

Guarding the Bermuda brand – The BMA’s approach to reputational risk

Thank you Laurie and thanks to all two hundred and forty of you for coming out today. I feel very honoured by the turnout for this lunch, honoured and at the same time disappointed because it seems I have missed a revenue opportunity. At \$60 a plate, I should have asked the BII for a commission.

But I didn't so I guess that tells you why I'm a regulator, not a broker!!

Anyway . . .

I do hope you are all sitting comfortably because I'd like to start off with a little story. It's got all the elements you would expect: an unusual setting, some interesting characters, an engaging plot, a journey of discovery and of course, the inevitable ingredient: conflict. This story also has a beginning and a middle, but it doesn't have an end, not yet! But I'll return to that a little later.

So let's begin . . .

Once upon a time, a long time ago there lived a special group of people in a rather special land. These people were risk professionals and they were exceptionally good at what they did. In fact, they were so good and so committed to developing their product that they soon built a glittering reputation for themselves and for the island they inhabited.

They had a fairly simple value proposition: “Bring your risk business to us and we will look after it for you. We understand financial risk and we understand your business. And don’t worry about excessive red tape because we don’t have any here. There are some regulations of course but they’re very light and easy to live with and you really don’t need to worry about them. Plus we also have a great relationship with the authorities, more like a friendly partnership really. In fact, the chief regulator is such a strong supporter of ours that he regularly travels the world actively promoting and marketing our services.”

Thus was born an early version of the Bermuda brand. These were pioneering times when all interests were fully aligned behind the single idea of creating a Bermuda Market. Everyone in those days was singing off the same hymn sheet: Government, professional service providers, the insurance managers and the regulator who, by the way, was then part of the Ministry of Finance. And it worked. It became a powerful and successful partnership. Everybody wanted to buy what they were selling which, in those days, was one form or another of a captive insurance programme. And every client was attracted by the idea of doing business in a friendly, favourably taxed and lightly regulated environment.

These were heady and exciting days. The business rolled in. Everyone was happy. Captive insurance management firms sprang up and the island became a Mecca for financial professionals.

I know because I was part of the resulting rush for accounting qualifications, a rush driven in large part by the 1978 Insurance Act, which helped increase demand for public accounting services. I well remember thinking how fortunate I was to be involved in what was then referred to as the exempted company business.

But imitation, they say, is the sincerest form of flattery and Bermuda pretty soon attracted the unwanted attention of other domiciles who quickly opened their doors for business. The barrier to entry in those days was not particularly high. There was a rather clubby vetting process in which new market entrants had to present their proposed business plans and projections to a committee of existing market players in order to be granted a license. By and large, this was a system of self regulation or co-supervision in which the law firms, the accounting practitioners, the banks, the insurance managers and the Registrar of Companies collectively policed the market. From the outside it probably appeared to be a little too cozy at times ... but it generally worked. That's not to say we didn't have any problems. After all, we had entered the era of what came to be called "naive capacity" so there were occasional hiccups but nothing that made us feel too uncomfortable.

Part of the reason for this comfort level was that the regulatory visionaries of the day had built some early warning safeguards into the system. These included the mandatory appointment by every licensed insurer of a Principal Representative, a resident who was responsible for informing the regulator, amongst other things, of any

change in the insurer's circumstances that could lead to an inability to pay claims. In addition, the Insurance Act created an entity known as the Insurance Advisory Committee, which was, and still is, a statutory body charged with advising the Minister of Finance of trends and developments in the insurance industry. These measures, along with the comparatively low-risk nature of the business that came to Bermuda at that time, proved to be adequate, even to the point of withstanding the occasional fairly significant captive insolvency. Indeed, Bermuda soon demonstrated that it was able to apply the same level of professional expertise to insolvencies that it provided to incorporations.

Then came the crossroads, the US casualty insurance crunch of the mid 1980s and, in rapid succession, the formation of ACE and XL. Pretty soon, the Bermuda Government and the insurance industry realized that our cozy self regulatory environment would need to be reviewed. By the early nineties it became clear that the regulatory rule book which had been written for what was predominantly a captive insurance industry was in need of an overhaul, one that recognized that the market had changed but the regulations hadn't.

By the end of 1995, after much consultation, Bermuda had adopted its first multi-license system of regulation, a risk-based system now seen as a forerunner of our present-day licensing framework.

