NEWSSTAND

Bermuda Regulation Review of 2008

March 2009

In January 2008, the Bermuda Monetary Authority (BMA) published its 2008 Business Plan highlighting the BMA's goal to become internationally recognised as a leading risk-based regulator. In this article, we look back at 2008 and the BMA's focuses for the year and review what steps the BMA took to meet its goal, particularly in light of the challenging market conditions resulting from the global financial crisis.

Mutual Recognition

In order to achieve continued growth in an increasingly globalised market, the BMA identified that full mutual recognition, being treated as having equivalent regulatory standards to those in the European Union, was crucial as this had the potential to simplify access by (re)insurers in each market to the other market.

Following the EU's proposal in 2007 for the introduction of the Solvency II Directive, in 2008 the BMA took a major stride towards mutual recognition by announcing significant changes to Bermuda's solvency and disclosure regulations.

Insurance Amendment Act 2008

Prior to the passing of the Insurance Amendment Act 2008, the Insurance Act 1978 in Bermuda required (re)insurers to meet a margin of solvency which had been calibrated based on the scale and class of the (re)insurer's business, with higher premium and/or reserving levels requiring more statutory capital and surplus. No account was taken of the fact that certain lines of business were inherently riskier than others. In July 2008, with the passing of the Insurance Amendment Act 2008, the Bermuda Solvency Capital Requirements (BSCR) were introduced to apply to Bermuda's Class 4 (re)insurers and was intended to establish risk based capital adequacy standards for high impact (re)insurers. Unlike the earlier fixed minimum solvency margin requirements, the BSCR take into account the relative underwriting risks of different lines of insurance as well as a broad range of other risk factors including credit risk, equity risk, liquidity risk, reserving risk and catastrophe risk. (Re)insurers are allowed (subject to the BMA's approval) to use their own internal capital models where they can establish that those models better reflect the inherent risks of their business. This approach owes much to the influence of the UK Financial Services Authority in the BMA's thinking.

This legislation also provides for the reclassification of the Class 3 insurance sector, which included firms ranging from captives writing a limited amount of third party business to large commercial (re)insurers. The reclassification focused on the respective risk profiles of the Class 3 companies and introduced a new Class 3A (small commercial insurers) and Class 3B (large commercial insurers) and a new category for insurance special purpose vehicles to be known as "Special Purpose Insurers". This allows the BMA to undertake a more detailed analysis in identifying the regulatory needs in relation to the different types of (re)insurers using its risk-based regulatory approach.

The changes to the Insurance Act 1978 have been supplemented with the following amendments:

Insurance Accounts Amendment Regulations 2008

These Insurance Accounts Amendment Regulations, which came into effect on 31 December 2008, amend the Insurance Accounts Regulations 1980 and set out the statutory financial accounting requirements for the purposes of BSCR for Class 4 (re)insurers. The amended statutory financial accounting requirements are more onerous and involve the submission of more detailed balance sheets (including detailed information about specific assets and distinguishing assets that are attributable to affiliates) and income statements to the BMA.

Insurance Returns and Solvency Amendment Regulations 2008

These Insurance Returns and Solvency Amendment Regulations, which also came into effect on 31 December 2008, amended the Insurance Returns and Solvency Amendment Regulations 1980. They made a general amendment to include references to Class 3A and Class 3B (re)insurers and a minimum margin of solvency for the new class of Special Purpose Insurers, and introduced a requirement for Special Purpose Insurers to submit a special purpose solvency certificate. These regulations were accompanied by the issuance of the Insurance (Prudential Standards) (Class 4 Solvency Requirement) Order 2008. The Order sets out the prudential standards that Class 3 (re)insurers must comply with when submitting a Capital and Solvency Return.

Response to the Global Financial Crisis

The Bermuda market has carefully monitored the situation since the onset of the crisis and, in particular, has focused on investment funds, banks and the insurance market, the areas most affected by the crisis. In the insurance sector, the BMA has taken a proactive role and has undertaken surveys to assess the companies' exposure in both investment portfolios and underwriting. The result of this was a focus on the financial guaranty firms who were the most affected. Some success has been achieved in helping these companies recover. However, the BMA has recognised that there is still work to do.

In 2008, the BMA collaborated with the New York State Insurance Department (NYSID) in relation to a number of firms within the financial guaranty sector impacted by sub-prime and matters related to AIG. This collaboration underscored the need to ensure that regulators could co-operate quickly and efficiently in the global insurance market and, as a result, the BMA and the NYSID signed a memorandum of understanding (MoU) on 29 September 2008. According to paragraph 2 of the MoU, its purpose is to facilitate a formal basis for consultation, co-operation and co-ordination between the two regulatory bodies. The MoU allows for the exchange of information relevant to each authority's supervisory, regulatory and examination responsibilities. Each authority can assist the other in investigative work regarding companies and persons engaged in insurance business, including questioning, taking testimony and conducting inspections and investigations.

The Year Ahead

On 15 January 2009, the BMA published its Business Plan for 2009. This year, the BMA will:

- continue to focus on the management of the financial crisis (in the same manner as in 2008, using soft tactics such as market surveys, stress tests and on-site reviews to identify firms for close monitoring)
- continue progress towards international mutual recognition for Bermuda (with a focus on EU and US markets)
- implement new money laundering standards (with a focus on on-site reviews and taking enforcement action as necessary)
- continue the improvement of operational efficiency within the market (by publishing service standards with regard to particular types of regulatory transactions rather than generally across the market).

The BMA also proposes to publish guidance on the regulatory standards for Special Purpose Insurers and to start a longer term project to review parts of the Insurance Act 1978 which require updating.

As the global financial system continues to dislocate, the BMA is taking steps to prepare for the next phase of the financial crisis. The Business Plan for 2009 is designed to chart a course to ensure that Bermuda succeeds as a leading financial market supported by a leading risk-based financial regulator.