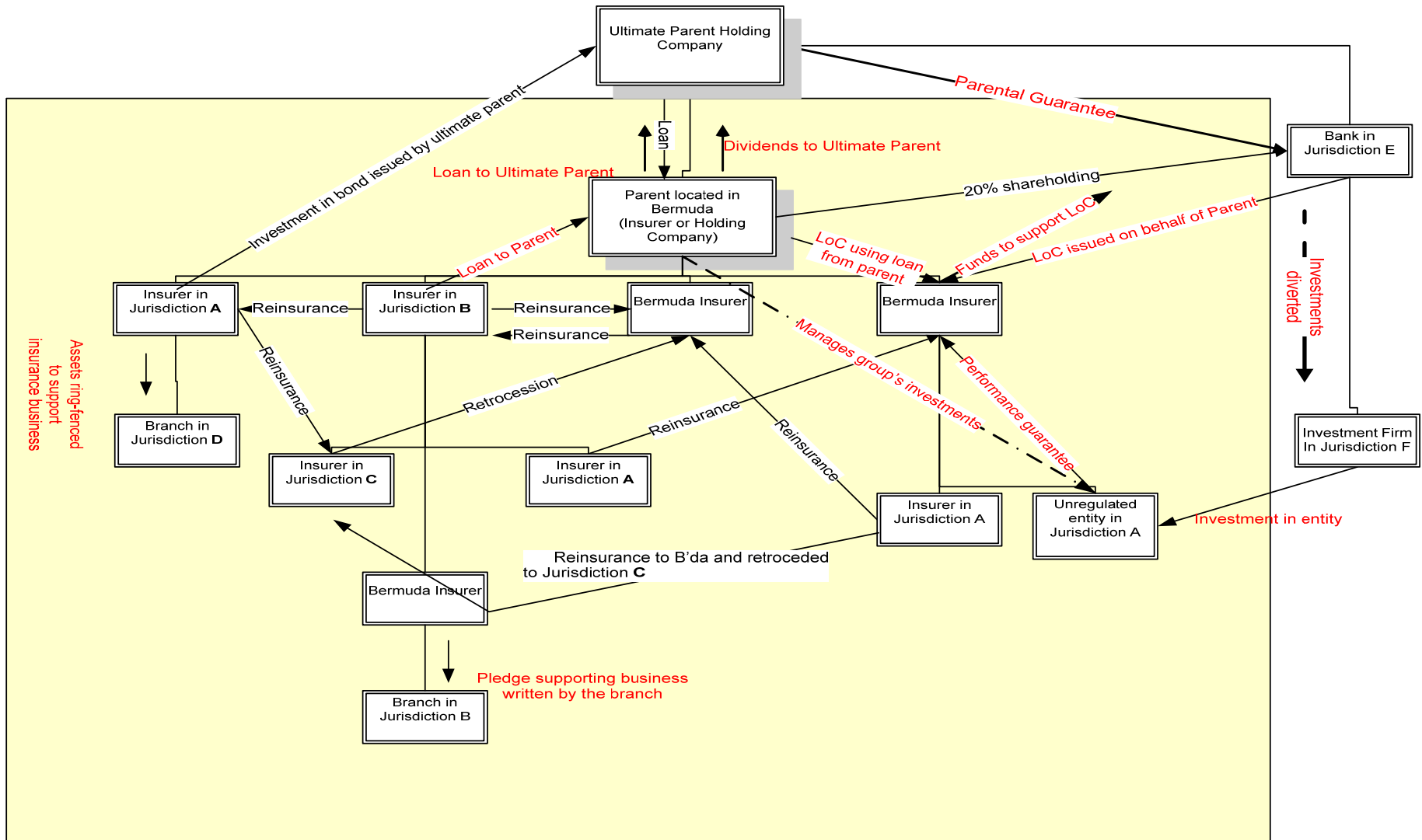
debated in the international fora that warrant careful consideration, and flexibility is thus required to ensure consistency with international regulatory best practice.

153. The Authority is already preparing for the transition into a group-wide supervisory regime by taking several actions including, hosting and participating in supervisory colleges. The Authority has always co-operated with supervisors on a number of issues (notably during the financial crisis) and the Authority views colleges as a major part of its group-supervision regime.

