



BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

**BUILDING RESOURCES TO MEET ADVANCES IN GLOBAL INSURANCE
SUPERVISION**

12th September, 2008

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GLOSSARY

ABF	Annual Business Fee
BMA	Bermuda Monetary Authority
EU	European Union
GPW	Gross Premium Written
Insurance Act	Insurance Act 1978 and Related Regulations
Insurer	An insurer authorised under the Insurance Act to conduct insurance business (which includes reinsurance business)
IAIS	International Association of Insurance Supervisors
IMF	International Monetary Fund
Class 1	<p>A body corporate is registrable as a Class 1 insurer where that body corporate:</p> <ul style="list-style-type: none">a. is wholly owned by one person and intends to carry on insurance business consisting only of insuring the risk of that person; orb. is an affiliate of a group and intends to carry on insurance business consisting only of insuring the risks of any other affiliate of that group or its own shareholders. <p>Class 2A body corporate is registrable as a Class 2 insurer where that body corporate is wholly owned by two or more unrelated persons and intends to carry on insurance business not less than 80% of the net premiums written in respect of which will be written for the purpose of:</p> <ul style="list-style-type: none">a. insuring the risk of any persons or of any affiliate of any of those persons; orb. insuring risk which, in the opinion of the BMA, arises out of the business or operations of those persons or any affiliates of any of those persons. <p>A body corporate is registrable as a Class 2 insurer where that body corporate would be registrable as a Class 1 insurer but for the fact that:</p> <ul style="list-style-type: none">a. not all of the premiums which it intends to carry on, but at least 80% of the net premiums written, will consist of business described as Class 1 business; or

- b. it intends to carry on insurance business not less than 80% of the net premiums written in respect of which will, in the opinion of the BMA, arise out of the business or operations of the person by whom it is owned or any of the affiliates of that person.

Class 3 A body corporate is registrable as a Class 3 insurer where that body corporate is not registrable as a Class 1, Class 2, Class 3A, Class 3B or Class 4 insurer.

Class 3A A body corporate is registerable as a Class 3A insurer where that body corporate intends to carry on insurance business in circumstances where:

- a. 50% or more of the net premiums written; or
- b. 50% or more of the loss and loss expense provisions;

represent unrelated business.

A body corporate is registrable as a Class 3A insurer if its total net premiums written from unrelated business are less than \$50,000,000.

Class 3B A body corporate is registerable as a Class 3B if it intends to carry on insurance business in circumstances where:

- a. 50% or more of the net premiums written; or
- b. 50% or more of the loss and loss expense provisions;

represent unrelated business.

A body corporate is registrable as a Class 3B insurer if its total net premiums written from unrelated business are \$50,000,000 or more.

Class 4 A body corporate is registrable as a Class 4 insurer where:

- a. it has at the time of its application for registration, or will have before it carries on insurance business, a total statutory capital and surplus of not less than \$100,000,000; and
- b. it intends to carry on insurance business including excess liability business or property catastrophe reinsurance business.

Where a body corporate is registrable as Class 4 insurer it shall not be so registered if it is also registrable as a Class 1 or Class 2 insurer.

1. EXECUTIVE SUMMARY

- 1.1 This consultation paper explains the BMA's proposals to ensure the Authority is able to build its resources to meet advances in global insurance supervision affecting commercial insurance firms.
- 1.2 Bermuda's supervisory framework for insurance has been recognised as highly compliant with international standards. However, the BMA's goal of being a leading risk-based financial regulator means the Authority is committed to ensuring that its supervisory framework receives "mutual recognition" status from other leading jurisdictions. Mutual recognition status is an important objective and will bring tangible benefits to firms and the broader Bermuda economy.
- 1.3 The first mutual recognition assessment will likely involve the EU under the Solvency II Directive, with a US assessment probably to follow at some later date. BMA is in a group of countries at the front of the pack in Solvency II preparedness. However, the Authority needs to build its resources to continue its progression towards Solvency II and US mutual recognition.
- 1.4 Mutual recognition involves appropriate on-site supervision and solvency standards being applied to all commercial insurers. The recent re-categorisation of Class 3 insurers to identify Class 3A and Class 3B commercial insurers means we are now moving into a new phase with these plans. The paper sets out proposals for fees for these new classes to ensure these initiatives are appropriately funded. These proposals include a sliding scale so that fees are set equitably based on size as a proxy for risk and complexity.
- 1.5 Proposals for revised fees for Class 4 insurers are also set out to reflect the increased work on mutual recognition for this class.
- 1.6 Our clear policy goal is to leave the regulatory framework and fee structure for the captive sector broadly unchanged: the proposals in this paper are designed to achieve this goal and we specifically invite comments to ensure that this intention is delivered.
- 1.7 The impact of these proposals is clearly linked to the manner in which the Authority interprets the scope of the Class 3A and 3B categories. We have included guidance on this in Appendix 1 of this paper. Our clear policy goal with this guidance is to ensure that commercial insurers fall within these categories and that captives remain within the Class 3 category, where fees remain unchanged. We also make proposals below concerning fees for long-term insurers and a range of transaction fees.

