



BERMUDA MONETARY AUTHORITY

Regulatory Update
November 2005

*(Incorporating Financial Statistics for the
Quarter ended June 2005)*

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(I) REGULATORY DEVELOPMENTS

a) **Investments**

Collective Investment Schemes Legislation

The Authority has received comments on the proposed new legislation from industry, including the Bermuda International Business Association (BIBA) Collective Investment Schemes Committee. The Authority will hold further discussions with industry shortly in order to finalise the proposals and bring them before Parliament.

b) **Banking and Trust**

Updates to Capital Adequacy Framework for Banks and Deposit Companies

The Authority circulated to industry for consultation a first draft revision of the 1999 paper on measurement of capital under the Banks and Deposit Taking Companies Act. These proposals represent a final stage of amendment to the capital framework for banks, in particular by providing more effectively for the measurement of risk resulting from traded market activity. This will be followed during 2006 by a first set of proposals relating to the forthcoming implementation of the Basel II framework.

(II) LEGISLATIVE DEVELOPMENTS

a) **Proceeds of Crime Act and Regulations – Possible Amendments**

The consultative process regarding proposed amendments to the Act and Regulations is underway. The Authority expects amendments to the Proceeds of Crime Act and Regulations to be tabled in Parliament later in this session. In the meantime, the Authority is holding discussions with industry groups, on behalf of the National Anti-money Laundering Committee, on revisions to the Guidance Notes previously circulated.

b) **Insurance**

Insurance Amendment Act Guidance Notes

Insurance Guidance Note on the Role of the Loss Reserve Specialist

A draft of the Guidance Note has been released to several industry groups for consultation and is also available on the Authority's website. Comments will be accepted

up to December 31, 2005. Subsequent to reviewing industry feedback the Authority will make any necessary changes. It is expected that the guidance will be finalised by late-January 2006.

The Authority has amended the due date for enactment of the guidance. Originally companies were expected to comply with the guidance when filing 2006 Statutory Financial Returns. However, compliance will now be required in Statutory Filings related to December 31, 2006 financial year-ends or later.

Draft Insurance Guidance Note on Accounting for Investment in Affiliates

The draft of the Guidance Note has been circulated to (ICAB) for comment before the end of November. After consultation with ICAB, the IAC Acts & Regulations Committee will discuss any proposed changes. The Authority will incorporate recommendations from the Committee prior to circulating the revised guidance to the IAC for comment.

(III) OTHER DEVELOPMENTS

a) IAIS Captive Insurance Paper

Work continues on the latest draft of the consultative paper ‘*The Regulation and Supervision of Captive Insurance Companies*’, which was discussed on a preliminary basis at the recent IAIS Annual General Meeting. The Authority has continued to reiterate in its remarks and feedback on the paper the appropriateness of applying a differentiated, risk-based regulatory approach for captive insurers as compared to the commercial insurance market, since the majority of captives write little or no third-party risk. The paper is due to be finalised for presentation to the IAIS within the first quarter of 2006.

b) IAIS Annual General Meeting – adoption of new papers:

The Authority was represented and participated in discussions at the Annual General Meeting of the International Association of Insurance Supervisors (IAIS) in October. The IAIS adopted the following papers at the meeting:

- The paper *A new Framework for insurance supervision*, underpinning the IAIS standard setting activities and the *Cornerstones for the formulation of regulatory financial requirements*, sketching the contours of a common structure for the assessment of insurer solvency;
- A *Guidance paper on risk transfer, disclosure and analysis of finite reinsurance* outlining the key related areas that supervisors should focus on;

- The *Standard on disclosures concerning investment risks and performance for insurers and Reinsurers*, the second of three standards which the IAIS is issuing regarding public disclosure requirements on insurers and reinsurers;
- A *Guidance paper on combating the misuse of insurers for illicit purposes*, which provides supervisors with indicators of higher risk situations and assessment elements for combating the misuse of insurers for illicit purposes; and
- The *Supervisory standard on fit and proper requirements and assessment for insurers*, consisting of a revision and upgrade of an existing guidance.

