



BERMUDA MONETARY AUTHORITY

INSURANCE DEPARTMENT

GUIDANCE NOTE # 16

ENHANCED CAPITAL REQUIREMENT

November 2008

GUIDANCE NOTE: ENHANCED CAPITAL REQUIREMENT

Introduction

- 1 The Bermuda Monetary Authority (“the Authority”) is introducing prudential standards in relation to the Enhanced Capital Requirement (“the ECR”). The prudential standards will come into effect on December 31, 2008.
- 2 The Authority recognizes the need for clarity as to the scope and implementation of the ECR if the regulatory system is to command the confidence of both insurers and policyholders. It seeks, therefore, to ensure that those operating in Bermuda have a good understanding of the nature of the ECR and the Authority’s approach in regulating the insurers.
- 3 While the Authority aims to provide clarity as to its approach, this guidance note cannot be exhaustive. The Authority will do its best through this and other guidance notes to set out information about the ECR.
- 4 Other guidance issued by the Authority may contain additional information on the implementation of the standard model and reporting requirements.
- 5 The Authority’s guidance is of a general application and seeks to take account of the wide diversity of institutions that may be licensed under the Insurance Act 1978 (“the Act”). There is likely to be a need for the guidance to be revised and developed over time. Material changes in the guidance will be published, generally through the issue of revised versions.

Application

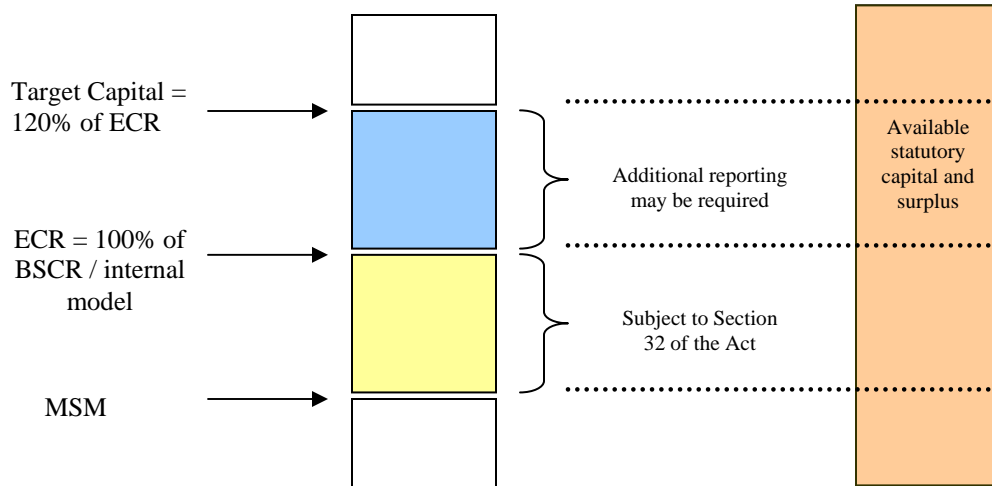
- 6 This guidance applies to all Class 4 insurers writing general business.

Enhanced Capital Requirement

- 7 Insurers will be required to hold available statutory capital and surplus equal to or exceeding the ECR prescribed by the Insurance (Prudential Standards) (Class 4 Solvency Requirement) Order 2008 (“the Order”).
- 8 The ECR is equal to the higher of each insurer’s Minimum Margin of Solvency (“the MSM”) as prescribed by Section 6 of the Act or the Bermuda Solvency Capital Requirement (“the BSCR”) / the approved internal capital model (“the internal model”) as prescribed by the Order.
- 9 Given the volatility of business, insurers will also be expected to hold a safety margin or buffer above the ECR, at least in total equivalent to 120% of the ECR (“the Target Capital”). Available statutory capital and surplus falling below the

Target Capital level will serve as an early warning signal that an insurer may be approaching solvency difficulties.

10 Insurers should have available statutory capital and surplus¹:



11 Where an insurer’s available statutory capital and surplus is between the Target Capital level and the ECR, the insurer is not considered insolvent under the Act, or in breach of the Order, but additional reporting requirements or other enhanced oversight may be imposed by the Authority.

12 Where an insurer’s available statutory capital and surplus is between the ECR and the MSM, the insurer is not considered insolvent under the Act but may be subject to regulatory actions taken by the Authority under Section 32 of the Act. The insurer is in breach of the Order.

13 An insurer must always hold available statutory capital and surplus exceeding the MSM pursuant to Section 6 of the Act. In the event that the BSCR / internal model is below the MSM, the MSM will serve as the “floor” for an insurer’s ECR.

Available statutory capital and surplus

14 The available statutory capital and surplus is defined in the Act as “an amount equal to the total statutory capital and surplus including any adjustments thereto made under section 6D”.

15 At the end of each insurer’s relevant year², the available statutory capital and surplus is equal to the insurer’s reported total statutory capital and surplus as reported in Form 1A, Line 40 of its Statutory Balance Sheet. The amount will

¹ See paragraph 14 for definition

² Relevant year is defined in the Order, in relation to an insurer, as financial year

serve as the insurer's available statutory capital and surplus until such time as the Authority assesses the insurer.



