BERMUDA MONETARY AUTHORITY

8 April 2024

NOTICE

Prior Approval of New Long-Term Block Reinsurance Transactions

The Bermuda Monetary Authority (Authority or BMA) would like to provide clarifications regarding its prior approval[1] process for all new long-term block reinsurance transactions[2] (hereafter referred to as 'block transactions'). Further, the Authority would like to clarify the prior regulatory approval requirements applicable to modifications of existing block transactions.

Context

As noted in the BMA Consultation Paper *Proposed Enhancements to the Regulatory Regime for Commercial Insurers*[3], since January 2023, the Authority has required long-term (life) commercial (re)insurers (Classes C, D and E) (hereafter referred to as 'relevant insurers' or 'insurers'), to seek prior approval for all block transactions. This requirement aimed to:

1. Facilitate understanding of all block transactions occurring in the Bermuda market and the emerging risks they create for relevant insurers;
2. Ensure block transactions are subject to adequate review and oversight by the relevant insurers' control functions and governance forums in line with existing requirements;
3. Enable proactive, effective and efficient cross-border regulatory collaboration regarding specific block transactions; and
4. Ensure block transactions are implemented in line with the regulatory and supervisory regime for commercial insurers.

[1] Relevant insurers must request, and receive, the BMA's prior written approval of proposed block transactions before they are entered into. Requests to the BMA for the prior approval should be provided in a timely manner before the transaction's proposed closing date.
[2] A long-term block reinsurance transaction is a block transaction that covers an existing policy that is written and in force on the books of the cedant, as of the date of the reinsurance transaction. Such transactions include but are not limited to pension risk transfer. Transactions covering both future premiums (i.e., flow transactions) and nonflow business are considered block transactions and are in scope.
[3] *Proposed Enhancements to the Regulatory Regime for Commercial Insurers* dated 28 July 2023: see page 3.

Scope

In addition to all new block transactions, modifications to existing block transactions will also be subject to the Authority's prior regulatory approval.

The requirement for prior approval of block transactions is in addition to the approval requirements that are applicable to 'material changes' under the Insurance Act 1978.

Transaction specific requirements

The BMA recognises that block transactions vary in their size, complexity and impact on the risk profile of the relevant insurer. In line with the Authority's overarching risk-based and proportional supervisory framework, more complex transactions will require more comprehensive documentation, review and regulatory engagement. Accordingly, the scope and depth of the BMA's review of individual transactions varies on a case-by-case basis. Additionally, the BMA continues to support and implement strong cross-border regulatory collaboration with other global regulators, including through the transparent exchange of information. Consequently, the BMA will generally also instigate transaction-specific regulator-to-regulator discussions.

The Authority's review process for block transactions is typically structured around a documentation review, followed by targeted discussions with the insurer's management team and, if required, other relevant regulatory contacts.

Existing requirements within the Insurance Code of Conduct require long-term (life) commercial insurers to maintain appropriate oversight and effective risk management and internal control frameworks, as well as adequate documentation regarding individual transactions. Therefore, the intention is that this process should not create any new process or documentation requirements for relevant insurers. Information provided to the Authority regarding proposed block transactions shall be largely the same as that used internally in the underwriting, risk assessment and governance review of the relevant transaction. In other words, the documents provided to the BMA shall be those that were used by the relevant insurer in its decision-making process and shall include information relating, but not be limited to[4], the following areas:

- Strategic rationale of the transaction
- Economics and key features of the transaction
- Information on fit to business, strategy (underwriting and investment), expertise and risk and capital management
- Agreements for reinsurance, collateral and investment management
- Impact on solvency and stress testing
- Total asset requirements (technical provisions plus capital requirements) under both Bermuda and the cedant's regulatory basis
- Governance and risk management, including Asset Liability Management

[4] Insurers may wish to engage with their supervisors for further information that will be required for specific transactions.

Information submitted to the BMA with respect to the total asset requirements should include, but not be limited to, the following items:

1. Capital requirements and the associated breakdown of the key drivers (e.g., market risk, credit risk, insurance risk, operational risk, diversification benefit, etc.);
2. Target solvency ratios, which should be tied to the insurer's capital management policy;
3. Excess capital and surplus (i.e., capital buffer(s) above the capital requirements);
4. Best estimate liabilities and risk margin; and
5. Explanation and reconciliation of the material differences between the total asset requirement of the cedant and the Bermuda insurer's total asset requirement at a granular level.

The Appendix includes a detailed list of information that the insurer may consider submitting to the Authority regarding block transactions to facilitate an effective and efficient engagement and review process in support of its prior approval.

To facilitate an efficient review process, the BMA encourages relevant insurers to engage supervisory teams in preliminary preapplication discussions regarding transactions in advanced stages, which may, therefore, become the subject of a request for prior approval. This can be achieved either by including a 'deal pipeline' discussion as part of regular supervisory engagements and/or through ad-hoc engagement initiated by the insurer to notify the BMA of upcoming transactions.

The exact timeframe for the BMA's review of proposed block transactions is expected to vary. However, where requests are supported by effective and proactive engagement alongside complete documentation, the Authority expects to reach a decision within two to four weeks. Requests that do not meet these criteria may require additional time and/or information to be provided for the BMA to be able to complete the review.