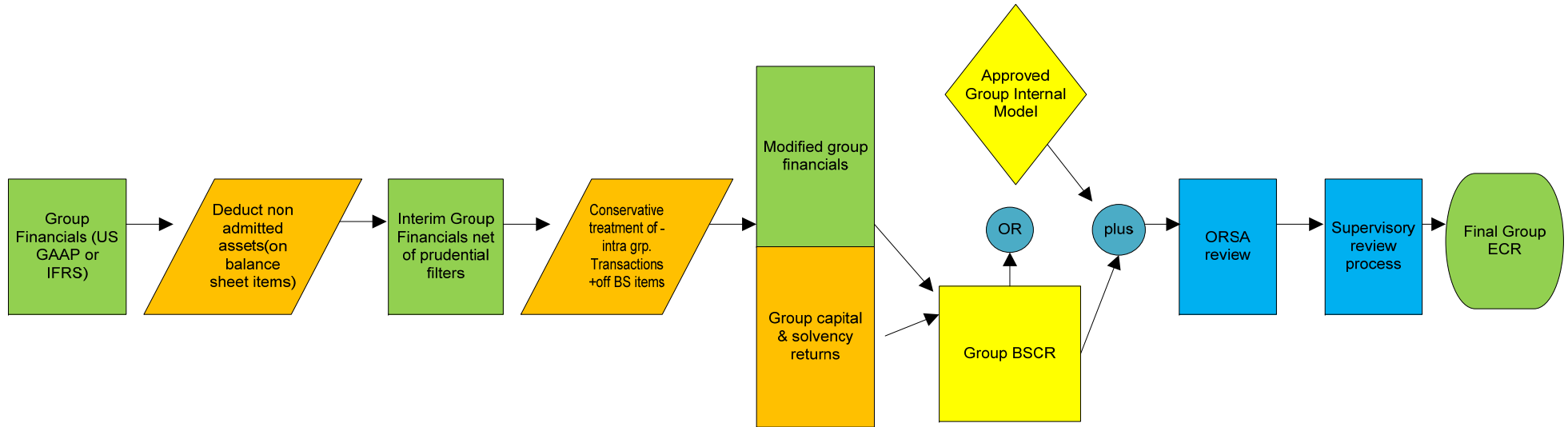
154. Additionally, group effects are factored into the solvency assessment for Bermuda insurers and also assessed during the on-site process. Further work includes a data call issued in Q4 2009 requesting specific information to assist in its policy work regarding intra-group transactions and off-balance sheet transactions.

155. Ultimately, the Authority proposes to adopt group-wide supervision by the enactment of primary and secondary legislation, a code of conduct and guidance notes. This should provide the necessary certainty and transparency with regard to the issues that have been highlighted in this paper.

APPENDIX I: SCOPE OF GROUP-WIDE SUPERVISION



APPENDIX II: PROPOSED GROUP SOLVENCY APPROACH



APPENDIX III: GROUP FINANCIALS TO COMPUTE GROUP SOLVENCY CALCULATION

ABC Reinsurance Limited and its subsidiaries consolidated statements
Year ended December 31, 2008
Amounts in \$ "000"

	Notes	GAAP	Adjustment	Modified GAAP
Assets				
Fixed maturity investments - available for sale at fair value		3,475,036	-	3,475,036
Equity securities		3,435	-	3,435
Short term investments at fair value		304,375	-	304,375
Total investments available for sale		3,782,846	-	3,782,846
Investments in affiliates	Note 1	314,053	(150,000)	164,053
Other investments		112,345	-	112,345
Total investments		4,209,244	(150,000)	4,059,244
cash and cash equivalents		1,324,294	-	1,324,294
premiums receivable		2,292,641	-	2,292,641
Reinsurance balances receivable		391,989	-	391,989
unpaid losses recoverable		5,889,001	-	5,889,001
Amounts due from parent		508,953	-	508,953
Accrued investment income		69,205	-	69,205
Deferred acquisition cost	Note 2	306,490	(306,490)	-
Prepaid reinsurance premiums	Note 3	1,147,853	-	1,147,853
goodwill and other intangible assets	Note 4	232,022	(232,022)	-
Deferred tax asset	Note 5	149,889	(149,889)	-
Other assets		235,513	-	235,513
		-		
Total assets		16,757,094	(838,401)	15,918,693
Liabilities				
Unpaid losses and loss expense		7,726,712	-	7,726,712
Deposit liabilities		829,622	-	829,622
Future policy benefit reserves		1,481,616	-	1,481,616
Unearned premiums		1,915,027	-	1,915,027
Unearned commission		286,781	-	286,781
Premiums receivable in advance		23,521	-	23,521
Reinsurance premiums payable		800,422	-	800,422
Amounts due to parent and affiliate		359,165	-	359,165
Accounts payable and accrued liabilities		360,133	-	360,133
Net payable for investments purchased		67,951	-	67,951
Minority interest		796	-	796
Letters of credit/commitments	Note 5	-	18,500	18,500
Total liabilities		13,851,746	18,500	13,870,246
Shareholders equity				
Common shares - issued and outstanding		500	-	500
Additional paid in capital		3,381,537	-	3,381,537
comprehensive income		(466,075)	-	(466,075)
retained earnings	Note 1-6	(10,614)	(856,901)	(867,515)
		-		-
Total shareholders equity		2,905,348	(856,901)	2,048,447
		-		-
Total liabilities and equity		16,757,094	(838,401)	15,918,693

