8 December 2022

NOTICE

Bermuda Monetary Authority (Authority or BMA) to Make Targeted Enhancements to Regulatory and Supervisory Regimes for Commercial Insurers[1]

This Notice informs stakeholders about upcoming enhancements to Bermuda's regulatory regime for commercial insurers. These enhancements will be consulted on with the market in the early part of 2023. The enhancements, mostly focused on the regulatory and supervisory frameworks for Long-term (Life) insurers, are aimed at ensuring that the regime continues to remain fit for purpose, in line with international standards and keeps pace with the market developments. The Notice also shares information about the cornerstones of Bermuda's regulatory and supervisory regime and a reflection of Bermuda market's contribution to policyholder protection over the years, including the US$13 billion gross losses relating to Hurricane Ian expected to be paid by Bermuda insurers to United States (US) policyholders, which is up to 25% of the industry losses.

Upcoming Proposed Enhancements

1. The BMA is confident that the cornerstones of the regulatory regime for Commercial Insurers are sound. The Authority continually monitors trends, and market developments, including evolving risks and business models, and adjusts its regime accordingly to international standards. This is consistent with our regulatory peers in key jurisdictions, such as the European Union and its Solvency II framework reviews, and the United States with its enhancements via the National Association of Insurance Commissioners (NAIC). Additionally, like other peer regulators, the BMA is assessing the adequacy of existing regulatory tools with a view to ensure that we continue to capture the risks and enhance the level of disclosures and transparency.

2. In this context, the Authority deems it appropriate to perform targeted enhancements to our regulatory regime and will issue a consultation paper in the first quarter of 2023. Again, these enhancements will primarily focus on our regulatory framework for Long-term (Life) insurers. The enhancements will cover technical provisions, Bermuda Solvency Capital Requirement (BSCR) computation and flexibility of the BSCR framework.

[1] Insurer on this statement encompasses Direct Insurers, Reinsurers and Insurance Groups.

3. Most recently, the BMA enhanced investment reporting, which is effective at the 2022 year-end. These enhancements were introduced to ensure that the asset regulatory reporting and disclosure requirements remain appropriate, considering the evolution of asset allocations and investment strategies adopted by Commercial Insurers and Insurance Groups. The enhanced reporting requirements will provide the Authority with more detailed information and visibility of the risks posed by insurers' differentiated investment strategies. The enhanced disclosures will also support the Authority's prudential assessment of the exposure to illiquid and other non-traditional assets, including but not limited to private debt and other structured assets.

4. Insurers with high asset allocations to illiquid and other non-traditional assets can expect intensive and comprehensive supervisory engagement as part of the Authority performing detailed analysis of the asset strategy in the context of prudent management of insurance liabilities. The Authority also expects insurers' Own Risk Self Assessments (ORSA) to demonstrate that the insurer can properly identify, measure, monitor, manage, control and report risks associated with illiquid assets and appropriately take these into account in the assessment of its overall solvency and liquidity needs. The data used to support the investment decision and ongoing risk management must be high-quality (complete, accurate and appropriate).

5. More broadly, the Authority will further intensify deep dives on the following: investment strategy, liquidity, asset liability management, risk management, intra-group transactions and affiliated relationships, governance and solvency. Where concerns are noted, as consistent with existing BMA practice, there could be a need for the imposition of additional measures such as additional reporting on assets, bespoke stress testing, capital and reserve add-ons, investment restrictions, dividend restrictions and the requirement for additional sources of capital to be put in place.

6. The Authority regularly revisits capital charges using the data it gathers from regulatory reporting and will reassess the adequacy of the capital charges of specific structured assets and may perform regulatory changes taking into account data and emerging trends.

7. In terms of technical provisions, the Authority seeks to perform changes to the standard discount curve for liabilities denominated in Euros, changes to the calculation of the risk margin for Insurance Groups (to be thereafter done on an unconsolidated basis) and changes to the scenario-based approach (SBA). The SBA changes will include enhanced modelling, governance, validation, stress testing and reporting requirements.

8. Regarding the calculation of the BSCR, changes will be made to the "other Long-term insurance risk capital charge" to increase its risk sensitivity for lapse and expense risks. Changes will also be made to catastrophe risk charges to better capture man-made risks.

