

EIOPA Advice to the European Commission

Equivalence assessment of the Bermudan supervisory system in relation to articles 172, 227 and 260 of the Solvency II Directive

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Chapter I: Introduction

Section 1 - Equivalence assessments under Solvency II – a brief summary:

1. Under the Solvency II directive the European Commission may determine whether the solvency regime of a third country is equivalent to that laid down in Solvency II in relation to three areas of focus. Article 172 relates to equivalence of the solvency regime applied to the reinsurance activities of insurers¹ with their head office in the third country concerned, where a positive determination would allow reinsurance contracts with insurers in that third country to be treated in the same way as reinsurance contracts with EEA insurers. Article 227 relates to third-country insurers which are part of EEA groups, where equivalence would allow groups to take into account the local calculation of capital requirements and available capital rather than calculating on a Solvency II basis for the purposes of the deduction and aggregation method. Article 260 relates to group supervision of EEA insurers with parents outside the EEA, where equivalence would mean EEA supervisors would rely on the group supervision of that third country.
2. The European Commission's Call for Advice of 11th June 2010 asked CEIOPS (EIOPA's predecessor organisation) to provide final advice on whether the supervisory regimes of certain third countries satisfy the general criteria for assessing third country equivalence. In its letter of 29th October 2010 the European Commission indicated that Bermuda should be assessed for equivalence under articles 172, 227 and 260. EIOPA was invited to provide its advice, by the end of September 2011, following full consultation.
3. In accordance with the methodology for equivalence assessments which can be found in consultation paper 82), we published a Call for Evidence on 1st December 2010, in which we invited interested parties to provide information and evidence on relevant aspects of the supervisory practices and insurance regulatory regime in Bermuda, based on their own experiences. EIOPA also invited the BMA (the Bermuda Monetary Authority) to complete a questionnaire on its regulatory regime and supervisory practices, in particular in relation to those areas relevant to the equivalence criteria. Following receipt of the responses, in February EIOPA commenced a desk-based review of the information received which lasted approximately three months and included an additional round of questions. This was followed by an on-site visit to clarify further our understanding of the Bermudan regime and supervisory practices, which included meeting with members of the Bermudan industry, followed by some further written queries.
4. Equivalence assessments are expected to take into account the principles contained in the Solvency II directive, as well as the general criteria for assessing third country equivalence to be found in the Level 2 Implementing Measures. The criteria (principles and objectives) set out in this report reflect those published in our previous consultation papers, however in our analysis we have aimed to take into account the most recent draft of the criteria which was available to us: we will review this advice again once the Level 2 Implementing Measures are finalised to check that it is consistent with the final published proposals. It is expected that our findings regarding the Bermudan supervisory regime for captives in particular will be revisited at that stage.
5. Statements in this report are based on Bermudan legislation and information

¹ Please note that throughout this report, where reference is made to "insurers" or "insurance" this includes reinsurers and reinsurance, unless otherwise specified.

received for the purposes of the assessment, predominantly from the BMA, including the responses to the questionnaire and further questions described above, as well as BMA statements during our on-site visit. We also note that we refer only to the regulations applying to those insurers which would, by virtue of their size and the nature of their activities, fall within the scope of the Solvency II Directive.

Section 2 - EIOPA methodology:

6. Our methodology is set out in greater detail in our consultation paper 82.
7. There are a number of over-arching principles under-pinning the assessment:
 - Equivalence assessments aim to determine whether the third country supervisory system provides a similar level of **policyholder and beneficiary protection**.
 - Supervisory cooperation under conditions of **professional secrecy** is a key, determinative element of a positive equivalence finding. When assessing the criteria relating to professional secrecy, the principle of proportionality will not apply.
 - The equivalence assessment is a **flexible process** based on principles and objectives (embedded in the general criteria for assessing third country equivalence). All the applicable criteria (the principles and objectives) need to be met for a positive equivalence assessment; there are a number of indicators associated with these principles to help to guide the assessment, but a positive equivalence assessment does not require that every indicator be fulfilled.
 - When pursuing an equivalence assessment, proper consideration should be given to the adequacy of third country practice in applying the **proportionality** principle. This is further developed below.
 - An equivalence judgement can only be made in respect of the **regime in existence** and applied by a third country supervisory authority at the time of the assessment. Plans and on-going initiatives for changing the national supervisory regime should not be considered an adequate support for a positive equivalence finding until the day of their actual implementation. Nevertheless, these initiatives should be taken into account, with due consideration given to their expected timing and the degree of commitment to them, when performing an equivalence assessment and providing advice to the Commission.
 - Assessments will be **kept under review** and take into account any developments that might lead to relevant changes in the third country supervisory regime. EIOPA will review its advice at least every 3 years or upon learning of significant developments within jurisdictions already found equivalent.
8. For a criterion to be considered equivalent, the third country supervisory authority must provide evidence that the relevant national provisions exist and are applied in practice. The process of assessing each principle and objective requires a judgmental weighting of numerous factors.

Proportionality

9. The proportionality principle is embedded in the Solvency II Directive, Article 29 (4) of which states that: “[...] Implementing measures [should ensure] the proportionate application of this Directive, in particular to small insurance undertakings”. Consistently with this, the Directive:

- Recognises that the principle of proportionality should apply to captives, given that they only cover risks associated with the group to which they belong (Article 13 (2) and Recital 21 Solvency II Directive);
 - Introduces a requirement for the system of governance to be proportionate to the nature, scale and complexity of the (re)insurance undertaking's operations (Article 41 (2) Solvency II Directive);
 - Allows for simplified methods and techniques to calculate technical provisions in order to ensure that methods are proportionate to the nature, scale and complexity of the risk supported by the (re)insurance undertaking, including captive (re)insurance undertakings. (Article 86 (h) Solvency II Directive);
 - Allows for simplified calculations for specific risk modules and sub-modules where this is justified taking into account the nature, scale and complexity of the risks faced by insurers, including captives (Articles 109 and 111 Solvency II Directive);
 - Establishes an absolute floor for the MCR (Minimum Capital Requirement) of €1m for captive reinsurers, as opposed to €3.2m for other reinsurers (Article 129 (2d) (ii) Solvency II Directive); and
 - Introduces a requirement for supervisory powers in deteriorating financial conditions to be proportionate and reflect the level and duration of the deterioration of the solvency position of the (re)insurance undertaking concerned.
10. In line with this, in its 1st April 2010 cover letter to the EC, EIOPA stated that equivalence was "a proportionate process. [...] As such, under each of the Chapters, [EIOPA] has advised that the existence of a proportionality principle in the application of regulatory provisions in 3rd country jurisdictions (contingent upon the nature, scale and complexity of the risks inherent in the business) should not be in itself and obstacle [...] to the recognition of equivalence." In its May 2008 advice on proportionality (paragraph 11, page 5), CEIOPS stated that "Proportionality does not mean the introduction of automatic and systematic simplifications for certain undertakings. [...] The individual risk profile should be the primary guide in assessing the need to apply the proportionality principle."
11. EIOPA has taken the principle of proportionality into account in its equivalence assessments in a manner consistent with the above. Under this approach application of the proportionality principle could include discretion for the supervisory authority to apply the requirements in different ways as proportionate, but would not include discretion for the supervisory authority to exempt insurers from certain requirements. For instance, a proportionate application of a requirement for all insurers to have certain function holders could include the supervisory authority being comfortable with a small insurer having one person who holds, for example, the risk management function and actuarial function at the same time; it would not include a small insurer not having one or other of these functions at all.

EIOPA's advice

12. In undertaking the assessment, the finding for each criterion will be given using five categories: equivalent, largely equivalent, partly equivalent, not equivalent and not applicable.
13. EIOPA's overall advice to the European Commission on the country's equivalence for each article will be given as one of the following:

- Country A meets the criteria set out by the Commission.
- Country A meets the criteria but with certain caveats.
- Country A needs to undertake changes in the following areas (...) in order to meet the Commission criteria for equivalence.

Section 3 - The Bermudan insurance sector and legislation – an overview:

Bermuda's Insurance Class System

14. In 1995, the BMA established a multi-licence system to categorise non-life insurers into four classes. In 2008, the Insurance Act was amended to allow for further segregation of Class 3 into small commercial (Class 3A), large commercial (Class 3B) and other insurers (Class 3). This class system is an important specificity of the Bermudan insurance sector. Classes are defined as follows:

- Class 1: single-owner captive insurers insuring only the risks of their owners or of affiliates of the owners. Third party liability risk of the owner can be insured.
- Class 2: single or multi-owner captive insurers deriving up to 20% of their net premiums from unrelated parties.
- Class 3: captive insurers deriving up to 50% of their net premiums from unrelated parties.
- Class 3A: commercial insurers deriving 50% or more of their net premiums (and/or net loss and loss expense provisions) from unrelated parties, where total net premiums from unrelated business are less than \$50 million.
- Class 3B: commercial insurers deriving 50% or more of their net premiums (and/or net loss and loss expense provisions) from unrelated parties, where total net premiums from unrelated business are \$50 million or more.
- Class 4: commercial insurers with capital and surplus² of \$100 million or more, or writing catastrophe business.
- Special Purpose Insurer ("SPI") class: insurers that conduct special purpose business.
- Long-Term Insurers: Insurers writing long-term (or life) business.

15. The 2010 amendments to the Insurance Act provide for a reclassification of the long-term insurers to both recognise existing captive insurance arrangements and facilitate the introduction of new capital and solvency reporting standards. The Insurance Act also provides for Dual Licence insurers. The classes of long-term insurers are:

- Class A: single-owner captive insurers insuring only the risks of their owners or of affiliates of the owners. Beneficiaries for related business may nevertheless be unrelated parties.
- Class B: single or multi-owner captive insurers deriving up to 20% of their net premiums from unrelated parties.
- Class C: commercial insurers with total assets³ less than \$250 million.

² "Capital and surplus" roughly equates to own funds in Solvency II terminology

- Class D: commercial insurers with total assets equal to or greater than \$250 million, but less than \$500 million.
 - Class E: commercial insurers with total assets equal to or greater than \$500 million.
 - Dual Licence: insurers writing a combination of long-term (or life) business and non-life business.
16. The above classifications provide the standard requirements for categorisation, however the BMA may at its discretion license an insurer in a different class from that suggested by the standard categorisation. In particular, the BMA anticipates that some long-term insurers writing business from their parent or affiliates only may nonetheless be licensed in Class C.
17. The provisions for long-term insurers (Classes A to E) has been in force since the beginning of 2011, and the reclassification of long-term insurers into these classes will be completed by end of 2011. EIOPA also notes that BMA intends to apply a regulatory and supervisory regime similar to that applied to Class 4, 3B and 3A insurers to long-term Class C, D and E insurers, as reflected in the consultation on the solvency framework for long-term insurers published in August 2010 and the associated draft legislation (see Annex 2). The significant progress in developing the long-term elements of the solvency regime is recognised, and when EIOPA reviews its advice once the Level 2 Implementing Measures are finalised this aspect of the Bermuda regime will be fully reflected.
18. In this context we also note that further developments to the Bermudan legislation have been announced by the BMA during the public consultation procedure on this report. EIOPA will be reviewing any such developments as part of its review of the current report following Level 2 Implementing Measures agreement. The BMA has made us aware of⁴ the following future initiatives:
- The BMA will issue a consultation paper aimed at enhancing the information required to be submitted in connection with a licensing application to include:
 - i. a five-year business plan,
 - ii. a demonstration of compliance with the ECR in the five-year pro forma balance sheets and income statements,
 - iii. an outsourcing policy, a conflicts of interest policy and a compensation policy.

This would come in addition to planned enhancements to Form 1B, which is submitted in connection with licensing applications.
 - The BMA will also be publishing enhanced criteria for shareholder controller assessments in connection with enhancements to its licensing application requirements.
 - The BMA has a consultative paper scheduled to be issued shortly that would propose the clear segregation and separate capitalisation of non-insurance activities.
 - The BMA will be consulting on a number of proposals including proposals that would require the commercial classes to:

³ Total assets are equivalent to assets held on the balance sheet, less amounts in segregated accounts

⁴ Please see EIOPA template for comments and resolutions for the BM Report – BMA replies.

- i. segregate and make the internal audit function independent from business lines, the underwriting and finance operations and the compliance function;
 - ii. provide prior notice to the Authority of material outsourcing arrangements, with provision for the Authority to object to such arrangements; and
 - iii. publicly disclose compliance with solvency requirements.
- The BMA would also clarify that all insurers must have the key functions of internal audit, compliance, actuarial and risk management.
- The BMA anticipates a comprehensive review of the Code of Conduct to reflect inter alia the requirement for a forward-looking assessment re CISSA and GSSA, to reaffirm that requirement to have a compliance function is applicable to all classes (2012),
- The BMA is also expected to produce proposals aimed at expanding the scope of what would constitute a material change subject to notice to and non-objection by the BMA to include specifically all material portfolio transfers and divestitures, as well as material changes to a business plan.
- The BMA will be publishing a consultative paper on an EBS framework. (Q1 2012)
- The BMA will be publishing a consultative paper covering specific and more detailed processes with respect to supervisory colleges and cooperation in general, information sharing, crisis management, dispute-solving mechanisms and supervisory cooperation with respect to internal models (Q1 2012).
- The BMA is consulting on a requirement to extend quarterly reporting to Class 4 and 3B insurers.
- The BMA will be consulting on a proposal to require all commercial insurers to report directly and immediately to the Authority any non-compliance with the minimum margin of solvency (MSM) or enhanced capital requirement (ECR) and to file a plan with the Authority outlining the actions to be taken by the insurer to restore the MSM and/or ECR to required levels and the timeline for such action.

Overview of the Bermudan insurance market

19. Bermuda plays an important role in the global and European insurance markets, in particular for reinsurance. It is home to 14 of the top 40 reinsurers in the world, and Bermudan groups write 40% of the European property catastrophe reinsurance market, and 27% of broker-placed European reinsurance. Bermuda's insurance market is predominantly focused on wholesale business, with the local retail market making up only around 0.01% of the total.
20. Bermuda's insurance market also has a strong focus on captive insurers, which make up more than half of the insurers supervised by the BMA. As of December 31 2009, the BMA regulated 799 general business captive insurers with gross premiums of \$33.4 billion, net premiums of \$28.5 billion, total assets of \$162.9 billion and capital and surplus of \$61.0 billion (see table

below). It should be noted that the Bermuda captive market has a strong focus on the US as opposed to the EU market as noted in the IMF's 2008 Assessment of Financial Sector Supervision and Regulation; this is also reflected in one of their capital requirements (see below under Principle 6).

