



BERMUDA INTERNATIONAL BUSINESS ASSOCIATION
LONDON ROUNDTABLE
Thursday 27th March 2008

Ladies and gentlemen, good morning and welcome to this year's BIBA Annual London Roundtable. BIBA have organized a number of panels throughout the course of the day which will provide you with an opportunity to learn about recent developments in Bermuda's financial markets and the benefits of doing business in Bermuda. This morning there are simultaneous panel sessions on trusts and Bermuda's insurance and reinsurance markets as well as an infrastructure session. This afternoon the Roundtable will extend to cover wealth management, hedge funds and alternative investments, and captive insurance. At lunch time I am looking forward to hearing from the Deputy Premier and Minister of Finance, the Hon. Paula Cox, with her perspective on Bermuda's developing financial markets.

The speakers throughout the day will, I am sure, be setting out the various attractions of Bermuda as a place to do business. It is clear, for example, that Bermuda benefits from having a stable political environment and a firm commitment from the Government to the development of international business. This is illustrated, for example, by the involvement of the Deputy Premier here today.

Bermuda benefits also from a clear concentration of both intellectual capital and financial capital in a range of important sectors: banking, trusts, investment funds and, of course, insurance and reinsurance. We have a “silicon valley” effect on the Island, with a nexus of human talent and financial capital providing a virtuous cycle of development and innovation.

Underpinning these benefits and advantages are some obvious attributes such as English language, proximity to the East Coast of the U.S., and a strong telecommunications and physical infrastructure. Also, closer to my heart as a regulator, are advantages such as being able to rely on English jurisprudence including the appeal to the Privy Council.

Finally, and not to be over-looked in current market conditions, the linkage of the Bermuda dollar to the US dollar currently provides a significant cost advantage for those clients earning in sterling or euro and paying for services in dollars.

This is an impressive combination of factors and is by no means an exhaustive list. But I would like to take the opportunity to talk about the role of regulation and how I believe that the regulatory environment in Bermuda provides a strong foundation for the jurisdiction’s success as an international financial centre.

My background is having worked for eight years at the UK Financial Services Authority before joining the BMA as Chief Executive Officer last summer. In my

view, the prudent and pragmatic regulatory framework that exists at the BMA and in Bermuda more generally is a key foundation for the success of Bermuda as a financial centre. The BMA plays an important role ensuring this approach. What I would like to do is take a few moments to outline the philosophical basis for the regulatory framework in Bermuda. Then I'd like to spend a minute or two on the topical issue of subprime, before handing back to Cheryl and letting you start your day.

The key starting point for the BMA's regulatory approach is our risk-based regulatory philosophy. In other words, we ensure that our approach to the regulation and supervision of firms is calibrated to the particular risks that firms pose to the Bermuda financial markets and the users of those markets.

This risk-based approach is used in two respects. First of all it provides a framework for our day-to-day operations as supervisors to allow us to apply more resources to those particular firms that pose the greatest risk. We do this through developing a risk-based supervisory model that allows us to rank the impact of different firms on Bermuda's financial markets. In light of this impact assessment we apply different standards of supervisory activity, such as onsite monitoring, reviews of financial data or more frequent meetings with senior management. Based on this level of intensity of contact, we can on a regular basis assess the probability of a firm's activities actually causing risks to crystallize. We have a systematic and structured risk model that lets us monitor and assess the firms that

are subject to our supervision. For example, in the insurance world this model lets us look at questions such as governance, claims paying ability, reserving ability, and underwriting ability. At the conclusion of such exercises we are in a position to have a more refined view of the risk a particular firm poses to our market.

Secondly, and equally importantly, our risk based approach is used to calibrate the burden of regulation and decide on the type of regulation and rules that we apply when it comes to drafting legislation or otherwise implementing our regulatory framework. What I'm driving at here, is that by taking a risk based approach we are able to calibrate our regulatory framework to the distinctively wholesale nature of the financial markets that operate in Bermuda. While there is a local retail market in Bermuda this is not large and by far the bulk of activity in Bermuda is of a wholesale nature. We therefore carefully segment our rules and standards so that we ensure that an appropriate regulatory framework is applied for those market participants that have a distinctively wholesale perspective.

For example, the reinsurance market is clearly a wholesale one, with large insurance companies as the principal counterparties of the reinsurance companies based in Bermuda. Our interest is therefore not in questions of conduct of business: those can be dealt with by the market participants themselves and are subject to their own commercial negotiation. We do, however, have a focus on solvency arrangements to ensure claims paying ability and financial stability.

