

REGULATORY, LEGISLATIVE AND OTHER DEVELOPMENTS

This bulletin reports on recent activities at the Bermuda Monetary Authority (“the Authority”) and recent developments affecting the financial sector, as well as the community generally. Attached to it are the regular statistical data covering Bermuda dollar money supply, Bermuda banks’ balance sheet analysis and other financial and company sector information, updated for the quarter ended 30 September 2004.

As announced previously, Balance of Payments Estimates and Associated Commentary are published in a separate document.

(I) REGULATORY DEVELOPMENTS

a) *International Monetary Fund (“IMF”)*

The IMF’s review of Bermuda’s regulatory structure for financial services, conducted as part of the Fund’s review of standards in Offshore Financial Centres, has now been completed and is expected to be published shortly. The review reflects the detailed assessments conducted by the IMF team during an on-site visit to Bermuda in the early part of 2003. Many of the specific recommendations made by the IMF related to issues that had already been identified and taken into account in the ongoing process of updating Bermuda’s financial services legislation and enhancing aspects of the supervisory frameworks that are in place.

b) *Insurance*

Supervisory Model for Insurance

As part of current enhancements to the Authority’s supervisory framework, the Insurance Department has developed a new risk-based Supervisory Model. This is an internal rating tool to be used by the Authority to assess and monitor risk within registered insurers in order to enhance further the effectiveness of supervision and to assist with the efficient allocation of the Authority’s supervisory resources. Following recent consultations with industry bodies, the model approach will be applied progressively across the sector during the remainder of 2005.

Insurance Guidance Notes

Recent amendments to the Insurance Act 1978 provided, among other matters, for the Authority to publish guidance on the application of the Act and related Regulations, including the duties, requirements, standards, procedures and sound principles that are to be complied with. The Insurance Department has been working, in close consultation with industry bodies, on a series of guidance notes. A first set of notes, comprising guidance on fifteen aspects of the insurance regulatory framework, has now been finalized and published, for implementation during the course of 2005. In particular, the guidance notes cover the following areas:

- Appointment, Role and Qualifications of the Inspector
- Fit & Proper and Approval Process for the Loss Reserve Specialist
- Role of the Loss Reserve Specialist
- Fit & Proper and Approval Process for the Approved Auditor
- Role of the Approved Auditor

- Fit & Proper and Approval Process for the Approved Actuary
- Role of the Approved Actuary
- Fit & Proper Criteria - Principal Representative, Insurance Manager and Intermediaries
- Role of the Principal Representative
- Appointment and Duties of the Insurance Manager
- Market Conduct for Domestic Business - Insurers and Intermediaries
- Corporate Governance
- Investments
- Insurance Activity
- Risk Management and Internal Controls

The Authority has also provided the industry with details of the implementation programme for the guidance notes. Certain of the guidance is of immediate application – in particular where it deals with new legal requirements stemming from recent amendments to the Insurance Act 1978. In other cases, where guidance clarifies or refines the Authority’s requirements or the standards of compliance that are expected, the Authority has set out the relevant timetables within which insurers are expected to come into full compliance with the guidance. A number of further guidance notes remain under discussion with industry and are expected to be finalized and introduced in the coming months.

On-Site Programme

The Insurance Department’s Compliance Team has been testing and fine tuning the enhanced monitoring element of its new risk-based framework. Both off-site and on-site work are integral to this programme and will result in the Authority detecting challenges at an early stage, and taking regulatory action, where necessary, in a timely manner.

During the month of January, the Compliance Team began the detailed work necessary to test the risk assessment element of the new risk-based framework. The objective of this work was to finalise the composite risk rating process, which involves an assessment of an insurer’s risk and the identification of expected changes in its risk profile. The Team conducted a detailed review of a high profile insurer in an effort to: a) fine tune the Compliance Team’s skills in preparing for the full roll-out of the on-site review process, and b) to adjust the programme based on feedback received from the off-site and on-site work performed on this high profile insurer.