We invite written comments from interested parties by 10 October.

2. INTRODUCTION

- 2.1 Over the last five years, there has been extensive policy development and public consultation in respect of the BMA's risk-based framework of prudential supervision. In 2005, the BMA introduced a new onsite supervisory regime for the Class 4 sector. The BMA has also recently established a new risk-based solvency capital requirement for the Class 4 sector. These initiatives have substantially strengthened and modernised the prudential requirements applying to Class 4 insurers.
- 2.2 In 2007 the BMA had its second detailed IMF assessment of Bermuda's commercial insurance sector supervision and assessors stated that an effective and comprehensive implementation of the risk-based regulatory system will depend on:
- a. a continuous review of regulatory resources;
 - b. preservation of regulatory independence and credibility;
 - c. high transparency and disclosure to enhance and support supervision, and;
 - d. a risk rating of the commercial Class 3 companies to allow for the granular tailoring of supervisory stance currently available for Class 4.
- 2.3 As the BMA has pressed to enhance the supervisory regime for the large commercial insurance sector progressively over the last 5 years, there has been tremendous support from the insurance market in general. The world is changing rapidly, and insurance business has globalised, as has regulation. Bermuda has been a significant beneficiary of that globalisation trend, and there is a shared responsibility between the regulator and the regulated to ensure that Bermuda's regulatory framework and standards complement its place in the world.
- 2.4 Market leaders that operate in the global marketplace clearly recognise the work that has already been undertaken and the ongoing work that will be necessary to ensure that the BMA continues to supervise to an internationally compliant level and that Bermuda continues to be a premier jurisdiction for all financial services.
- 2.5 Bermuda has already achieved an independent level of accreditation from the IMF. In its latest assessment of Bermuda IMF assessors commented that the BMA's commercial sector insurance supervision has achieved a high level of observance with the IAIS Core Principles. However, mutual recognition, a process by which jurisdictions are assessed to see whether their rules are deemed broadly equivalent with international standards, will be determined on a more stringent set of criteria. Where such recognition is provided, firms from that jurisdiction can operate without discriminatory provisions and minimise overlapping and duplicative regulation. Mutual recognition status is therefore an important objective for the BMA and Bermuda's commercial insurance market and will bring tangible benefits to firms and to the broader Bermuda economy.
- 2.6 It is likely that the first mutual recognition assessment will take place with the EU under the Solvency II Directive. At some later date a similar assessment by the US insurance

regulators is likely and other jurisdictions are also moving in this direction. The US National Association of Insurance Commissioners has launched a process of modernizing its solvency framework which is moving towards a process of mutual recognition. Successful recognition would mean a reduction in collateral requirements for Bermuda reinsurers.

- 2.7 The BMA has made significant progress towards achieving Solvency II equivalence and is in a group of countries at the front of the pack in moving towards mutual recognition with the EU. The adoption of the Insurance Act Amendments in July of this year were a significant milestone, with the passage of the legislative framework for the BMA's new risk-based Bermuda Solvency Capital Requirements (BSCR) and provisions for GAAP disclosure, as well as the new Class 3 sub-classification structure. The BMA is consulting on the detailed regulations for the BSCR and is moving forward with work to permit the use of internal economic capital models.
- 2.8 The most significant external driver that will significantly impact the supervision of the large commercial insurers is the EU's Solvency II Directive, which is scheduled for implementation by the end of 2012. The Solvency II framework is aimed at ensuring that the financial resources held by insurance firms are more closely aligned with the risk profile of each firm. The implication for our Bermuda Class 3B and 4 insurers that operate in the global context, is that non-EU jurisdictions will need to gain a level of recognition for the standards of supervision that they impose on those global players seeking to conduct business in the EU post 2012 and the implementation of the key principles of effective supervision as outlined in the Solvency II framework.
- 2.9 However, there remains a substantial, but achievable, "to-do" list of work to be accomplished. Our Business Plan for 2009 will provide more detail on these initiatives, which will include a Discussion Paper on Group (or Consolidated) Supervision, a consultation on further transparency and disclosure proposals, a consultation on the definition of eligible capital and work to complete the BMA's supervisory framework by finalizing our Code of Conduct and developing proposals for an enterprise risk management-type assessment by commercial insurers.
- 2.10 The focus of this consultation paper is to set out proposals for amendments to supervisory fees paid by the commercial insurance sector, which will directly support the enhancements that will take place to the regime as the BMA prepares for Solvency II equivalency. Firms primarily affected by these proposals will be the large insurers in the new Class 3B category and the existing Class 4 insurers. Our clear policy goal has always been to leave the existing regulatory framework and fee structure for the captive sector broadly unchanged.
- 2.11 In developing our thoughts on how best to fund the enhancements to commercial sector supervision, the BMA has aimed to ensure that there is sufficient funding to support our work-plan for the next 3 to 5 years. We believe that any amendment to the existing supervisory fee structure should:

- a. reflect to some extent the variable costs of supervising different company types and sizes of insurers;
- b. cover in the aggregate all costs associated with building the foundational elements of the enhanced commercial sector supervisory regime, and costs of implementation; and
- c. be competitive, when compared to supervisory fees charged by other financial centres with a global insurance market.