The Authority had provided comments and input on all of these papers as they were in development.

c) **CFATF Typologies Project Questionnaire – Misuse of Corporate Vehicles**

The Authority submitted input for this questionnaire, in conjunction with the Ministry of Finance, which will comprise Bermuda's response to the Caribbean Financial Action Task Force (CFATF). The questionnaire was compiled by the Financial Action Task Force (FATF) for use in typologies research – the examination of money laundering and terrorist financing methods and trends. The information from the questionnaire will be used in aggregate by the FATF as part of its assessment on the misuse of corporate vehicles. A completed report on the misuse of corporate vehicles will be published on the FATF website in June 2006.

d) **Seminars, Conferences and Publications**

Cheryl Lister, Chairman and CEO, spoke as a member of a panel at the International Symposium on Economic Crime, which took place at Cambridge University from September 5th – 9th.

Mrs. Lister, **Jeremy Cox**, Supervisor of Insurance, and **Shelby Weldon**, Deputy Director Compliance-Insurance, also spoke on a variety of regulatory issues as members of panels at the inaugural Bermuda Captives Conference, which took place from September 12th – 14th.

Tina Woods, Principal, Trust attended the “Beyond the Level Playing Field”, Trusts and International Tax Treaties Symposium 2005 held in London on 19 and 20 September. The topics presented included a presentation on “OECD Harmful Tax Practices Project” and the debate as to whether Offshore Financial Centers (“OFC’s”) should continue to battle those perceptions on an individual basis or press towards establishing a level playing field on a group basis. Mutual assistance agreements, tax treaty arrangements, the EU Savings Directive impacts and the European Court of Justice were also discussed.

Shelby Weldon and **Shanna Lespere**, Deputy Director, Licensing and Authorisations-Insurance, attended a Reinsurance Seminar hosted by the Financial Stability Institute

(FSI) in Basel, Switzerland, from September 20th – 22nd. The seminar provided detailed updates on a number of topics relative to the regulation of reinsurance.

From September 27th - 28th **Susan Kovacs**, Principal, Compliance attended a conference hosted by the American Conference Institute (ACI) in New York entitled "Preparing for the Future of Finite and Structured Risk (Re) Insurance". Representatives from the SEC, New York State Insurance Department, and New York State Attorney General's office spoke about the state of the market. Differences between finite and traditional (re) insurance and the issue of risk transfer were covered in depth. The conference concluded with a workshop addressing accounting for finite deals, led by a senior reinsurance manager of the NAIC.

Leila Madeiros, Deputy Director, Policy, Research and Communications, **Shanna Lespere** and **Shelby Weldon** attended the Annual General meeting of the International Association of Insurance Supervisors (IAIS) from October 17th – 21st in Vienna, Austria. The meeting covers major developments in international insurance regulation, as well as formally adopting IAIS guidance and position papers finalised during the year.

e) *New Staff*

Elizabeth Amyoony has joined the Authority as Senior Learning and Development Officer.

William Kattan has joined the Authority as Director of Legal Services and Enforcement.

Carnell Lambert has joined the Compliance Group within the Insurance Department as a Senior Analyst.

Terry Pitcher has joined the Finance Department as Financial Controller.

Sophie Tod has joined the Legal Services and Enforcement Department as Legal Counsel.

Special Feature: IAIS Guidance Paper on Finite Reinsurance Released for Consideration

As reported elsewhere in this Regulatory Update, a wide variety of guidance papers was presented and adopted by the International Association of Insurance Supervisors (IAIS) at its recent Annual General Meeting. Perhaps most significant among them was the *Guidance Paper on Risk Transfer, Disclosure and Analysis of Finite Reinsurance* (“Finite Risk Guidance Paper”) which was much-anticipated given the industry, regulatory and media attention finite risk products have received during 2005.

The Finite Risk Guidance Paper provides background on the development and uses of finite reinsurance products by insurers and has been circulated to insurance regulators worldwide. The paper seeks to give insurance regulators guidance regarding the supervision of finite reinsurance by:

- Providing a definition of finite reinsurance
- Indicating what constitutes risk transfer and recommending how risk transfer should be assessed
- Listing different types and characteristics of finite risk policies, and providing examples
- Describing related benefits and issues that may arise
- Discussing related accounting and disclosure issues
- Suggesting various supervisory approaches to finite reinsurance

The guidance provided in the paper is linked to a number of existing IAIS Core Principles on insurance supervision. The IAIS developed the Core Principles in order to provide a framework for the regulation and supervision of the insurance sector that could be applied globally. The intention was to achieve consistency in the quality of regulation across jurisdictions in an effort to promote and maintain efficiency, fairness, sound financial infrastructures and stability in insurance markets.

