



BERMUDA MONETARY AUTHORITY

BMA House

43 Victoria Street
Hamilton HM 12 Bermuda

P.O. Box 2447
Hamilton HM JX Bermuda

tel: (441) 295 5278 fax: (441) 292 7471
email: info@bma.bm website: www.bma.bm

BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

Table of Contents

0.	Introduction.....	3
1.	Preliminary.....	3
2.	Proportionality principle.....	4
3.	Corporate governance.....	5
4.	Risk management.....	9
5.	Governance mechanism.....	17
6.	Outsourcing.....	20
7.	Market discipline and disclosure.....	21
8.	Implementation and transitional period.....	25

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

0. INTRODUCTION

1. This Consultation Paper outlines the Bermuda Monetary Authority's ("the Authority") proposed Insurance Code of Conduct ("the Code"). In this paper, the term "insurer" includes "reinsurer", "insurance" includes "reinsurance", and "policyholder" or "policyholders" include current and past policyholders and beneficiaries in which the insurer is contractually obligated to fulfil their insurance obligations.

2. Concurrent with the establishment of the Code, the Authority is reviewing the insurance statement of principles and guidance notes. This is part of an exercise that the Authority has embarked upon in relation to its desire to streamline and harmonise the various instruments that form part of its supervisory toolkit. The Authority will publish any changes.

3. The Authority's current regulatory framework is primarily solo (legal) based. It is envisioned that proposals outlined in this Code would apply equally to groups (upon adoption of the Authority's group-wide supervision regime and where the Authority is the appointed group-wide supervisor). An exception may arise on the issue of independent directors. In this instance, paragraph 15 (enclosed in square brackets) applies only to groups.

4. 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 no later than November 30th 2009. The Authority intends to publish the final version of the Code by January 31st 2010.

1. PRELIMINARY

5. The Authority proposes to issue the Code pursuant to the powers under Section 2BA of the Insurance Act 1978 ("the Act"). The Code establishes duties, requirements, and standards to be complied with by insurers registered under Section 4 of the Act, including the procedures and sound principles to be observed by such persons. Failure to comply with provisions set out in the Code will be a factor taken into account by the Authority in determining whether an insurer is conducting its business in a sound and prudent manner, as required by paragraph 4 of the minimum criteria.

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

2. PROPORTIONALITY PRINCIPLE

6. The Authority appreciates that insurers have varying risk profiles arising from the nature, scale, and complexity of their business, and that those insurers with higher risk profiles would require more comprehensive governance and risk management frameworks to conduct business in a sound and prudent manner.

7. Accordingly, the Authority will assess the insurer's compliance with the Code in a proportionate manner relative to its nature, scale, and complexity. These elements will be considered collectively, rather than individually (e.g. an insurer could be relatively small in relation to scale, but write extremely complex business thus still requiring a sophisticated risk management framework).

- Nature includes the relationship between the policyholder and the insurer (e.g. captive versus commercial) or characteristics of the business written (e.g. volatile versus stable, etc.);
- Scale includes size aspects such as volume of business written or size of the balance sheet in conjunction with materiality considerations; and
- Complexity includes organisational structures and ease of information transmission, multifaceted business or business lines, and/or skill level required to properly assess the risks of contractual provisions (e.g. existence of options, etc. in business products).

8. In the application of the principle of sound and prudent business conduct, the Authority will have regard to the appropriateness of provisions of the Code in relation to their application to a particular insurer taking into account the insurer's nature, scale, and complexity and the Authority's prudential objective underpinning the provision being effectively met.

9. Captive insurers, in particular, should be mindful of the proportionality principle in establishing a sound corporate governance, risk management, and internal controls framework and complying with provisions of the Code, and should be guided by paragraph 8 in documenting their compliance with the Code.

10. The proportionality principle, discussed in paragraph 7 above, is applicable to all sections of the Code regardless of whether the principle is explicitly mentioned.

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

3. CORPORATE GOVERNANCE

11. Every insurer must establish and maintain a sound corporate governance framework. The framework should have regard for international best practice on effective corporate governance. Corporate governance includes principles on corporate discipline, accountability, responsibility, compliance, and oversight.