2.12 As can be seen from the pages that follow, our proposals are focused solely on the commercial insurance sector, to ensure that the enhancement of commercial sector supervision does not impact the captive sector. Therefore no annual business fee increases are being proposed for the captive sector.

2.13 The BMA welcomes comments on these proposals as outlined in this paper which should be submitted in writing to Suzanne Williams (swilliams@bma.bm) no later than 10th October 2008. We will reflect carefully on the views we receive before finalizing our proposals and sending them to the Ministry of Finance for the Minister's consideration and we remain open to practical alternative suggestions to the proposals set out here.

3. SOME GUIDING PRINCIPLES

- 3.1 In developing these proposals, the BMA has used the following guiding principles:
- a. A company's risk profile will dictate the amount of attention it gets from the supervisors. Class 3B and Class 4 insurers will eventually be assessed on a common basis to reflect the convergence in on-site work and the regulatory framework that is taking place.
 - b. In light of the interim differences in the scale of supervisory and policy work conducted with these classes, the process of convergence of fees will take place over time.
 - c. Market constituents will be provided with clear guidance that will allow them to gauge where their portfolio of Class 3 companies sit on the spectrum of Class 3 licensing options available. This information is critical to the market knowing exactly where their firms fit in the reclassification exercise. (Appendix 1)
 - d. New fee proposals will be designed to reflect the relative supervisory risks posed by the different categories and sizes of licensees, with the objective of more closely relating annual business fees to the actual costs of supervision. We are therefore proposing a sliding scale of fees for the Class 3B and Class 4 insurers.
 - e. Finally, the new system will not place a greater financial burden on the captive sector, because of the risk-based focus of its application.
- 3.2 We invite comments on whether these guiding principles are an appropriate starting point for our proposals.

4. BACKGROUND ON FEE PROPOSAL

- 4.1 The BMA charges an annual business fee to all registered insurers on the basis of their class of license. The class of license issued is indicative of the types of business undertaken. Annual business fees are payable by 31st March in each calendar year. These fees range from BD\$ 10,000 for Class 3 insurers, to BD\$ 210,000 in the case of the larger commercial insurers that are issued a Class 4 license. Fees are charged once a year, and responsibility for collecting these fees passed to the BMA in 2002, as part of a reform to transfer responsibility for the supervision of insurance entities to an independent supervisor.
- 4.2 In short, the existing fee structure needs updating to reflect the risk based nature of our supervisory model, such that:
- a. it addresses the need for certain categories of insurers with higher risk profiles to have the full complement of the supervisory framework applied to their sector;
 - b. it ensures that the BMA has sufficient resources to continue effectively operating its supervisory functions, whilst minimizing costs to licensees to the extent possible; and
 - c. it is more transparent and equitable across different categories of insurers.

Table 1

	Class 4	Class 3B	Class 3A	Captives Classes 1-3	Long- term Insurer
On-sites	x	x	x	via Insurance Managers onsite	X
Relationship Management Meetings	x	x			
Policy Development (e.g. Mutual Recognition policy changes)	x	x	x		X
BSCR	x	2010/11			
Advocacy/International Work	x	x			

Table 1 illustrates those elements of the risk-based framework that will be applied to the respective classes of insurers. It is evident that most of the key supervisory initiatives will be focused on the larger commercial insurers licensed in Class 3B and Class 4. The Class 4 sector has been subjected to the full complement of the framework for the last 2 years.

- 4.3 In line with international standards and in response to international scrutiny, the BMA amended its legislation in July 2008 in order to reclassify the Class 3 sector. The goals of the reclassification were to recognise the broad mix of entities and the varying risk profiles of those insurers contained within the existing Class 3 sector and to stratify that class in order to deploy the appropriate level of supervision to the companies contained

therein. The reclassification creates two additional classes of insurers, namely class 3A and 3B which are deemed to be commercial insurers, based on the level of third party risks insured. Once the reclassification exercise has been completed the BMA will continue its progressive rollout of all elements of the risk-based framework to the Class 3B insurers.