21. As it can be seen in the table below, the commercial sector (classes 3A, 3B and 4) write 64.5% of the total non life premiums and captives (classes 1 to 3) 35.5%.
22. Overall, as of December 31 2009, the BMA regulated 1,061 insurers with gross premiums of \$119.8 billion, net premiums of \$106.3 billion, total assets of \$496 billion and capital and surplus of \$182.1 billion. The split of insurers between classes (as set out above) is as follows:

Class of Insurer	No. of insurers	Gross Premiums (\$bn)	Net premiums (\$bn)	Total Assets (\$bn)	Capital and Surplus (\$bn)
Class 1	251 (24%)	3.6 (3%)	2.7 (3%)	15.3 (3%)	9.6 (5%)
Class 2	278 (26%)	8.4 (7%)	6.7 (6%)	41.2 (8%)	18.0 (10%)
Class 3	277 (26%)	21.9 (18%)	19.6 (18%)	91.8 (19%)	28.9 (16%)
<i>Total classes 1-3</i>	<i>806 (767%)</i>	<i>33.9 (28%)</i>	<i>29.0 (27%)</i>	<i>148.3 (30%)</i>	<i>56.4 (31%)</i>
Class 3A	132 (12%)	14.8 (12%)	13.4 (13%)	56.4 (11%)	21.4 (12%)
Class 3B	16 (2%)	15.0 (13%)	11.5 (11%)	36.4 (7%)	15.9 (9%)
Class 4	32 (3%)	31.7 (26%)	27.9 (26%)	146.3 (29%)	71.7 (39%)
<i>Total non-life</i>	<i>987 (93%)</i>	<i>95.4 (79%)</i>	<i>81.9 (77%)</i>	<i>387.5 (77%)</i>	<i>165.4 (91%)</i>
Long-Term	73 (7%)	24.4 (20%)	24.4 (23%)	108.5 (22%)	16.7 (9%)
SPI	1 (0%)	-	-	0.01 (0%)	0.00 (0%)
Total	1061 (100%)	119.8 (100%)	106.3 (100%)	496.0 (100%)	182.1 (100%)

23. Financial information on composites is included under Class 1 to Class 4 data, e.g. Class 1 to 4 gross written premiums includes USD 15.37bn of long term business mainly in classes 3, 3A and 3B).

Overview of the institutional and legal framework for the financial sector of Bermuda

24. Bermuda is a British Overseas Territory; it is self-governing and has its own legal framework. Following a 1966 Constitutional Conference between the UK Government and Bermuda representatives, the Bermuda Constitution Order 1968 (the "Constitution") was enacted as a UK Order in Council. It included provisions relating to the Bermudan Governor, Legislature, Executive, Judiciary, Public Service and Ombudsman.
25. Most recently the Secretary of State of the United Kingdom revised the entrustment to the Government of Bermuda, by letter of entrustment which took effect in December 2009. Under this entrustment the Government is authorised to negotiate and conclude trade agreements related to treatment of goods and services, as well as agreements for technical assistance or of a cultural or scientific nature.
26. **Primary Acts** - Primary acts are laws which are enacted by Bermuda's Parliament and which set down the legislative framework for a regulatory regime. These laws, commonly referred to as statutes, set out the basic regulatory requirements, the regulatory authority, the enforcement powers and offences and penalties which are applicable. Accordingly, the Insurance Act 1978 (IA) is

primary legislation and sets out the framework for regulating persons carrying on insurance business in and from Bermuda. For purposes of the Insurance Act, the definition of insurance business includes the reinsurance business.

27. Parliament may in some instances delegate to a Government Minister or a regulatory body such as the BMA the power to make secondary (subsidiary) legislation such as rules or regulations which will supplement the primary acts and the scope of such rules or regulations, as well as other ancillary regulatory directives such as a statement of principles and codes.
28. **Secondary (subsidiary/delegated) legislation** - Subsidiary legislation may include regulations, rules or orders which may be made under the authority of the primary legislation. The primary legislation would clearly set out the scope of the subsidiary legislation. The person making the subsidiary legislation must ensure that it is within scope of the enabling provision. Secondary legislation is usually reviewed by the Parliament. However, the Parliament may expressly direct that specific secondary legislation is not subject to Parliamentary scrutiny. Therefore BMA has the power to adopt rules without Parliamentary review.
29. These mechanisms are used to address technical details which may need to be frequently amended. For example the BMA is enabled to make rules as set out under Articles 6 and 27B IA. These regulations and rules being statutory provisions are similar to provisions of a primary statute in that they are binding and a penalty may be imposed.
30. Subsidiary legislation made under the IA includes the:
 - Insurance Returns and Solvency Regulations 1980
 - Insurance Accounts Regulations 1980
 - Insurance (Prudential Standards)(Class 4 and Class 3B Solvency Requirements) 2008

Rules published in draft:

- Insurance (Group Supervision) Rules 2011
 - Insurance (Prudential Standards) (Insurance Group Solvency Requirements) Rules 2011
 - Insurance (Prudential Standards) (Class E Solvency Requirements) Rules 2010
 - Eligible Capital Rules 2010
 - Insurance (Prudential Standards) (Class 3A Solvency Requirements) 2011 – currently being consulted by BMA
31. **Statement of Principles** – A Statement of Principles is an instrument made in accordance with an Act of Parliament which details how a regulator will apply certain provisions of the Act.

Under Article 2A IA there is a duty imposed on the BMA to issue a Statement of Principle dealing with the following:

- Interpreting the minimum criteria imposed on all licensees
- Exercising powers to register or cancel the registration of a licensed person
- Exercising power to impose or grant a condition on a licensed person
- Exercising power to require and obtain information, reports
- Exercising power to adjust of a licensed person's available statutory capital

and surplus or enhanced capital requirements

- Exercising powers to give directions under Article 32 or 32A
- Exercising discretion under Article 27B to determine whether to be group supervisor

32. The BMA issued a Statement of Principles in June 2007.
33. **Codes of Conduct** - Codes of Conduct are made in accordance with an act of Parliament however they are not defined as secondary legislation. They are an instrument which establishes certain standards – industry standards or otherwise - which insurers are expected to apply and which are enforceable, but which do not have the same weight as a rule or a regulation, in that failure to comply does not usually give rise to a direct penalty.
34. The BMA issued the Insurance Code of Conduct in February 2010. This Code of Conduct is enforceable in that BMA will take into consideration failure to comply with the Code as part of its assessment of the insurer's compliance with provisions of the Act or the Minimum Criteria. BMA may issue directions to comply with the Code and, if the entity does not respond, the BMA may take other enforcement actions. Failure to comply with a direction is an offense. BMA applies the Code to all insurers and monitors compliance
35. **Guidance** - Guidance may be issued from time to time by the BMA. It is not a legislative instrument, but rather is intended to convey expectations regarding the prudent conduct of the insurance business. It is not binding and has no legal effect. BMA is in the process of transitioning specific guidance notes into codes of conduct.
36. Under Article 2B IA the BMA may issue guidance at its discretion. The BMA has issued over 20 guidance notes dealing with various aspects of the IA.

EIOPA advice on Bermuda's equivalence under Article 172

37. EIOPA's advice is that Bermuda meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II for insurers of Classes 3A, 3B and 4, but with certain caveats set out below. The regime applicable to insurers of other classes does not meet the criteria. EIOPA also notes that these conclusions will only apply when the provisions are fully implemented, for example in the case of Class 3A. Regarding the provisions for long-term insurers (Classes A to E), the regime has only been in force since the beginning of 2011 and the reclassification of long-term insurers into these classes will be completed by the end of 2011. When EIOPA reviews its advice once the Level 2 Implementing Measures are finalised this aspect of the Bermuda regime will be fully reflected.
38. We find the BMA largely equivalent with regard to its powers and responsibilities as a supervisory authority for Class 3, 3A, 3B and 4 insurers and to be partly equivalent for Class 1 and 2 insurers under Principle 1. Although the BMA has at its disposal a series of powers and reporting obligations, all these obligations vary according to the insurer's class.
39. We find the BMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2. We have no caveats to add in relation to this principle.
40. We find the BMA partly equivalent with regard to its authorisation of insurers under Principle 3. The BMA is empowered to obtain all the information necessary for licensing, however the degree of discretion around what may be required is not in line with the Solvency II authorisation requirements and risks producing different treatments of similar issues.
41. There is no legal requirement to ensure that an insurer has its head office situated in the same country as its registered office. Furthermore, the possibility of carrying out both insurance and non-insurance business in a single company represents a potential risk for reinsurance cedents, and constitutes a significant difference from the provisions under Solvency II.
42. We find the BMA partly equivalent for Classes 4 and 3B, and not equivalent for Classes 1, 2, 3 and 3A, with regard to its governance and public disclosure requirements under Principle 4. EIOPA has identified a number of areas where the BMA regime would have to be strengthened or addressed in order to be considered equivalent to Solvency II: stricter provisions around the requirements for key functions, independence of internal audit, outsourcing and public disclosure. The code of conduct applies to all insurers however EIOPA considers that BMA has a staggered approach in applying the Code, these concerns were even more serious for insurers in Classes 1, 2, 3 and 3A.
43. We find the BMA not equivalent with regard to its requirements around changes in business, management and qualifying holdings under Principle 5. Although the Insurance Act (IA) requires that insurers' shareholder controllers be assessed, neither the IA nor any other law requires insurers to provide the BMA with details of changes to their scheme of operation. Therefore only few critical changes in business, including engaging in non-insurance business, require BMA approval. To be equivalent, legally binding criteria would need to be developed to achieve a clear set of business change situations which require BMA approval rather than

relying on internal and unpublished supervisory practice. In addition, there is significant outsourcing in Bermuda, in particular for captives. For equivalence the legally binding requirements around the notification process for the outsourcing of key functions would need to be expanded. Furthermore, publicly available guidance would also need to be introduced regarding the documents and information required for an appropriate shareholder controller assessment.

44. We find the BMA largely equivalent for Classes 3A, 3B and 4 (subject to the equivalence of upcoming valuation standards), and not equivalent for Classes 1 to 3 with regard to their solvency regime for reinsurance undertakings under Principle 6.
45. EIOPA cannot positively conclude on the current valuation framework, given the variety of different valuation standards available, or on the proposed valuation standards, given the material uncertainties which remain around the economic balance sheet framework being developed. Furthermore the lower capital requirement, the only one insurers of Classes 1, 2 and 3 are subject to, is not risk-based and in practice can be very low for insurers with a high risk profile. For some risks, including currency, concentration and counterparty risks, the higher capital requirement lacks risk-sensitivity compared to the SCR.

EIOPA advice on Bermuda's equivalence under Article 227

46. EIOPA's advice is that Bermuda meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II for insurers of Classes 3A, 3B and 4, but with certain caveats set out below. The regime applicable to insurers of other classes does not meet the criteria set out by the Commission. EIOPA also notes that these conclusions will only apply when the provisions are fully implemented, for example in the case of Class 3A. EIOPA was not in a position to assess the provisions for long-term insurers (Classes A to E) as the regime has only been in force since the beginning of 2011 and the reclassification of long-term insurers into these classes has not yet been completed.
47. We find the BMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2. We have no caveats to add in relation to this principle.
48. We find the BMA largely equivalent for Classes 3A, 3B and 4 (subject to the equivalence of upcoming valuation standards) with regard to their solvency regime for insurance undertakings under Principle 7.
49. EIOPA cannot positively conclude on the current valuation framework, given the variety of different valuation standards available, or on the proposed valuation standards, given the material uncertainties which remain around the economic balance sheet framework being developed. Furthermore the lower capital requirement is not risk-based and in practice can be very low for reinsurers with a high risk profile. For some risks, including currency, concentration and counterparty risks, the higher capital requirement lacks risk-sensitivity compared to the SCR.

EIOPA advice on Bermuda's equivalence under Article 260

50. EIOPA's advice is that Bermuda meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II for group supervision but with certain caveats set out below. The assessment is based on

the proposed regime for group supervision that is expected to be implemented by the end of 2011.

51. We find the BMA largely equivalent with regard to its powers and responsibilities as a supervisory authority for group supervision under Principle 1. Although the BMA has at its disposal a series of powers and reporting obligations, the application of all these obligations varies according to the insurer's class.
52. We find the BMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2. We have no caveats to add in relation to this principle.
53. We find the BMA's proposed regulatory framework equivalent with regard to the scope of its group supervision under Principle 8.
54. We find BMA partly equivalent with regard to its co-operation and exchange of information with other supervisory authorities under Principle 9. The BMA's requirements and procedures in this area would need further development to be equivalent to Solvency II. Areas where specific and more detailed processes would be beneficial are, inter alia: how the BMA will ensure cooperation where there is no college of supervisors; how the supervisory authorities concerned should cooperate in crisis situations; the establishment and composition of colleges; information exchange; dispute-solving mechanisms; and how supervisory cooperation will operate for the approval of a group internal model.
55. We find the BMA partly equivalent for group supervision with regard to its governance and public disclosure requirements under Principle 10. EIOPA has identified a number of areas where the BMA regime would have to be strengthened or addressed in order to be considered equivalent to Solvency II: independence of internal audit, outsourcing and public disclosure.
56. We find the BMA not equivalent with regard to its requirements around changes in business, management and qualifying holdings under Principle 11. Although the Insurance Act (IA) requires that insurers' shareholder controllers be assessed, neither the IA nor any other law requires insurers to provide the BMA with details of changes to their scheme of operation. Therefore only few critical changes in business, including engaging in non-insurance business, require BMA approval. To be equivalent, legally binding criteria would need to be developed to achieve a clear set of business change situations which require BMA approval rather than relying on internal and unpublished supervisory practice. In addition, there is significant outsourcing in Bermuda, in particular for captives. For equivalence the legally binding requirements around the notification process for the outsourcing of key functions would need to be expanded. Furthermore, publicly available guidance would also need to be introduced regarding the documents and information required for an appropriate shareholder controller assessment.
57. We find the BMA largely equivalent for group supervision (subject to the equivalence of upcoming valuation standards) with regard to their solvency regime for groups under Principle 12.
58. EIOPA cannot positively conclude on the current valuation framework, given the variety of different valuation standards available, or on the proposed valuation standards, given the material uncertainties which remain around the economic balance sheet framework being developed. Furthermore for some risks, including currency, concentration and counterparty risks, the higher capital requirement lacks risk-sensitivity compared to the SCR.