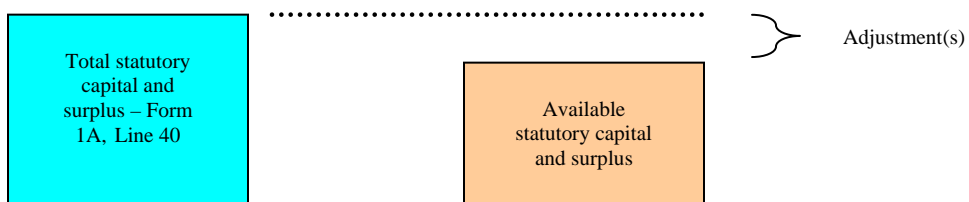
Adjustments to ECR and Available Statutory Capital and Surplus

- 16 Pursuant to Section 6D of the Act, the Authority may make adjustments to an insurer's ECR and available statutory capital and surplus where the Authority concludes that the risk profile of the insurer deviates significantly from:
 - (a) the assumptions underlying the ECR applicable to it; or
 - (b) the insurer's assessment of its risk management policies and practices in calculating the ECR applicable to it.

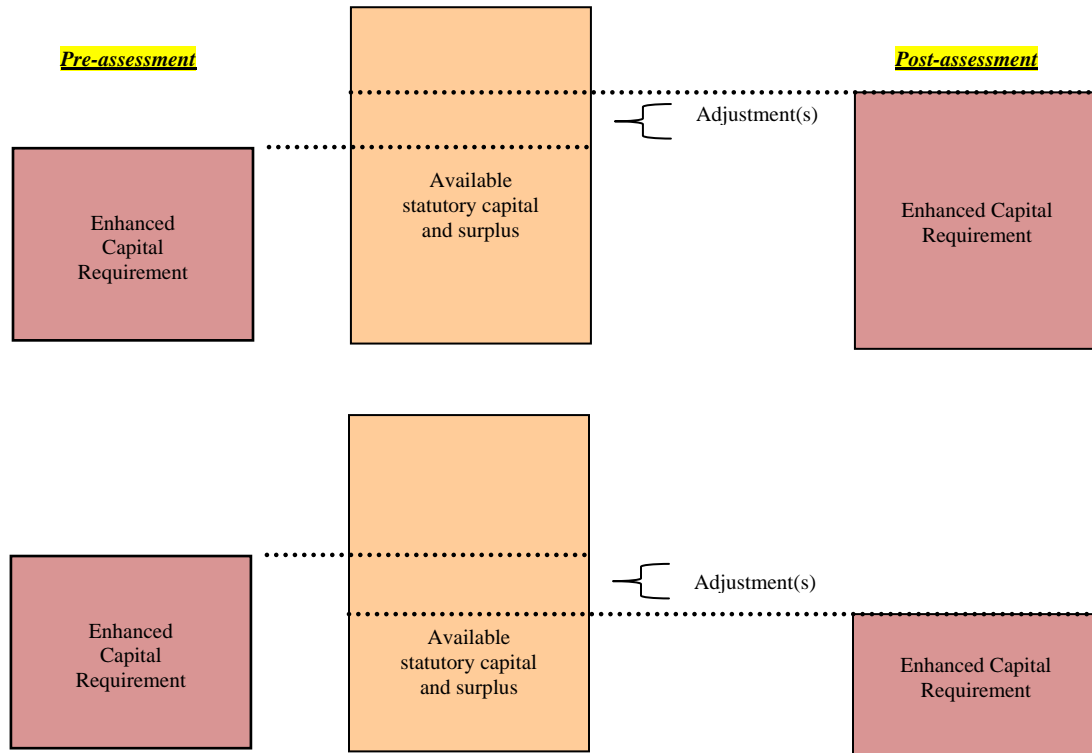
- 17 The Authority will notify the insurer of its intention to adjust and provide the insurer with the opportunity to make representation. The insurer will have 28 days to make representation to an in-house panel comprising of Risk, Actuary, and Supervisory staff members at the Authority. The Authority will consider the representation of the insurer before reaching a decision. Once a decision is reached by the Authority, the insurer will be notified of the Authority's final decision. The adjustment will not come to effect until 90 days (or such longer period as the Authority may determine) from the final notification date.

- 18 The insurer may appeal to a tribunal outlined in Part VIIIA of the Act if it is aggrieved by the Authority's decision with respect to the adjustment(s).

- 19 Following an adjustment referred to in paragraph 16 or 17:
 - (a) the available statutory capital and surplus will be equal to the insurer's total statutory capital and surplus (as reported at its previous year-end) plus any adjustment(s). This new available statutory capital and surplus will serve as the new benchmark for the ECR.



(b) the ECR will be equal to higher of the insurer’s MSM or BSCR / internal model plus or minus any adjustment(s). This new ECR will serve as the new benchmark for the available statutory capital and surplus.



Principal Representatives

20 Pursuant to Section 8A of the Act, Principal Representatives are required to report to the Authority any event that “is likely to cause the insurer to be unable to comply with the enhanced capital requirement applicable to it.” Such events may include external and internal events. External events include but are not limited to catastrophic and/or economic events. Within 45 days of notifying the Authority of such an event, principal representatives must furnish the Authority with updated Capital and Solvency Return (pursuant to Section 6A of the Act), which includes the BSCR / internal model prepared using post-loss data.

End of Guidance Note.

If you have questions on this or other guidance from the Policy, Research & Risk Assessment Department please email policy@bma.bm . Please put “Insurance Guidance” in the title of your email.