3.1 The Board

12. The ultimate responsibility for sound and prudent management of the insurer rests with its board of directors (“the board”). In this regard, the board is responsible for ensuring corporate governance policies and practices are developed and applied in a prudent manner. Delegation of authority to board committees, chief and senior executives, or external parties does not absolve the board of its ultimate responsibilities.

13. The board must ensure that the business is effectively directed and managed, and conducted in a sound and prudent manner with integrity, due care, and the professional skills that are appropriate. Therefore, it is the responsibility of the board to establish processes to assess and document the fitness and propriety of its members, controllers, and officers. The board must also take into account the fact that conflicts, or potential conflicts of interest, may on occasion preclude the involvement of specific individual members on particular issues or decisions.

14. The board should comprise an appropriate number of non-executive directors. However, such directors may instead form part of the parent’s board of directors (“the parent’s board”) under certain circumstances. Such circumstances include the following:

- Where the insurer is centrally controlled and oversight provided by the parent’s board; and
- Where the parent’s board can demonstrate sufficient knowledge of the insurer’s business to ensure that adequate policies and procedures are implemented by the insurer.

15. [Where the Authority is the appointed group-wide supervisor, an appropriate number of non-executive directors should meet conditions of being considered independent in line with relevant international corporate governance standards.]

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

3.2 Oversight Responsibilities of the Board

16. The board is responsible for setting appropriate strategies and policies, and for providing suitable prudential oversight of the insurer's risk management and internal controls framework, regardless of the extent to which associated activities and functions are delegated or outsourced. A list of oversight responsibilities that the board should consider when establishing and assessing the effectiveness of the corporate governance framework include the following:

- Establish operational and oversight responsibilities toward sound corporate governance throughout the organisation;
- Establish processes to assess and document the fitness and propriety of board members, controllers, officers, and third-party service providers, including insurance managers, auditors, actuaries, and the principal representative;
- Establish board committees to oversee key operational areas including underwriting and investments and key functions including risk management, corporate governance, audit, and compliance;
- Establish processes to ensure key staff members are adequately skilled, having the expertise in their relevant field and knowledge of policies and procedures to execute and discharge their duty;
- Establish broad business and operational strategies, and significant policies and procedures including those surrounding oversight;
- Review and approve, at least annually (see paragraph 45), significant policies and procedures promoting effective corporate governance across the organisation, including those for risk management and internal controls, internal and external audit, compliance, and actuarial functions;
- Ensure the role and responsibilities of the board, the chief and senior executives, and key staff delegated corporate governance responsibilities are clearly documented and reviewed frequently;
- Establish independent functions such as risk management, internal audit, actuarial, and compliance to assist in oversight responsibilities, and ensure these functions have direct communication to the board and relevant committees;
- Establish procedures for engaging and dismissing the services of the chief and senior executives and third-party service providers assisting with oversight responsibilities including policies and procedures to manage and mitigate conflicts of interest and undue influence;
- Establish processes to ensure the board has appropriate access to accurate, relevant, and timely information, including relevant information available to stakeholders participating in the corporate governance process;

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

- Provide oversight of the market conduct of the insurer, including establishing, documenting, and reviewing policies on independence, conflicts of interest and disclosures to external stakeholders;
- Establish internal policies and procedures to address potential issues arising from the business conduct and unethical or fraudulent actions by board members, chief and senior executives, and staff;
- Review compliance with all relevant laws, regulations, codes of conduct, industry standards, and guidance notes;
- Establish information systems appropriate to support the organisation's business platform, including producing reliable information to the relevant business functions;
- Ensure that sufficient records are properly maintained as required by laws and regulations;
- Establish contingency plans, including those surrounding natural disasters and information recovery, to ensure the continual operation of the insurer; and
- Ensure that sensitive information is properly safeguarded, including employee and policyholder information.