9. BMA aims to revise its framework regarding application processes for modifying specific BSCR parameters in situations where the BSCR framework may not adequately reflect the insurer's risk

profile as per Section 6D of the Insurance Act 1978. The revisions will seek to ensure that the framework is more clearly defined, standardised, and transparent in terms of scope and requirements. Among other things, it will help provide insurers with a better understanding of the areas and/or circumstances where an application for adjustments to the standard BSCR framework may be allowed if it does not adequately reflect insurers' risk profile without requiring the approval of a full or partial internal model for regulatory capital purposes.

10. The BMA will also issue a consultation paper in 2023 on Insurance Rules governing recovery plans, building on the amendments to the Insurance Act 1978 in 2022 that gave the BMA formal powers to require recovery plans from insurers. We will also work on developing a resolution planning and the powers framework will continue.

Supervisory Regime

11. In addition to changes to the regulatory regime and reporting requirements, the Authority will also make targeted enhancements to the supervisory review process and published information on the market to further enhance good governance and risk management practices, transparency, and market discipline.

12. Insurers will be required to disclose to the Authority the nature and characteristics of all assets, including funds held by ceding insurers. These characteristics shall include all forms of direct and indirect private debt and loans, structured assets, alternative assets, and derivatives. In addition, the Authority will strengthen existing requirements related to liquidity, in particular stress testing, contingency funding plan and risk management reporting. Insurers will be required to identify all related party-originated investments (and other activities) and the potential conflict of interest associated with the related party activities and disclose how the potential conflict is managed.

13. The Authority's expectation is also that insurers' ORSAs will include a detailed description of the insurer's asset liability management, risk management infrastructure and governance, as well as evidence of proper due diligence prior to the investment decisions and ongoing risk management support.

14. Insurers must also demonstrate that management and boards have the requisite skills and expertise and control frameworks to understand, manage and mitigate the wide range of risks underlying their selected asset classes. This knowledge and skillsets should not be limited to investment teams but extend through all the lines of defence and the governance structure (risk management, internal audit, actuarial and the board).

15. The BMA intends to strengthen supervisory cooperation and exchange of information and continue to have a leading role in developing international insurance standards. The BMA will enhance the level of information that it publishes for all segments.

16. The continued development of the Bermuda insurance marketplace has enabled BMA to acquire valuable supervisory experience over the years and to build out internal expertise to address the risks posed by relevant new business models and innovation. The Authority has added a large number of new positions in insurance supervision, especially in the last five years, increasing the number of actuaries and investment specialists. For the BMA to continue to conduct effective supervision adequate to its market nature, scale and complexity, it will continue to increase the resources allocated to supervisory activities, particularly in areas requiring specialised expertise.

Bermuda Regulatory Regime

17. The Bermuda Monetary Authority continues to act in the public interest to promote financial stability and policyholder protection through effective and efficient supervision and regulation of our registrants.

18. The Authority has developed over the years a robust risk-based solvency regime for the Commercial Sector that is appropriate to our market's nature, scale and complexity and in line with international standards as attested by international evaluations.

19. Bermuda Insurance risk-based solvency regime was first implemented in 2008 for Property and Casualty (P&C) Insurers with the development of the BSCR, which was refined and expanded to Long-term Insurers and Groups in 2011. The regime has been subject to additional improvements over the years.

20. The Bermuda Solvency Regime is anchored and addressed in three Pillars:
    - Pillar One – Quantitative requirements
    - Pillar Two – Qualitative requirements, supervisory review process and powers
    - Pillar Three – Supervisory reporting and public disclosure

21. Our regime's Pillar One quantitative requirements are predicated on risk-based capital requirements, an economic valuation framework of assets and liabilities, and criteria and limits for what constitutes eligible capital and surplus for regulatory purposes.

22. Our capital requirements are calibrated to Tail Value-at-Risk (TVaR) at a 99% confidence level over the one-year time horizon for all quantifiable material risks. Assets and liabilities are measured consistently according to the Economic Balance Sheet (EBS) framework – an economic valuation framework. Insurance technical provisions are decomposed into a best-estimate liability component and a risk margin component. Eligible capital and surplus are determined by evaluating capital instruments under the following criteria: loss-absorbing capacity, subordination, maturity, permanency and absence of encumbrances and mandatory charges. Additionally, they are subject to a three-tier system that sets limits in terms of the composition of such funds, ensuring that policyholder obligations are covered by high-quality capital.