Non admitted assets

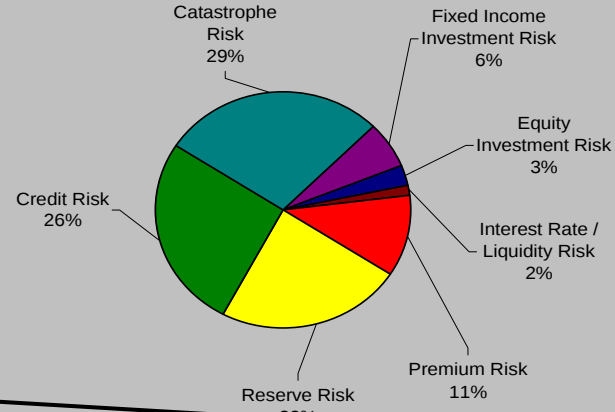
Note 1	Investments in affiliates includes an amount of \$150 million relating to investments in non regulated entities.
Note 2	Deferred acquisition cost is a non admitted asset. See Insurance Accounts Regulation page 70 under line 13 sundry assets. However, GAAP prorates the commissions and brokerage expenses over the life of the contract. Therefore, an adjustments is done to GAAP to exclude them from b/s.
Note 3	Prepaid reinsurance premiums are admitted assets and are netted off against unearned premiums as prescribed in the Insurance Accounts regulation on page 71 under unearned premiums.
Note 4	Goodwill and other intangible assets are non admitted assets. See Insurance Accounts Regulation page 70 under line 13 sundry assets, and are therefore deducted from GAAP statements.
Note 5	deferred tax assets are non admitted assets. See Insurance Accounts Regulation page 70 under line 13 sundry assets, and are therefore deducted from GAAP statements
Off balance sheet items deducted from the financial statements	
Note 6	ABC Reinsurance Limited has committed \$18.5 million of collateral to support a letter of credit for XYZ Reinsurance Limited, a related party. ABC Reinsurance Limited. The letters of credit are secured by cash and investments of similar amounts.

APPENDIX IV: GROUP BSCR

ABC Reinsurance Limited and its subsidiaries
Bermuda Solvency Capital Requirement (BSCR)
(\$000)

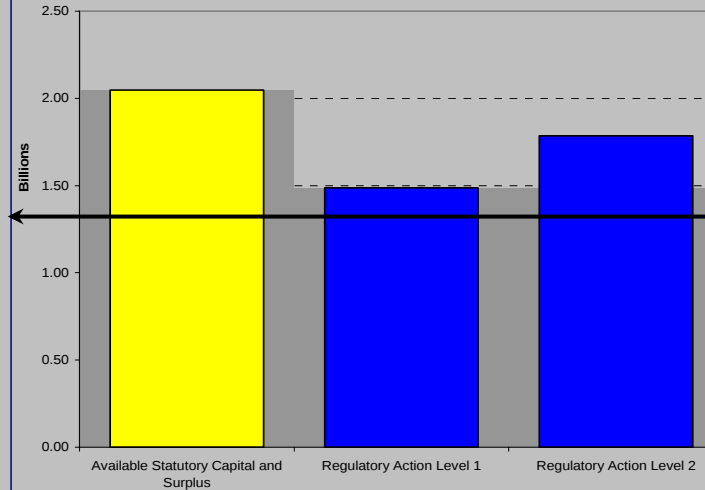
REQUIRED CAPITAL AND SURPLUS		2008-gaap
C_{fi}	Fixed Income Investment Risk	176,615
C_{eq}	Equity Investment Risk	70,066
C_{int}	Interest Rate / Liquidity Risk	45,353
C_{prem}	Premium Risk	301,639
C_{rsvs}	Reserve Risk	639,510
C_{cred}	Credit Risk	723,216
C_{cat}	Catastrophe Risk	774,386
BSCR (Prior to Covariance Adjustment)		2,730,785
BSCR (After Covariance Adjustment)		1,364,484
Operational risk charge (%)		9%
Operational risk capital charge (\$)		122,804
Capital add-on (BMA assessment)		
BSCR		1,487,287
AVAILABLE STATUTORY CAPITAL AND SURPLUS		2008-gaap
Total statutory capital and surplus Form 1A, Line (40)		2,048,447
Capital Contribution		0
Pre-adjustment available statutory capital and surplus		2,048,447
Capital reduction (BMA Assessment)		0
Available statutory capital and surplus		2,048,447
MINIMUM MARGIN OF SOLVENCY		2008-gaap
Minimum Margin of Solvency		1,316,015
ENHANCED CAPITAL REQUIREMENT & TARGET CAPITAL LEVEL		2008-gaap
Enhanced Capital Requirement		1,487,287
Target Capital Level		1,784,745
RATIOS		2008-gaap
Bermuda Solvency Capital Requirement Ratio		138%
Enhanced Capital Requirement Ratio		138%

Solvency Capital Distribution



The supervisory review process using the ORSA and the BSCR may generate a capital add-on.

Regulatory Action Level vs. Available Statutory Capital and Surplus



The insurance group's MSM is derived using the aggregation approach

$$\text{Group BSCR} = \sqrt{C_{gfi}^2 + C_{geq}^2 + C_{gint}^2 + C_{gbprem}^2 + C_{giprem}^2 \left[\frac{1}{2} C_{gcred} + C_{gbrsvs} + C_{glrsvs} \right]^2 + \left[\frac{1}{2} C_{gcred} \right]^2 + C_{gbcats}^2 + C_{glcats}^2 + C_{gop}}$$

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