3.3 Responsibility of the Chief and Senior Executives

17. Supporting the board, the chief and senior executives are also responsible for the prudent administration of the insurer. Such responsibilities include:

- Manage and execute the day-to-day operations of the insurer, subject to the mandate established by the board and laws and regulations in the operating jurisdiction;
- Assist the board to develop and implement an appropriate control environment including those around reporting systems;
- Provide recommendations on strategic plans, objectives, key policies, and procedures to the board for evaluation and authorisation;
- Assist the board with its oversight responsibilities by ensuring that the board has accurate and timely information, allowing the board to conduct robust and candid discussions on operational performance, strategy, and major policies, and to appraise the performance of management;
- Support oversight of internal functions including risk management, audit, compliance, actuarial, and external third-party services;
- Ensure that key functions assigned corporate governance responsibilities are supported with adequate resources to execute and discharge their duties including

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

independent functions having direct access to the board and relevant committees;
and

- Ensure that external service providers, including the principal representative, insurance manager, and approved auditors have adequate resources and information to fulfil their role, including access to timely and accurate internal and outsourced records.

3.4 Relationship between the Insurer (including the board and the chief and senior executives) and the Authority

18. The insurer, its board, and chief and senior executives, should communicate with the Authority in an open and cooperative manner.

3.5 Insurance Managers

19. Where the insurer employs an insurance manager, the board must ensure that the duties, responsibilities, and authorities of the insurance manager are clearly set out in a management agreement. The management agreement may effectively outsource the chief and senior executives' responsibilities to the insurance manager. In these instances, provisions relating to the chief and senior executives throughout the Code would be applicable to insurance managers.

20. The insurer should assess the fitness and propriety of the insurance manager including ensuring that the insurance manager has a strong risk management and internal controls framework and is sufficiently knowledgeable about jurisdictional laws and regulations to appropriately discharge its responsibilities. The board should receive sufficient information in order to permit it to apply effective oversight of the insurance manager's function.

21. The management agreement should include terms obliging full cooperation with the Authority. This includes producing documents relating to the insurer upon request or assisting the Authority with its on-site assessment of the insurance manager's corporate governance and risk management framework.

3.6 Principal Representative

22. The role of the approved principal representative is integral to the Bermuda insurance supervisory framework. While the board and the chief and senior executives of

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

the insurer have primary responsibility for the conduct and performance of the insurer, the approved principal representative acts in an “early warning” role and monitors the insurer’s compliance in accordance with Section 8A of the Act on a continuous basis.

23. The Act requires every insurer to appoint a principal representative resident in Bermuda and to maintain a principal office in Bermuda for approval. The appointed principal representative must be knowledgeable in insurance and Bermuda laws and regulations.

24. The approved principal representative would generally be a director or senior executive of the insurer normally resident in Bermuda, or a Bermuda registered insurance management company. Under Section 8A of the Act, the approved principal representative has the legislated duty to report certain events to the Authority.

25. The insurer must make arrangements to enable the approved principal representative to undertake its duties pursuant to the Act in an efficient and effective basis, including access to relevant records.

4. RISK MANAGEMENT

26. The board and the chief and senior executives should, based on their judgment, adopt a sound risk management and internal controls framework. The framework should have regard for international best practice on sound risk management and internal controls. This includes ensuring the fitness and propriety of individuals responsible for the management and oversight of the framework.

27. Minimally, the risk management framework should:

- Be embedded in both the organisational structure and strategic oversight process, supported by appropriate internal control policies and procedures;
- Be supported by information systems that appropriately capture underwriting, investment, and operational data and provide relevant, accurate, and timely information to the applicable business functions;
- Include techniques necessary to identify, measure, respond to, monitor, and report, on a continuous basis and on an individual and aggregate level, all material risks (e.g. financial and non-financial, on and off-balance sheet, current and contingent exposures, etc.);

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

- Include frequent reviews of the operating environment to ensure material risks are continuously assessed and monitored, and appropriate actions are taken to manage exposures and adverse developments;
- Include objectives, risk tolerance levels, and appropriate delegation of oversight, reporting, and operating responsibilities across all functions;
- Include reporting systems that are appropriate for the insurer taking into consideration any outsourcing of responsibilities and safeguarding of assets;
- Include documentation of significant policies and procedures; and
- Include the review and approval of these policies and procedures by the board and the chief and senior executives, on a risk basis, at least annually (see paragraph 45).

28. A sound risk management framework requires each insurer to:

- Identify all material risks, including financial and non-financial, on and off-balance sheet, and current and contingent exposures;
- Measure the potential impact of all material risks, including material risks affecting capital requirements and capital management, short-term and long-term liquidity requirements, policyholder obligations, and operational strategies and objectives; and
- Develop policies and strategies to manage, mitigate, and report all material risks effectively.