Chapter III: Assessment of each principle

Principle 1 - Powers and responsibilities of third country supervisory authorities

Objective - *The supervisory authorities of the third country have the necessary means, and the relevant expertise, capacity, and mandate to achieve the main objective of supervision, namely the protection of policyholders and beneficiaries regardless of their nationality or place of residence. In particular, the supervisory authorities in that third country shall have the necessary capacities, including financial and human resources.*

For reinsurance assessments:

The supervisory authorities of the third country are empowered by law or regulation to effectively supervise domestic insurance or reinsurance undertakings carrying out reinsurance activities and to undertake a range of actions, including the ability to impose sanctions or take enforcement action in relation to the domestic insurance or reinsurance undertakings carrying out reinsurance activities that it supervises.

For group supervision assessments:

The supervisory authorities of the third country shall be empowered by law or regulation to supervise insurance and reinsurance undertakings which are part of a group.

The supervision of insurance and reinsurance undertakings which are part of a group shall be carried out effectively and the supervisory authorities of the third country shall be empowered by law or regulation to undertake a range of actions, including the ability to impose sanctions or to take enforcement action in relation to the group that it supervises.

The supervisory authorities of insurance and reinsurance undertakings which are part of a group shall be able to assess the risk profile and solvency and financial position of that group as well as its business strategy.

The supervisory authority

The BMA's responsibilities and enforcement powers

59. Article 2 IA provides that the BMA is responsible for the supervision of insurers, insurance managers (see further details on insurance managers under Principle 3) and intermediaries. Failure to comply with specific provisions of the IA is a criminal offence. Failure to comply with subsidiary regulations and rules is an indictable or summary offence.
60. The IA provides the BMA with a wide range of powers, including, if the insurer appears to be at risk of becoming insolvent, the powers to restrict its activities, to restrict investments, to remove the management, to prohibit the payment of dividends, and to freeze its assets (Article 32). If the insurer "has failed to satisfy an obligation to which it was subject by virtue of this Act" (Article 35 (1b)) or if "any of the minimum criteria is not or has not been fulfilled (Article 41(1b vii)), the BMA may present a petition for the winding up of the insurer, or cancel its registration.

Freedom from undue political, governmental and industry interference in the performance of supervisory responsibilities

61. The BMA is an independent authority established by its own Act of Parliament, the Bermuda Monetary Authority Act 1969 (BMA Act). The BMA Act established the BMA as a body corporate which is allowed to create its own rules, operating procedures and organisational structures separate from those that exist in Government.
62. The Minister of Finance appoints the BMA's non-executive board members, including the Chairman of the Board, but does not appoint the CEO or other senior management. Executive directors of the BMA are appointed by a committee of non-executive members of the Board who are responsible for determining the remuneration and other terms of service of the executive members of the Board. It is the responsibility of the CEO (subject to the authority of the Board) to administer the affairs and to execute the functions of the BMA.
63. In the IMF's 2008 Assessment of Financial Sector Supervision and Regulation, it was recommended that, in relation to insurance, "the BMA should periodically review its relationship with industry to preserve regulatory independence". In this context we note that active industry practitioners, including representatives of insurers and insurers' accountancy firms, make up a substantial proportion of the BMA's Board of Directors. Although the BMA's Board Code of Conduct and, more specifically, Board of Directors Conflict of Interest Code set out guidance on ethical issues, and directors are required under Article 13 (5) and (6) BMA Act to disclose conflicts and excuse themselves where necessary, this arrangement nevertheless poses risks, in particular in relation to access to firm-specific information or cases where a specific supervisory action is being decided upon.

Transparency of supervisory processes/procedures

64. The BMA usually undergoes a wide consultation process before adopting any new regulation. The BMA's annual reports are posted on its website.

Adequate financial and non-financial (e.g. sufficient numbers of appropriately skilled staff) resources

65. The BMA is funded through fees charged to regulated entities.
66. As of April 2011, the BMA comprised 171 staff, with the following breakdown:

Supervision	85	(50%)
Regulation	39	(23%)
Support	47	(27%)
67. The main problem EIOPA identified was the scarcity of actuarial resources. As of April and June 2011 they amounted to six staff. This (relative) weakness could in particular be seen from some of the supervisory files, where it was difficult to determine what actuarial methods the insurers' actuary or loss reserve specialist had used to assess the prudence of technical provisions (Actuaries' or loss reserve specialists' reports are commented below under 'Financial Supervision'). In its 16 June follow-up response to the on-site visit, the BMA stated that two additional actuaries would join the BMA by the end of August, and that it also had three consulting actuaries on contract.

Appropriate protection from being liable for actions taken in good faith

68. Article 4B of the BMA Act provides that no action can be brought against agents of the BMA that have acted in good faith in the execution of their missions.

Powers to take preventative and corrective measures

69. IA provides the BMA with various actions. The BMA is empowered to authorise insurers (Article 3 IA), to investigate them (Article 30 IA), to object to a change in control (Article 30F, see further details under Principle 5). See above under "The BMA's responsibilities and enforcement powers" the actions it is empowered to take when solvency requirements are not met.

Financial supervision

70. The IA and the related Code of Conduct establish the general framework as to the requirements for the system of governance. The BMA has a general power to assess and ensure insurers' compliance with these requirements, although in practice, the scope and intensity of the BMA's supervisory activity is determined by the class the insurer belongs to. Further to this, we note that the proposed framework for group supervision will also include governance arrangements at group level, including the BMA's powers in relation to supervising this aspect.

71. Bermudan legislation also includes provisions as to undertakings' reporting obligations as to solvency conditions and provides the BMA with general powers for supervision in this area. The BMA exerts its powers by verifying both off and on-site the financial condition and technical provisions of an insurer. The table below provides the breakdown by class of the supervisory reports issued by the BMA during the period 2008–2010:

	2008	2009	2010	Number of insurers as of 31.12.2010
Class 4	3	9	11	30
Class 4 & Long Term		3	4	
Class 3B				15
Class 3A			2	123
Class 3	8	3	1	277
Class 3 & Long Term			2	
Class 2	1			272
Class 1				250
Long Term	1		1	71
Insurance Manager	7	3		
Total	20	19	21	1038

72. As part of the assessment, EIOPA reviewed some supervisory reports, and in particular examined how the BMA ensured that the financial position of the insurer was sound and that TP were calculated prudently. Although it was clear that the BMA had carried out relevant checks, the documentation was not informative on the processes pursued.

73. As to general reporting requirements, for the purpose of this chapter we note that the IA and the Insurance Returns and Solvency Regulations, as well as the proposed Insurance Group Supervision Rules establish a general framework for reporting to be submitted to the BMA.

Qualifying holdings

74. Any person proposing to acquire 10%, 20%, 33% or 50% of an insurer should notify the BMA of their intentions. The BMA will assess the fitness and propriety of the prospective acquirer and may object to the acquisition (Article 30F IA).

The BMA has the authority to place a restriction on the sale or transfer of the shares of such persons pursuant to Article 30I IA.

Specificities for 172

Type and frequency of accounting, prudential, statistical information obtainable by the supervisory authority from an undertaking

75. Article 15 IA provides that all insurers should file statutory financial statements with the BMA, by a date that depends on the class of the insurer⁵. The penalty for late filing of these statements also depends on the insurer's class: the fine is \$500 per week of delay for Classes 1 and 2; \$1000 per week for Classes 3, 3A and 3B; and so on⁶. If an insurer fails to provide the BMA with statutory financial statements within 3 months of the filing date, in the case of Class 3B or 4 insurers only the BMA "shall appoint an inspector to investigate the affairs of [the] insurer"⁷.
76. The contents of other reporting obligations also depend on the class of the insurer, making it difficult to have a global picture of the Bermudan reporting obligations. The opinion of a loss reserve specialist is not compulsory reporting for Class 1 (although a judgment regarding the sufficiency of reserves is made annually during the statutory audit review); it has to be provided to the BMA every 3 years for Class 2; it has to be provided every year for the other non-life classes (Article 18B IA). Reporting the schedule of ceded reinsurance is compulsory only for Class 3A, 3B and 4. Additional GAAP financial statements are compulsory for Classes 3B and 4.
77. Reporting obligations for insurers in difficulties also depend on the insurer's class. When the solvency margin is breached, the Principal Representative⁸ must provide the BMA with a written report in all cases, but only insurers of Classes 3, 3A, 3B and 4 are required to provide the BMA with a report themselves⁹, and only insurers of those classes also have to provide the BMA with a business plan.
78. The BMA has issued a June 2010 consultation paper on Disclosures and transparency (including regulatory disclosures) and an August 2010 discussion paper on Economic balance sheet and Proposed changes to regulatory reporting. Most of the proposed disclosures will only apply to commercial insurers. However there is an exception to this in the June 2010 paper, where it is proposed (§§65–66 pp29–30) that some obligations to notify specific changes to insurance business, that at present only apply to Class 4 insurers, should apply to all insurers in future.
79. It should be noted that under EU regulation reporting obligations are not subject to broad exemptions of this sort dependent on the size of the insurer or whether or not it is a captive.

Specificities for 260

Type and frequency of accounting, prudential, statistical information obtainable by the supervisory authority from the parent undertaking

80. Under Article 27F IA, the BMA is able to make rules regarding supervisory reporting in respect of insurance groups, which apply to designated insurers

⁵ 6 months extensible to 9 months for classes 1 and 2; 4 months extensible to 7 months for classes, 3, 3A, 3B, 4 (Article 17(4) IA).

⁶ Article 18A (2) IA.

⁷ Article 18A (5) IA.

⁸ The role of the 'Principal Representative' is further detailed under Principle 3.

⁹ This is further developed under Principle 6.

within the group. Their reporting requirements for groups are in line with the solo requirements outlined above. In addition, the current draft Group Supervision rules also set out reporting requirements for groups.

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81. The BMA has at its disposal a series of powers, including, in the event the insurer becomes insolvent, the powers to restrict the insurer's activities, to restrict its investments, to freeze its assets, to remove its management and to prohibit the payment of dividends. Reporting obligations vary according to the insurer's class.
82. In respect of the Solvency II Directive, Principle 1 is considered to be largely equivalent for Classes 3, 3A, 3B and 4 insurers, including in group supervision, and to be partly equivalent for Classes 1 and 2 insurers.

Principle 2 - Professional secrecy, exchange of information and promotion of supervisory convergence

Objective – *The supervisory authorities of the third country and supervisory authorities of Member States involved in the supervision of domestic insurance and reinsurance undertakings shall cooperate and, where relevant, ensure the effective exchange of information.*

The supervisory authorities of the third country shall provide that all persons who are working or who have worked for the supervisory authorities, as well as auditors and experts acting on behalf of those authorities, are bound by obligations of professional secrecy.

The above mentioned obligations of professional secrecy shall extend to information received from the supervisory authorities of Member States.

83. The BMA has developed a framework establishing the preconditions necessary for effective and efficient information exchange. This framework is applicable to information exchange in solo and group contexts.
84. All persons who receive information under the IA shall not disclose such information, except with the prior consent of the person to whom it relates or from whom it was received. "All persons" can include directors, board members, employees or contractors, as well as persons who have previously occupied one of those roles. This ensures that the concept of confidentiality is broad and will be applied across all operations possible in the field of supervisory information exchange. Violations of the confidentiality regime may lead to criminal investigations and may result in a fine of up to \$100,000 or imprisonment for up to five years.
85. The BMA is only allowed to pass on such confidential information in a few cases. There are information gateways for information to be provided to the Minister of Finance or other authority where this would assist them in discharging regulatory functions. However, information can only be provided to these authorities for well-defined purposes, including supervisory purposes, as well as criminal proceedings and enabling inspectors to carry out investigations for the BMA.
86. Furthermore we note that the Minister does not actually have any regulatory functions with respect to insurance supervision. The registrar of companies is the only other authority which could be a possible recipient of information. The scope of information to be included on the register will be limited, though. As such the information gateways would have limited application.
87. If supervisory authorities from outside Bermuda provide information to the BMA, it will not be passed on except with the prior consent of the authority which provided the information (Articles 52B (4) and 52 (1) IA). The only possible circumstance where the BMA would disclose confidential information without such prior consent would be if a subpoena were served and the (civil) Court issued a direct order on the BMA to provide the desired information. While the IA (and also the Solvency II Directive) do not provide for such disclosure of confidential information and remain silent in this respect, the concept of assigning the final decision with respect to disclosure to the Court rather than to the supervisory authority is also applicable to some European countries. With respect to equivalence, it also has to be noted that the risk of such a circumstance arising is relatively remote and has never materialised to date.
88. The BMA has recently begun to develop tools for group supervision. To this end,

it has drafted guidance notes on *Supervisory Cooperation and Information Exchange* and on *Determination and Responsibilities of a Group-Wide Supervisor, and Principles of Group-Wide Supervision*. The IA is being amended in line with this guidance. In addition, in the past three years the BMA has hosted five supervisory college meetings, accompanied by numerous bilateral meetings with other relevant supervisors. These colleges were attended by supervisors from North America, Europe, and Asia. In preparation for these colleges, the BMA's Legal Services performed analyses of the participating supervisors' legal frameworks. During our on-site visit the BMA explained in detail the arrangements and planning for an upcoming supervisory college. These details included the conditions for participation, including a sufficiently detailed framework for the protection of confidential information. Our discussions covered the timeline, format, and agenda of this particular college.

89. In the past three years the BMA has attended thirteen college meetings for seven different groups. Information exchange within these meetings and otherwise as part of college cooperation included the communication of concerns regarding insurance groups active in Bermuda that were affected by the last financial crisis. The BMA was involved as both a host and guest in colleges when a number of supervisory measures were applied to the entities concerned.
90. International information exchange is also needed for the successful assessment of director and shareholder suitability. In this respect, research is performed by a specialised unit within the Licensing and Authorization Department. Background checks include using commercial services for compliance solutions, and information requests to other supervisors. In practice information flows both ways, as long as the aforementioned preconditions for information exchange are in place.
91. The BMA has entered into various cooperation agreements with, at the current time, sixteen supervisors from North America, Europe, and elsewhere. Furthermore, it is a member of the IAIS and IOSCO MMoUs, and participates actively in the work of these bodies. However, the existence of such an agreement is not seen by the BMA as a precondition to information exchange.