23. Pillar Two of our regime sets out requirements for risk management, governance and insurers' ORSA. Each insurer is required to assess the adequacy of its risk management system as well as the current and prospective solvency positions under normal and severe stress scenarios. This ensures that the regulatory framework is combined with each insurer's own risk management system to further enhance policyholder protection. As a result, the Authority utilises a wide range of supervisory tools throughout the lifecycle of regulated entities, including taking preventive, enforcement and remedial actions where necessary. Insurers are subject to both regulatory and insurer-specific stress and scenario testing covering a wide variety of risks, including investment and biometric risks. The Authority also conducts onsite and offsite inspections, focusing on critical areas, such as investment strategy, liquidity and asset liability management, risk management, governance, and solvency and capital adequacy. In support of cross-border collaboration and transparent exchange of information, the Authority establishes robust group supervision that includes actively hosting supervisory colleges at least annually to jointly assess insurers' risks and formulate work plans. We also actively participate in various other supervisory colleges and engage in bilateral discussions as needed.

24. Under Pillar Three, the Authority receives a wealth of information from Commercial Insurers, including but not limited to GAAP financial statements, statutory financial statements and statutory declaration of compliance, the capital and solvency return (which includes the EBS, key business, financial and actuarial information, stress testing results, the ORSA report and regulatory capital requirements, inter alia) and actuarial opinion. The Actuarial Opinion is provided by a BMA approved qualified actuary and provides an independent assurance of the reasonableness of the technical provisions. Our Commercial Insurers need to publicly disclose the GAAP financial statements, the statutory declaration of compliance and the financial condition report, which includes information on business and financial performance, governance, structure, risk profile, solvency valuation, capital management and subsequent events.

25. Bermuda's regulatory framework for Commercial Insurers complies with the Insurance Core Principles of the International Association of Insurance Supervisors (IAIS). The BMA is a founding member of the IAIS and actively participates in the organisation's work with representation at nearly all Committees and Sub-committees and holding several leadership positions. Our supervisory approach is risk-based and forward-looking and adheres to international best practices. Our regulatory and supervisory frameworks have been assessed and continue to be regularly assessed by international regulatory setting bodies, including the European Commission, which granted Bermuda Full Solvency II Equivalence and the US NAIC, which granted Bermuda Qualified and Reciprocal Jurisdiction status. The continuous dialogue and sharing of information and ideas with these bodies and other international peer regulatory bodies allow Bermuda to maintain its regulatory and supervisory frameworks at the international best practice level.

26. The Supervisory collaboration aimed at transparency and the exchange of information is critical in the supervision of Bermuda insurers. This is achieved through mechanisms such as group-wide supervision. In addition, written regulator-to-regulator inquiries and bilateral meetings between the original and reinsuring jurisdictions are an avenue for any arising concerns to be discussed and

resolved. The BMA is a signatory of the IAIS Multilateral Memorandum of Understanding (MoU) and has signed nearly 30 MoU with foreign insurance regulators worldwide, including in the US and Europe.

Bermuda's market contribution to policyholder protection

27. The robustness of the Bermuda regulatory regime has sustainably enabled global policyholder obligations to be met while ensuring the financial stability of the Bermuda market and contributing to the reduction of the protection gap by both stabilising rates through the provision of reinsurance capacity, especially in catastrophe-exposed regions but also by supporting the development of new insurance products. Bermuda insurers estimate that they will incur gross claim losses of US$13 billion as payments to US policyholders and cedants to cover the damaging effects of Hurricane Ian, which made landfall in Florida in September 2022, causing catastrophic damage to property and loss of human life. Based on publicly available estimates from catastrophe risk modellers, (re)insurance losses resulting from Hurricane Ian are expected to be in the top ten of the costliest catastrophe events in the US, with estimated totals of between US$50 billion and US$75 billion.

28. Furthermore, Table 1 below shows gross payments by Bermuda insurers to US, UK and EU policyholders and cedants for large catastrophes, P&C losses and life insurance claims. This demonstrates Bermuda's important role in supplying risk capacity across the globe.

Table 1

	2016 - 2021			**1997 - 2021**
	P&C	**Life**	**Total**	**Total**
	(US$ Billion)	(US$ Billion)	US$ Billion	(US$ Billion)
United States	164	137	301	490
United Kingdom	32	13	45	75
European Union	31	8	39	70

The data in Table 1 does not include losses covered by the majority of insurers in Bermuda's insurance-linked securities sector. Including losses covered by this sector in the data would result in even larger loss payments.