The regulator then, as now, faced some difficult challenges as he sought to protect the Bermuda brand. In addition to technical

expertise he needed very sensitive antennae and some highly developed tightrope walking skills. It was a sometimes precarious balancing act. He had to carefully pick out from the clamour the voices of those who lobbied for what they claimed was the insurance wave of the future. He then had to balance their arguments against the arguments of those who had ridden in on an earlier wave, And he needed to be ever mindful that the risks and rewards of a particular course of action would be scrutinized and generally picked apart by every competing insurance jurisdiction in the world, eagerly trawling for errors or sloppy drafting or ways they could simply improve their own rulebook.

Not that there was anything particularly wrong with light touch supervision at that time. After all, no standards were agreed for the supervision of reinsurance until October 2003.

The addition to the Bermuda register of ACE and XL and other companies that didn't behave like captives, even though some of the new entrants resembled large group-owned entities, was an early test for the Bermuda brand, which was beginning to be re-shaped, initially ever so slightly.

The all-for-one and one-for-all song which the market had been singing was losing its popularity and the lyrics of the old hymn sheet were gradually being re-written. It seemed that the captive movement and the nascent commercial market did not always want the same thing. Interests were no longer identical.

Over the next few years, as Bermuda's commercial market grew, it seemed that reference to a partnership between the regulator and the regulated was not always appropriate or as widely welcomed by everyone. The light touch began to give way to the firm hand of the regulator, alignments began to lose their shape and, gradually, what was once considered the advantage of a mild regulatory climate began to be seen by some as a distinct disadvantage. Customers increasingly wanted to be able to point to a robust regulatory environment, not light touch supervision. Additionally, as the market grew, the regulator's marketing role shrank.

It will be for history to judge whether one end of the market was accommodated at the expense of the other? Did everyone fully understand the nuances and ambiguities? Did they realize that they were part of an industry in transition?

Fast forward that story to today and you will see that many of these issues are now firmly reflected in our multi-disciplined, many tiered insurance and reinsurance industry, which draws its strength from a unique mix of differences and similarities.

Where does that leave the BMA? Where should the regulator sit on these and other points of potential conflict? I believe, and I've said it before, that the Bermuda Monetary Authority is a consistent regulator for all seasons, for peacetime as well as wartime, for periods of economic contraction as well as expansion. And I believe it is

fortunate that we have weathered occasional squalls in the past because I think we have entered a potentially stormy period. And the name of the next weather system is Solvency 2.

The Sol 2 Directive is a law that will soon govern solvency requirements for insurers operating throughout Europe. Given the significant amount of insurance business conducted between the Bermuda insurance market and Europe, it is important that we ensure our regulations are deemed to be equivalent to Solvency 2's requirements. Is equivalence under Sol 2 the final frontier for Bermuda? Probably not. It is in the nature of things for us to face Sol 3 or 4 and so on. But for now Sol 2 equivalence is indeed the Holy Grail.

To get a sense of just how important this Directive is, you need to remember that Bermuda's Class 4 companies have a global footprint. Their principal interest is not how much they will save on their effective tax rate by being in Bermuda, or whether they can hire adequate support staff in Hamilton, or find appropriate office accommodation. By far the biggest concern for these companies, the issue that will have most bearing on their domicile selection, indeed on whether they remain in Bermuda, is the quality of regulation over time. For these companies, and for our Class 3(B) license holders, it is absolutely vital that Bermuda secures equivalence under the Solvency 2 Directive. For these companies, equivalence is their passport to non-discriminatory treatment in those markets in which they wish to trade. And when I say non-discriminatory treatment, I'm

referring, for example, to not being made subject to special contingent capital requirements which could be applied by an EU supervisor who does not recognize the regulatory provisions in your country of domicile as providing the same protections and safeguards as those afforded in the country in which you are seeking to conduct business.

So, the inevitable question: Will Bermuda get equivalency? The only way I can answer that question is to tell you what we've done and what we plan to do.

In August 2008 we announced significant enhancements to insurance solvency and disclosure regulations. The Insurance Amendment Act 2008 introduced new and expanded regulatory initiatives and the Bermuda Solvency Capital Requirement (BSCR), which was an enhanced solvency regime applicable to the Class 4 license holders.

At the same time, the legislation reclassified Bermuda's Class 3 insurance sector, which includes a large number of firms ranging from captives writing a limited amount of third-party business to large, purely commercial (re)insurers. This change established sub-categories within the Class 3 group based on respective risk profiles and allowed us to refine our application of risk-based supervision for these companies to ensure they receive a level of oversight appropriate to their business.

Along with the reclassification we introduced a new category of 'Special Purpose Insurer' focused on fully collateralized special purpose vehicles that are established to conduct specific insurance transactions.

