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Dear Class 4 and 3B (Re) Insurers:

RE: DISCUSSION PAPER ON THE OWN RISK AND SOLVENCY ASSESSMENT PROCESS
("the Discussion Paper")

The Bermuda Monetary Authority ("the Authority") wishes to thank the stakeholders for their continued support on its initiatives. Recently, the Authority published a Discussion Paper on the Own Risk and Solvency Assessment Process. A number of comments were received and the Authority's responses are outlined below.

Streamlined Reporting

Comments were expressed regarding the Authority's proposed electronic reporting platform.

An efficient and streamlined ORSA process is important to the Authority. In this regard, the Authority is working to streamline its regulatory procedures and envisages a consolidated reporting package. In particular, the Authority is currently developing an electronic reporting facility using an XBRL¹ platform.

The Authority acknowledges that some insurers may not currently use XBRL reporting functionality. To facilitate the introduction of XBRL, the Authority will supply XBRL enabled filing documents. Additionally, an insurer with its own XBRL technology will also be able to file using XBRL formatted information taken directly from its internal systems or using its internal forms that have been XBRL enabled. Accordingly, the Authority will allow for appropriate testing and implementation time.

Capital add-ons

Clarity was requested on the capital add-ons with regard to the following:

- **A capital add-on being triggered on account of additional risks not captured by ECR calculated from a standard formula (BSCR) or an internal model**
- **Whether during the appeal process a capital add-on is in force or not.**
- **The Authority's expectations with regards to the assessment of certain risks such as reputational and strategic risk**

The Authority proposes to impose a capital add-on in exceptional circumstances and only as a last resort measure. The Authority proposes a capital add-on in the following circumstances:

¹ eXtensible Business Reporting Language.

- a) Where the Authority concludes that the ECR for an individual insurer calculated using the BSCR or an approved internal model is not prudent enough compared to the insurer's risk profile, either because the risks are not adequately captured by the ECR calculation, or the risks are not covered.
- b) Where the Authority concludes that there are material deficiencies in the internal control or governance structure of insurers and these may impair the identification, measuring, monitoring and managing of risks.

The Authority's position on capital add-ons is similar to the Solvency II approach which is outlined in Article 37 of the directive as follows:

“Following the supervisory review process supervisory authorities may in exceptional circumstances set a capital add-on for an insurer. That possibility shall only exist in the following cases:

- (a) the supervisory authority concludes that the risk profile of the insurer deviates significantly from the assumptions underlying the solvency capital requirement as calculated using the standard formula, and the requirement to use an internal model has been deemed ineffective or while a partial or full internal model is being developed.*
- (b) the supervisory authority concludes that the risk profile of the insurer deviates significantly from assumptions underlying the solvency capital requirement as calculated using the internal model or partial internal model, because certain quantifiable risks are captured insufficiently and the adaptation of the model to better reflect the given risk profile has failed within an appropriate timeframe.*
- (c) The supervisory authority concludes that the system of governance of an insurer deviates significantly from the standards laid down, in that those deviations prevent it from being able to properly, identify, measure, monitor, manage and report the risks that it is or could be exposed to and the application of other measures is in itself unlikely to improve the deficiencies sufficiently within an appropriate timeframe.”*

The Authority intends to be transparent with insurers in the application of any capital adjustments. During the supervisory review process the Authority proposes to accept or contest suggested capital add-ons and insurers will have the opportunity to challenge such decisions. Further, insurers will have an opportunity to appeal to an independent Tribunal appointed by the Minister of Finance pursuant to Section 44A of the Insurance Act 1978.

A capital add-on will not be in force during the appeal process. Insurers can appeal to the Authority through the proposed appeal process. Once the final decision is reached, the Authority will notify the insurer of the final decision and the capital add-on, if imposed, will come to effect no earlier than 90 days from the date of the final decision.

The Authority is cognizant of the difficulty in quantifying qualitative risks and will be expecting firms to come forward with their own assessment of such risks and potential proposal of ECR adjustments, in cases where such risks have been identified by the company as a material risk. Attachment I of the Discussion Paper lists the key principles and guidance of ORSA. The mitigation measures that the insurer has implemented in relation to such risks would also be considered prior to ECR adjustment decisions.

Groups versus legal entity

Comments were expressed on the group entities that should be included within the ORSA assessment of group risk.

The Authority is currently developing its group-wide supervision regime; as such the application of ORSA to groups would reflect the definition of groups in the group-wide supervision regime. The Authority in its paper on group-wide supervision proposes the definition of a group to be an insurance group and all the requisite entities: insurance and non insurance entities (regulated and unregulated). As for unregulated entities, the Authority proposes to limit the scope of unregulated entities to cover intra-group transactions and investments in unregulated entities.

Responsibility for risk taking versus risk assessment

Comments were expressed on the requirement to have independence between risk taking and risk assessment responsibilities as an important control around ORSA.

The Authority is in agreement that independence between risk taking and risk assessment may not necessarily be a feasible control tool in certain situations. The Authority is currently developing a Code of Conduct which proposes that an insurer should establish a function to assist it with the oversight responsibility of the organisation's risk management. Depending on its risk profile, the function may be headed by a Chief Risk Officer or the responsibilities shared among the operational unit leaders at the insurer. However, there should be a mechanism to allow direct reporting to the board or established committees.

The Authority again thanks stakeholders for their comments on the Discussion Paper and reiterates commitment to working with the industry and other stakeholders to ensure a result that is in the best interest of the Bermuda market, taking into account the costs to the industry.

Please feel free to contact the Authority if you have any questions.

Yours sincerely,

Bermuda Monetary Authority