29. Material risks to be addressed by the risk management framework include:

- Insurance underwriting risk;
- Investment, liquidity, and concentration risk;
- Market risk;
- Credit risk;
- Systems and operations risk (operational risk);
- Group risk;
- Strategic risk;
- Reputational risk; and
- Legal / litigation risk.

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

4.1 Material Risks

4.1.1 Insurance Underwriting Risk

30. The insurance underwriting risk component of the insurer's risk management framework should include:

- Underwriting strategies that are aligned with the overall organisational strategy, including alignment to the appropriate investment strategy and risk tolerance levels;
- Underwriting policies, including exposure limits by line of business, geographical areas, and counterparties (e.g. brokers and ceding reinsurers);
- Reserving techniques prescribed by jurisdictional laws and regulations and that adequately reflect the obligations to policyholders;
- Management of policyholder claims including those surrounding claims processing (validation of claims, timely settlement of payments, and capturing and storing claims data);
- Methodologies to identify and evaluate risks arising from insurance policies and obligations, including concentration of risks;
- Measurement techniques to ensure compliance with risk tolerance levels and overall strategy;
- Response techniques to ensure that unexpected exposures or deviations are mitigated, including those surrounding reserves, and that risk mitigation strategies are appropriately employed;
- Systems to capture, maintain, and analyse underwriting data and policies and procedures to ensure relevant and accurate data is used to price underwriting contracts, establish adequate reserves, appropriately settle claims, and establish strategies and objectives; and
- The board and the chief and senior executives' oversight, including employing techniques such as benchmarking and stress and scenario testing to review, approve, and assess strategies and tolerance limits.

31. Underwriting risks may be mitigated by way of reinsurance or other risk transfer techniques. Risk mitigation techniques should be embedded into the insurer's underwriting strategies. The insurer should develop processes and procedures to approve, evaluate, and assess the effectiveness of the risk mitigation techniques employed in light of the insurer's risk tolerances, underwriting results, and investment

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

strategies. This includes identifying and monitoring potential material risks that may arise while executing the strategy.

4.1.2 Investment, Liquidity, and Concentration Risk

32. The investment risk component of the insurer's risk management framework should include:

- Adopting the “prudent person” principle in relation to the investment of its assets;
- Establishing strategies that align with the overall organisational strategy, especially those surrounding underwriting (including claims management) and capital requirements and capital adequacy;
- Designing an investment policy, supporting established strategies, that:
 - Governs the selection and composition of the investment portfolio, including detailed composition and allocation limits, to allow appropriate execution of the investment policy and strategies and future assessment of compliance;
 - Governs the employment, valuation, and effectiveness of off-balance sheet hedging and derivative instruments;
 - Aligns with the insurer's overall risk tolerance limits and exposures;
 - Governs the selection and compensation of service providers including those providing custodian and investment management services;
 - Governs the reporting and data management of the investment portfolio; and
 - Governs the oversight responsibilities of board sub-committees, internal functions, and third-party service providers;
- Establishing techniques to analyse performance results and identify current and contingent exposures arising from execution of a planned strategy or market development;
- Establishing techniques to regularly assess and monitor the adequacy of capital to support the current strategy and the effectiveness of the management of assets and liabilities including the effectiveness of hedging strategies, the development of contingent exposures, and the impact of embedded options in long-term products (Long-term insurers); and
- Reporting of investment results to the board and the chief and senior executives on a timely basis for monitoring and for ensuring compliance with the established investment policy.

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

33. The “prudent person” principle requires that an individual entrusted with the management of a client’s funds may only invest in instruments that any reasonable individual with objectives of capital preservation and return on investment would own. In case of the insurer, this principle requires that the insurer, in determining the appropriate investment strategy and policy, may only assume investment risks that it can properly identify, measure, respond to, monitor, control, and report while taking into consideration its capital requirements and adequacy, short-term and long-term liquidity requirements, and policyholder obligations. Further, the insurer must ensure that investment decisions have been executed in the best interest of its policyholders.