International Association of Insurance Supervisors (“IAIS”)

Following the introduction of the new IAIS Standard of Supervision for Reinsurers, and the amended IAIS Insurance Core Principles, the Authority (in common with regulatory authorities in other jurisdictions) has been completing a detailed self-assessment of Bermuda’s insurance regulatory framework against the new 28 IAIS Core Principles for supervision. This will allow the Authority to identify those areas of strength and weakness, and to develop and implement action plans that prioritise the improvements needed to maintain a sound insurance regulatory and supervisory system. This process has also been used to inform and validate the existing initiatives that the Authority has

been carrying forward, in close consultation with the insurance industry, aimed at ensuring that Bermuda's insurance regulatory regime remains in compliance with the new international standards.

c) **Banking & Trust**

The Banking Team is continuing work on a number of enhancements to the present regulatory framework for banks and deposit companies, intended to help prepare for eventual implementation of the new Basel II capital framework. In particular, work is under way on the development of a market risk regime. Much of this year's on-site supervisory programme will be geared to helping develop a more complete understanding of banks' internal risk management processes, as part of the preparation for the enhancements to the framework that Basel II will require.

The Trust Team is making good progress with the continuing rollout of the on-site supervisory programme for licensed firms that was initiated in mid-2004, with a view to monitoring practices and procedures in place and ensuring consistency of standards across the trust industry.

d) **Investments**

Investment Business Act 2003

The Investment Team is engaged in completing the implementation of the Investment Business Act 2003. In particular Client Money Regulations under the Act are now in place. Further secondary legislation, notably to provide a regime governing unsolicited calls ("cold calling") and refining the circumstances in which persons will be deemed to be carrying on business in Bermuda for the purposes of the Act, is expected to be introduced shortly, following completion of industry consultations. Work is also under way in close collaboration with the Bermuda Stock Exchange on regulations dealing with recognized investment exchanges.

The Investment Team is also working on a Risk Assessment Model to be applied to licensed investment providers with a view to helping determine the allocation of regulatory resources among firms and to identify key areas of focus for future on- and off-site review programmes.

On 9 February 2005 the Investment Team hosted the first in a planned series of Investor Education seminars for the public. The primary purpose is to provide consumers with information on the Authority's role in regulating the investment industry as well as general guidance on investment issues, geared towards the average retail customer. The session included a presentation by The Bermuda Society of Financial Analysts.

(II) LEGISLATIVE DEVELOPMENTS

a) **Insurance**

Insurance Amendment Act 2004

The Insurance Amendment Act 2004 was passed by the House and the Senate and was signed into law on 10 December 2004. The amendments provide for the Authority to publish guidance notes, clarify the power of the Authority to revoke approvals for skilled professionals such as Approved Auditors and Loss Reserve Specialists, and clarify how inspectors are to be compensated, as well as updating notification requirements that apply to Approved Auditors and Principal Representatives. (See Special Feature article later in this bulletin)

Bermuda Monetary Authority Amendment Act (No. 4) 2004

This Act introduced a number of amendments to registration and annual fees, as well as the administrative fees that apply to the different types of insurance companies. The Act came into effect on 1 January 2005.

b) Investments

Collective Investment Schemes Act 2005 (“CIS Act”)

Work on a CIS Act is now at an advanced stage. A draft of the Bill has recently been circulated to industry for final consultations, with the intention of introducing it into the House in the spring. The Authority is also continuing to work on revisions to the current CIS Regulations and on preparing other secondary regulation, codes and guidance that will form part of the updated regulatory framework that is proposed.

In the meantime in a further streamlining initiative, the Minister of Finance has agreed to delegate to the Authority full powers for the registration/incorporation of schemes. The relevant changes to the Companies Act are expected to be implemented during the first quarter of 2005.

c) Proceeds of Crime Act and Money Laundering Regulations

The Authority has been closely involved in work by the National Anti-Money Laundering Committee (“NAMLC”) aimed at identifying the changes needed to ensure that Bermuda’s anti-money laundering provisions are consistent with the revised international standards. Detailed proposals for a series of amendments to the Act and Regulations have been prepared for early submission to Cabinet. The resultant proposals will then be shared with the industry for consideration as part of the detailed consultations on revised AML Guidance Notes which will take place during the spring with the various industry sectors. Perhaps the most significant changes relate to the broadening of the scope of the Regulations to cover a range of “gatekeepers” in the financial sector, including lawyers, accountants and corporate service providers.