Similarly, for the trust market where clients are high net worth individuals we can have a differentiated approach than for retail financial services. This differentiation of rules and full recognition of the wholesale nature of market participants also applies in the case of investment funds. Here, as you will hear about later, there have been revisions and enhancements to the regulatory framework in Bermuda to make this distinction even clearer. Recent amendments to the Investment Funds Act provided a clear differentiation between wholesale and retail investment funds. While we retain prudent entry criteria for both sets of funds, including the need for a prospectus which is reviewed by the Authority, we have carefully differentiated the ongoing monitoring and compliance burden of each set of participants. This means that wholesale funds have less reporting obligations than their retail counterparts, for example.

Our starting point, then, is our risk based approach which allows an efficient application of our supervisory resources and careful differentiation of our regulatory approach between wholesale and retail market participants.

The second benchmark of our approach as a regulatory authority is one of transparency. In this respect the Authority has recently published a business plan of its activities in the forthcoming year. This is in order to be fully transparent to market participants as to the changes that are emerging in the regulatory regime

and to let firms comment and plan accordingly. I would encourage you to take an opportunity to visit our website at www.bma.bm to have a look at the Business Plan as it provides an insight into the activities of the Authority.

Let me take an opportunity to highlight just a few of the changes that are coming through in the forthcoming year and are explained in the Plan.

Firstly, the Authority is planning enhancements to the solvency and capital regimes that apply to both banks and insurance companies. In the case of banks we are moving forward with our implementation of the Basel II capital framework which provides for enhanced capital requirements for banks' credit and operational risks. We are coming to the end of our consultation exercises on these changes and anticipate implementing the new regime at the beginning of 2009.

On the insurance side we are just embarking on a major revision to the solvency requirements for class 4 insurers, that is the class of insurers and reinsurers that have the most significant market presence. We are supplementing our existing minimum solvency regime with the Bermuda Solvency Capital Requirements or BSCR. These are a risk based solvency framework that provides for a differentiation of solvency requirements based on the different risk profile of underwriting activities, as well as credit and market risk. These requirements came in on a trial basis at the beginning of the year and will be finalised in the course of

2008. Our plan is to supplement this new solvency regime with stress tests from the largest insurance companies. In line with other leading international jurisdictions, such as the EU under Solvency II, our regime will also provide for the use of advanced internal economic capital models to be employed by firms as an alternative to our standardized risk based solvency regime. We will be conducting a review of modeling practice in Bermuda towards the second half of 2008 and will be opening the doors to applications to employ internal models in 2009. Both these changes are focused on the solvency and capital side of regulation, in line with the wholesale nature of our financial markets and our risk based approach, which I have described earlier.

The second highlight I would draw to your attention is the fact that the Authority has started work on group supervision for large insurance companies. We already have in place a group supervision regime for banks and large investment firms. What we are moving to now is a group or consolidated supervision regime for the largest insurance companies to bring our approach in line with that emerging in Europe in Solvency II. Bermuda is the home to some very large insurance groups with diverse international activities and a significant role in the global financial markets. We believe it's important that, as a supplement to our existing supervision of the individual legal entities based in Bermuda, we can develop a more comprehensive picture of the risk profile of the group as a whole.

Thirdly, I would highlight that the Authority, in line with other regulatory bodies in Bermuda and around the world, is undertaking work to enhance our current regime for anti-money laundering. Bermuda has a long standing history of rigorous know-your-customer requirements and a well-deserved reputation as a quality international financial centre. The BMA, with Government support, is now further enhancing the AML regime in Bermuda in line with the international standards that have been developed by the Financial Action Task Force. This includes new civil fining ability for the BMA. We also are increasing our resources devoted to AML activities and will be conducting a series of themed visits to check on the quality of AML controls in the Bermuda market. This shows our commitment, and that of the Government, to ensure that Bermuda remains a quality financial jurisdiction committed to the highest standards.

I have spoken about the plans of the BMA and also the support we have from the Government to ensure high standards of regulation in Bermuda. I should also mention briefly that there is another regulatory authority of sorts on the Island. That is the Bermuda Stock Exchange. In line with other stock exchanges in the world, the BSX has a self-regulatory role which we fully support. It would be remiss of me if I didn't report to you an important development about the BSX concerning the UK tax authorities.