34. The liquidity risk component of the insurer’s risk management framework should include:

- Adopting sound liquidity management practices covering short, medium, and long-term objectives that support the overall organisational strategy, including investment, underwriting, and claims strategies;
- Adopting practices to manage short-term liquidity requirements, including access to sufficient funds to meet its day-to-day obligations; and
- Adopting benchmarking and stress and scenario testing to assist in the identification and determination of unexpected adverse developments in the medium and long-term.

35. The concentration risk component of the insurer’s risk management framework should include developing strategies and policies to identify, measure, respond to, monitor, mitigate, and report credit risk arising from an individual risk exposure or from a combination of risk exposures such as credit, market, underwriting, and liquidity.

4.1.3 Market Risk

36. The market risk component of the insurer’s risk management framework should include:

- An investment strategy that is aligned with the insurer’s overall short-term and long-term strategic objectives, including those surrounding the management of assets and liabilities;
- Detailed policies on allocation limits, including those on counterparty, zones and territories, currency, assets, and sectors;

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

- Identification and quantification techniques related to both on and off-balance sheet exposures, including materiality, level, and trend;
- Performance measurement techniques, including benchmarking and stress and scenario testing to ensure compliance with the investment strategy;
- Monitoring procedures to assess the insurer's tolerance to changes in the market; and
- Mitigation techniques to ensure appropriate management of adverse developments.

4.1.4 Credit Risk

37. The credit risk component of the insurer's risk management framework should include:

- A credit risk policy that is aligned with the insurer's overall short-term and long-term strategic objectives;
- Detailed exposure limits surrounding:
 - Individual counterparty or concentration of counterparties;
 - Intra-group transactions;
 - Assets and / or sectors;
 - Off-balance sheet (e.g. guarantees and letters of credit); and
 - Zones and territories;
- Identification and quantification techniques related to both on and off-balance sheet exposures, including materiality, level, and trend;
- Mitigation tools employed to manage adverse developments; and
- Measurement techniques to assess the risk exposures and effectiveness of the mitigation tools used, including stress and scenario testing.

4.1.5 Systems and Operations Risk (Operational risk)

38. The systems and operations risk (operational risk) component of the risk management framework should include:

- Defining the systems and operations risk and establishing tolerance limits for each material risk areas, which may include business process risk, business continuity

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

- risk, compliance risk, information systems risk, distribution channels risk, fraud risk, human resources risk, and outsourcing risk;
- Establishing a system to identify systems and operations exposures, and to capture and track systems and operations near-miss data;
 - Establishing a system of effective internal reporting and operating controls (including IT infrastructure) to manage and appropriately mitigate the systems and operations risk;
 - Establishing measurement techniques, such as stress and scenario testing, to assess the vulnerability of the insurer; and
 - Establishing frequent reviews to ensure mitigation strategies, such as an early warning system, has been effectively deployed and the systems and operations risk is within a tolerable limit.

4.1.6 Group Risk

39. The group risk component of the insurer's risk management framework should include:

- Identifying the group structure and interrelationships, including ownership and management structure;
- Identifying and measuring material intra-group transactions and exposures, including intra-group guarantees and contagion risks; and
- Evaluating and executing strategies to mitigate group risk and ensure that the insurer is operating within its tolerance levels, as established by the board and the chief and senior executives.

4.1.7 Strategic Risk

40. The strategic risk component of the insurer's risk management framework should include:

- Developing processes and procedures to ensure the execution of the insurer's overall organisational strategy; and
- Developing techniques to measure the effectiveness of the insurer's strategy as compared to the desired objective, to monitor the performance of the resources as they discharge responsibilities, and to mitigate and respond to exposures and risks arising while implementing strategies.

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

41. The insurer should pay particular attention to the resources that will be needed to accomplish the strategic objectives including internal and external resources, and tangible and intangible resources.

4.1.8 Reputational Risk

42. The reputational risk component of the insurer's risk management framework should include:

- Procedures to identify and monitor potential reputational risks; and
- Methodologies to understand the impact of other material risks as they relate to the insurer's reputation.