In addition the Authority has distributed to financial institutions, at the request of NAMLC, copies of an informational pamphlet titled “Fighting Crime & Terrorism – You Can Help” detailing to the public the “Know Your Client” procedures that regulated institutions are obliged to have in place, as well as providing contact information for reporting suspected cases of money laundering. The pamphlets were issued in conjunction with a press release from the Ministry of Finance on 9 February 2005.

(III) OTHER DEVELOPMENTS

a) IMF: Offshore Financial Centre Information Framework

Bermuda has agreed to participate in an IMF initiative for Offshore Financial Centres involving the production and publication of certain aggregate data on various financial business sectors. This is intended to be part of a global initiative defining minimum standards of transparency for the financial sector. The data covers mostly banks, insurance companies and collective investment schemes. In the case of Bermuda, most of the data are already published either in the Authority’s Annual Report or in other publications.

b) *Seminars, Conferences & Publications*

Mrs. Cheryl Lister, Chairman & CEO, spoke at the BIBA London briefing on international hedge fund regulation in November 2004.

On 15 November 2004, the Director of Legal Services, Enforcement & International Affairs spoke at a U.S. Securities & Exchange Commission seminar in Washington, D.C. on Regulatory Cooperation and the status of Bermuda's legislation.

Mr. Shelby Weldon, Deputy Director, Insurance attended the 14TH World Captive Forum in Aventura, Florida from 15 to 17 November 2004. The Conference focused on issues of fronting, reinsurance and cost containment within the captive sector.

Mr. Weldon also attended the Standard & Poors 16th Annual Executive Conference of the P&C Industry in New York from 18 to 19 November 2004. The Conference was attended by various Senior Directors and Officers of the major US and international insurance companies and was designed to provide an overview of the current P&C market. This year's Conference was dominated by discussions with respect to the on-going investigation by the New York Attorney General into certain practices and products of the insurance industry.

A Senior Analyst from the Compliance team, **Mrs. Mesheiah Crockwell**, attended the "Strategic Guide to Insurance Insolvency – Overcoming Business Legal & Regulatory Hurdles" in New York from the 15 November to 16 November 2004. The seminar was arranged by the American Conference Institute and was designed to assist regulators and legal professionals better understand the legal, technical and regulatory implications of an insurer becoming insolvent.

During December **Banking & Trust staff** attended a Global Anti-Money Laundering Seminar presented by KPMG and a PwC talk on Corporate Governance.

Members of the **Investment Department** attended a presentation of the results of an AML survey conducted by KPMG on 5 November 2004.

c) *New Staff*

Neysan Sobhani has joined the Authority as Legal Counsel.

Susan Kovacs has joined the Insurance Department as a Principal in the Compliance Team.

Suzanne Williams has joined the Insurance Department as a Principal in the Compliance Team.

Akilah Wilson has joined the Insurance Department as a Senior Analyst in the Licensing and Authorisations Team.

Special Feature: The Insurance Amendment Act 2004

The Insurance Amendment Act 2004 (“Amendment Act”), which amends the Insurance Act 1978 (the “Insurance Act”), was passed by both the House of Assembly and the Senate soon after Parliament reconvened in November, and received assent from the Governor on 10 December 2004. The Amendment Act had been subject to an extensive process of consultation with representative groups of insurers and reinsurers, brokers, captive managers, accountants, law firms - as part of a number of refinements and enhancements to Bermuda’s already strong insurance regulatory regime under the Insurance Act.

The Amendment Act is part of a wider review of, and update to, Bermuda’s regulatory framework for insurance, reflecting the need to ensure consistency with developments in internationally agreed standards for insurance supervision, and to deal with specific recommendations stemming from international reviews of Bermuda’s regulatory framework conducted by KPMG in 2000 and more recently by the International Monetary Fund.

One of the most important components of the Amendment Act provides for the publishing of guidance notes by the Bermuda Monetary Authority on the application of the Insurance Act. Guidance Notes on numerous aspects of Bermuda’s regulatory regime under the Insurance Act, such as the role of auditors, insurance managers and principal representatives, have been developed during the consultation process, simultaneously with the Amendment Act. A first set of Guidance Notes has now been published and are being implemented progressively during 2005. Copies of the Guidance Notes are available from the Authority.

