



November 14th 2011

NOTICE

Insurance (Prudential Standards) (Class 4 and Class 3B Solvency Requirement) Amendment Rules 2011 (the “Rules”)

In June 2011, the Authority posted draft proposed amendments to the Insurance (Prudential Standards) (Class 4 and 3B Solvency Requirement) Rules 2008 for market consultation. The the Rules prescribe the method for determining the Bermuda Solvency Capital Requirement (BSCR) for all Class 4 and 3B registered insurers and related solvency reporting pertaining to risks which are filed with the Bermuda Monetary Authority (the “Authority”) annually.

Based on comments received and reviewed from the consultation, the Authority has revised the proposed amendments to clarify certain provisions, as set out below. The amending rules are due to come into effect on December 31st 2011 and are attached to this notice.

The changes to the Rules are as follows:

1. Rule 2 “Interpretation” sets out the definition of “double or multiple gearing”, “interest rate/liquidity risk” and “material intra-group transactions” as used in the Rules and attached Schedules.
2. Rule 3 “Paragraph 5 of Principal Rule amended” makes provision for the Authority to revoke its approval of the use of an approved internal capital model, where the Authority deems it is no longer appropriate for determining the

Enhanced Capital Requirement (ECR). Circumstances under which a model may not be appropriate include where the business has substantially changed.

3. Rule 4 “Paragraph 6AB of the Principal Rule added” makes provision for the requirement for insurers who not are members of an insurance group for which the Authority is the appointed Group Wide Supervisor to submit to the Authority quarterly financial returns by a specified filing date. These returns enable the Authority to make timely assessments of their solvency and liquidity positions. There was concern raised as to the need for this level of reporting and the possibility of relying on the relevant group supervisor. The Authority is of the view that quarterly filings that include intra-group transactions are necessary for proper oversight of solo entities.
4. Rule 5 “Schedule I amended” makes provision for the interest rate shock to be increased from 120 basis points to 200 basis points in order to be comparable with international regulatory standards and in line with the present economic environment.
5. Rule 6 “Schedule V amended” makes provisions for additional disclosure requirements by Class 4 and Class 3B insurers under the Schedule of Risk Management as follows:
 - a. Line (a) Governance and Group Structure: The additional disclosure requirements, items (iii) to (ix), are the same data requested from all insurers (via a group data call request) for the initial assessment of Bermuda groups. Such information enables the Authority to monitor and reassess any material change (e.g. in its group structure, group strategy, etc.), which could appropriately alter an insurer’s position (from a member of a non-Bermuda group to a member of a Bermuda group);
 - b. Line (b) Intra-group exposures: In order to provide clarity, additional disclosure requirements are listed, along with the definition of a “material” intra-group transaction; and
 - c. Lines (g) gross probable maximum loss, (h) net probable maximum loss and (i) average annual loss: An additional provision to retain and make available to the Authority upon request all supporting documentation used to derive these numbers is added.
6. Rule 7 “Schedule VII amended” reflects the following amendments:

- a. Capital for “operational risk” is deducted from “Total capital after diversification before operational risk”;
- b. Another option – “Regulatory capital requirements” — for aiming at the disclosed CISSA amount is provided; and
- c. The methodologies to aggregate risk categories are listed for insurer to select applicability.

[The Rules are subject to final legislative review by the Attorney General’s Chambers as required under the Statutory Instrument Act 1977; further amendments are not anticipated but may possibly result from that review]

BR / 2011

**Insurance (Prudential Standards)(Class 4 and 3B Solvency Requirement)
Amendment Rule 2011**

In exercise of the powers conferred upon the Bermuda Monetary Authority by section 6A of the Insurance Act 1978, the following Rule is made:

Citation and commencement

1. These Rules which amend the Insurance (Prudential Standards) (Class 4 and Class 3B Solvency Requirement) Rules 2008 (the “principal Rule”) may be cited as the Insurance (Prudential Standards) (Class 4 and Class 3B Solvency Requirement) Amendment Rules 2011, and shall come into operation on the 31st day of December 2011.