4.1.9 Legal / Litigation Risk

43. The legal / litigation risk component of the insurer's risk management framework should include developing mitigation and monitoring techniques to ensure compliance with internal and jurisdictional laws and regulations; safeguarding of policyholder and organisational assets; market discipline; and financial or public reporting. This includes:

- Ensuring that the management and access of records meet requirements established by laws and regulations;
- Complying with internationally recognised contract certainty standards and codes; and
- Maintaining appropriate documentation of all transactions such as documentation on investments, underwriting, and claims management transactions, and agreements (e.g. custodian, investment management, letters of credit, debt agreements, etc.).

4.2 Policies and Procedures

44. The insurer should clearly document significant policies and procedures surrounding its risk management and internal controls framework, including significant policies on internal audit and outsourcing. The operating and oversight responsibilities should be clearly defined and reporting of material deficiencies and fraud activities should be transparent and devoid of conflicts of interest.

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

45. Significant policies and procedures should be reviewed at least annually to ensure that they continue to support the overall operational strategy. Where appropriate, an insurer may take a risk-based approach to its review spanning over several annual periods.

46. The design and effectiveness of the risk management and internal controls framework should be regularly assessed and reported to the board and the chief and senior executives to ensure amendments are incorporated as appropriate. Internal controls should facilitate effective and efficient operations and should address the organisational structure, in particular:

- Duties and responsibilities;
- Decision-making authority and procedures;
- Segregation of duties; and
- Internal monitoring and reporting.

47. Further, the insurer should establish sound accounting and financial reporting procedures and practices. The accounting and supporting records should provide a timely, complete, and accurate representation of the insurer's financial position.

5. GOVERNANCE MECHANISM

48. Conducting business in a prudent manner should also include the insurer establishing sound governance mechanisms. These should be embedded in the corporate governance and risk management framework and their effectiveness assessed frequently. Functions assisting the board with its oversight responsibilities may be internally developed, such as independent risk management, internal audit and/or compliance functions, or outsourced to third-party service providers, as appropriate, given the insurer's risk profile.

5.1 Risk Management Function

49. The insurer should establish a function to assist it with the oversight responsibility of the organisation's risk management framework. Depending on its risk profile, the function may be headed by a Chief Risk Officer or the responsibilities shared amongst the operational unit leaders at the insurer. Regardless, there should be a mechanism to allow direct reporting to the board or its established committees. The board should ensure the fitness and propriety of the individual(s) entrusted with the responsibility.

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

50. The risk management function should include:

- Establishing clearly defined and documented roles and responsibilities that are reviewed and approved by the board on a frequent basis;
- Establishing a sound and effective risk management framework including developing (with the support of operational unit leaders) policies, procedures, and internal controls promoting the identification, evaluation, mitigation, monitoring, and reporting of material risks;
- Assessing the effectiveness of policies, procedures, and internal controls and compliance with established policies (e.g. investment, underwriting, etc.), tolerance limits, and strategies;
- Employing measurement techniques such as benchmarking or stress and scenario testing; and
- Reviewing on a regular basis the risk management techniques employed in light of changing operational, regulatory, and market developments to ensure continued effectiveness and adoption of international best practice.

5.2 Internal Controls

51. The board and the chief and senior executives should review and assess the effectiveness of the internal reporting and operating controls. Material deficiencies should be documented and resolution measures should be implemented in a timely manner. The board and the chief and senior executives should also develop policies and procedures that require direct reporting of internal control weaknesses to them.

5.3 Internal Audit Function

52. The insurer's internal audit function should:

- Have clearly defined and documented roles and responsibilities that are reviewed and approved by the board on a frequent basis;
- Document material policies and procedures to be approved by the board, at least annually (see paragraph 45);
- Have unrestricted access to all areas of the organisation, including access to records held at third-party service providers;
- Examine operational practices to ensure compliance with jurisdictional laws and regulations, and internal policies, procedures, and controls;

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

- Have appropriate authority within the organisation to ensure management addresses current and prior period recommendations, including those arising from the reviews conducted by external auditors;
- Have sufficient resources and fit and proper staff to carry out duties and responsibilities;
- Have sufficient knowledge and experience to employ methodologies designed to assist the insurer in identifying key risks; and
- Assist the board to identify areas for improvement in light of the changing operating environment.