The BSX regularly subjects itself to third party review and peer assessment to ensure that its standards are judged to meet recognized international benchmarks. The BSX is for example a long standing member of the World Federation of Stock Exchanges. However, you will be interested to know that very recently the Bermuda Stock Exchange was approved as a Recognized Stock Exchange by Her Majesty's Revenue and Customs. This designation extends to the entire BSX and any securities listed on the BSX. It means these securities now meet the Customs and Revenue interpretation of being listed as set out in the relevant UK Financial Services Taxation Legislation. This provides, I understand, very real benefits to investors on the BSX in terms of the tax treatment they can receive from the UK tax authorities, and provides a clear indication of the standards applied at the BSX. I hope my remarks have given you a clear understanding of the regulatory framework in Bermuda, a high level overview of our plans at the BMA and an appreciation of the philosophical underpinning of our regulatory approach in terms of our commitment to risk based supervision and transparency.

What I would like to do for the remaining minutes of these introductory remarks is to speak about a subject of considerable topical interest, namely the impact of the subprime market disruption.

As you are aware, over the past nine months or so the financial markets have witnessed significant dislocation triggered by an increase in defaults on subprime

mortgages. The credit markets more generally have seen a necessary and desirable repricing of risk premia. However, the speed and severity of this repricing has caused clear disruption to a range of markets and a severe contraction of market liquidity. Central bankers around the world have been in the forefront of addressing this liquidity question by providing additional liquidity to the banking market.

From Bermuda's perspective it is notable that the dislocation in the financial markets has primarily arisen from onshore banking centres. However, the implications of the subprime crisis are far reaching and are impacting all financial centres. In the case of Bermuda, it is worth saying a word about the three particular sectors that could be exposed to subprime, namely the investment funds sector, the banking sector and the insurance sector. In the case of Bermuda's investment funds, as is indeed the case with hedge funds more generally in the global financial markets, the level of resilience to subprime disruption has been remarkable. However, there have been casualties and there is pain to be borne by some investors in particularly exposed hedge funds. Also, as you know, generally returns for the sector have been adversely affected by market developments. BMA monitors net asset value levels in Bermuda-based investment funds to provide indications of significant changes in the fortunes of funds registered in the jurisdiction. We will continue this monitoring activity to provide an insight into the resilience of individual funds and the sector as a whole.

In terms of banking exposure Bermuda's banks have been relatively isolated from the wider credit and liquidity concerns generated by subprime. Bermuda's own housing market remains resilient with credit standards significantly stronger than those demonstrated in the US subprime market. Capital levels and controls remain strong and where banks have had limited exposure via their investment portfolios, these have not generated mark to market losses and have been subject to close monitoring by both banks' management and the BMA.

Turning to the insurance markets, BMA has been proactive in establishing the impact of subprime on the significant insurance and reinsurance players domiciled in Bermuda. At the outset of the subprime crisis last August the Authority conducted a rapid survey of the subprime exposures of the largest Bermuda insurers via both their investment portfolios and underwriting activities. We subsequently conducted a follow-up survey at the end of last year covering the same areas to provide an updated picture of the market's exposure. This survey comprised all thirty-seven Class 4 insurance companies – in other words, the largest commercial insurers and reinsurers – plus eighty or so Class 3 firms, the next tier down of insurance companies. Our survey showed that the Bermuda insurance market as a whole has limited investment portfolio exposure to subprime. The survey has also allowed us to conduct stress tests on firms' solvency and liquidity positions. These stress tests have been used to identify

outlier firms for enhanced supervisory monitoring. We are, for example, closely monitoring the exposure of financial guarantee companies and reinsurers, including the impact of write-downs of equity holdings in these companies. As you are aware a number of these companies have suffered significant mark to market losses and actual or threatened rating downgrades. Our close supervisory monitoring is allowing us to assess the continuing claims paying ability of these firms despite adverse market developments. Further on the horizon, D&O and E&O exposures are at an early stage and are beginning only now to crystallize. These are also subject of close monitoring by the Authority.

I hope these remarks provide a good starting point for today's Roundtable. You will hear much today about the financial, economic, political, geographic, legal, and infrastructure advantages of Bermuda. I hope, however, that you will agree with me that the success of Bermuda as a financial centre is equally based on the quality of its regulatory regime.

Thank you.