Other key amendments effected by the Amendment Act include:

Notification of change in particulars

The Insurance Act previously required that an insurer notify the Authority within 21 days of any change in particulars of its principal representative, insurance manager or approved auditor, and also of any change in the location of its principal office. The Amendment Act reduces the time within which the Authority must be notified from 21 days to 14 days.

Notification by principal representative

The Insurance Act previously provided that the principal representative make a written report to the Authority if, for example, the principal representative reaches a view there is a likelihood of the insurer for which he acts becoming insolvent. A report must be made within thirty days of the relevant view, etc., being reached. This requirement is an important component of Bermuda’s insurance regulatory framework, given that one of the key roles of the principal representative is to provide early warning of emerging concerns. The Amendment Act legislates current practice by introducing an obligation for principal representatives to notify the Authority immediately, and also reduces the time in which the principal representative must deliver to the Authority a written report regarding the above from 30 days to 14 days.

Approval of loss reserve specialist

A loss reserve specialist must be appointed by each Class 2, 3, and 4 insurer (as well as a Class 1 insurer in certain circumstances) and must be approved by the Authority prior to appointment. In practice the Authority has approved individuals only in respect of a particular insurer, rather than approving an individual for appointment by any insurer. The Amendment Act clarifies this practice as well as the procedure for approval and revocation of approval based on fit and proper criteria, which are further detailed in the Guidance Notes.

Approval and appointment process for auditors

As with loss reserve specialists, the Amendment Act clarifies the approval and appointment process for auditors on the basis of fit and proper criteria as further explained in the Guidance Notes. It also introduces a provision similar to those found in Bermuda's other financial services statutes (for banks and investment businesses) to enable the Authority to appoint an auditor where one has not been appointed, and to set the remuneration.

Auditor independence standard

The Amendment Act modifies the Insurance Act auditor independence standard to make it consistent with the standards in Bermuda's other financial services statutes. No auditor of an insurer may have an 'interest' in that insurer other than as an insured. The term 'interest' would include, for example, shares in an insurer.

Auditor notification requirements

In conjunction with the clarification of the approval and appointment process for auditors noted above, the Amendment Act introduces an obligation for an auditor to notify the Authority in the event of his resignation or removal, or if he makes a material modification to a report on an insurer's statutory financial statements.

In addition to the amendments to the primary legislation contained in the Amendment Act, a number of related amendments to secondary legislation are also in development. In particular they relate to the Insurance Returns and Solvency Regulations 1980 (to add to the basic regulatory information to be reviewed by the principal representative before filing annual returns), and the Insurance Accounts Regulations 1980 (clarifying the accounting standards to be applied). It is expected that these amendments will be made shortly by way of amendment regulations.

Overall, the Amendment Act consolidates and provides statutory backing and detailed written guidance for a number of matters and processes that have already been applied as best practice within the current regulatory framework. The Amendment Act is intended to enhance Bermuda's regulatory regime without creating any material increase in the regulatory burden on Bermuda's insurance companies.

STATISTICAL ANNEXE

BERMUDA MONEY SUPPLY

	<i>(BD\$ millions)</i>					
	2003-Q2	2003-Q3	2003-Q4	2004-Q1	2004-Q2	2004-Q3
Notes & Coins in Circulation *	83	88	94	86	90	90
Deposit liabilities:						
Banks and Deposit Companies (unconsolidated)	3,061	3,156	3,232	3,387	3,491	3,544
	3,144	3,244	3,326	3,473	3,581	3,634
Less: Cash at Banks and Deposit Companies	18	23	28	21	24	23
Bermuda Money Supply	3,126	3,221	3,298	3,452	3,557	3,611
% Growth on Previous Period	1.82%	3.04%	2.39%	4.68%	3.06%	1.52%
% Growth Year-on-Year	11.96%	8.82%	10.49%	12.42%	13.79%	12.11%

* This table includes the supply of Bermuda dollars only. United States currency is also in circulation in Bermuda but the amount has not been quantified.