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92. Under the Bermudan legal framework, and under the provisions established by the BMA, confidential supervisory information is protected from unwarranted access as well as disclosure and transmission. Overall the level of protection is equivalent to that built into the Solvency II Directive.
93. Information obtained by the BMA, be it by means of research, reporting, or information sharing by other (supervisory) authorities, is strictly protected under the IA. All persons who are working for the BMA, or have previously done so, must comply with these provisions, breach of which would be prosecuted as a criminal offence. Voluntary disclosure of information to third parties needs prior explicit consent of the party which provided the information. Furthermore, the BMA may be compelled to disclose information in criminal matters or if a direct subpoena were served on it for the purposes of court proceedings, in cases other than those covered by Articles 68 to 70 Solvency II Directive. Since the latter has not been of practical relevance so far, and is not expected to be in the foreseeable future, it does not have a negative bearing on the assessment. As to information sharing in practice, the BMA has a proven track record of information sharing through the numerous agreements it has entered into, and through supervisory colleges they have hosted or participated in. Therefore, Principle 2 is

in respect of the Solvency II Directive considered to be equivalent.

Principle 3 - Taking-up of business

Objective – *The taking-up of the business of reinsurance in the third country shall be subject to prior authorisation. Authorisation for the taking-up of business shall be conditional on the undertaking meeting a clear, objective and publicly available set of written standards on a continuous basis. Insurance business in Bermuda is subject to prior authorisation ("registration"). Insurers may take on the legal form of an incorporated entity under the Companies Act 1981, a company incorporated overseas with a special permit under said Act, or a Non-Resident Insurance Undertaking.*

Head office requirements

94. Article 20 Solvency II Directive requires that insurers' head offices be situated in the same Member State as their registered office. In Bermuda under Article 8 IA the only requirement is that every insurer must maintain a principal office in Bermuda, and appoint and maintain a principal representative approved by the BMA.
95. Under Guidance Note (GN) 1 on the Role of the Principal Representative (PR) it is further explained that "the principal office can be the office of the [PR], or the office of the [insurance] management company". The management company referred to is the Insurance Manager (IM) that an insurer may have – although it is not a requirement (Article 8.2.b of the IA). The duties of the IM are described in GN 8.
96. The following paragraphs set out in more detail the roles of the PR and the IM, to clarify the nature of the principal office.
97. GN1 (7) indicates that the PR "would generally be either a director, senior financial officer or manager normally resident in Bermuda, or a Bermuda registered insurance management company"; they may therefore be internal or external to the insurer. The role of the PR is defined in the IA, in particular under Article 8A IA, and in GN1 and they are subject to a number of regulatory requirements: in particular, they are required to immediately notify the BMA of any likelihood of the insurer becoming insolvent (Article 8A (1a) IA), or of other events listed under Article 8A (2) IA and in certain cases they are also required to provide the BMA with further information and materials such as interim financial statements (see Article 8A (2a and b) IA). They act as a link between the insurer and the BMA, and indeed the PRs visited described their role as acting as a regulatory advisor.
98. In most cases the PR is a member of the insurer's board; if not, they request to attend board meetings. Under GN1 (17), insurers are required to ensure the PR has access to the necessary information to fulfil its role; GN1 (19) states that "Where the [PR] does not have access to sufficient information about the insurer [...], the [PR] should contact the [BMA]." Article 12 states that "while the Board of Directors and the have the primary responsibility for the conduct and performance of the insurer, the [PR] acts in an 'early warning' role and monitors the insurer's compliance with the [IA] on a continuous basis." They are also responsible for the filing of financial returns and statements and for the maintenance and custody of statutory accounting records (GN1 (7)).
99. Where Bermudan insurers have an IM, they are subject to a number of regulatory requirements. The role of the IM is outlined in Article 1(1) of the IA, which states that the IM is "a person who, not being an employee of any insurer, holds himself out as a manager in relation to one or more insurers, whether or not the functions performed by him as such go beyond the keeping of insurance

business accounts and records". GN8 deals with the appointment and duties of the IM. It is a requirement that there should be a formal agreement between the IM and the insurer that sets out the respective functions, duties and responsibilities. IMs are subject to registration and supervision by the BMA. Furthermore, as allowed for in GN1 (7), where an insurer has an IM they would often also be appointed to be the PR.

100. An IM is in practice an external company to which an insurer's functions, up to and including the responsibilities of the chief and senior executives (Paragraph 15 of the Insurance Code of Conduct), may be outsourced (see Article 1 (1) IA for a legal definition). They play a particularly important role in the management of captives. In the context that some of these insurers may have very low volumes of business, a single IM may be responsible for the management of (and may act as PR for) tens to hundreds of insurers. There may be issues around conflicts of interest if third party business is being pursued.
101. Although in practice some principal offices may constitute the central administration of the insurer, and could be regarded as head offices¹⁰, the current legal framework does not ensure that this is the case, as the formal requirements for a principal office relate to a narrower range of functions than those of a head office. Since no distinction is made between classes in this regard, it remains theoretically possible for even a large commercial insurer not to have a substantive head office in Bermuda. As such we conclude that Bermuda does not have any equivalent requirement to Article 20 Solvency II Directive to ensure that insurers' head offices are situated in the same country as their registered office.

Licensing process

102. According to the IA, undertakings can obtain licences for general insurance, for long-term insurance (see paragraphs 14, 15 and 21 above), or for both ("dual license"). However, the option of obtaining a dual licence under Article 4 (1c) IA will be subject to review in 2012. Insurance managers and other intermediaries are also subject to authorisation.
103. The BMA may issue a licence for a different class than that applied for (Articles 4 (6) and 4EA IA). Besides this, applicants can also be licensed as a Special Purpose Insurer (SPI). During the past three years, 48 licences were issued for Classes 2, 3, 3A, 3B, and 4 (of which 10 were dual licences), two for long-term-business, and ten for insurance managers.
104. Applications are handled by the Assessment and Licensing Committee (ALC), which also makes the decisions on them. Its seven members are to be drawn from senior staff in each of the relevant departments (Insurance, Banking, Policy, and Legal Services and others). The Unit is able to draw on the support of a Risk Committee and a Technical Advisory Group consisting of industry experts.
105. The Solvency II authorisation requirements are defined in the Directive and are publicly available (e.g. Articles 18, 23, 100 et seq. and 128 et seq. Solvency II Directive). The fundamental elements are: defined own funds, a defined solvency level, and a scheme of operations (including the nature of risks, reinsurance arrangements, cost-estimates, forecast balance sheets, and estimates of the MCR/SCR (Minimum Capital Requirement and Solvency Capital Requirement)). The BMA, on the other hand, relies on minimum criteria set out in the law and has the right to impose further conditions for licensing as it deems necessary. In

¹⁰ With reference to the Judgment of the ECJ in Case 81/87 (Daily Mail), which equates the "real head office" with the "central administration of the company".

determining any further conditions, the BMA attaches much importance to the proportionality principle.

106. Minimum criteria (as set out in the Schedule to the IA) are inter alia:

- Every controller and officer has to be a fit and proper person.
- Body corporates must be directed by at least two individuals, and have non-executive directors on their board as the nature of the business requires.
- The entity must conduct its business in a prudent manner, must have sufficient capital, and must maintain adequate accounting and business records as well as adequate control systems to comply with all applicable provisions.

In addition, the Insurance Code of Conduct provides further directions, predominantly around governance and risk management.

107. These criteria provide a broad framework and are further elaborated upon in an ALC information bulletin which is publicly available. Every application must include a detailed scheme of operation; income statements and balance sheets on a 5-year basis; information on shareholders, owners and directors; and information on insurers the applicant plans to do business with.

108. Assessments include fitness and propriety checks for key individuals who are performed on the basis of personal declarations and CVs submitted by applicants. Background checks are also common (see Principle 2).

109. Under Article 4 (1c) IA, insurers may obtain a dual licence for non-life and long-term business classes to be conducted together. Although this differs from Article 73 (1) Solvency II Directive, this difference is of limited relevance for the licensing of insurance undertakings carrying out reinsurance activities, which are not required to separate their portfolios into life and non-life insurance for that business, and does not influence our advice for this principle. Article 73 Solvency II Directive also in some cases allows a single company to pursue both life and non-life business - for certain non-life insurance activities (new-style composites) or under a permit to pursue rights arising from an old licence (old-style composites).

110. Article 19 IA implies that insurers may also conduct non-insurance business. The BMA claims it has not received, or approved, any applications for non-insurance business to be carried out; however the relevant provision was effective only as of 2010. In this respect, the legal regime differs considerably from that set out in Solvency II.

111. Although the assets and liabilities are to be kept segregated from those belonging to the insurance business and the accounts kept separated, there is a possibility that risks may spill over, leading to ceding companies bearing an insolvency risk arising from business other than the insurance business. A separation of accounts or segregation of assets does not seem to be an effective countermeasure against such contagion. The BMA states that it would carefully consider, before issuing such a licence, all relevant factors and in particular the nature of the risks involved. The combination of insurance and unrelated non-insurance business in a single company is not recognised under the Solvency II regime (Article 18 (1a) Solvency II Directive), and this has been the case ever since the single market was established. The risks covered must be genuine insurance risks or arise directly from them.

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112. Principle 3 is partly equivalent. The BMA is empowered to obtain all the information necessary for licensing, however the degree of discretion around what may be required is not in line with the Solvency II authorisation requirements and risks producing different treatments of similar issues. Furthermore there is no legal requirement to ensure that an insurer has its head office situated in the same country as its registered office.

113. The possibility of carrying out both insurance and non-insurance business in a single company represents a potential risk for reinsurance cedents, and constitutes a significant deviation from the Solvency II regime.

Principles 4 and 10 - System of Governance and Public Disclosure

Objective - *The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings carrying out reinsurance activities to have in place an effective system of governance which provides for sound and prudent management of the business, and require groups to have in place such a system at the level of the group. That system shall at least include an adequate transparent organisational structure with a clear allocation and appropriate segregation of responsibilities, requirements for ensuring that persons managing the undertaking are fit and proper and effective processes to ensure the timely transmission of information both within the undertaking or group and to the relevant supervisory authorities.*

The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings carrying out reinsurance activities to have in place an effective risk-management system comprising the strategies, processes and internal and supervisory reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis and at an individual and an aggregated level, the risks to which the undertaking is or could be exposed, and their interdependencies, as well as an effective internal control system. It shall require groups to have in place such a system at the level of the group.

The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings carrying out reinsurance activities to establish and maintain risk-management, compliance, internal audit and actuarial functions. Groups shall be required to establish and maintain these functions at group level.

The solvency/prudential regime of the third country shall require groups and domestic insurance and reinsurance undertakings carrying out reinsurance activities to disclose publicly, on at least an annual basis, a report on their solvency and financial condition.

For group supervision assessments:

The prudential regime of the third country shall require the group to have sound reporting and accounting procedures to monitor and manage its intra-group transactions and risk concentrations and to report at least annually significant risk concentration at the level of the group and significant intra-group transactions.

Governance

114. The BMA's 'Insurance Code of Conduct' (the 'Code') became effective from July 2010 with a deadline for compliance set for July 2011. The Code of Conduct applies to all insurers and the BMA must be satisfied that a company is conducting its business in a sound and prudent manner, as evidenced by compliance with the Code. The BMA verifies compliance with the Code in on-site reviews and off-site analysis. In the event that the BMA finds an insurer's compliance with the Code to be deficient, it notifies the company (or its insurance manager, as appropriate) of the need for corrective action and agrees a timeline for action.
115. The BMA considers that the Code brings together in a codified form and updates much of its earlier governance requirements and guidance for insurers. The BMA states that the Code largely represents existing practice for the market with some updates to reflect recent changes in international standards.
116. The Code of Conduct contains the core criteria that any insurer registered in Bermuda has to consider. Relative to Solvency II, the Code does appear to be equivalent with various requirements of the Directive, although there are a

number of differences in content.

117. The Code is principles-based and its application in the market depends on the nature, scale and complexity of the insurer, which the BMA determines on a case by case basis. The BMA will have regard for the appropriateness of provisions of the Code in relation to their application to a particular insurer taking into account the BMA's prudential objective underpinning the provisions being effectively met. This means that some requirements of the Code will not be applied in full to all areas of the market, particularly in the case of classes 1 to 3.
118. In addition to the Code, which applies to all insurers, the BMA has also published its draft 'Insurance (Group Supervision) Rules 2011' (the 'Group Rules'), which were under consultation during part of the assessment. Whilst a draft of these rules (version: 31 December 2010) has been considered, BMA still needed to integrate the comments of the consultation over the course of summer 2011. The group rules will then be published and in force at the end 2011. Some comment is made on these rules where relevant, although they will need to be reviewed in their final form and application.

Fit & proper

119. An underpinning principle of an effective governance system is the fitness and propriety of the key individuals operating in the market. It is therefore essential that the supervisory authority and the firms in the market have appropriate processes to make this assessment. In Bermuda paragraph 12 of the Code, gives insurers' boards responsibility for ensuring the fitness and propriety of key individuals and having in place appropriate processes to assess this. The roles requiring assessment are 'board members, controllers, officers and third-party service providers, including insurance managers, auditors, actuaries and the principal representative'. These BMA requirements are equivalent to Article 42 Solvency II Directive which requires assessment of those who "effectively run the undertaking". Requirements regarding fitness and propriety are reiterated in paragraph 4 (4) of the draft Group Rules, which determines that "Membership of the parent's board must be kept under continual review to ensure that members continue to be fit and proper and the board collectively has the requisite skills and expertise given the nature, scale and complexity of the group's operations."

Risk management

120. The requirement for a risk function is established in paragraph 45 of the Code and paragraph 7 of the Group Rules, which require the risk function to be embedded in the insurer's organisational structures and strategic oversight processes. Paragraphs 11 to 23 of the draft Group Rules and paragraphs 22 to 43 of the Code describe in detail the risk management framework and its essential features, establishing a comprehensive set of requirements similar to those of Articles 44 (1-4) Solvency II Directive. However this is also subject to the BMA's proportionality principle and this requirement may not be fully exercised in respect of insurers in classes 1 to 3, which would be a point of difference relative to Solvency II.
121. The BMA is developing a Group's Solvency Self Assessment ('GSSA') for insurance groups and a Commercial Insurer's Solvency Self Assessment ('CISSA') for commercial insurers in classes 4, 3B and 3A. These are similar in concept to the Solvency II requirement for the Own Risk and Solvency Assessment ('ORSA'). Both of these processes are currently going through consultation and trial run processes, with the aim of implementation from 2011 year end. For the classes of insurers not covered by the CISSA or GSSA, paragraph 53 of the Code requires insurers to conduct an annual self-assessment

of their risks. However, unlike under Solvency II, there is no explicit requirement that this risk assessment take account of future strategy.