The BMA encourages insurers to notify their BMA supervisory contacts of any envisaged block transactions that the insurer plans to engage in as early as possible.

Appendix: Detailed Information to Support a Block Transaction's Prior Regulatory Approval

Relevant insurers may wish to consider the following considerations as the basis for efficient and effective engagement with the Authority regarding future block transactions. Information provided to the Authority may, therefore, include, but not be limited to:

1) Strategic rationale for the transaction;
2) Structure of the transaction;
3) Details of the underlying product (i.e., features and key terms), as well as the profile of the target policyholder(s);
4) Business background of the counterparty, including the results of its recent ratings and an assessment of its latest audited financial statements;
5) Risk profile, including a summary of underwriting risks and position against approved risk appetites and or risk limits;
6) Details regarding the transaction's funding;
7) A holistic picture of all relevant fees related to the transaction, e.g.,:
    a. Ceded commissions;
    b. Asset management fees projected to be earned by intra-group and affiliated entities; and
    c. All fees that accrue to the cedant or an affiliated party in any other way;
8) Liability profile (e.g., information on duration, the duration metric used, the basis of the duration calculation, etc.);
9) Asset portfolio profile (i.e., actual allocation and target allocation, if there is a difference);
10) Collateral and custodian arrangements;
11) Reinsurance and or retrocession arrangements and agreements, if any;
12) Investment management arrangements and agreement(s);
13) Total asset requirement (TAR) for this transaction:
    The Bermuda long-term reinsurer should provide a detailed breakdown of the TAR based on the solvency regime of the cedant, such as the US Statutory and RBC framework if the ceding company is in the US, as well as the Bermuda Economic Balance Sheet (EBS) framework. The following information should be provided at a minimum:

    a) Capital requirements and the associated breakdown of the key drivers (e.g., market risk, credit risk, insurance risk, operational risk, diversification benefit, etc.).

    b) Target solvency ratios – this should be tied to the capital management policy.

    c) Excess capital and surplus, i.e., capital buffer above the capital requirement.

    d) Best estimate liabilities and risk margin.

    e) Explanation and reconciliation of the material differences between the TAR of the cedant and the Bermuda EBS TAR at a granular level. The cedant TAR should be reported both on the cedant reporting basis e.g., book value and market value basis, if this does not already apply under the cedant regime. The Bermuda long-term reinsurer should perform an attribution analysis to demonstrate the impact of each of the following changes, as the reserves, capital requirements, and eligible capital transition from the cedant's solvency regime to Bermuda EBS. The minimum steps involved in the attribution analysis are as follows:

1. Begin with the cedant's balance sheet for the applicable block of business under their solvency regime.

2. If cedant's solvency regime is on a book value basis, then convert the TAR from 1 to a market value basis.

3a, 3b, 3c, etc. Include a separate step to quantify each material difference in liability assumptions between the balance sheet under the cedant's solvency regime and the same balance sheet under the Bermuda Standard Approach.

3n. This is the final step in the roll-forward which starts with 3a, reflecting all assumption changes and methodology changes needed to transition to the Bermuda EBS Standard Approach. Calculate the Bermuda EBS TAR using the Standard Approach, using the actual beginning assets. Where the actual ECR ratio is materially greater than the target ECR ratio, please provide commentary e.g., on dividend policy.

4. Calculate the Bermuda EBS TAR using the Scenario Based Approach (SBA), if such approach is to be used, using the actual beginning assets as in Step 3n. Where the actual ECR ratio is materially greater than the target ECR ratio, please provide commentary e.g., on dividend policy. The purpose of this step is the same as for Step 3, but it specifically applies to companies that use or intend to use the SBA.

5. Adjust Step 3n (for companies using or planning to use the Standard Approach) or Step 4 (for companies using or planning to use the SBA) to account for any planned changes to asset allocation, as well as increases or decreases to capital to achieve the target ECR ratio.

For reinsurance transactions that include multiple product types, the TAR should be disclosed for each product. GAAP or IFRS reserve numbers should also be provided. The Authority will publish separately, tables outlining the format in which the information should be provided.

14) Impacts on solvency and stress testing, such as:
   a. Impacts on excess (economic) capital;
   b. Impacts on surplus liquidity;
   c. Financial projections for the next five years;
   d. Capital projections for the next five years; and
   e. Proforma Bermuda Solvency Capital Requirements.

15) Operational impacts, including comment on the continued suitability of the current capital charge for Operational Risk;
16) Impacts on the Scenario-Based Approach (if utilised);
17) Actuarial analysis and commentary on assumptions;
18) Termination events;
19) Risk function's view of the transaction and an assessment of risks to the relevant insurer that are inherent within the transaction; this should also detail the Risk Function's involvement in the transaction;
20) Minutes and papers from the meetings of the appropriate governance forum within the Company confirming approval of the proposed business;
21) Internal memos, including pricing, experience studies for key assumptions, or any other management information considered for the transaction.
22) Confirm whether the cedant requires regulatory approval to complete the transaction; and
23) Contact details of the cedant supervisor.

Please note that the Authority does not expect separate documents to be created to cover the above information requests. However, it may be helpful to provide a cover sheet, if needed, to provide relevant context to the prior approval application, indicate where relevant information is located or indicate when any information not provided may be expected to be submitted to the Authority.

END.