BD\$ DEPOSIT PROFILE - COMBINED BANKS AND DEPOSIT COMPANIES (UNCONSOLIDATED)

	<i>(BD\$ millions)</i>					
	2003-Q2	2003-Q3	2003-Q4	2004-Q1	2004-Q2	2004-Q3
Deposit Liabilities	3,061	3,156	3,232	3,387	3,491	3,544
Less: Loans, Advances and Mortgages	-2,485	-2,535	-2,567	-2,566	-2,667	-2,752
Surplus deposits	576	621	665	821	824	792
Percentage of Deposit Liabilities Lent	81.2%	80.3%	79.4%	75.8%	76.4%	77.6%

**COMBINED BALANCE SHEETS OF BERMUDA BANKS AND DEPOSIT COMPANIES
(CONSOLIDATED)**

	<i>(BD\$) millions</i>								
	2003-Q2			2003-Q3			2003-Q4		
	Total	BD\$	Other	Total	BD\$	Other	Total	BD\$	Other
ASSETS									
Cash	153	48	105	500	88	412	277	31	246
Deposits	7,111	23	7,089	7,271	48	7,223	9,066	86	8,980
Investments	6,992	25	6,967	7,209	14	7,195	7,718	14	7,704
Loans & Advances	4,399	2,441	1,958	4,666	2,492	2,174	4,845	2,524	2,321
Premises & Equipment	262	206	56	261	200	61	266	204	62
Other Assets	290	58	232	268	49	219	232	43	189
TOTAL ASSETS	19,207	2,800	16,407	20,175	2,891	17,284	22,404	2,901	19,504
LIABILITIES									
Demand Deposits	8,783	808	7,975	9,275	877	8,398	10,685	903	9,782
Savings	1,351	920	431	1,349	939	410	1,450	951	499
Time Deposits	7,001	1,331	5,670	7,507	1,360	6,148	7,981	1,368	6,613
Sub Total - Deposits	17,135	3,059	14,076	18,131	3,175	14,956	20,116	3,222	16,894
Other Liabilities	775	128	647	708	111	597	897	97	800
Sub total - Liabilities	17,909	3,186	14,723	18,839	3,286	15,553	21,012	3,319	17,694
Capital	1,298	509	789	1,336	508	828	1,391	567	824
TOTAL LIABILITIES AND CAPITAL	19,207	3,695	15,512	20,175	3,795	16,381	22,404	3,886	18,517

	<i>(BD\$) millions</i>								
	2004-Q1			2004-Q2			2004-Q3		
	Total	BD\$	Other	Total	BD\$	Other	Total	BD\$	Other
ASSETS									
Cash	168	23	145	405	35	370	486	84	403
Deposits	9,174	115	9,059	9,109	99	9,010	7,598	98	7,500
Investments	8,297	18	8,279	8,347	17	8,330	8,514	18	8,496
Loans & Advances	5,104	2,540	2,563	5,487	2,629	2,858	5,326	2,714	2,613
Premises & Equipment	325	273	52	335	279	57	332	274	58
Other Assets	332	43	289	353	31	323	206	23	183
TOTAL ASSETS	23,398	3,012	20,386	24,037	3,089	20,948	22,462	3,211	19,253
LIABILITIES									
Demand Deposits	11,665	755	10,909	12,282	817	11,465	10,943	823	10,120
Savings	1,862	1,266	596	2,033	1,325	708	2,165	1,348	817
Time Deposits	7,442	1,371	6,072	7,128	1,329	5,798	7,016	1,321	5,695
Sub Total - Deposits	20,969	3,392	17,577	21,443	3,471	17,972	20,124	3,492	16,632
Other Liabilities	1,134	165	969	1,166	212	954	919	227	692
Sub total - Liabilities	22,103	3,557	18,546	22,608	3,683	18,926	21,043	3,719	17,324
Capital	1,295	619	676	1,428	606	822	1,420	587	833
TOTAL LIABILITIES AND CAPITAL	23,398	4,176	19,223	24,037	4,289	19,748	22,463	4,306	18,157