5.4 Compliance Function

53. The insurer should develop a function to assist it to monitor and evaluate its compliance to internal controls, policies, and procedures, and external laws and regulations. This function may be delegated to third-party service providers or internal audit.

5.5 Actuarial Function

54. The insurer should establish an effective actuarial function based on the nature, scale, complexity, and profile of risks to which the insurer is exposed. The function may be outsourced to third-party service providers; however, it may be performed by the approved loss reserve specialist (general business insurers) or approved actuary (Long-term insurers) in addition to their respective responsibilities to the Authority.

55. Activities of the actuarial function include:

- Performing or overseeing the estimation of policyholder obligations, including assessing the adequacy of methodologies and assumptions and the quality of underlying data;
- Assisting in the execution of the risk management framework particularly as it relates to modelling techniques used to estimate policyholder obligations, potential exposures, and capital requirements;
- Assisting with the underwriting process, including those surrounding pricing and writing of underwriting contracts and risk transfer mechanisms (e.g. ceding reinsurance, derivative instruments, catastrophe bonds, etc.);

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

- Performing analysis comparing the estimated policyholder obligations against actual policyholder obligations paid; and
- Reporting to the board and the chief and senior executives on the dependability and sufficiency of the estimates.

56. The insurer should ensure the fitness and propriety of the individuals performing the actuarial function. This includes retaining individuals with the appropriate qualification in actuarial science or mathematics, and knowledge and experience in the industry.

5.6 Self-Assessment

57. The insurer must develop policies, processes, and procedures to assess its material risks and self-determine the capital requirement it would need to support its insurance undertaking, at least annually. The insurer should be guided by the proportionality principle in establishing the framework. Minimally, the assessment should:

- Be an integral part of the insurer's risk management framework;
- Be clearly documented, reviewed, and evaluated regularly by the board and the chief and senior executives to ensure continual advancement in light of changes in the strategic direction, risk management framework, and market developments; and
- Ensure an appropriate oversight process whereby material deficiencies are reported on a timely basis and suitable actions taken.

58. The insurer should ensure the fitness and propriety of key individuals overseeing and performing the assessment; this includes third-party service providers assisting with assessment procedures.

59. Upon implementation of the Own Risk and Solvency Assessment framework, relevant insurers must follow standards, guidance, and requirements established in place of the self-assessment noted above.

6. OUTSOURCING

60. Where the insurer outsources functions either externally to third parties or internally to other affiliated entities, the insurer should have oversight and clear

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

accountability for all outsourced functions as if these functions were performed internally and subject to the insurer's own standards on corporate governance and internal controls. The insurer should also ensure that the service agreement includes terms on compliance with jurisdictional laws and regulations, cooperation with the Authority, and access to data and records in a timely manner.

7. MARKET DISCIPLINE AND DISCLOSURE

Retail Business

61. If the insurer conducts retail business, it must establish and maintain properly documented systems, controls, and procedures to enable on going monitoring of compliance with the market conduct outlined in this section. A policy statement on the treatment of policyholders should be developed and approved by the board. This policy statement should be communicated to all relevant staff and appropriate training should be provided to ensure compliance by personnel and any authorised sales representatives.

62. Where the insurer grants terms of business to an authorised intermediary (see paragraph 71) in respect of retail business, the insurer must:

- Ensure that the terms of business agreement have been completed and signed by the authorised intermediary to require the authorised intermediary to warrant that the agreement does not breach any legal obligations, and that the authorised intermediary will clearly explain the risks inherent in the product to policyholders or prospective policyholders; and
- Take measures to monitor the performance of the authorised intermediary, including complaints made against the authorised intermediary with respect to advice or sales made by the authorised intermediary on behalf of the insurer.

7.1 Responsibility to Policyholders

63. The insurer must make certain that its business is conducted in such a way as to treat its policyholders fairly, including through dealing appropriately with conflicts of interest and disclosing relevant information.

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

7.2 Integrity and Fair Dealing

64. The insurer should observe high standards of integrity and fair dealing in the conduct of its business. The insurer must avoid misleading and deceptive acts or representations. It should not seek to exclude or restrict any duty or liability to a policyholder unless the liability is clearly excluded from the policy. Additionally, it should not seek to rely unreasonably on any provision of a contract seeking to exclude or restrict any such duty or liability.