- 4.4 Our concern is to ensure that Bermuda's financial markets remain competitive and that the costs of supervision are reasonable means that we will carefully consider representations from stakeholders about the potential competitive implications of any fee increases. We will continue to ensure effective management and cost control so that market participants can be assured that the BMA discharges its responsibilities as efficiently as possible. The BMA also seeks to implement a prioritised and focused Business Plan.
- 4.5 The significant work involved with the drive towards mutual recognition is, in our view, an important priority for Bermuda. We believe that the costs associated with the proposed fee increases are considerably outweighed by the benefits of receiving a favorable mutual recognition assessment, in terms of reduced regulatory costs for firms, continuing market access and favorable counterparty and investor sentiment towards Bermuda-based firms.
- 4.6 Additionally, the BMA is proposing amendments to the existing legislated fee schedule for transactions, as well as introducing new fees in connection with the Bermuda Capital and Solvency Requirement and Internal Models. The proposed increases to existing application fees are based on a review of all existing transaction types (i.e. Section 56 directions, relevant asset requests, etc.) and consistent with our risk based approach, we determined that there are certain applications that require an enhanced level of review and specialist skills. Therefore, the BMA has only proposed increases to application approvals where they have assessed the costs to be significantly in excess of the fee assessed (See Appendix 2).
- 4.7 Given the above-mentioned issues it is now appropriate to introduce a fee structure that is substantively more risk-based, rational, and equitable, in its application across the whole of the commercial insurance sector.

5. CLASS 3B AND CLASS 4 INSURER PROPOSAL

- 5.1 The proposal introduces an annual business fee for Class 3B and Class 4 insurers that would be set according to a sliding scale, reflecting that the cost of supervision may vary with the volume of GPW. In general it costs more to supervise the large commercial insurers because of their global outreach. Further, much of the regulatory and supervisory framework enhancement that has taken place over the last 3 years and will continue to be undertaken in preparation for the EU's Solvency II initiative, will directly affect those entities licensed as Class 3B and Class 4 insurers.
- 5.2 This new system will relate the scale of annual fees more directly to an insurer's size and company type, whilst retaining as much simplicity as possible. GPW is proposed as a proxy for size and complexity (and hence likely level of supervisory burden). No single factor provides a perfect solution, but it was felt that GPW's were a common factor of relevance across different types of insurers.
- 5.3 The BMA did reflect on the merits of setting a temporary fee increase to cover the transitional costs of Solvency II implementation, as some other jurisdictions have done. We have not pursued this approach for three principle reasons:
- a. on-site supervision and solvency assessment for Class 3B and Class 4 insurers are on-going costs that need to be funded on a continuing basis and are not transitional;
 - b. policy development costs will also be ongoing in the context of insurance supervision. The IAIS is a maturing organization and the standards for insurance supervision are very much in the developing stages when compared to banking sector supervision; and
 - c. while some policy development costs may reduce over time, the Authority will need to gear up to fund consolidated supervision

<i>Sliding Scale ABF</i>		
Gross Premium Written	2009	2009
	Class 3B	Class 4
2,000,000,001+	\$175,000	\$300,000
350,000,001 – 2,000,000,000	\$140,000	\$275,000
150,000,001 – 350,000,000	\$100,000	\$210,000
50,000,000 – 150,000,000	\$75,000	\$210,000

- 5.4 The Authority is currently in the process of reviewing its database of firms to assess the precise distribution of Class 4 and 3B firms across these proposed bands. In light of this analysis (and the preparation of our 2009 operating budget), we may revise the boundaries of these bands. We therefore invite comments on the proposed scale, as well as the suggested fee levels.

5.5 *Definition of Gross Premiums Written*

Numbers for GPW would be taken from the most recently available audited SFR of the licensee concerned.

In the case of a single legal entity holding two licenses (e.g. a general business and long-term license), then as a general principle only one calculation (for GPW) would need to be undertaken. For example, where a Class 3B insurer with GPW of up to \$150 million is also holding a long-term business license, the annual business fee for the insurer would be \$100,000 in 2009.

5.6 *New Licensees*

Under this proposal, the annual business fee charged for new registrations for Class 3B and Class 4 insurers, for the first year, would be \$100,000. In addition, where a new license is granted after August 31st the first year annual business fee charged will be 50% of the annual fee or \$50,000 and where a new license is granted after November 30th the first year annual business fee charged will be 25% of the annual fee or \$25,000.

5.7 *Future Developments*

In light of the convergence in the scale and nature of supervisory and policy work conducted with Class 4 and Class 3B insurers, it is the Authority's intention that the fee levels for the two classes will be brought on to a common scale in due course.

6. CLASS 3A AND LONG-TERM INSURER PROPOSAL

- 6.1 The proposal introduces an increased annual business fee for Class 3A and long-term insurers, reflecting that the cost of supervision will increase as a result of the continued progressive rollout of the onsite-inspection programme. In general it costs more to supervise commercial insurers versus the captive sector because of the element of unrelated business written.
- 6.2 In addition, it is anticipated that long-term insurers and perhaps some 3A insurers may need to be subject to enhanced solvency regulation over time due to mutual recognition process. The funding proposed here will ensure the Authority has adequate policy resources to devote to develop enhanced solvency requirements that are proportionate and adapted to the characteristics of these firms.
- 6.3 The additional fees for long-term insurers are also designed, in part, to account for the fact that most of these firms will be within the scope of anti-money laundering regulation, an area where the Authority is increasing its resources.