Totals may not add due to rounding

**COMBINED BANKS AND DEPOSIT COMPANIES FOREIGN CURRENCY POSITION
(CONSOLIDATED)**

	2003-Q2	2003-Q3	2003-Q4	2004-Q1	2004-Q2	2004-Q3
Total Foreign Currency Assets	16,407	17,284	19,504	20,386	20,948	19,252
Less: Other Assets	232	219	189	289	323	241
Less: Foreign Currency Loans to Residents	684	728	743	779	854	762
Net Foreign Currency Assets	15,491	16,337	18,571	19,318	19,772	18,249
Foreign Currency Liabilities	14,723	15,553	17,695	18,546	18,926	17,324
Add: BD\$ Deposits of Non-Residents	100	115	174	156	176	185
Net Foreign Currency Liabilities	14,823	15,668	17,869	18,702	19,101	17,509
Net Foreign Currency Position (consolidated)	668	669	702	616	670	740

Totals may not add due to rounding

COMPANIES PARTERNSHIPS & PERMITS STATISTICS

APPLICATIONS APPROVED

SUMMARY Q3-2004

	2003-Q2	2003-Q3	2003-Q4	2004-Q1	2004-Q2	2004-Q3
Exempted Companies (Bermuda companies exempted from the 60% Bermudian ownership requirement)	230	233	309	256	244	260
Exempted Partnerships (partnerships established in Bermuda to carry on business in or from within Bermuda)	19	17	31	25	11	13
Overseas Partnerships (overseas partnerships applying for permits to carry on business in or from within Bermuda)	2	1	0	0	1	0
Overseas Permit Companies (overseas companies applying for permits to carry on business in or from within Bermuda)	9	9	4	5	14	3
Unit Trusts	35	4	11	21	3	10
Continuation Companies (companies from other jurisdictions continuing into Bermuda as exempted companies)	11	4	23	5	8	3
Unlimited Liability Companies	1	1	3	0	0	0
Local Companies	55	48	50	59	62	48
Total Applications Approved	362	317	431	371	343	337

ADDITIONS TO THE INSURANCE REGISTER

	2003 Q2	2003 Q3	2003 Q4	2004 Q1	2004 Q2	2004 Q3
Class 1	10	2	13	3	10	4
Single-parent captive insuring only risks of its owners or affiliates of the owners						
Class 2	3	1	4	7	1	0
(a) a multi-owner captive insuring risks of its owners or affiliates of the owners;						
(b) a single-parent and multi-owner captive:						
(i) insuring the risks related to or arising out of the business or operations of the owners and affiliates, and/or						
(ii) deriving up to 20 percent of its net premiums from unrelated risks						
Class 3	11	4	15	5	3	6
Insurers not included in Class 1, 2 or 4, such as						
i) Reinsurers writing third party business;						
ii) Insurers writing direct policies with third party individuals;						
iii) Single parent, group, association, or joint venture captives where more than 20% of their net premiums written arises from risks which are unrelated to the business of the owners;						
iv) Finite reinsurers and rent-a-captives						
Class 4	1	1	0	0	0	1
Insurers and reinsurers capitalised at a minimum of \$100 million underwriting direct excess liability and/or property catastrophe reinsurance risk						
Long-Term Insurers	1	2	4	2	2	2
Insurers writing long-term (or life) business						
Composites	0	0	0	0	0	1
Insurers writing combination of long-term (or life) business and Class 1, 2, 3 or 4 business						
Total additions during quarter	26	10	36	17	16	14

STATISTICAL ANNEXE

COLLECTIVE INVESTMENT SCHEMES STATISTICS

	2003-Q2	2003-Q3	2003-Q4	2004-Q1	2004-Q2	2004-Q3
MUTUAL FUNDS	763	759	817	849	834	855
Umbrella Funds	53	56	57	62	69	72
Sub-Funds	436	407	395	422	441	409
SEGREGATED ACCOUNT COMPANIES	6	9	9	13	20	26
SEGREGATED ACCOUNTS	21	35	43	46	87	137
TOTAL	1,279	1,266	1,321	1,392	1,451	1,499
Unit Trusts	65	63	72	93	65	74
Umbrella Trusts	64	65	67	67	72	72
Sub-Trusts	32	50	82	115	195	119
TOTAL	161	178	221	275	332	265
TOTAL	1,440	1,444	1,542	1,667	1,783	1,764
TOTAL NET ASSET VALUE (IN BILLIONS)	\$88.72	\$99.35	\$115.84	\$129.60	\$133.02	\$141.25