Internal audit function

122. Article 47 Solvency II Directive requires that insurers falling under the scope of the Directive shall provide for an effective internal audit function. This internal audit function must be objective and independent from the operational functions. For the BMA, the internal audit function is dealt with in paragraph 48 of the Code and in paragraph 7 of the draft Group Rules. However, the requirement for a separate internal audit function is not absolute, other than in the case of groups. This is an area where the BMA considers that it is proportionate not to require the separate function for smaller insurers; this would include classes 1 to 3, and in some cases 3A. This is however inconsistent with the Solvency II requirements.

123. A further difference from the Directive is that under paragraph 49 of the BMA's Code, insurers are allowed to combine the compliance and internal audit functions. This may also be possible for group functions as the requirements are only that this function is 'independent from the underwriting and financial operations of the group in respect of the managerial reporting relationships.' Because of the importance of an independent internal audit function, this would be a shortfall relative to the Directive. However subsequent to the on-site assessment, the BMA has advised EIOPA that they will review this aspect of the current provisions as part of a planned review of the Code provisions in the third quarter of 2012.

Effective controls and contingency plans

124. Paragraphs 40-43 of the Code articulate requirements for insurers to have effective processes and controls. Paragraph 12 of the Code requires the Board to ensure the existence of 'contingency plans, including those surrounding natural disasters and information recovery, to ensure continual operation of the insurer'. It is considered that this is equivalent with the requirements of Solvency II.

125. Anti-money laundering is an important area of an effective control framework, which the Directive picks up by reference to other legislation in article 59. In this area we note that there is a difference in that under the BMA regulations there is no definite cash payment threshold that would trigger specific obligations. It was also difficult to evidence whether effective controls have been exercised in this area between 2008 and 2010.

Actuarial function

126. Paragraph 51 of the Code specifies the role of the actuary, which appears largely equivalent with Article 48 Solvency II Directive. However this is also subject to the BMA's proportionality principle and this requirement may not be exercised consistently in respect of insurers in classes 1 to 3 and life firms of a similar profile.

127. One other area of difference is that the Directive requires the actuarial function to 'express an opinion' on underwriting policy and adequacy of reinsurance, whereas the BMA's Code only suggests that they 'assist' with the process. This is a difference because 'expressing an opinion' implies a degree of oversight over the effective underwriting of the insurer whereas the latter does not.

Outsourcing

128. In respect of outsourcing, a key requirement under article 49 of the Directive is that insurers remain responsible for all of the activities that they outsource.

Paragraph 56 of the BMA's Code requires that "the insurer should have oversight and clear 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", which is equivalent to Solvency II requirements. This part of the Code goes on to require transparency of information as similarly required by Article 38 Solvency II Directive.

129. The Directive imposes restrictions on outsourcing, in that when it is of "critical or important operational functions", account needs to be taken of factors such as whether this will impair the system of governance or increase operational risk. In contrast, there are no restrictions on what can be outsourced in Bermuda. Outsourcing can incorporate all core activities and, per paragraph 15 of the Code, insurers may also "effectively outsource the chief and senior executives' responsibilities to the insurance manager", a practice that is common for the majority of insurers in classes 1 to 3. EIOPA consider that in these cases, although the board remains accountable, the insurer has little real substance, which could impair full and effective governance being exercised. This is of particular concern where there are policyholder protection issues: in captives with a significant proportion of unrelated business, or where beneficiaries could be unrelated parties.
130. Unlike the Code, Article 49 Solvency II Directive also requires that insurers "notify the supervisory authorities prior to the outsourcing of critical or important functions or activities". In view of the significant amount of outsourcing in the Bermudan market this was considered to be a point of non-equivalence relative to the Directive's requirements. However since our on-site visit, the BMA has advised that it will review the notification requirements for outsourcing and is currently planning a consultation process to make changes in this regard.

Compliance function

131. Paragraph 49 of the Code establishes that insurers should have a compliance function. However this is also subject to the BMA's proportionality principle and this requirement may in practice not be enforced in relation to insurers in Classes 1 to 3, although the function is nonetheless likely to be performed by an insurance manager. For full equivalence, the actual requirement to have the function would need to be in place.

Deteriorating financial conditions

132. Article 36 Solvency II Directive requires that the regulatory authorities have in place appropriate monitoring to enable them to identify deteriorating financial conditions in insurance or reinsurance undertakings, and the firms themselves are required to have these processes in place per Article 136 Solvency II Directive.
133. The BMA has in place an annual filing process to identify issues with minimum solvency requirements. The BMA does not have a quarterly process, although it receives information from commercial insurers on a quarterly basis that would allow it to check for a breach in the Minimum Solvency Margin as the items needed for its calculation are included. It is understood that the BMA is investing in appropriate IT that will make this possible on the scale required in due course.
134. In paragraph 18 of the Code the BMA has a requirement that the Principal Representative¹¹ "acts in an "early warning" role and monitors the insurer's compliance in accordance with Article 8A IA on a continuous basis". Article 8A IA

¹¹ The role of the *Principal Representative* is described under Principle 3.

refers to the insolvency of the insurer and to “failure by the insurer to comply with a condition imposed upon the insurer by the Authority relating to a solvency margin or liquidity or other ratio”.

Auditor’s responsibilities

135. Under Article 72 Solvency II Directive, auditors have a responsibility to report material breach of laws, impairment of functions, refusal to certify accounts and non-compliance with MCR/SCR, and generally to respond to relevant information requests from the supervisory authorities. In Bermuda, under Article 16A IA, auditors are required to report issues to the BMA related to the accounts and “any fact or matter which is likely to be of material significance for the discharge, in relation to the insurer, of the Authority’s functions under this act”. Provided exercised appropriately this is equivalent to the requirements of the Directive.

Public disclosure

136. The public disclosure requirements for Bermudan insurers are currently being developed. A consultation process is on-going, and includes the trialing of some disclosures to the regulator. This disclosure programme currently includes insurance groups and insurance firms in classes 4 and 3B. This programme would require these insurers to publish audited general purpose financial statements providing limited information on: business and performance, system of governance, risk exposure, concentration, mitigation and sensitivity, assets, technical provisions and capital management. Insurers will initially file their statements with the BMA, but these will be made public a year later. This approach may be expanded to some other classes at a later stage.

137. Within article 51 of the Directive, there are also requirements to disclose compliance with regulatory capital requirements. In this regard, we are advised that the BMA has no current plans to increase disclosure other than for groups. There is some discussion of a Financial Condition and Solvency Report, but the requirements are not currently defined and the requirement to disclose such information is not contained in the latest draft of Groups Rules. The BMA advises that it plans to review international developments in this area and tailor them to its market. The BMA regards the lack of public disclosure on capital requirements as a proportionate approach in what is largely a wholesale market, where interested stakeholders can access information through other means. However as Solvency II will not make this distinction, this is an area of non-equivalence.

138. Statutory financial statements are presented on a net basis – be it for technical provisions (TP) or for losses. Only Class 4 and 3B insurers are required to disclose both gross and ceded TP. This is an area of non-equivalence with EU regulation. BMA informed us that requirements for the disclosure of financial information on both gross and net basis will be applied to all commercial insurers (classes 3A, 3B and 4) for the 2011 year end.

139. The BMA also advises that there are no current plans to introduce any enhanced public disclosure at all to the captive market. Again the BMA considers this is a proportionate response for this sector of its market. However, relative to Solvency II, this is not equivalent. EIOPA considers the main risk from this approach to be the unrelated business that these insurers may have, where there are retail policyholders or beneficiaries.

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140. The BMA framework, made up of its Code of Conduct, rules, and guidelines, requires insurers to have in place an effective system of governance which provides for sound and prudent management of the business and an effective risk management system. Where the Code is applied to its fullest extent (for Groups, Classes 4, 3B, and in some cases 3A), other than the exceptions detailed below, it is considered that the framework is partly equivalent to that under Solvency II.

141. EIOPA has identified a number of areas where the BMA regime would have to be strengthened or addressed in order to be considered equivalent to Solvency II. These are:

- Stricter provisions around the requirements for key functions. Under Solvency II the key functions of risk, internal audit, actuarial and compliance are required for all firms. In terms of proportionality, discretion may be exercised in terms of how these functions are fulfilled but not in terms of whether or not they are required for individual insurers.
- Independence of internal audit. Under Solvency II internal audit should be independent of all other functions, whereas in Bermuda it is possible to combine this role with other functions.
- Outsourcing. There are key differences in the supervisory regime in relation to outsourcing, in terms of notification requirements to the BMA as well as the nature and scope of what can be outsourced. With regards to the latter point, this is particularly relevant to classes 1 to 3 and is covered further below.
- Public disclosure. The BMA's current regulation and plans for public disclosure are different from Solvency II in terms of (intended) scope and market reach. Solvency II is based on a three pillar approach with significant emphasis placed on pillar 3 disclosure requirements. The BMA considers that a different approach is appropriate with regards to a largely wholesale market. However the distinction between wholesale and retail markets is not made under Solvency II. It is also considered that captives' 'unrelated business' could include retail business and that these policyholders would be entitled to the same rights of disclosure in an equivalent regime.

142. Consequently where these rules apply in full (for Groups, Classes 4, 3B, and in some cases 3A) the supervisory regime should be deemed to be partly equivalent with Solvency II.

143. However with regards to smaller insurers (classes 1 to 3, and in some cases 3A), EIOPA found that the supervisory regime was not applied or intended to be applied to its fullest extent. In part this was a consequence of the BMA's view of proportionality. In particular, some of the key differences that EIOPA identified were:

- The application of the proportionality principle for the requirements on the key functions of risk, internal audit, actuarial and compliance would go further than the way it will be applied under Solvency II.
- The requirements for smaller insurers' own risk and solvency assessments are more limited and do not require them to take account of future strategy.
- There are no plans to include this sector of the market in any future

developments with regard to public disclosure.

- The extent of outsourcing that is common-place in this market is beyond that which would be considered appropriate under Solvency II.

144. Disapplication of the rules is not consistent with the principle of proportionality as it will be applied under Solvency II. Consequently where there is disapplication of the rules (for classes 1 to 3, and in some cases 3A) the supervisory regime should be deemed not to be equivalent with Solvency II.

Principles 5 and 11 - Changes in business, management or qualifying holdings

Objective – *The solvency/prudential regime of the third country shall require that proposed changes to the business or management of domestic insurance or reinsurance undertakings carrying out reinsurance activities or of groups, or to qualifying holdings in such undertakings and groups are consistent with maintaining the sound and prudent management of the domestic insurance or reinsurance undertaking or group.*

Acquisitions of insurers

145. According to Article 30D (1) IA persons with the intention of becoming a shareholder controller (Article 1A (3) to (5) IA) in a registered private insurer in Bermuda must notify the BMA. After the notification the BMA has 45 days to provide a 'no objection' notice. In addition, the BMA must be notified within 45 days of a person becoming a shareholder controller of a public insurance company, in accordance with Article 30E IA. The thresholds for notification are 10%, 20%, 33% or 50% of the capital or voting rights. Failure to give the required notification is an offence (Article 30G IA).

146. In this process the BMA is empowered to object to a new or increased controller if it is not satisfied that they are fit and proper, if the interests of clients or potential clients of the insurer are threatened or if the insurer will no longer meet minimum supervisory requirements under Article 30F IA.

147. Furthermore the BMA has the power to impose restrictions on shareholders' voting rights or to void share transfer agreements according to Article 30I IA.

Existence of provisions in relation to disposals

148. There is no legal requirement to notify the BMA of disposals of qualifying holdings.

Existence of provisions regarding the information obtainable from an undertaking and regarding thresholds prompting notification of acquisitions and disposals and regular notification (e.g. annual) of qualifying holdings, including size

149. According to Article 30J IA all insurers have to inform the BMA in writing when any person becomes or ceases to be one of their controllers.

150. However, for Class 1 and 2 insurers and Special Purpose Insurers this information only has to be filed as part of the annual financial statement under Article 17 IA, according to 30J (4a) IA.

Existence of provisions in relation to outsourcing

151. According to paragraph 56 of the Code, the insurer should have oversight and clear 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 BMA, and access to data and records in a timely manner.

152. However, the status of the Code is not directly comparable to law (see introduction). It elaborates a standard set by the BMA and that the BMA expects to be met by market participants. The BMA considers the Code of Conduct is an indicator of compliance with the Minimum Criteria set forth in the Insurance Act.

According to the BMA, failure to comply with the Minimum Criteria gives rise to enforceable actions by the BMA.

Ongoing assessment, approval and disclosure of relevant information (including portfolio transfers, changes to board and senior management and scheme of operation)

153. The IA requires that the BMA be notified of and approve all long-term business portfolio transfers (Article 25 IA) in accordance with Articles 30JA to 30JD IA. However, under Article 25 (7) IA, these requirements do not apply to reinsurance business. Therefore, there are no specific requirements for approval of reinsurance portfolio transfers.
154. Under Article 30J IA an insurer must notify the BMA of changes to its Officers. 'Officers' means directors, chief executives and senior executives exercising functions in relation to underwriting, actuarial, risk management, compliance, internal audit, finance and investment matters.
155. Articles 30JA to 30JD IA pertain to changes to business operations in relation to:
- Transfer or acquisition of insurance business being part of a scheme falling within Article 25 IA or section 99 of the Companies Act 1981;
 - Amalgamation with or acquisition of another firm;
 - Engaging in non-insurance business and activities related thereto, where such business or related activity is not ancillary to the insurance business of the insurer; and
 - Engaging in unrelated business that is retail business.
156. The changes above are qualified material according to Article 30JA IA and require approval from the BMA. Other changes to the scheme of operation do not legally require approval.
157. Further to the IA, the BMA stated that under standard industry practice a material change would be understood to include any change which significantly impacts the insurer's risk profile, solvency, liquidity, regulatory compliance or reputation.
158. From the BMA's perspective material changes would therefore also include:
- Portfolio transfers;
 - Changes in key personnel or shareholder controllers;
 - Mergers, acquisitions and divestitures;
 - Change in business plan including new products and territories;
 - Significant reduction of statutory capital and surplus; and
 - Expansion and contraction.
159. Insurers making such changes have to obtain approval from the BMA re-file their BSCR and/or business plan and pro-forma financials if the change will affect their capitalisation.
160. However, requiring approval for all portfolio transfers seems to be inconsistent with the legal basis which only requires such approval for the transfer of long-term insurance business other than reinsurance business.
161. Even though authorisation in a particular class of insurer does not impose any limitations in terms of lines of insurance business, a scheme of operation,

including details of the business which the company intends to conduct, should nonetheless be required in order for the regime to be considered equivalent. In line with this every change to such a scheme of operation should be approved by the BMA.