	<u>Existing Fee</u>	<u>Proposed Fee</u>
Class 3A insurer	\$10,000	\$20,000
Long-term insurer	\$10,000	\$20,000
Class 3A and Long-term	\$10,000	\$20,000

7. SUMMARY OF IMPACT ANALYSIS

- 7.1 The impact on individual firms is clearly linked to the particular application of the Class 3 re-categorisation exercise. In parallel to preparation of this consultative paper, the BMA has been working with industry stakeholders to develop the guidance notes that explain how the new categories should be interpreted. The most recent copy of this guidance is attached. The BMA has developed this material to ensure that our overall objective of ensuring that the regulatory framework -- and fee levels -- for captive insurers is broadly unchanged. Thus, the focus of the most significant fee increases, for Class 3Bs, is clearly directed at those firms that are conducting commercial insurance activities of a significant scale. Again, to be clear: we propose to keep fee levels for captives unchanged to reflect the price sensitive and competitive nature of this market segment.
- 7.2 An important consideration in making final proposals on fees is the impact this could have on the competitive position of Bermuda's financial markets. We have conducted a preliminary comparison of the level of supervisory fees between comparable jurisdictions, focusing on non-captive jurisdictions in light of the nature of these proposals and drawing on useful information provided by stakeholders. Direct comparisons are difficult, in light of the different calculation methods. However, our preliminary assessment is that the proposed fees would mean Bermuda is roughly in the middle of the range of fees set by Australia, Ireland, New York, Switzerland and the UK. We would invite stakeholders to provide any information they may have to better assess this impact.
- 7.3 There are significant benefits in enhancing the existing fee base in a more transparent and equitable way across the different categories of insurer along the lines described above, and we invite comments from stakeholders as to the impact of these changes.
- 7.4 The Authority recognises that in particular circumstances the impact of a fee may be inappropriate. For example, where a licensee is in run-off or in financial distress the BMA may consider it prudent to waive all or a part of an annual business fee. We also appreciate that there may be "captive" long-term insurers for whom a fee increase is not appropriate in light of our clear policy objective of leaving captive fees unchanged. The Authority will therefore explore obtaining the legislative flexibility to waive fees (and to reclaim waived fees where appropriate) on a case-by-case basis.

8. IMPLEMENTATION

- 8.1 The BMA intends to finalise these proposals following the consultation during October, to allow fees due in 2009 to be collected under the new system 31st March 2009.
- 8.2 For Class 3B and Class 4 insurers, the fee paid will be based on the GPW in the audited financial statements for the Statutory Financial Return for the 2007 year end. Upon the filing of the Statutory Financial Return for the 2008 year end, if the audited accounts reflect a change in GPW that would cause the insurer to fall into a different fee band, the insurer shall include either the additional fee owed or an application for a rebate with its annual filing.

9. CONSULTATION QUESTIONS

9.1 In responding to this consultation paper, respondents are asked to consider the following questions, in addition to any other comments they may wish to make. Comments must be received by the BMA by 10th October 2008.

9.2 Overall Approach

Q.1 Do you agree that the objective of mutual recognition is a major jurisdictional priority?

Q2 Do respondents broadly agree with the overall approach taken in framing the proposed new fees for Class 3B and Class 4 insurers – namely, a sliding scale system based on the guiding principles noted above?

Q.3 If the answer to Q. 2 is ‘no’, which alternative approach(es) would respondents propose instead?

Q.4 Are any of the guiding principles identified irrelevant, in the view of respondents, and/or are there any other principles that respondents believe should have been taken into account?

9.3 Specific parameters chosen

Q.5 Do respondents broadly agree with the fee bands set for different Class 3B and Class 4 insurers?

Q.6 If the answer to Q.4 is ‘no’, what alternatives would respondents propose, and what would be their rationale?

Q.7 Are there any specific anomalies created by the fee structure proposed?

Q.8 Do respondents have views on the proposals as they impact long-term insurers and Class 3A commercial insurers?

9.4 Practical implementation

Q.9 Would the new system be reasonably straightforward to apply?

Q.10 Are there any specific questions or difficulties that respondents wish to raise, in terms of understanding how to apply the new system in practice?

9.5 Other Issues

Q.11 Are there any other issues – not covered above – that respondents wish to comment on?

APPENDIX 1

GUIDANCE NOTES FOR RECLASSIFICATION IN ACCORDANCE WITH THE INSURANCE AMENDMENT ACT 2008

1. Introduction

These Guidance Notes have been produced with the aim of providing informal, non-statutory guidance on the reclassification requirements and additional information for consideration when applicable (re)insurers are determining the appropriate class for re-classification applications

The aim of these Guidance Notes is to facilitate the uniform application of the legislation as it relates to the reclassification of all applicable Class 3 insurers. All applicants should note however, that it is the responsibility of individual businesses to ensure their compliance with the law. The reader with specific queries may seek further advice from the Authority, as appropriate.