The paper states that finite risk products, which have been used by insurers for decades as highly structured vehicles to transfer clearly defined, limited amounts of insurance risk, must be separated from possible abuse. Examples of such abuse could include when there is inadequate risk transfer in finite risk transactions, or transaction is not accounted for appropriately. The paper lists the following examples as appropriate uses of finite reinsurance by insurers:

- To capitalise on an insurer’s above average underwriting loss experience when traditional reinsurance coverage is too expensive;
- To increase underwriting capacity, to take larger retention in favourable underwriting environments or risks that traditional markets would not cover;

- To have the ability to purchase reinsurance protection when an insurer's historic underwriting loss experience is much worse than average, making 'reasonably' priced reinsurance unavailable;
- To provide reinsurance cover when an insurer wants to exit lines of business; and
- To protect against potential adverse loss development, including the acquisition of new blocks of business.

According to the paper, the following represents an inappropriate use of finite reinsurance:

- To engineer the insurer's reported financial position and present better results or enhance the balance sheet for a number of reasons, such as to avoid a ratings downgrade, to avoid non-compliance with creditor lending conditions, or to avoid or delay supervisory intervention.

Based on feedback received from regulators during the development of the paper, the following examples of finite reinsurance uses may be permitted in some jurisdictions but not in others:

- To effect discounting of insurance liabilities in jurisdictions where discounting is not permitted and/or equalization reserves are not used;
- To reduce volatility in reported earnings (i.e. smoothing) and enhance the financial position of the insurer over a period of time (e.g. multi-year contracts);
- To provide surplus relief of capital enhancement in jurisdictions where acquisition expenses are non-deferrable; and
- To transfer insurer's profits to another jurisdiction or to an affiliate (e.g. potentially minimising taxes).

Development of the paper may have been driven in large part by concerns over the past year regarding improper uses of finite reinsurance. However, overall the paper does provide a balanced overview of how finite products are used legitimately, and provides for consideration by regulators a range of approaches for supervising finite reinsurance.

The key areas of concern that have received the most attention from a regulatory perspective relate to ensuring that there is proper accounting and disclosure of finite reinsurance transactions and assessing whether there is adequate risk transfer when these take place. It is on these areas that the recommendations for supervising finite reinsurance contained in the paper place most emphasis. The recommendations include ensuring that the supervisor has access to all reinsurance documentation to aid in understanding the structure of agreements and the underlying commercial reality, and having the ability to verify that insurers have disclosed and accounted for any separate or side agreements between the parties to finite reinsurance agreements that might reduce or offset the reinsurer's obligations.

The Authority, in common with other regulators around the world, has been actively reviewing all the concerns regarding finite risk as they might relate to the Bermuda

market. The Authority also participated in the work conducted by the IAIS to develop the Finite Risk Guidance Paper. Our review of finite reinsurance products continues and the Authority will consider the recommendations in the paper and assess their applicability to the Bermuda market; consultation with industry on these issues will begin in the New Year.

STATISTICAL ANNEXE

BERMUDA MONEY SUPPLY

(BD\$ millions)	2004-Q1	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2
Notes & Coins in Circulation*	86	90	90	100	93	93
Deposit liabilities:						
Banks and Deposit Companies (unconsolidated)	3,387	3,491	3,544	3,558	3,579	3,562
	3,473	3,581	3,635	3,658	3,672	3,655
Less: Cash at Banks and Deposit Companies	21	24	23	27	26	28
BD\$ Money Supply	3,452	3,557	3,612	3,630	3,646	3,628
% Growth on Previous Period	4.68%	3.06%	1.52%	0.51%	0.43%	-0.07%
% Growth Year on Year	12.42%	13.79%	12.14%	10.09%	5.63%	5.10%

* 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)