Interpretation

2. Paragraph 2 of the principal Rule is amended by inserting the following definition in its alphabetical order—

“double or multiple gearing” means the same capital being used towards satisfying regulatory capital requirements in two or more entities”;

“interest rate / liquidity risk means the risk that asset values are adversely affected by changes in current interest rates”;

“material intra-group transaction” means an intra-group transaction where the total value is greater than or equal to 5% of the insurer’s available capital and surplus; or a series of linked intra-group transactions that have a cumulative value that is greater than or equal to 10% of the insurer’s available capital and surplus; or where the qualitative risk characteristics of an intra-group transaction are assessed as high risk (including liquidity and solvency risk implications) and may adversely impact existing policyholders even though the quantitative impact remains unknown.

Paragraph 3 of principal Rule amended

3. Paragraph 3 of the principal Rule is amended by deleting subparagraph (2)(b) and inserting-

“(b) the ECR calculated after an adjustment has been made by the Authority under section 6D and has not otherwise been suspended under section 44A (4) of the Act”.

Paragraph 5 of principal Rule amended

4. Paragraph 5 of the principal Rule is amended in subparagraph (6) by inserting after “approval”; and before the “.” “or where the approved internal capital model is deemed by the Authority no longer appropriate for the determination of the ECR”.

Paragraph 6 of principal Rule amended

5. Paragraph 6 (5) of the principal Rule is repealed.

Paragraph 6AB Quarterly financial return

6. The Principal Rules shall be amended by inserting after paragraph 6A—

“6AB Quarterly financial return

- (1) Every insurer, where the insurer is not a member of the group for which the Authority is the group supervisor, shall prepare and file quarterly financial returns to the Authority on or before the last day in the month’s of May, August and November of every year.
- (2) An insurer’s quarterly financial return shall comprise the following –
 - (a) Quarterly unaudited financial statements in respect of its business for each financial quarter, such statements should be the most recent produced by the insurer, and must not reflect a financial position that exceeds two months
 - (b) Intra-group transactions and risk concentrations which include –
 - (i) A list of material intra-group transactions
 - (ii) Details of material intra-group transactions including (where applicable):
 - (a) exposure value (face value or market value, if the latter is available);
 - (b) counterparties involved including where they are located;
 - (c) summary details of the transactions – including purpose, terms and transaction costs;
 - (d) duration of the transaction; and
 - (e) performance triggers.
 - (iii) Details surrounding all intra-group reinsurance and retrocession arrangements, and other material intra-group exposures including:

-
- (a) aggregated values of the exposure limits (gross and net) by counterparties broken down by counterparty rating;
 - (b) aggregated premium flows between counterparties (gross and net); and
 - (c) the proportion of the insurer's insurance business exposure covered by internal reinsurance, retrocession and other risk transfer arrangements.
- (iv) Ten largest exposures to counterparties and any other counterparty exposures exceeding 10% of the insurer's statutory capital and surplus, including:
- (a) name of counterparty;
 - (b) exposure values (face value or market value); and
 - (c) transaction type.
- (3) Quarterly unaudited financial statements shall minimally include a balance sheet and income statement
- (4) The information required to be included in the quarterly unaudited financial statements shall be information calculated to fulfil (in addition to any other purposes for which this Rule may require) the following purposes –
- (a) To give as early warning as possible to any person examining the said statements (whether by way of notice of the observance or non-observance by the insurer of any ECR, or in any other way) of any financial or operational difficulties into which the insurer's business has fallen or might appear likely to fall; and
 - (b) To provide the basis on which the Authority or any other authority may in good time take action under the Act or any other statutory provision to exercise any statutory power available to it for the safeguarding of any element of the public interest involved in or affected by the insurer's business."

Schedule I amended

7. The Bermuda Solvency Capital Requirement of Schedule I of the principal Rule is amended in Table 3- Interest rate adjustment for *bonds* by—

- (a) deleting "120" and inserting "200" in the fourth column; and
- (b) deleting "1.2%" and inserting "2.0%" where it occurs.