2. Scope of Guidance

The Insurance Amendment Act 2008 (the "Amendment Act") came into force on 30th July, 2008 and created three new classes of insurance license, Class 3A, Class 3B and Special Purpose Insurers. These Guidance Notes relate principally to the rules set down in the Insurance Act 1978, (as amended by the Insurance Amendment Act 2008) which facilitate the reclassification of the existing Class 3 sector. They also provide additional information for consideration when applicable (re)insurers are determining the appropriate class for reclassification applications.

3. Definitions

In these Guidance Notes, the following terms are used.

"The Act" means the Insurance Act 1978 and its related regulations.

" Class 3 insurer " means the description in section 4D of the Act as amended by section 7 of the Amendment Act.

" Class 3A insurer " means the description in section 8 of the Amendment Act.

" Class 3B insurer " means the description in section 8 of the Amendment Act.

"Unrelated business", in relation to an insurer, means insurance business consisting of insuring the risks of persons who are not shareholders in, or affiliates of, the insurer (see Section 2 of the Insurance Returns and Solvency Regulations 1980).

"Affiliate" means a body forming part of a group with that insurer (Section 2 of the Act).

"Sidecar" means a special purpose reinsurance vehicle with a defined purpose and a limited lifetime.

4. Application Process

All applicable Class 3 (re)insurers qualifying for reclassification are required to submit an application by 31st December 2008.

Please be advised that those existing Class 3 (re)insurers that do not meet the new licensing criteria for a Class 3A or Class 3B (re)insurer, are still required to submit only the Form T-1 together with a brief description of why said (re)insurer should remain licensed as a Class 3 (re)insurer. Please note however that such (re)insurers shall not be required to remit the application fee.

Any Class 3 (re)insurer that qualifies for reclassification as a Class 3A or Class 3B but fails to apply for reclassification by the 31st December, 2008 may have its registration cancelled by the Bermuda Monetary Authority (“the Authority”) in accordance with Section 27(4) of the Insurance Amendment Act 2008 (“the Act”).

The following documents must accompany a completed Form T-1 application form

- a. The company’s original Certificate of Registration
- b. An updated business plan (see appendix 1)
- c. Most recent audited statutory financial statements
- d. Management accounts as at 30th June, 2008 or more recent if available
- e. The applicable application fee \$500.00 in the case of Class 3A and \$1000.00 in the case of Class 3B.

The Authority, in accordance with Section 4A (2) of the Insurance Act 1978 may register a (re)insurer as a particular class of insurer where it would not be so registrable under sections 4B to 4E if, after taking into account –

- a. the nature of the intended relationship between the (re)insurer and its intended policyholders, the interests of those policyholders and of the public generally, and
- b. the level of regulation which is applicable to the different classes of insurer.

The Authority may exercise the powers of Section 4A in certain circumstances were the (re)insurer’s business model, international profile and/or conditions of license (including Section 56 directions and any other regulatory approvals) may warrant registration in a class that the (re)insurer may not normally qualify to be registered in. This could result in a (re)insurer that may normally qualify to be registered in a class having increased regulatory oversight being allowed to register in a lower class and vice versa.

ISSUES FOR CONSIDERATION

5. Affiliated Reinsurers

An affiliated (re)insurer currently registered as a Class 3 insurer shall be registrable as a Class 3A (re)insurer if said (re)insurer is only assuming reinsurance from an affiliated ceding (re)insurer.

An affiliated (re)insurer shall be allowed to assume non-affiliated reinsurance of up to 20% of its total net premiums written and continue to be registrable as a Class 3A. However, if an affiliated reinsurer assumes in excess of \$50 million non-affiliated reinsurance it shall be registrable as a Class 3B.

6. Connected Business

Connected business in this regard is defined as “risk which, in the opinion of the Authority, arises out of the business or operations of those persons or any affiliates of any of those persons”. For the purposes of the reclassification project connected business shall be considered as related party business and shall not be included in the unrelated business percentage when determining the appropriate class of registration.

Should any (re)insurer deem certain lines of its business to be connected for this purpose, said (re)insurer shall provide with its application a detailed description of said business providing a rationale for said business to be considered connected for licensing purposes. The business shall only be considered connected once the Authority has reviewed the details and issued a connected business certificate. If any company, based on the amount of connected business written, believes that it should remain a Class 3 (re)insurer, said company shall follow the instructions in section 4 above with respect to the application process for those companies not qualifying for re-registration as a Class 3A or Class 3B (re)insurer.

