



BERMUDA MONETARY AUTHORITY
COMMERCIAL INSURER RISK ASSESSMENT (“CIRA”) PROCEDURES – CLASS
4 INSURERS OPERATIONAL RISK CONSULTATION PAPER
JUNE 18, 2008

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Commercial Insurer Risk Assessment (“CIRA”) Procedures – Class 4 Insurers

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0. Introduction

1. This paper outlines the Bermuda Monetary Authority’s (“the Authority”) proposed procedures to be followed by Class 4 insurers (“the insurer”), as defined under Section 4 of the Insurance Act 1978 (“the Act”) to be read in conjunction with Section 1 of the Act in relation to the Commercial Insurer Risk Assessment (“CIRA”).

2. The views of the insurance industry and of other interested persons on the proposals set out in this paper are invited. Comments should be sent to policy@bma.bm no later than July 20, 2008.

3. Operational risk is the risk of loss arising from inadequate or failed **internal processes, people, systems or external events**. Operational risk also includes **legal risks**. Reputation risks arising from strategic decisions do not count as operational risks.¹

4. The CIRA is to be completed by every Class 4 insurer and submitted to the Authority with the Bermuda Solvency Capital Requirement (“BSCR”) model as prescribed by the [Insurance (Prudential Standards Class 4 Solvency Requirements) Order 2008] (“the Order”).

5. The CIRA will serve primarily as a tool to enhance the Authority’s risk-based supervisory framework. The CIRA will form part of the onsite supervisory process which will complement the existing, and where applicable, enhance the Authority’s examination of insurer’s operational processes and related risk exposures. The CIRA will also assist the Authority in determining the Operational Risk Charge to be assigned to the insurer for the purposes of determining its Enhanced Capital Requirement (“ECR”) as defined under the Order. The Operational Risk Charge percentage will be applied to the “BSCR (After Covariance Adjustment)” subtotal in the BSCR model to arrive at the Operational Risk Charge dollar amount.

¹ CEIOPS–DOC–23/01: QIS4 Technical Specifications

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6. The insurer must undertake a self-assessment and document the results on the CIRA. In the absence of other evidence, the Authority will accept the CIRA Operational Risk Charge assessed by the insurer. Where there is a difference of opinion, the insurer will be able to exercise its right to appeal the Authority's decision through the Appeals process, as outlined below.
7. In an effort to avoid re-assessment by the Authority, the insurer is encouraged to retain documentation supporting its assessment in the event such documentation is requested for inspection by the Authority's Onsite function.
8. The CIRA is to be signed by the insurer's Board of Directors.

1. Operational Risk Insurer Self-Assessment Framework

9. The CIRA Framework contains questions designed to prompt the insurer to assess the quality of its risk management function with respect to its operational risk exposures.
10. Seven operational risk areas are included in the CIRA:

Business Interruptions and Systems Failures Risk: includes utility disruptions, software and hardware failure.

Business Process Risks which include data entry and data processing errors arising from application design misspecifications.

Clients, Products and Business Practices Risks which include mis-selling and product defects.

Compliance Risks which include legal and regulatory breaches.

Damage to Physical Assets Risks which include damage arising from natural disasters and vandalism.

Employee Practices and Workplace Safety Risks which include workers' compensation and employee health and safety.

Fraud Risks which include intentional misconduct or unauthorized activities such as misappropriation of assets, information theft, forgery and fraudulent claims.

11. The CIRA Framework recognises that the Corporate Governance function serves a critical role in promoting a risk culture within the organisation. The Corporate Governance function, by extension, is also responsible for creating an appropriate risk

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management structure. Therefore, the CIRA highlights standards with respect to Corporate Governance and Risk Management, and provides insurers with credit for instituting such standards.

12. The Risk Management process to be assessed in the CIRA, is segmented into six areas: Risk Identification, Risk Measurement, Risk Control, Risk Mitigation, Risk Monitoring and Risk Reporting. The insurer will undertake a self-assessment by answering questions related to the calibre of the risk management process in each operational risk area.

13. The Authority encourages insurers to consistently review and improve upon their risk management practices. As a result, the CIRA embodies a maturity model approach to capture an insurer's progression or developmental stage and rewards that insurer for advancement.

14. To benefit from the credit attributed to a developmental stage, an insurer must fulfil all criteria in the associated "Description" or "Dimension". Where an insurer falls in between progression steps, the insurer must select the lower stage of progression and will receive credit for that lower developmental stage.

15. The total scores for each CIRA component are aggregated. The CIRA Framework provides instruction with respect to mapping the insurer's score to the relevant Operational Risk Charge. Subject to the Authority having a differing of opinion, this Operational Risk Charge will be applied against the insurer's "BSCR (After Covariance Adjustment)" to generate the Operational Risk Capital Charge, which will range between 1% and 10% of the "BSCR (After Covariance Adjustment)". The Operational Risk Capital Charge contributes towards the insurer's Enhanced Capital Requirement for the year-end filing.

16. A reassessment qualifies as a Capital Add-on and is governed by section 6D of the Act [draft Insurance Amendment Act 2008 ("the Amendment Act")].

2. Appeals

17. The Authority supports due process and proposes to introduce an appeals process for insurers having a difference of opinion regarding the Authority's rating.

18. Where there is a difference of opinion in a given assessment Dimension or framework area (arising from the Authority performing an Onsite assessment), the Authority will notify the insurer. The Authority will also give reasons for its opinion. The insurer must then use the Authority's score with respect to the given assessment area for all subsequent filings of the CIRA until such time as the insurer has satisfied the Authority that the score should change, and the insurer has received written permission from the Authority to alter the score. The adjustment or charge will come into effect at

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least 90 days from the date of notification or an extended period as the Authority may determine. The Authority will apply all changes prospectively from the date of notification.

19. Where the Authority has notified the insurer of a difference of opinion, the insurer will be given 28 days to appeal the decision to an in-house panel comprising of Risk, Actuary and Supervisory staff members at the Authority. The adjustment or charge will not come into effect until the in-house panel has completed its review and rendered a decision.

20. Should the insurer decide that it will not appeal the decision rendered by the in-house panel, the adjustment or charge will come into effect at least 90 days after the date of notification or an extended period as the Authority may determine.

21. The insurer may appeal before a Tribunal pursuant Section 44A of the Act [the Amendment Act] if it is aggrieved by the Authority's in-house panel's decision.