Schedule V amended

8. (1) The Schedule of Risk Management of Schedule V of the principal Rule is amended—

- (a) in paragraph (a) by inserting “and group before “governance”;
- (b) in paragraph (b) by inserting “and risk concentrations;” after “exposures”;
- (c) in paragraph (o) by deleting “the risk register.” and inserting “Exposure territories;”; and
- (d) by adding “(p) the risk register.” after paragraph (o).

(2) Under **“INSTRUCTIONS AFFECTING SCHEDULE V”** —

- (a) in paragraph (a) by inserting “and group” after “governance”;
- (b) in subsection (a) (i) by inserting “including” after “names,” and by deleting “and” after “officers;”;
- (c) in subsection (a) (ii) by deleting “.” after “sub-committees” and inserting “;”;
- (d) by adding after (a) (ii)—
 - “(iii) Name of the jurisdiction(s) where the group’s board of directors primarily deliberates on matters including:
 - (a) setting strategic decision;
 - (b) determining the (re)insurer’s risk appetite;
 - (c) choice of corporate structure, including amalgamations, acquisitions and strategic alliances;
 - (d) choice of new lines of business, new products, marketplace positioning; and
 - (e) assessing solvency needs.
 - (iv) Name of the jurisdictions where the group’s board of directors and chief and senior executives primarily reside;
 - (v) Name of the jurisdictions where the group’s central control functions reside (i.e., group finance, actuarial, and risk management);
 - (vi) The group’s financial position based on its most recent audited general purpose financial statement regarding its:
 - (a) Total assets;
 - (b) Total reserves; and

-
- (c) Capital and surplus.
 - (vii) (a) Name of insurers within the group that have the three highest: (i) total asset value; (ii) total insurance reserve value; and (iii) total capital and surplus based on the group's most recent audited general purpose financial statements;
 - (b) Provide the total values for (i), (ii) and (iii) in (a); and
 - (c) List the jurisdiction of incorporation of each insurer **(a)**;

Confirm if any events have occurred or decisions made subsequent to the relevant year-end that would, or have, materially changed the information in paragraphs iii through vii above (e.g., amalgamation or acquisition or restructuring, etc.). If yes, please provide a detailed response? explain; and

- (viii) Provide a copy of the latest group organizational chart."

(e) in paragraph (b) by -

- (a) deleting "." and inserting ", and risk concentrations which must include disclosures relating to material counterparty transactions and
- (b) adding after "(ii)";
- (iii) A list of material intra-group transactions;
- (iv) Details of material intra-group transactions including where applicable:
 - (a) exposure value (face value or market value, if the latter is available);
 - (b) counterparties involved including where they are located;
 - (c) summary details of the transactions – including purpose, terms and transaction costs;
 - (d) duration of the transaction; and
 - (e) performance triggers.
- (v) Details surrounding all intra-group reinsurance and retrocession arrangements, and other material intra-group exposures including:

-
- (a) aggregated values of the exposure limits (gross and net) by counterparties broken down by counterparty rating;
 - (b) aggregated premium flows between counterparties (gross and net); and
 - (c) the proportion of the insurer's insurance business exposure covered by internal reinsurance, retrocession and other risk transfer arrangements.
- (vi) The ten largest exposures to counterparties and any other counterparty exposures exceeding 10% of the insurer's statutory capital and surplus, including:
- (a) name of counterparty;
 - (b) exposure values (face value or market value); and
 - (c) transaction type."
- (f) in subsection (g) by deleting "," and inserting ".The documentation used to derive the gross probable maximum loss must be retained for at least five years once a capital and solvency return has been filed in accordance with paragraph 6 at the registered office of the insurer and shall be presented to the Authority upon request;";
- (a) in subsection (h) by deleting (;) after "model" and inserting ". The support documentation used to derive the net probable maximum loss must be retained for at least five years once a capital and solvency return has been filed in accordance with paragraph at the registered office of the insurer and shall be presented to the Authority upon request;"; and
 - (b) in subsection (i)-
 - (c) by deleting "and;" in subparagraph (i);
 - (d) by inserting "and" after "component)" in subparagraph (ii); and
 - (e) by adding after subparagraph (ii) -
- "(iii) The support documentation must be retained for at least five years once a capital and solvency return has been filed in accordance with paragraph 6 at the registered

office of the insurer and shall be presented to the Authority upon request;”.