The following are examples of the types of business that have been deemed connected by the Authority in the past. Please note that this list is not exhaustive and does not suggest that such lines of business would automatically qualify as connected. The applicant would still need to demonstrate, and the Authority will need to agree, that the risks arise out of the operations of the shareholders or its affiliates:

- a. Credit and Credit Life
- b. Malpractice Insurance (or other Professional Liability cover) of Non-employed Physicians
- c. Employee Benefits
- d. Risk arising from Joint Venture Projects
- e. Warranty
- f. Collision Damage Waiver
- g. Care, Custody and Control
- h. Agency Business (reinsurance only)
- i. Supplier/Contractor Insurance

7. Premium vs. Loss & Loss Expense Provisions

For the purposes of the reclassification requirement any (re)insurer whose net premiums written and/or loss provisions exceeds the 50% unrelated test shall be required to re-register as a Class 3A or Class 3B (re)insurer i.e. if a company is not writing in excess of 50% unrelated net premiums but its booked reserves include over 50% of unrelated loss & loss expense provisions, then said (re)insurer would still meet the criteria of a Class 3A insurer and would be required to make application to re-register. If said (re)insurer is also exceeding the \$50 million unrelated premium test then said (re)insurer would be required to re-register as a Class 3B even if such unrelated premiums are less than 50% of the net premiums written.

8. Net Premiums Written

For the purposes of the re-registration requirement the 50% unrelated test shall apply to the net position only. The gross position with respect to related vs. unrelated shall not be considered.

9. De minimus Premiums Written

The Act makes no express provision for registration as a Class 3 (re)insurer if said (re)insurer meets the criteria for registration as a Class 3A (re)insurer however the amount of net premium written is deemed to be de-minimus. In this regard any (re)insurer writing in excess of 50% unrelated net premiums will be required to make application to be registered as a Class 3A (re)insurer regardless of the dollar amount of said net premiums written.

Please note however that section 4A(2) of the Insurance Act 1978 as noted above allows the Authority to register a (re)insurer in any particular class even if that company may not qualify to be registered in said class, should the Authority deem such registration appropriate. In this regard, should an applicant wish to have the Authority consider registration as a Class 3 (re)insurer when said (re)insurer meets the criteria for registration as a Class 3A (re)insurer, the applicant will need to include with its application a detailed description of the rationale for why said applicant would be more appropriately registered as a Class 3 (re)insurer as opposed to a Class 3A (re)insurer. The Authority will consult with individual firms prior to making a final registration recommendation.

10. In force Regulatory Approvals

All existing regulatory approvals including but not limited to section 56 directions, relevant asset approvals and other fixed capital approvals shall remain in force despite the reclassification of the (re)insurer in accordance with the new criteria. Please be advised that the Authority shall review all such approvals as it reviews the application for re-registration to ensure that said approvals remain appropriate. Should the Authority deem any previously granted approval to no longer be appropriate during the review and analysis of the re-registration application, the Authority shall consult with the applicant prior to amending or voiding said approval.

11. Segregated Accounts Companies/Rent-A-Captives

For the purposes of the re-registration requirement all Segregated Accounts Companies and/or "Rent-a-Captives will be allowed to remain registered as Class 3 (re)insurers at this time. The Authority, as part of its 2009 Business Plan, plans to review this sector of the market with the view

of proposing additional amendments to both the regulatory regime and the fee structure in 2009/2010.

12. Permit Companies

Existing Class 3 (re)insurers operating in Bermuda via a 134 permit (Companies Act) that have also been granted a Section 56 Direction giving approval to file a modified return shall also be allowed to retain their current Class 3 license at this time. In this context a modified return shall mean the Financial Statements and Returns and other information filed with the Insurance Regulatory Authorities in the country in which the company is incorporated. As with Segregated Accounts Companies the Authority plans to review our current regulatory regime with respect to such permit companies and will be proposing amendments to the regime in 2009/2010.

13. Sidecars

Existing Class 3 Sidecars established with “fully collateralized” reinsurance policies will not be required to reregister as Class 3A or Class 3B. In this regard “fully collateralized” reinsurance policies shall mean reinsurance policies in respect of which the maximum liability to be incurred thereon at predetermined future dates is assessed at the time of issuance of said policies, and provisions made therein for meeting of those liabilities in full.

At this time the Authority will not require existing Sidecars or other special purpose type insurance vehicles which were previously registered as Class 3 insurers to re-register as Special Purpose Insurers as such term is defined in the Act. Should any entity wish to avail themselves of this new category of registration, the company will need to make application to the Authority for a change of class. Such applications will be considered outside of this Class 3 re-classification exercise and be addressed as a routine change of class by the Licensing & Authorizations Team.

14. Run-off Companies

As per the instructions described above with respect to “Premiums vs. Loss & Loss Expense Provisions” an existing Class 3 (re)insurer which has entered into run-off and is not currently writing any premium will still be required to make application to register as a Class 3A (re)insurer if that (re)insurer would qualify as such based on the percentage of unrelated loss provisions included in line 17 of the statutory balance sheet.

15. Mutual Companies

For the purposes of the current re-classification exercise, insurance and/or reinsurance business written by “Mutual” companies will be considered related party business as long as said Mutual (re)insurer is insuring or reinsuring the risk of its members only.