(BD\$ Millions)	2004-Q1	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2
Deposit Liabilities	3,387	3,491	3,544	3,558	3,579	3,562
Less:						
Loans, Advances and Mortgages	(2,566)	(2,667)	(2,752)	(2,865)	(2,942)	(3,079)
Surplus deposits	821	824	792	693	637	484
Percentage of Deposit Liabilities Lent	75.8%	76.4%	77.6%	80.5%	82.2%	86.4%

**Combined Banks and Deposit Companies Foreign Currency Position
(Consolidated)**

	<u>(BD\$ millions)</u>					
	2004 - Q1	2004 - Q2	2004 - Q3	2004 - Q4	2005 - Q1	2005 - Q2
Total Foreign Currency Assets	20,386	20,948	19,252	17,221	19,211	15,621
Less: Other Assets	289	323	241	284	285	265
Less: Foreign Currency Loans to Residents	779	854	753	850	917	995
Net Foreign Currency Assets	19,318	19,772	18,249	16,087	18,009	14,361
Foreign Currency Liabilities	18,546	18,926	17,324	15,278	17,253	13,517
Add: BD\$ Deposits of Non-Residents	156	176	161	142	117	124
Net Foreign Currency Liabilities	18,702	19,101	17,509	15,420	17,370	13,641
Net Foreign Currency Position (consolidated)	616	670	741	667	640	720

Totals may not add due to rounding

Statistics for earlier periods have been revised to reflect more recent data

COMPANIES PARTNERSHIPS & PERMITS STATISTICS

APPLICATIONS APPROVED SUMMARY Q2-2005

	2004-Q1	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2
Exempted Companies (Bermuda companies exempted from the 60% Bermudian ownership requirement)	256	244	260	287	266	229
Exempted Partnerships (partnerships established in Bermuda to carry on business in or from within Bermuda)	25	11	13	27	23	30
Overseas Partnerships (overseas partnerships applying for permits to carry on business in or from within Bermuda)	0	1	0	2	2	0
Overseas Permit Companies (overseas companies applying for permits to carry on business in or from within Bermuda)	5	14	3	10	13	7
Unit Trusts	21	3	10	19	12	14
Continuation Companies (companies from other jurisdictions continuing into Bermuda as exempted companies)	5	8	3	11	4	5
Unlimited Liability Companies	0	0	0	1	0	0
Local Companies	59	62	48	53	62	54
Total Applications Approved	371	343	337	410	382	339

COLLECTIVE INVESTMENT SCHEMES STATISTICS

	2004-Q1	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2
Mutual Funds	849	834	855	879	906	919
Umbrella Funds	62	69	72	70	64	67
Sub-Funds	422	441	409	500	524	551
Segregated Account Companies	13	20	26	29	38	45
Segregated Accounts	46	87	137	159	177	247
Total	1,392	1,451	1,499	1,637	1,709	1,829
Unit Trusts	93	65	74	96	100	105
Umbrella Trusts	67	72	72	75	77	84
Sub-Trusts	115	195	119	203	217	264
Total	275	332	265	374	394	453
TOTAL PORTFOLIOS	1,667	1,783	1,764	2,011	2,103	2,282
TOTAL NUMBER OF SCHEMES	1,084	1,060	1,099	1,149	1,185	1,220
TOTAL NET ASSET VALUE (IN BILLIONS)	\$129.60	\$133.02	\$141.25	\$158.18	\$166.50	\$178.58

ADDITIONS TO THE INSURANCE REGISTER

	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2005 Q1	2005 Q2
Class 1	7	10	4	11	2	3
Single-parent captive insuring only risks of its owners or affiliates of the owners						
Class 2	7	1	0	4	3	3
(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	5	3	6	10	6	7
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	0	0	1	0	0	0
Insurers and reinsurers capitalised at a minimum of \$100 million underwriting direct excess liability and/or property catastrophe reinsurance risk						
Long-Term Insurers	2	2	2	5	3	3
Insurers writing long-term (or life) business						
Composites	0	0	1	0	0	0
Insurers writing combination of long-term (or life) business and Class 1, 2, 3 or 4 business						
Total additions during quarter	17	16	14	30	14	16

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