Schedule VII amended

9. The Schedule of Commercial Insurer’s Solvency Self Assessment of Schedule VII of the principal Rule is amended by deleting in Table 8 under “**INSTRUCTIONS AFFECTING SCHEDULE VII**” “**Table 8 CISSA Capital Summary**” and substituting —

“Table 8 CISSA Capital Summary

Risk categories	(a) CISSA capital	(b) Regulatory capital
Premium risk		
Reserve risk		
Catastrophe risk		
Market risk		
Credit risk		
Liquidity risk		
Group, Concentration, Reputational and Strategic risk		
Other (specify)		
Total capital pre- diversification between risk categories		
Diversification credit between risk categories		

Total capital after diversification between risk categories before operational risk		
Operational risk		
Total capital after diversification and operational risk		

Where:

- (a) CISSA capital is the amount of capital the insurer has determined that it requires to achieve its strategic goals upon undertaking an assessment of all material (reasonably foreseeable) risks arising from its operations or operating environment; and
- (b) Regulatory capital is determined by the BSCR or an approved internal capital model at 99.0% Tail Value-at-Risk ("TVaR") over a one year time horizon.

ADDITIONAL INFORMATION

1. What is the primary reason(s) (select multiple responses where applicable) for aiming at the disclosed CISSA amount? (select all that apply)

- target agency rating (e.g. "A-", "AA", etc);
- market share;
- business expansion;
- nature of product(s) (e.g. risk characteristics);
- manage downgrade risk;
- regulatory capital requirements; and
- others. _____ (Please provide a description)

2. What methodology is used to aggregate the risk categories in deriving the

CISSA capital? (select all that apply)

- correlation matrix;
- linear correlations;
- T copulas;
- gumbel copulas;
- clayton copulas;
- causal drivers approach e.g., inflation, cycles; and
- others. _____ (Please provide a description)

3. What contingency plans are in place for raising additional capital under stress situations? (select all that apply)

- parental guarantees;
- revolving letters of credit;
- issue subordinated debt;
- issue preference shares;
- float additional shares;
- capital injections from parent;
- contingent surplus notes;
- catastrophe derivatives (e.g. bonds, swaps and options); and
- others

4. Does the insurer have arrangements / contractual commitments to provide Support, including forward purchase arrangements or guarantees, to affiliates/other companies in stressed situations? (Yes or No)

If yes, briefly describe the arrangement(s) and the aggregate exposure.

5. Has the insurer down streamed debt to establish equity positions (participations), or engaged in double or multiple gearing? (Yes or No)

If yes, provide details and amount of capital.

6. Has debt been down streamed to establish equity positions in the insurer, or is the insurer using capital that is double or multiple geared? (Yes or No)

If yes, provide details and amount of capital.

Schedule X amended

10. The Schedule of Eligible Capital of Schedule X of the principal Rule is deleted and replaced with the following Schedule-

**“SCHEDULE X (Paragraph 6)
SCHEDULE OF ELIGIBLE CAPITAL**

The schedule of eligible capital shall provide particulars of the following matters:

- a) Tier 1, Tier 2 and Tier 3 eligible capital (Table 9); and
- b) particulars of each capital instrument approved by the Authority as “ Any other fixed capital” (in accordance with Form 8, Line 1(c) under the Insurance Accounts Regulations 1980).

Table 9

Total statutory capital and surplus (Form 8, Line 3)

Less: Encumbered assets (not securing policyholder obligations)

Subtotal:

Tier 1 – basic capital

- (a) Fully paid shares (Form 8, Line 1(a))
- (b) Contributed surplus or share premium (Form 8, Line 1(b))
- (c) Statutory surplus- End of Year (Form 8, Line 2(h) (deficit) or retained earnings)
- (d) Capital adjustments
- (e) Hybrid capital instruments:
Non-cumulative, perpetual or fixed term preference shares
- (f) Other:
- (g) Less: Difference between encumbered assets for policyholder

obligations (Part II, Note 1 of the Notes to the Statutory Financial Statements), including funds held by ceding reinsurers (Form 1A, Line 12)) and policyholder obligations (Form 1A, Lines 16, 17(a) and 18) - Encumbered assets for policyholder obligations (Part II, Note 1 of the Notes to the Statutory Financial Statements), including funds held by ceding reinsurers (Form 1A, Line 12)