16. Other issues

Please note that the definition of a Class 3 (re)insurer has been amended such that a Class 3 (re)insurer is now defined as “A body corporate is registrable as a Class 3 insurer where that body corporate is not registrable as a Class 1, Class 2, Class 3A, Class 3B or Class 4 insurer.”

Please be advised that all financial information required to determine the appropriate class of registration shall be based on audited Bermuda statutory financial statements. Financial information based on Generally Accepted Accounting Principles will not be considered. In addition all financial information included with the application should be based on the 2007 audited accounts or the 2008 audited accounts if said audited accounts have been finalised at the time of application.

- Please send the completed application form and the accompanying documents directly to:

The Bermuda Monetary Authority
Insurance Division
BMA House
43 Victoria Street
Hamilton HM 12

P.O. Box 2447
Hamilton HM JX

- Should you have any questions, queries or concerns please contact Mr. Shelby Weldon @ (441)278-0209 or sweldon@bma.bm

FAQ

1. What does the Insurance Amendment Act 2008 cover?

The Act prescribes prudential standards in relation to an enhanced capital requirement and a capital and solvency return to be complied with by registered insurers; to make new provision for classes of insurers, and for Special Purpose Insurers; to provide for additional financial statements to be prepared in accordance with Generally Accepted Accounting Principles by Class 4 insurers;

2. What if an insurer is a composite (i.e., licensed to conduct both “commercial” general and long-term business)?

The re-registration requirement is only applicable to the general business insurance license. The Long-Term license is not affected by this process.

3. What if there are entities that are not currently holding a Class 3 license and they wish to re-register into one of the new Class 3 sub-classes?

Whilst such companies are not the focus of this current reclassification project, in accordance with our established policy any company wishing to change class can make application to the Licensing & Authorization Unit for a change of class.

4. Where the volume of “unrelated” net premiums written is significant (i.e., greater than \$50 million), but less than 50% of the total business written in a given year, what class of license should be requested?

The first test i.e. % of unrelated business written or loss reserves booked will determine whether or not the company should be licensed as a commercial insurer. The dollar amount of net premiums written will only be used to determine if the (re)insurer is deemed a large commercial (Class 3B) or small commercial (Class 3A) (re) insurer.

5. What happens if a Class 3A insurer breaches the \$50 million unrelated net premiums written threshold?

The Insurance Amendment Act 2008 states that “where a Class 3A insurer exceeds the net premium limitation imposed on that class by section 4DA(2), the insurer shall, notwithstanding such excess, be entitled to carry on insurance business in that class if –

- (a) its principal representative notifies the Authority of an event mentioned in section 8A (2)(h);*
- (b) the insurer makes application under section 56 for a direction that section 4DA(2) would continue to apply to it notwithstanding the excess; and*
- (c) the Authority does not require the insurer to be classified as a Class 3B insurer.”.*

In addition the notification mentioned in (a) above shall include:

- (i) particulars of the circumstances leading to the unprojected increase of unrelated business net premiums written in that year;*
- (ii) unaudited interim statutory financial statements covering such period as the BMA may require; and*
- (iii) a general business solvency certificate in respect of those statements.*

APPENDIX 1A

All business plans submitted with respect to the re-registration application shall include at a minimum the following information:

- (a) Executive Summary which shall discuss the basis for the class of registration for which the company has made application.
- (b) Ownership details.
- (c) Description of insurance program(s).
- (d) 3 year pro-forma statutory financial statements which shall estimate the percentage of unrelated business and BD\$ amount of net premiums written over the succeeding 3 year period.
- (e) Assumptions supporting pro-forma statements.
- (f) Any additional information as advised in the afore-mentioned instructions or as the applicant deems necessary to support the application.

Appendix 2

2009 Proposed Application Fees

<u>Fee Description</u>	<u>Proposed Fee</u>
Applying for registration as -	
(a) an insurer under section 4(1)	\$500.00
(b) an insurance manager, broker or agent- under section 10	\$300.00
Applying -	
(a) to receive Bermuda Monetary Authority approval for an insurer to reduce total statutory capital by 15% or more under section 31C	\$525.00
(b) to be granted a direction under section 56	
(i) Exemption from Loss Reserve Specialist opinion	\$350.00
(ii) Exemption from Loss Reserve Specialist opinion	\$525.00
(iii) Modified Minimum Solvency Margin	\$350.00
(iv) Modified Statutory Financial Return	\$350.00
(c) to receive Bermuda Monetary Authority approval for an asset not appearing on lines 1, 2, 3(a), 5(a), 9, 10, 11 and 12 as required by the Insurance Accounts Regulations 1980, to be treated as "relevant assets"	\$525.00
(d) to receive Bermuda Monetary Authority approval of letters of credit, guarantees and any other instruments to be treated as other fixed capital	\$350.00
Share Transfer under Section 30	\$210.00
Deregistration	\$350.00
Changes in Business Plan/Class & Certificate of Approval	\$350.00
Approval of Internal Models	\$50,000