Specificities for 172

Details as to the existence and content of standards in respect of the undertaking's obligation to provide information on assessment of the reputation and financial soundness of the acquirer

162. In addition to the notification requirements for shareholder controllers, insurers are also required under Bermudan law to seek permission for transfers of shares under the Exchange Control Act 1972, including transfers to foreign-owned Bermuda registered entities. This requirement indirectly imposes a duty on the insurer to assess the soundness of new shareholders. The BMA provides an opinion on share transfers by issuing a 'no objection' notice. Share transfers or allotments between 1% and 4.9% are considered minor and the BMA does not necessarily require prior review of personal declaration forms. Between 5% and 49%, personal declaration forms with net worth statements are required for review, including review by the BMA's Insurance Department.

163. Where there is a majority change in beneficial ownership to an unrelated new owner of 51% or greater, this purchase is reviewed by the ALC, which means that the following items will have to be provided to the BMA:

- Information on the principals (parent company):
 - Audited financial statements of the parent
 - Regulatory filings, if applicable
 - Background information
- Information on the individuals involved with the insurer:
 - Personal declaration forms
 - Bank references
 - Net worth statements
 - Curriculum vitae

164. If the overseas parent of the Bermudan insurer amalgamates with another overseas company, the BMA explains that it only notes the change, as it has no control over the overseas company. However, if the overseas parent wishes to sell all or part of the Bermudan insurer to an unrelated entity, the BMA's Authorisation and Compliance Department, with the input of the Insurance Department, must indicate whether they will approve the change in control.

165. Finally, should the overseas parent place an intermediate company between the Bermudan insurer and themselves, or remove an intermediate company, the ultimate beneficial owner does not change and there is no impact on the class of the company, and consequently the BMA would give its approval.

Specificities for 260

Existence of provisions regarding the information obtainable from an undertaking relative to thresholds prompting notification of acquisitions/disposals and regular notification of qualifying holdings, including size

166. For groups the insurer must notify the BMA of changes in shareholders and

controllers within 45 days of the person becoming or ceasing to be a shareholder or controller, following the same rules as solo insurers under Articles 30D to 30JD IA.

167. The legal basis is equivalent, however the BMA has not been able to share any examples relating to groups. We note, however, that the BMA's group supervision regime is still in its early stages.

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168. Principles 5 and 11 are not equivalent. Although the IA requires that insurers' shareholder controllers be assessed, neither the IA nor any other law requires insurers to provide the BMA with details of changes to their scheme of operation. Therefore only a few critical changes in business, including engaging in non-insurance business, require BMA approval. To be equivalent to Solvency II would require legally binding criteria to achieve a clear set of business change situations necessitating BMA approval rather than relying on internal and unpublished supervisory practice. In addition, there is significant outsourcing in Bermuda, in particular for captives. Full equivalence would require legally binding requirements around the notification process for the outsourcing of key functions. Furthermore, the BMA would also need to develop publicly available guidance regarding the documents and information required for an appropriate shareholder controller assessment.

Principles 6, 7 and 12 – Solvency Assessment

Objective - *The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings and groups to hold adequate financial resources.*

The assessment of the financial position of domestic insurance and reinsurance undertakings and groups in the third country shall rely on sound economic principles and solvency requirements shall be based on an economic valuation of all assets and liabilities.

The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings and groups to establish technical provisions with respect to all of their insurance and reinsurance obligations towards policyholders and beneficiaries of insurance and reinsurance contracts.

The solvency/prudential regime of the third country shall require that assets held to cover technical provisions are invested in the best interests of all policyholders and beneficiaries taking into account any disclosed policy objective and that domestic insurance and reinsurance undertakings and groups only invest in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report.

The solvency/prudential regime of the third country shall require domestic insurance and reinsurance undertakings and groups to meet capital requirements that are set at a level which ensures that in the event of significant losses policyholders and beneficiaries are adequately protected and continue to receive payments as they fall due to a level of confidence at least equivalent to that achieved by Article 101 of Directive 2009/138/EC. Those capital requirements shall be risk-based with the objective of capturing quantifiable risks. Where a significant risk is not captured in the capital requirements, then that risk shall be addressed through another supervisory mechanism. The calculation of capital requirements shall ensure accurate and timely intervention by supervisory authorities of the third country.

The solvency regime of the third country shall require domestic insurance and reinsurance undertakings and those which are part of a group to maintain a minimum level of capital, non-compliance with which shall trigger immediate and ultimate supervisory intervention.

The solvency regime of the third country shall require domestic insurance and reinsurance undertakings to meet the capital requirements referred to above with own funds that are of a sufficient quality and which are able to absorb significant losses. Own-fund items considered by the supervisory authorities to be of the highest quality shall absorb losses both in a going concern and in case of a winding up.

For group supervision assessments:

The calculation of group solvency in the third country's prudential regime shall produce a result that is at least equivalent to the result achieved by either one of the calculation methods set out in Articles 230 and 233 of Directive 2009/138/EC. The calculation shall ensure that there is no double use of own funds to meet the group capital requirement and that the intra-group creation of capital through reciprocal financing is eliminated.

Financial supervision

169. At a high level the legislation requires that any concern regarding the insurer should be reported to the BMA.

170. Some of the relevant provisions, however, have aspects which may be unclear, and some overlap with one another, which is also detrimental to clarity and transparency. For example, Article 31A IA, applying to Classes 3, 3A, 3B and 4 only, requires an insurer failing to meet its Minimum Solvency Margin (MSM) to send the BMA a written report within 30 days covering the causes of the failure and the ways the insurer intends to rectify it. At the same time Article 8A IA, applying to all classes, requires the PR to notify the BMA immediately if an insurer is likely to become insolvent or “fails to comply substantially with a condition imposed upon the insurer by the [BMA] relating to a solvency margin ratio”.
171. It is not clear why the provision relating to insolvency does not apply identically to all insurers, and why, for Classes 1 and 2, the reporting obligation lies with the PR and not with the insurer itself.

Valuation

172. The BMA legislation regarding the valuation of assets and liabilities for commercial insurers is under revision: in effect, current legislation does not take into account recent developments at international level. The current standards include a mixture of fair value and cost valuations (for example for bonds held to maturity or real estate) that may not be applied consistently across the market.
173. Therefore the BMA’s current framework cannot be considered to be equivalent to the economic balance sheet required by the Solvency II directive, given the lack of consistency with which assets and liabilities are measured.
174. Class 4 and 3B insurers are already required to make some adjustments to the valuation of certain assets and liabilities, under Article 17A IA which states that “Every Class 3B or Class 4 insurer shall, in addition to preparing statutory financial statements under section 15, prepare financial statements as required by this section (“additional GAAP financial statements”) in respect of its insurance business for each financial year. Such financial statements shall be prepared in accordance with any one of the following standards or principles:
- International Financial Reporting Standards (‘IFRS’);
 - generally accepted accounting principles (‘GAAP’) that apply in Bermuda, Canada, the United Kingdom or the United States of America; or
 - such other GAAP as the Authority may recognise.”
175. The BMA is currently undertaking consultation to move towards an economic balance sheet that should produce consistent valuation of assets and liabilities. That framework is expected to be applied initially to Classes 3A, 3B and 4.
176. That upcoming framework is expected to rely on fair value for assets and liabilities in line with IFRS. The BMA intends to follow the IASB work, however there remain material uncertainties as to what the outcome of that work will be.
177. As a consequence, the equivalence assessment of the valuation standards will have to be reconsidered once those uncertainties are clarified.

Technical provisions

178. As well as the variation in valuation techniques, discretion in the discounting of TP may also lead to similar insurers applying different treatments. It should also be noted that the BMA relies on the appointed actuary opinion to assess whether TP are calculated in line with the legislation in force and the non-binding guidance issued by the BMA (see the previous section).
179. Under Article 17A IA, as outlined above, insurers may prepare financial

statements according to various accounting standards, with the result that TP are not assessed consistently across the market, preventing comparison between undertakings.

180. There remain material uncertainties around the outcome of the IASB's work in this area, which the BMA intends to follow in their own moves towards a consistent economic balance sheet. These relate in particular to the valuation of technical provisions with regards inter alia to boundaries of contracts, discount rate and risk margin.
181. The equivalence assessment in relation to technical provisions will have to be reconsidered once those uncertainties are clarified.

Own funds

182. In the current framework, assets such as goodwill, deferred tax assets and prepayments are not admitted. The BMA also currently requires insurers to comply with a liquidity ratio where an insurer must hold liquid assets such as cash, securities or receivables that must be at least 75% of total liabilities, excluding deferred tax liabilities. To further enhance policyholder protection, the BMA has published for consultation draft legislation envisaging a transition to a tiered capital system. The liquidity requirement is linked to the specificities of non-life reinsurance.
183. The BMA is proposing to introduce a tiered capital system for Classes 3A, 3B and 4 effective from year end 2011, with categorisation into tiers based on the instrument's ability to absorb losses in the case of winding-up or on a going concern basis.
184. Tier 1 capital will be the highest quality capital; it is available when required and can fully absorb losses at all times. Capital instruments included in Tier 1 should fully satisfy the following characteristics:
- Full loss absorbency in going concern, run-off, insolvency, and winding-up;
 - Subordination in going concern, run-off, insolvency, and winding-up;
 - Permanency (free from requirements or incentives to redeem);
 - Perpetuality (undated or adequate duration); and
 - Absence of mandatory fixed charges and encumbrances.
185. Tier 2 capital includes other capital instruments that, to varying degrees fall short of the quality of Tier 1 capital, but nonetheless provide protection to policyholders. Tier 3 consists of capital instruments not meeting all of the characteristics of Tier 1 or Tier 2 but having full subordination on winding-up.
186. It is worth noting that under the upcoming BMA legislation, certain debt instruments (e.g. subordinated liabilities) will be considered to be Tier 1 ancillary capital if they meet all the criteria of Tier 1 capital. Therefore while the term 'ancillary capital' has a different meaning to that under Solvency II, the same outcome in terms of classification of own funds is achieved.

Minimum Solvency Margin (MSM) coverage

187. For Class 3B and 4 insurers and insurance groups only the high quality capital of Tiers 1 and 2 can cover the MSM. In addition, given that a breach of the MSM would constitute insolvency for regulatory purposes, a higher proportion of the capital available to meet the insurer's MSM must be Tier 1. Consequently, the BMA proposes that the MSM requirement may be met by a minimum of 80% Tier 1 capital and maximum of 20% Tier 2 capital (equivalent to Tier 2 not exceeding

25% of Tier 1). The same limits are proposed for 3A insurers.

Enhanced Capital Requirement (ECR) coverage

188. The BMA has proposed in its draft legislation for Class 3B and 4 insurers (and insurance groups) that capital covering the ECR (defined as the greater of the BSCR or the MSM) must be at least 60% Tier 1 capital and no more than 15% Tier 3 capital.
189. The BMA has proposed in the draft legislation to allow Class 3A insurers to hold a minimum of 50% Tier 1 capital and a maximum of 15% Tier 3 capital for the purposes of the ECR.

Capital requirements

The existence of two risk-based capital requirements

190. BMA regulation defines two capital requirements: the Minimum Solvency Margin (MSM) and the Bermuda Solvency Capital Requirement (BSCR).
191. The MSM applies to all insurers.
192. The BSCR is currently in place for Class 4 (since 31 December 2008) and Class 3B (since 31 December 2010); it is scheduled to be in place for Class 3A insurers from 31 December 2011.
193. The BSCR is not scheduled to be introduced for Classes 1, 2 and 3.
194. It follows from the above that Class 1, 2 and 3 insurers are subject to only one capital requirement.
195. The Solvency II Directive provides that insurers should comply with two capital requirements, the MCR and the SCR, the breaches of which trigger different degrees of supervisory intervention. This is therefore an area where the Bermudan system diverges from Solvency II.

Risk sensitivity of the lower capital requirement

196. The non-life MSM is defined as the maximum of three calculations: 'Calculation A' is an absolute floor, 'Calculation B' is based on net premiums, and 'Calculation C' is based on technical provisions.

Non-life MSM:

	Calculation A (\$m)	Calculation B (% of premiums)	Calculation C (% of TP)
Class 1	0.12	1st tranche: 20% 2nd tranche: 10%	10%
Class 2	0.25	1st tranche: 20% 2nd tranche: 10%	10%
Class 3	1	1st tranche: 20% 2nd tranche: 15%	15%
Class 3A	1	1st tranche: 20% 2nd tranche: 15%	15%
Class 3B	1	1st tranche: 20% 2nd tranche: 15%	15%
Class 4	100	50% ¹²	15%

197. Under Solvency II the MCR is the lower control level, the breach of which would

¹² With limit on ceded premiums at 25% of gross premiums.

trigger the strongest supervisory actions. It corresponds to an amount of own funds “below which policyholders are exposed to an unacceptable level of risk” (Article 129 (1b) Solvency II Directive) and is calibrated using a VaR (Value-at-Risk) measure with an 85% confidence level over a one-year period (Article 129 (1c) Solvency II Directive). Since only a breach of the lower capital requirement allows the supervisor to invoke its strongest actions, it follows that the lower capital requirement should not be too low in relation to the risk profile of the insurer or in comparison with the higher requirement, and should remain sufficiently risk-based. Under Solvency II it is therefore floored at 25% of the SCR.

198. The absence of any linkage between the MSM and BSCR, and the factors on which the MSM calculation is based, result in the MSM being insufficiently risk-sensitive¹³.
199. In addition, under Solvency II the absolute floor of the MCR is €3.2m for reinsurers, except for captive reinsurers where it is €1.0m (Article 129 (1d) Solvency II Directive). The Bermudan absolute floor (calculation A) is lower than this for a number of classes.
200. During the wrap-up session that closed the on-site visit, the BMA representatives seemed to indicate that the design of a new MSM may be envisaged in the future.

The higher capital requirement (BSCR)

Calibration of the BSCR

201. The BSCR is calculated to cover unexpected losses arising from existing business that correspond to the Tail VaR subject to a confidence level of 99% over a one-year period. It is generally accepted that a Tail VaR subject to a confidence level of 99% over a one-year period is at least as strong as a VaR subject to a confidence level of 99.5% over a one-year period and as such, provides equivalent policyholder protection as under the Solvency II Directive requirement.