65. The insurer should either avoid any conflict of interest arising or, where a conflict arises, should ensure fair treatment to affected policyholders through disclosure, internal rules on confidentiality, declining to act, or otherwise, as appropriate. The insurer must not unfairly place its interests above those of its policyholders.

7.3 Skill, Care and Diligence

66. The insurer should act with skill, care, and diligence in the conduct of its business and in its dealings with policyholders. Where the insurer is responsible for providing advice or exercising discretion for, or in relation to, policyholders, it must be able to demonstrate that the advice is appropriate for the policyholder. It should seek from them such information about their circumstances and objectives as may be appropriate with regard to the services requested. Any information that a policyholder can reasonably expect to be kept confidential should be treated as such.

67. The insurer should transact its business (including the establishment, maintenance, transfer, or closure of business relationships with its policyholders) in an expeditious manner.

7.4 Disclosure and Information

68. The insurer should take reasonable steps to give policyholders, in a comprehensible and timely way, information to assist their decision making while avoiding misleading or deceptive representations or practices. The insurer should communicate in writing:

- Relevant and meaningful information in a timely and comprehensive manner before entering into a contract;
- Benefits and risks to the policyholder in a fair and balanced way;

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

- Obligations of the parties involved, including those for insurers, intermediaries, policyholders in a clear and understandable way, for the duration of the contract;
- Complaints handling and other contractual arrangements; and
- Duty of policyholders to disclose material information.

69. The insurer should be prepared to provide a policyholder with a full and fair account of the fulfilment of its responsibilities. The frequency with which additional information is to be disclosed during the course of the contract depends on the type of contractual arrangement. Reasonable care should be taken to ensure that the information disclosed is accurate in all material respects, not misleading, easily understandable, and available in writing or through appropriate electronic means.

7.5 Policyholder Assets

70. Where the insurer has control of, or is otherwise responsible for, assets belonging to a policyholder, the insurer must arrange proper protection. Protection can be by way of segregation and identification of those assets or otherwise, in accordance with the responsibility it has accepted. Such protection must be in compliance with the terms and conditions established in the contractual agreement and authorised by the policyholder.

7.6 Authorised Intermediaries

71. The insurer is required to take responsibility for the appointment and activities of authorised intermediaries. In this respect, the insurer must, in relation to its authorised intermediaries who are carrying on business in Bermuda:

- Ensure they are registered with the Authority; and
- Ensure that they provide policyholders and prospective policyholders with the name of the insurer represented by the authorised intermediary and the types of product(s) the authorised intermediary is authorised to sell and / or provide advice on, on behalf of the insurer.

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

7.7 Advertisements

72. The insurer should ensure that its advertisements:

- Do not contain a statement, promise or forecast that is untrue or misleading;
- Are not designed in such a way as to distort or conceal any relevant subject material;
- Are clearly recognisable as advertisements;
- Do not contain a statement relating to taxation benefits unless it contains appropriate qualifications to show what it means in practice and to whom such benefits apply
- Include a statement of the related risks; and
- Do not contain a statement relating to past performance unless:
 - The basis on which such performance is measured is clearly stated and the presentation is fair;
 - It is accompanied by a warning that past performance is not necessarily a guide to future performance; and
 - The past performance is relevant to the investment or the services offered by the investment provider.

73. If the insurer undertakes long-term business, the insurer in its promotional material should endeavour to impress upon policyholders that a whole life or endowment policy is intended to be a long-term contract and that surrender values, especially in early years, are frequently less than the total amount of premiums paid.

7.8 Complaints Procedure

74. The insurer must have procedures in place, as appropriate, to deal with policyholder complaints effectively and fairly through a simple and equitable process. These procedures should be well disclosed and easily accessible. A record of the details of the complaint, the insurer's response and any action taken as a result, must also be made and retained.

BERMUDA MONETARY AUTHORITY
CONSULTATION PAPER ON THE INSURANCE CODE OF CONDUCT
SEPTEMBER 2009

8. IMPLEMENTATION AND TRANSITIONAL PERIOD

75. The implementation of the Code begins on July 1st 2010 with a transitional period extending to December 31st 2010.