Less: Policyholder obligations (Form 1A, Lines 16, 17(a) and 18)

Less: Encumbered assets (not securing policyholder obligations)

Tier 1 - ancillary capital

(a) Perpetual or fixed term subordinated debt (Form 8 Line 1(c))

Total Tier 1 available capital

Tier 2 -basic capital

(a) Hybrid capital instruments:

Cumulative preference shares

(b) Other:

(c) Add: Difference between encumbered assets for policyholder Obligations (Part II, Note 1 of the Notes to the Statutory Financial Statements), including funds held by ceding reinsurers (Form 1A, Line 12) and policyholder obligations (Form 1A, Lines 16, 17(a) and 18) deducted from Tier 1 (if it qualifies)
XXX

Tier 2 -ancillary capital

(a) Unpaid and callable common shares (Form 8 Line 1(c))

(b) Qualifying unpaid and callable hybrid capital (Form 8 Line 1(c)) XXX

(c) Qualifying unpaid and callable non-cumulative, perpetual preference shares (Form 8 Line 1(c))

(d) Perpetual or fixed term subordinated debt (Form 8 Line 1(c))

(e) Approved letters of credit (Form 8, Line 1(c))

(f) Approved guarantees (Form 8, Line 1(c))

Total Tier 2 available capital

Tier 3 -basic capital

- (a) Short-term hybrid capital instruments Cumulative preference shares
- (b) Short-term subordinated debt

Tier 3- ancillary capital

- (a) Short-term subordinated debt (Form 8, Line 1(c))
- (b) Approved letters of credit (Form 8, Line 1(c))
- (c) Approved guarantees (Form 8, Line 1(c))

Total Tier 3 available capital

Total available capital and surplus

Regulatory Capital Level

Minimum Margin of Solvency

Enhanced Capital Requirement

Instructions affecting Table 9

Table 9 inputs are subject to Eligible Capital Rules 2011 made under Section 6A of the Act.

The insurer shall include all components of total statutory capital and surplus (Form 8 Line 3 of the Insurance Accounts Regulations 1980) subject to adjustments made under Section 6D of the Act in Table 10 in accordance with the provisions of Eligible Capital Rules 2011.

For the Tier 1 capital, to calculate the “Difference between encumbered assets for policyholder obligations and policyholder obligations”, the insurer shall determine the difference between the encumbered assets for the policyholder obligations, including funds held by ceding reinsurers and the higher of i) the policyholder obligations of the insurer for which assets have been held and calculated in accordance with Form 1A, Lines 16, 17(a) and 18 and ii) the capital requirement applicable to the

encumbered assets for policyholder obligations where the encumbered assets for policyholder obligations exceeds both policyholder obligations and the capital requirement applicable to the encumbered assets for policyholder obligations.

For Tier 2-basic capital, to calculate the "Difference between encumbered assets for policyholder obligations and policyholder obligations", the insurer shall determine the difference between the encumbered assets for the policyholder obligations and the higher of i) the policyholder obligations of the insurer for which assets have been held and calculated in accordance with Form 1A, Line 17(a) and ii) the capital requirement applicable to the encumbered assets for policyholder obligations where the encumbered assets for policyholder obligations exceeds both policyholder obligations and the capital requirement applicable to the encumbered assets for policyholder obligations.

Table 9A

For the year ending _____, 20XX
expressed in _____ (currency)

Description of Date of issue Maturity date (as Value of the Eligible capital Capital applicable) Tier Instrument instrument

Total available capital and surplus

Instructions affecting Table 9A

The insurer to include every capital instrument contributing to the amount reported in Form 8 Line 1(c) of the Insurance Accounts Regulations 1980 in Table 9A in accordance with the provisions of Eligible Capital Rules.

Made this day of , 2011.

Alan Cossar
Chairman
Bermuda Monetary Authority