EIOPA’s approach to assessing the equivalence of the BSCR

202. In assessing whether the BSCR is equivalent to the SCR, EIOPA’s approach was not to look for an exact match between the BSCR and SCR formulae, but rather to assess whether the BSCR and the SCR provided a similar overall level of safety and risk-sensitivity. The following three paragraphs illustrate this approach.
203. In the BSCR formula, the correlation factor between equity and property risks is **1**; in the SCR standard formula, it is **0.75**. The SCR formula thus provides a slight incentive for an insurer to diversify its investments between equities and property; the BSCR formula does not provide such an incentive. However, the difference in capital charge is very small, and so this difference could not reasonably be a basis for a finding that the two capital requirements are not equivalent.
204. In the BSCR formula, the correlation between credit risk on the one hand and fixed income, equity and interest rate risks on the other hand is **0**. In Solvency II, the correlation between counterparty default risk (which corresponds to the BSCR credit risk) and market risk (which corresponds to the BSCR fixed income,

¹³ One Class 3A reinsurer supervisory file that was examined by EIOPA during its on-site visit provided an illustration of this. The reinsurer was a ‘top-layer’ that had incurred no loss during the past 5 years. As a consequence, the MSM requirement was very low for this high risk-profile reinsurer.

equity and interest rate risks), is **0.25**. A similar example is the correlation between premium and reserve risks: the BSCR assumes that it is **0** — which might seem counter-intuitive — whereas in the SCR, the proposed correlation has been set as **0.5** in each line of business¹⁴. These differences per se do not mean that the BSCR is less “prudent” than the SCR: the overall prudence of the BSCR and SCR also crucially depends on the calibrations of the individual modules and sub-modules.

205. On the other hand, in the SCR the capital charge for 100 credit exposures of €1 with 100 independent reinsurers is **a tenth** of the capital charge for one credit exposure of €100 with one reinsurer (see below). This is intended to encourage insurers to diversify their credit exposures. In the BSCR, the credit risk capital charge is insensitive to such diversification: both the above exposures attract **the same** capital charge. EIOPA regard this difference in risk-sensitivity as material in terms of risk-based supervision.

The non-life BSCR is globally risk based

206. The BSCR formula is reproduced in Annex 1. Using different terminology to Solvency II, the BSCR covers the following risks: counterparty risk (BSCR: credit risk); spread risk (BSCR: fixed income risk); market risk (BSCR: equity risk); underwriting risk (BSCR: premium risk and reserve risk); interest risk; catastrophe risk; operational risk.

Some risks covered by the SCR standard formula, are not covered by the BSCR

207. The BSCR does not include the risks covered in the currency and concentration risk sub-modules of the SCR’s market risk module.

208. This point was raised during the on-site visit. The BMA representatives indicated that given usual Bermudan market practice, the incentives within the BSCR operational risk module, and the close monitoring of insurers by the BMA, it was very unlikely that an insurer would take a substantial currency position, or concentrate their exposure on one single counterparty. Accordingly, the BMA did not believe that such modules were appropriate for its market.

209. While the point relating to risk concentration is examined separately below, the reasoning put forward by the BMA also raises a general issue. In the EEA, risky positions are preventatively and automatically disincentivised by such risk modules. This approach acknowledges that since markets will continue to evolve and develop, and since it will not always be possible for supervisors to close and pro-actively monitor all insurers’ risks, such risk modules are not superfluous even where such positions are not general practice.

Credit risk: transparency

210. The multiplying factor for credit risk in the BSCR formula is 0.707, rather than 1 as in the other risk modules.

211. This unusual feature means it is not always obvious what the credit risk charge is. For instance, while the BSCR specification seems to indicate that the capital charge for one retrocession receivable of €100 is **€10**, in reality the effective capital charge is $0.707 * €10 = \mathbf{€7.07}$.

212. This gives a misleading picture of the credit risk charge, and makes it difficult to compare it with the credit risk capital charge under other standard formulae, or with another risk capital charge under the BSCR.

213. Annex 1 sets out how the BSCR formula could be amended to improve

¹⁴ Cf. QIS 5 Technical Specifications, § SCR.9.31 p. 202.

transparency and allows comparison. It should be underlined that the proposed amendment does not change the value of any capital charge but only allows better readability, understanding and transparency.

Some risks are not covered under the BSCR in a risk-based way; or, the BSCR sensitivity to these risks is very low, in a way that is not equivalent to Solvency II

214. While the BSCR formula introduces in some areas some quite subtle differences between fairly similar risk profiles — for instance, the apparent credit risk charge for a €100 exposure to a retrocedent is **€10**, while it is **€9.40** for a €100 exposure to an insurer that is not a retrocedent¹⁵ — in other respects the BSCR formula fails to differentiate between risk profiles that are markedly different.

- a. One exposure of €100 to a single counterparty, as opposed to 100 exposures of €1 to 100 independent counterparties.

As mentioned above, in the Solvency II SCR the scenario with multiple counterparties would result in a capital charge about **a tenth** of the one for the single counterparty. The SCR thus encourages and rewards risk diversification.

In the BSCR formula, these two situations lead to the **same** capital charge.

- b. One exposure of €100 to a AAA-rated reinsurer, as opposed to one exposure of €100 to a B-rated reinsurer.

In the SCR (under the QIS 5 calibrations), the exposure to the AAA-rated reinsurer contributes **0.68** to the counterparty default risk charge; the exposure to the B-rated reinsurer contributes **36.4**.

In the BSCR, both exposures contribute **the same** amount (**6.65**) to the credit risk charge.

- c. Cash at bank.

In the BSCR, cash at bank seems to be covered through the fixed income risk module. The capital charge is 0.3% of the amount, and does not vary according to the soundness of the bank. The BSCR does not take into account whether the exposure is to a single or multiple counterparties.

Internal models

215. The Bermudan regulation on internal models consists of the Insurance (Prudential Standards) (Class 4 and 3B Solvency Requirements) Order 2008 based on Article 6A IA. As the name implies, this order currently applies to class 4 and 3B insurers only, but the BMA intends to broaden its scope to include Classes 3A and Groups in 2011. Furthermore, the BMA has codified its criteria for evaluating internal models in its guidance note entitled "Standards and application framework for the use of internal capital models for regulatory capital purposes", dated June 2009.

216. Our assessment is of a preliminary nature as the BMA has recently (in 2010) conducted a pilot programme with two insurers, designed to refine the BMA's internal capital models assessment process.

Calibrations

217. According to section A30 in the aforementioned guidance note, internal models should be calibrated such that the resulting capital requirement gives a confidence level of 99% Tail VaR over a one year period with a complete run-off

¹⁵ As mentioned above, the effective contributions of these two credits to the credit risk module are $0.707 \times 10 \text{ €} = \mathbf{7.07\text{€}}$, and $0.707 \times 9.4\text{€} = \mathbf{6.65\text{€}}$.

to extinction of all liabilities.

218. If another calibration metric is used, the insurer has to demonstrate that this metric is at least as effective as 99% Tail VaR over a one year period. It should be noted that the BMA expresses a preference for coherent risk measures¹⁶, which is more specific guidance than is given under Solvency II. In light of the above observations it can be concluded that the calibration standards codified in section A30 of the guidance note on internal models are equivalent to the requirements of the Solvency II Directive.

Pre-approval

219. Article 5 of the Class 4 Standards requires that the internal model be approved before it can be used to calculate regulatory capital by the insurer.

Adequate risk management system

220. A requirement for the insurer to demonstrate prudent capital management is one of the pre-application conditions for internal models, as stated in section 20 of the aforementioned guidance note.

Use test

221. The mandatory use test is prescribed by section A15 of the guidance note. As far as could be seen in the documents provided, the BMA's understanding of the use test is consistent with the one in Solvency II, except that it also incorporates the profit and loss attribution requirement.

Statistical quality standards

222. The guidance note defines the appropriate treatment of diversification effects in internal models more closely than Solvency II, which could be regarded as a conservative approach. Risks associated with derivatives, guarantees and any contractual options should be reflected in the internal model, including any off-balance sheet exposures, which again is equivalent to the requirements of the Solvency II Directive. Given these observations, it can be concluded that the statistical quality standards prescribed by the BMA are broadly equivalent to those required by the Solvency II Directive.

Validation standards

223. According to the guidance note for internal models, a periodic validation process should exist and should include a review of the model's predictive performance, an on-going assessment of the appropriateness of material assumptions and methodologies, a review of model output for reasonableness and an examination of the sensitivity of results to changes in key underlying assumptions. This is equivalent to the requirements of the Directive.

Documentation standards

224. The documentation standards codified in section A40 of the guidance note on internal models are equivalent to the requirements of the Solvency II Directive.

Profit and loss attribution

225. Profit and loss attribution is considered to be a part of the use test under the BMA regime. However, this is not yet reflected in the guidance note. BMA considers the concept of profit and loss attribution as covered by the validation test prescribed by the guidance note, since it refers explicitly to requirements to compare model results to historical performance.

¹⁶ As set out in P. Artzner, F. Delbaen, J-M. Eber and D. Heath, "Coherent Measures of Risk", *Mathematical Finance*, Vol. 9, No. 3. (1999).

226. It is our view that explicit requirements for profit and loss attribution would be beneficial as part of best practice.

Partial internal model

227. Currently no provision is made for partial internal models in Bermudan insurance regulation. However the BMA is working on expanding the scope of the internal model review framework to consider partial internal models.

Investments

228. The Solvency II provisions on investments are set out in Articles 132 to 135 Solvency II Directive.

229. The Bermudan investments provisions are set out in paragraph 4.1.2 of the Code. As outlined under Principle 4, some 'requirements' of the Code will not be applied in full to all market participants, particularly in the case of classes 1 to 3.

230. Having this in mind, the provisions of paragraph 4.1.2 are, by and large, equivalent to those of Solvency II; in some aspects however, they seem to lack precision. For instance, paragraph 31 of the Code states that "The concentration risk component of the insurer's risk management framework should include [...] identifying, responding to, monitoring, mitigating, and reporting [...] credit risk arising from an individual risk exposure [...]." This absence of a precise obligation can be understood in light of the lack of a concentration risk module in the BSCR standard formula applying to Classes 3A, 3B and 4. Paragraph 32 and 33 of the Code provides additional requirements on the market and credit risk components that partially offset the above mentioned concern.

Specificities for 227

Sufficient information on the constitution of own funds

231. Insurers in Bermuda are required to report intra-group transactions on a quarterly basis, except for captives. As laid out under Principle 8, it can be assumed that the BMA has a good overview over the scope of the group and any relevant subsidiaries. Hence it can be concluded that the BMA would have enough information to detect double gearing of capital.

Specificities for 260

232. The consolidated approach is used to address double gearing and intra-group creation of capital, since all such arrangements are removed from the calculation. The BMA requirements are therefore equivalent to Solvency II in this respect.

233. The assessment of fungibility and transferability of assets is conducted at entity level to avoid netting out the difference between the value of the encumbered assets for policyholder obligations and the higher of the values of the obligations or the capital requirements arising from those assets. Solo deficits are deducted from available statutory capital and surplus in the full amount where the group exercises control, and a proportional share of participation is deducted where the group exercises significant influence.

234. The group BSCR model applies a combination of risk-based capital factors, a stress test, and stochastic processes, addressing all material quantifiable risks, to arrive at a capital requirement. Where risks are not appropriately reflected in the capital requirement, adjustments can be made under Article 6D IA.

235. To ensure that the ECR addresses all risks applicable to the group, both asset charges and non-regulated surcharges are applied to non-regulated entities based upon the level of risk they pose to the group. Capital requirements for

non-insurance financial entities are aggregated net of intra-group transactions to yield the overall ECR.

236. Under Article 6D IA, the BMA may make adjustments to either the ECR or the available capital and surplus, as it considers appropriate, for example where the BMA concludes that the risk profile of the group deviates significantly from the assumptions underlying its ECR or the group's assessment of its risk management policies and practices in calculating its ECR.
237. The BMA also assesses intra-group impacts by closely reviewing investments in affiliated companies, intra-group reinsurance and off-balance sheet transactions. The intra-group and off-balance sheet impacts will be considered in determining any capital add-ons for the group.
238. In addition, the designated insurer for an insurance group has an obligation to report certain events to the BMA, including significant losses that are reasonably likely to cause the group to be unable to comply with the applicable ECR. In the event of such losses, the designated insurer shall submit a BSCR model reflecting an ECR prepared using post-loss data within 45 days of notification of the loss event.
239. The BMA stated that it expects to consult and involve overseas supervisors in examining a group-wide internal model and in making the final assessment. It should be pointed out that the BMA has only recently completed a pilot run with respect to internal model approval and that practical implementation of the approval process, including the supervisory cooperation aspects, could not be assessed during the on-site visit.
240. Where the BMA is the group supervisor, it is required under Article 27E (a) IA to consult other involved authorities in matters of common concern. The BMA emphasised that it would consult and involve in advance the relevant supervisory authority prior to carrying out any inspections in the EEA.
241. Article 27 of the Group Rules requires insurance groups to maintain available statutory capital and surplus equal to or in excess of the group's ECR. Failure to do this would constitute a breach under the Act. The legislation does not prescribe the exact actions to be taken upon a breach of the ECR; rather, Section 32A (1) grants the BMA the powers to issue any remedial directions the BMA believes is "desirable for safeguarding the interests of policyholders and potential policyholders of the insurance group." Appreciating that any action taken by the BMA within a group's context may affect solo entities in other jurisdictions (e.g. where there are support agreements or other intra-group transactions, etc.), the BMA's position is that it would consult with host supervisors in determining the most appropriate direction having regard for the particulars of the group and views of host supervisors.
242. Under Article 3 of the Group Rules the ECR is based on the group BSCR or an approved internal model, subject to a requirement that it should "at all times be an amount equal to, or exceeding, the minimum margin of solvency within the meaning of paragraph 25 of the Group Rules."

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243. EIOPA's overall advice on Principles 6, 7 and 12 is that the BMA's supervision of

Class 3A, 3B and 4 insurers is largely equivalent, subject to the equivalence of upcoming valuation standards, and subject to other caveats that are summarised hereunder. This would need to be revisited and verified once the regime is finalised. The BMA's supervision of Class 1, 2 and 3 insurers is not equivalent. The following paragraphs elaborate on this advice.

