

Bermuda insurance update — the bid for regulatory equivalence with the EU

Aug 12 2010 [Nick Miles](#)

A number of regulatory developments took place this summer in Bermuda. These respond to proposals adopted by international and regional authorities (the International Association of Insurance Supervisors (IAIS) and the European Union's Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). They represent major contributions to the jurisdiction's bid for prudential and regulatory equivalence with the European Union. Equivalence is an extremely important commitment of the Bermuda Monetary Authority, given the benefits to the island which it perceives:



Nick Miles

the ability to compete in global markets on a non-discriminatory basis;

lower risk of multiple capital requirements;

removal of the need for group solvency calculations on a number of different regulatory fronts; and

improved ability to optimize (and increased fungibility) of group capital.

The developments coincide with publication of advice by the CEIOPS on equivalence assessments, in which Bermuda and Switzerland both vie for third country equivalent status.

In summary, the proposals/legislative changes comprise:

A consultation paper on a full-blooded solvency self-assessment requirement for certain larger insurers.

A pilot for internal capital models used for calculating "enhanced capital requirement".

A consultation paper on a proposed new catastrophe risk return — a fresh reporting requirement for larger insurers addressing certain "model" risks.

A consultation paper on enhanced disclosure.

Proposed draft legislation enhancing the regulatory reporting requirements for larger insurers.

CISSA — "know thyself"

All insurers must conduct a solvency self-assessment according to policies and procedures developed by the insurer itself having regard to the nature, complexity and scale of its business.

The proposed Commercial Insurer Solvency Self-Assessment (CISSA) broadens and deepens what that self-assessment involves for Class 4 and Class 3B general insurers. (Class 4 insurers have at least \$100 million in statutory capital and surplus and write excess liability or property catastrophe reinsurance; at least 50 percent of business written and retained by Class 3B insurers (or 50 percent of their loss provisions) must be "unrelated business," and net premiums from unrelated business must equal or exceed \$50m.)

CISSA adapts the Own Risk Self-Assessment (ORSA) familiar to European insurers. Like ORSA, it encapsulates the "entirety of the processes and procedures performed by an insurer to identify, assess, monitor, manage and report on the short and long term risks it faces and to determine capital resources it requires to maintain solvency at all times."

The assessment is to be regularly performed and insurers must demonstrate a link between capital adequacy, risk management and governance, and strategic decision-making. The aim is that the insurer is at all times in a position to assure itself that, when it comes to risk management, it has no known unknowns and as few unknown unknowns as possible.

Again in common with ORSA, CISSA will sit alongside regulatory capital requirements. Insurers must maintain capital and surplus at least equal to their "enhanced capital requirement" (ECR). Unless the insurer has an approved internal model, calculation of the ECR is based on the "Bermuda Solvency Capital Requirement (BSCR) Model." The BSCR Model schematically imposes specific capital charges in respect of certain categories of risk (investment, liquidity, reserve, credit, catastrophe and operational).

But the BSCR Model is not bespoke and its underlying assumptions will not reflect the risk profile of all insurers. By requiring insurers to engage in a much more soul-searching exercise, CISSA will align an insurer's internal risk management processes with its regulatory reporting.

As well as flagging up any significant idiosyncrasies in a risk profile, CISSA will require Class 4 and Class 3B insurers to hold capital sufficient to provide a 99.0 percent confidence level over a one year time horizon, measured using the results of the CISSA process.

One major market concern is whether emergence of a significant deviation from BSCR assumptions will occasion the imposition of "capital add-ons" to the insurer's statutory ECR. The Insurance Act 1978 empowers the BMA to impose such adjustments. The Consultation Paper advises that capital add-ons are expected only in "exceptional" circumstances.

CISSA will impinge at the group level, for many Bermuda insurers. Where the BMA is the insurer's "Group wide supervisor," CISSA must be conducted on a group-wide dimension. This will occasion a substantial overhaul in the internal processes of some groups. In theory it may be possible to confine duplication (at group level and at the "solo" (or "legal entity") level) to a minimum, provided it is possible to extract the legal entity data from the group CISSA.

Internal capital model pilot

The BMA is conducting a pilot of its internal capital models framework with select Class 4 insurers. The pilot allows the BMA to test its review process and may result in refinements to the framework.

Consultation on Eligible Capital Proposals Completed; Enabling Legislation Currently in Development Market consultation on the BMA's eligible capital proposals is completed and the BMA is preparing draft legislation. In common with the Solvency II Directive, the legislation will adopt a tiered approach to the eligibility of capital eligible to satisfy statutory capital and surplus requirements.

Cat return

Class 4 and 3B insurers are to complete and submit a "Catastrophe Risk Return" ("Cat return") from 2010 year end (by way of a trial run). Class 3A insurers writing property catastrophe and insurance groups must also submit the return from 2011 year end. The return shows the insurer's reliance on vendor models in assessing cat exposure, indicating "model risk" — the risk that the same model relied on by multiple insurers underestimates exposure. Insurers are to monitor model risk, for example by applying suitable capital leverage guidelines based on aggregated information such as exposure rather than modeled statistics like probable maximum losses.

The Cat return will be embedded in the BSCR return to avoid filing duplication (see below).

In the interests of enhancing its reputation as a leader in the regulation of catastrophe markets and improving transparency, the BMA proposes to use the cat returns as a source for the publication of aggregated catastrophe modeling practices within the Bermuda market.

Enhanced disclosure

Two initiatives here run in parallel: enhanced regulatory reporting, to improve the BMA's ability to supervise; enhanced public reporting, to allow stakeholders to assess the financial position of insurers and associated risks.

Regulatory reporting

At present, Class 4 insurers must make a capital and solvency return to the BMA comprising the BSCR, and schedules of fixed income investments, loss and expense provisions by line of business, premiums by line of business, and particulars of the insurer's risk management structures.

The BMA proposes to extend these regulatory disclosures to Class 3B insurers, and add the following to the list of reporting items for the 2010 reporting year onwards:

Loss triangles categorized by line of business

CISSA

Cat return

Public disclosure

Enhancements to the regulatory filing represent the first phase of a three-part process of enhancing and standardizing disclosures.

Phases two (reporting periods 2012-2014) and three (reporting periods 2015 and beyond) will concern broader public disclosures. The drive for transparency is again a response to developments overseas including in the European Union. The BMA regards transparency as "a key component of jurisdictional equivalence assessments."

Nevertheless, the BMA has determined to postpone public disclosure (beyond the requirement already in effect to make audited general purpose financial statements public). Given the predominantly wholesale nature of business written in Bermuda, the need for public disclosure is less pressing than in some jurisdictions where retail business represents a more substantial component.



Nick Miles of Sedgwick's London office, is an insurance and reinsurance lawyer specializing in a broad range of contentious matters, reorganizations and regulatory matters. He also works with Sedgwick Chudleigh, the firm's affiliated Bermuda office.

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