



7th September, 2016

Dear Stakeholders:

Re: Economic Balance Sheet & Bermuda Solvency Capital Requirement Trial Run Report 2015

The Bermuda Monetary Authority (the Authority) would like to thank stakeholders for their continued support of our key initiatives. The Authority embarked upon an Economic Balance Sheet (EBS) framework in 2010 and has issued a number of policy papers, conducted field testing and hosted a series of market meetings to develop a framework suitable for the Bermuda commercial insurance market. The support we have received from our industry stakeholders demonstrates the commitment to ensure that Bermuda's regulatory regime is aligned with international standards.

For the 2015 financial year, the Authority required commercial insurers to include in their regular statutory filing a trial run submission of their EBS filing that included Bermuda Solvency Capital Requirement (BSCR) capital charge amendments for cash and cash equivalents credit risk, currency risk, concentration risk, and geographic diversification (for general business only). To assist with completing the EBS trial run, the Authority included in the regular BSCR model additional forms/schedules for EBS reporting, and a guidance note for statutory reporting that provided detailed valuation principles for reporting on an economic valuation basis.

Below are detailed results from the EBS trial run submissions:

Economic Balance Sheet

Based on the submissions received, the EBS trial run and BSCR capital charges amendments did not lead to any participants producing solvency ratios that breached the insurer's Target Capital Level (120% of the Enhanced Capital Requirement). Although the insurer's regulatory solvency requirement under the current (unconsolidated) basis is not strictly comparable to the EBS (consolidated) basis (except for insurance Groups), overall there were no significant changes based on the 2015 EBS trial run results.

Based on these results, the Authority concludes that the EBS framework and BSCR changes form a sound basis for regulatory reporting and there will be no significant amendments to the legislation in 2016 in this regard.

Below is a general overview on the topics/observations from the EBS trial run.

BSCR Changes

Similar to the prior trial runs, the BSCR proposals were broadly acceptable to the industry and did not raise any major issues. The main comments received were to provide further guidance on the currency risk, concentration risk, risk margin, technical provision calculations, and bound but not incepted business, which the Authority plans on enhancing in the Capital and Solvency Return Instruction Handbook and Guidance Note for Statutory Reporting Regime.

Currency Risk

The main queries received were in relation to the calculation of the BSCR proxy which is the total liability on an EBS basis and EBS ECR charge for the prior three years. The Authority would like to clarify that:

- 1) Although the total liabilities and ECR may not be available on an EBS basis for the prior three years, the Authority will accept unconsolidated / non EBS basis until such time as the figures becomes available; and
- 2) If an insurer does not have data for the prior three years (for example where the insurer is a newly formed insurer), the insurer shall provide the current year balances without taking into consideration the currency risk charge.

Generally, the new currency risk charge was not punitive to the insurers and did not significantly affect the overall BSCR capital charge on an EBS basis.

Concentration Risk

The main queries received were in relation to the consideration of counterparty exposure grouping when completing the schedule. The Authority would like to confirm that when considering a counterparty exposure, it should be viewed with regards to the:

- a) Control relationship: one of the counterparties, directly or indirectly, has control over the other(s);
- b) Economic inter-dependence: if one of the counterparties were to experience financial distress, in particular funding or repayment difficulties, the other(s) as a result, would also be likely to encounter funding or repayment difficulties

Overall, the new concentration risk charge was not punitive to the insurers and did not significantly affect the overall BSCR capital charge on an EBS basis.

Risk Margin, Technical Provision and Bound But Not Incepted

Based on the feedback received, some insurers requested additional guidance on the risk margin, technical provision and bound but not incepted business calculations which the Authority responded to on an individual basis. The Authority does not expect to amend the legislation for these items in 2016 and further guidance is expect to be included in the 2016 “Guidance Note for Statutory Reporting Regime” for queries/clarity on issues that were frequently asked.

The Authority would like to advise that there will be a further consultation paper expected to be released in Q4-2016 for proposed changes to the BSCR to be implemented for the 2017 year-end filings and beyond. Additional details will be provided in due course.

Conclusion

Based on the results of the trial run and industry feedback, the Authority concludes that the EBS framework and proposed BSCR changes form a sound basis for the commercial insurance regime for the financial years ending December 31, 2016 and beyond.

The Authority would like to thank stakeholders for their comments on the EBS trial run for the 2015 year-end, and we remain committed to working with the industry and other interested parties to ensure that results achieved are in the best interest of the Bermuda market.

Yours sincerely,

The Bermuda Monetary Authority