244. EIOPA cannot positively conclude on the current valuation framework, as there is no comparability between insurers since it is possible for them to adopt a variety of different valuation standards. EIOPA is also unable to conclude on the equivalence of the BMA's proposed valuation standards for assets and liabilities, given the material uncertainties which remain around the economic balance sheet framework being developed.
245. Own funds requirements can be considered equivalent to Solvency II, subject to their implementation as planned in the draft regulation for Classes 3A, 3B and 4.
246. The MSM, which is for commercial insurers the lower BMA capital requirement, is not equivalent to the MCR. It is not risk-based and in practice can be very low for very high risk reinsurers.
247. The BSCR (the higher BMA capital requirement, which will only be applicable to commercial insurers), incorporates a number of risks in a way that seems broadly equivalent to Solvency II.
248. For some risks, the BSCR lacks risk-sensitivity compared to the SCR. These risks include currency risk, concentration risk, and counterparty risk.

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249. The intensity of captive supervision seems low. The BMA receives regulatory reports submitted by the insurers and supervises the insurance managers.
250. The BMA capital requirements that apply to captives are not equivalent to Solvency II capital requirements, despite the fact that Bermudan captives can write third-party liability business and, to varying extents, unrelated business. In effect, only one capital requirement (the MSM) applies to Bermudan captives. And this capital requirement is not risk-sensitive.
251. The BMA's proposed regulatory framework with regard to internal models, as discussed above, is equivalent to Solvency II. However that framework is only applicable to Class 3B and 4 insurers and might still be subject to revision to reflect the results of the pilot study. It is not possible to come to any final conclusions on Classes 3A and groups, as they will not be included in the internal model regime until 2011.
252. In some areas — including the reporting of concerns to the supervisor, the definition of the BSCR formula and investments rules — BMA legislation could be clearer and/or made directly applicable to insurers rather than to the PR.

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253. The BMA's requirements in relation to group-specific aspects of own funds are equivalent to Solvency II if put in place as foreseen in the upcoming legislation.
254. It was not possible to come to any conclusions in terms of the internal model regime applicable to groups at this stage, as they will not be included in the internal model regime until 2011.

Principle 8 - Parent undertakings outside the Community: scope of group supervision

Objective - *The supervisory authorities of the third country shall have a legal or regulatory framework for determining which undertakings fall under the scope of supervision at group level.*

The scope of supervision at group level shall at least include all undertakings over which a participating undertaking, as defined by Article 212 of Directive 2009/138/EC, exercises dominant or significant influence. The scope may exclude undertakings where this would be inappropriate to the objectives of group supervision.

255. The general definition of an insurance group under Article 1 IA is complemented by Article 25 IA which clarifies that it will include all entities under the control or significant influence of the parent undertaking. For this purpose the BMA bases its considerations on the accounting definition of dominant and significant influence according to the IASB. At the same time, the BMA has the power under Article 27C IA to include or exclude an entity from the scope of the group, if this is deemed appropriate to the objectives of group supervision. The BMA relies on the insurer's financial filings, as well as the report on intra-group transactions, to identify entities which may need to be included in the group. The BMA has clear criteria for determining whether it is the group supervisor, as laid out in Article 27B IA. The criteria under Article 27B (3b and c) IA mean that no Bermudan insurers of any size may be excluded from consideration as to whether BMA group supervision should apply. The practical consideration behind the criteria is the BMA's ability to exercise effective group supervision, for example in terms of access to the necessary information.
256. The BMA will have a defined procedure (in the context of its group rules coming into effect at the end of 2011) for coordination with the other authorities involved in determining the group supervisor. If even after negotiations no group supervisor can be identified, due to constraints or unwillingness on the part of the jurisdictions involved, the BMA will consider defining the part of the group in its own jurisdiction as a group for supervisory purposes and ensure that at least for that part of the group effective group supervision can be guaranteed. If other supervisors claim the role of group supervisor as well as the BMA, the BMA will consult them and engage in discussions to determine the authority best suited to be group supervisor. If the group is already under group supervision that the BMA deems equivalent, the BMA will consider recognising another group-wide supervisor. The BMA emphasised during the on-site visit its willingness to build a relationship of trust with other supervisors. It should be noted that under the BMA approach, where it does not consider itself to be in a position to exercise effective group supervision it may conduct its own analysis regarding the suitability of other supervisors to take on this role, whom they may then approach. However, the BMA stated that its next step would be to consider the viewpoint of all the other regulators involved.
257. The BMA's duties as group supervisor are codified in Article 27E IA and require a similar level of supervisory activity to the Solvency II Directive. The BMA presented to the assessment team two pilots for group-wide supervision on insurance groups from its jurisdiction, which evidenced a sound supervisory approach and the initiation of cooperation with other jurisdictions. If the BMA is the group supervisor, under Article 27E (a) IA it is required to consult the other authorities involved in matters of common concern. The BMA emphasised that it

would consult and involve in advance the relevant supervisory authority, prior to carrying out any inspections in the EEA.

258. Under Article 27C IA the BMA is required to notify the supervisory authorities concerned of any exclusions it makes from group supervision and the reasons they were undertaken.

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259. In light of these observations it can be concluded that the supervisory regime of Bermuda is likely to be equivalent in respect of Principle 8. However the Bermudan regulatory framework for group supervision is still under development, and the application of group-wide supervision is – following the two pilot runs – just about to be launched for all groups.

Principle 9 - Parent undertakings outside the Community: cooperation and exchange of information between supervisory authorities

Objective - *Third country supervisory authorities shall be empowered by law or regulation to enter into coordination arrangements to ensure that the requirement in Article 261(2) of Directive 2009/138/EC can be met.*

Determination of the group supervisor

260. The BMA's proposed procedure in relation to the identification of the group supervisor is dealt with under Principle 8 above. In respect of the rules and guidelines regarding the determination of a group supervisor, there will inevitably be differences in wording and possible interpretation between regimes. EIOPA will therefore recognise a broadly similar approach to determining group supervision as equivalent, providing this does not prejudice the proper exercise of supervisory responsibilities under Solvency II. Therefore where a third country has been assessed as equivalent, it is essential that there be cooperation between all supervisors concerned prior to decisions on group supervision being taken and communicated to insurers.

Rights and duties of the group supervisor

261. Article 27 IA sets out the BMA's high level group supervision powers and responsibilities. Further to this the BMA has developed a document titled "Supervisory cooperation and information exchange" which sets out the BMA's approach to supervisory colleges, in particular the way it proposes to operate them in its capacity as a group-wide supervisor. In developing it, the BMA has consulted U.S. and a few European supervisors, and followed the IAIS model. The document is not binding or compulsory, and could be subject to change in future as and when the BMA finds it appropriate.

262. Point 3.1. (a) of the BMA document states that "The Authority will consider establishing a supervisory college where it is necessary to improve the effectiveness and efficiency of group wide supervision. Underlying this consideration will be the principle of materiality and proportionality. The Authority currently would only consider the establishment of Supervisory Colleges for the Class 4 and 3B insurers where it considers itself to be the group wide supervisor or there is ambiguity over which regulator is to act as the Group Wide Supervisor."

263. In contrast to this, Article 248 (2) Solvency II Directive provides that "In order to facilitate the exercise of the group supervision tasks referred to in paragraph 1, a college of supervisors, chaired by the group supervisor, shall be established."

264. There thus exists a clear difference between the two systems, since the establishment of a college is an obligation under Solvency II but not under the BMA regulation. The BMA's general ability and willingness to exchange information under conditions of professional secrecy is noted under Principle 2.

265. Under Article 261 Solvency II Directive, where there is a positive equivalence finding for Article 260, Articles 247 to 258 of the Solvency II Directive will apply mutatis mutandis. Currently, BMA binding legislation does not provide specific requirements as to the information exchange that needs to be ensured where a college of supervisors is not set up. Furthermore, it is difficult to rely on the non-binding BMA document on "Supervisory cooperation and information exchange", since changes may be made to it without prior consultation of other supervisory authorities.

Exchange of information and cooperation

266. Article 27E (a) IA makes the BMA responsible as group supervisor for “coordination of the gathering and dissemination of relevant or essential information for going concerns and emergency situations, including the dissemination of information which is of importance for the supervisory task of other competent authorities”. Elaborating on this, point 4.3 of the aforementioned BMA document states that “The key areas that the Authority would be asking the Supervisory College to share information on would include the following:

- information on major intra-group transactions (dividends, capital injections, etc.);
- information on various risk areas;
- the results of risk assessments conducted by each supervisor;
- reports and letters drawn up by each authority on matters of major importance;
- summaries of the findings of on-site investigations;
- developments in markets that constitute the group’s business areas;
- important approvals granted by each authority, or in progress;
- significant organisational changes in the group;
- changes in management or ownership, or the establishment of a presence in another country.”

267. As the approach set out in the document remains under development, the possibilities for assessing practical examples of information exchange within this framework were limited.

268. As the BMA further develops its approach to colleges, it would be beneficial to include defined processes in relation to cooperation and information sharing under both going concern and crisis circumstances. In particular, clarity is needed on what the supervisors involved (both group and solo supervisors) need to do under crisis circumstances (breach of capital requirements or other exceptional circumstances) to commence the resolution of such a situation.

Dispute solving mechanism

269. The aforementioned BMA document does not currently include any details of the decision-making process in the college of supervisors, and the BMA currently does not have any specific procedures set down for resolving disputes in case of disagreement with other relevant supervisory authorities.

General supervisory powers to require insurers to submit necessary information

270. Under Article 27F IA, the BMA is empowered to make rules applying to “designated insurers” which take into account, in their case, the activity of the group to which they belong, including rules relating to supervisory reporting and disclosures in respect of the insurance group. Article 29 IA further sets out the BMA’s ability to require information and reporting from such designated insurers (including “such information as the Authority may reasonably require with respect to matters that are likely to be material to the performance, in relation to [...] the relevant insurance group, of its functions under this Act”).

The assessment of the application for a group internal model

271. There are 21 groups in Bermuda which use an internal model (market,

underwriting and reserving risk). Six to nine groups are expected to seek the approval of an internal model for regulatory purposes.

272. The BMA is currently developing the supervisory review process for its group regulatory regime and will work with other supervisors in formalising the procedures and requirements for group internal capital model approval. Thus, the BMA will provide further guidance regarding coordination with other supervisors regarding the approval process in the future. At the current time there is no guidance or rules in relation to group internal model coordination.

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273. Principle 9 is partly equivalent. Full equivalence with Solvency II requirements would require some attention to: cooperation in relation to the determination of the group supervisor; how the BMA will ensure cooperation takes place where there is no college of supervisors; how the supervisors concerned should approach cooperation in a crisis situation; the establishment and composition of colleges; information exchange; dispute-solving mechanisms; and how supervisors will cooperate for the approval of a group internal model.

Annex 1: The non-life BSCR

The BSCR formula is as follows:

$$\text{BSCR} = \sqrt{C_{fi}^2 + C_{eq}^2 + C_{int}^2 + C_{prem}^2 + \left(\frac{1}{2} C_{cred} + C_{rsvs}\right)^2 + \left(\frac{1}{2} C_{cred}\right)^2 + C_{cat}^2 + C_{op}}$$

Where:

C_{fi}	=	Fixed income investment risk charge
C_{eq}	=	Equity investment risk charge
C_{int}	=	Interest rate / Liquidity risk charge
C_{prem}	=	Premium risk charge
C_{rsvs}	=	Reserve risk charge
C_{cred}	=	Credit risk charge
C_{cat}	=	Catastrophe risk charge
C_{op}	=	Operational risk charge

A peculiarity of the BSCR overall formula is as follows: the multiplying factor of C_{cred} under the square root is 0.5 ($= 0.5^2 + 0.5^2$); it is not 1. This unusual feature makes it difficult to understand how C_{cred} corresponds to the resulting capital charge. By defining $C'_{cred} = C_{cred} / \sqrt{2}$, the formula can be written in the following way:

$$\text{BSCR} = \sqrt{C_{fi}^2 + C_{eq}^2 + C_{int}^2 + C_{prem}^2 + C_{cred}^2 + C_{rsvs}^2 + 1.414 * C'_{cred} * C_{rsvs} + C_{cred}^2 + C_{cat}^2 + C_{op}}$$

It thus seems more appropriate to set out that

- the credit risk charge is C'_{cred} ($= C_{cred} / \sqrt{2}$ or $= C_{cred} * 0.707$); and
- the correlation between credit risk and reserve risk is 0.707 ($= 1/\sqrt{2}$).

Annex 2: Development of the long term insurers supervisory and regulatory framework

The BMA's provisions for long-term insurers (Classes A to E) have not been examined in detail. The regime has only been in force since the beginning of 2011 and the reclassification of long-term insurers into these classes will be completed by end of 2011.

EIOPA notes that BMA intends to apply a regulatory and supervisory regime similar to that applied to Class 4, 3B and 3A insurers to long-term Class C, D and E insurers, as reflected in the consultation on the solvency framework for long-term insurers published in August 2010 and the associated draft legislation.

Regarding the developments of the long term elements of the BSCR model, BMA identified the insurers expected to be classified as Class E insurers and a mandatory trial run for these companies is underway, with filings due by August 31, 2011. The trial run includes the BSCR model, a schedule of investments, group structure, risk register, material intra-group transactions, investment policy, a description of the company's underwriting strategy, a statement of financial impact, a description of stress tests and scenario analyses, a description of the risk management program, and a commercial solvency self-assessment. The long-term BSCR will apply to Class E insurers as of year-end 2011. A similar trial run will be held at year-end 2011 for long-term Class C and D insurers, with an implementation planned as of year-end 2012.

The re-registration of long-term insurers is underway, as noted above, with all long-term insurers planned to be assigned to an appropriate class by year-end 2011. The Authority also has under active consideration the issuance of a consultative document that would require separately licensed companies for the conduct of life and non-life business.

It should also be noted that under the BMA's proposals for the full regime to be applied:

- Reporting is required under Section 31A (requirement of an insurer failing to meet its Minimum Solvency Margin (MSM) to send the BMA a written report within 30 days covering the causes of the failure and the ways the insurer intends to rectify it) of the Insurance Act for Class C, D and E long-term insurers;
- The economic balance sheet framework would also apply to Class C, D and E long-term insurers.
- The tiered capital system and MSM coverage would also apply to Class C, D and E long-term insurers. The current draft of the legislation includes Class E insurers
- The CISSA will be cascaded to the Class C, D and E long-term companies for 2012 year-end reporting.
- The Insurance (Prudential Standards) (Class 4 and 3B Solvency Requirements) Rules 2008 on internal model will apply to Class E long-term insurers, effective as of the 2011 year-end.