More recently in our 2010 Business Plan, we explained that a key part of the equivalence effort will be the introduction of group supervision for Bermuda's largest insurers, to ensure that all the risks related to a particular insurance group are considered in our supervisory process. The Plan also talked about developing enhanced solvency and capital standards for long-term or life insurers and introducing a Code of Conduct for the insurance market. It's important for me to note here that, while we are committed to ensuring we achieve consistency with international standards set by initiatives such as Solvency 2, we do not intend to clone them and blindly apply them here. Instead, we aim to adapt such standards appropriately to take account of the nature of business conducted in Bermuda and the characteristics of this market to ensure our frameworks remain practical as well as equivalent.

Another key aspect of the BMA's strategic role is to maintain a high level of engagement and participation in the work of international standard setting bodies. We now represent Bermuda at the decision-making level in the International Association of Insurance Supervisors, the IAIS, which sets the global standards for insurance supervision. In fact, we sat on the IAIS working group that created the first standard for reinsurance supervision in 2003 which I

mentioned earlier. I became a member of the IAIS Executive Committee this year and the Authority now participates in a total of 13 IAIS committees and sub-committees, thereby enabling us to monitor and contribute to the evolving international regulatory environment.

I hope I've given you a sense of how the BMA, while evolving and adapting, has constantly sought to protect the Bermuda brand and the jurisdiction's reputation over the years.

Now I know what you're thinking. I can almost hear the question: That's all very interesting Jeremy, but what about that Holy Grail of Solvency 2 equivalence? Will Bermuda get it?

And here's my answer: Bermuda now has a robust risk-based prudential supervisory framework in place. We are well on our way to being able to tick the box on group supervision. We have earned the respect of regulators and the regulated for our leadership as a financial supervisor. So ... If we continue to do all that is being asked of us ... if the Solvency 2 assessors who will be visiting later this year give us a passing grade ... (and I will do everything in my power to make that happen) ... there is no technical impediment that I am aware of that will prevent us from being granted equivalence.

Said another way ... If Bermuda does not get equivalence, it will not be because we lack the technical expertise. We clearly don't ... as

many of you who deal with us regularly can attest. It will not be because we have a record of corporate failures. Our record indicates the opposite. It will not be because we have lost the support of the marketplace. We continue to attract new business and to add new companies to our register. If Bermuda fails to secure equivalency, it is likely to be due to the arcane politics of Europe. After all, what other reason could there be to exclude a respectable jurisdiction with an industry that provides an estimated 10% of broker market reinsurance capacity to the European market, an estimated 40% of windstorm and flood reinsurance to Europe's leading property and casualty insurers and which employs approximately 7,000 people in the EU?

Will having a credible brand help? Absolutely it will help. A good brand goes on talking long after you have left your customer's office. A solid reputation and a world class image of financial strength, stability and expertise have long been the hallmark of the Bermuda brand and will continue to speak volumes about us.

This is because the promise of your brand is not confined to what you say on your web site, or what your logo says, or your literature, or even your CEO. In fact, it's usually not really what **you** say that determines your brand, it's what your customers say.

Earlier, when I spoke about the pioneering days of the Bermuda insurance industry, I referred to my story as having a beginning and a

middle but that the ending was still to be determined. That's because, when it comes to reputations, in my experience, they seldom stray very far from the path of actions taken by people and organisations (and regulators). In other words, **our** brand, **our** reputation is largely in **our** hands and is, therefore, always a work in progress.

That said, I think it is particularly important that everyone understands the Authority's brand and its risk-based approach to regulation which remains effective for the Bermuda market. It is this approach that allows us to differentiate between captive and commercial supervision and to allocate resources efficiently to firms with higher risk profiles.

In closing I should tell you that I have been a regulator for more than 17 years and I have seen several versions of the Bermuda market brand come and go. I guess that's the reality of changing expectations, a shifting context and the ability to reinvent yourself as circumstances demand. Currently there's an expectation that Bermuda's regulator needs to communicate that he has wide powers and real teeth, that he is able to stand shoulder to shoulder with international regulators, and that he is ready to apply his powers or as one CEO put it the other day, show that he is willing to hold CEOs accountable and is prepared to heavily penalize those who engage in imprudent practices.

I will resist the temptation to say be careful what you wish for because I believe that all of that is true. I do indeed have to provide

that context for our global insurers. But, ladies and gentlemen, I also believe we are at another cross roads in the development of the Bermuda insurance industry and I think that the best way I can guard the Bermuda brand is simply to continue to demonstrate the competency, accomplishments and technical strength of the BMA, its people and its tough, risk-based regulatory framework.

.....Thank you.