



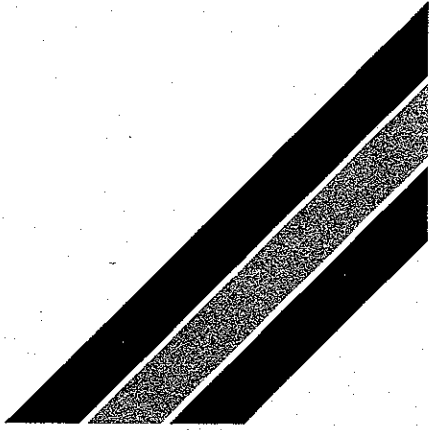

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**BERMUDA MONETARY AUTHORITY**

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***Regulatory Update***  
**June 2006**

*(Incorporating Financial Statistics for the  
Quarter ended December 2005)*



## **Special Feature – Development of the Capital Adequacy Regime for Bermuda’s Re-Insurance Businesses**

As part of the Authority’s ongoing review of Bermuda’s insurance supervisory framework, consultations are currently underway with the Class 4 re-insurance sector regarding further enhancement of the capital adequacy framework for Class 4 re-insurers.

Such revisions would mark an important refinement in the Authority’s ability to assess the adequacy of capital for its most significant commercial re-insurance sector. However, the minimum solvency margin requirements currently applied to the generality of insurers licensed under the Insurance Act 1978 will continue to apply for all other classes of re-insurers.

The financial stability of several insurers in some of the major markets has been significantly affected over the past few years by deteriorating underwriting results and substantial catastrophe claims. In the coming years leading insurance regulators will be redesigning their insurer capital requirements:

1. The European Union (EU) is replacing its Solvency I regime, where the minimum capital requirement is calculated for general insurers by a formula (expressed as a percentage of gross premium and gross loss reserves, with an allowance for up to 50% for reinsurance). Solvency II is due to come into force in 2010. This regime will be based on a Three Pillar approach comprising: quantitative requirements, supervisory review and disclosure requirements.
2. The United Kingdom has already introduced internal capital assessment standards, where insurers must perform their own individual capital assessment taking into account their risk exposure.
3. The National Association of Insurance Commissioners’ (NAIC) existing risk-based capital model computes a capital adequacy formula used for calculating a company’s minimum capital requirement in the United States.
4. The International Association of Insurance Supervisors (IAIS) will be implementing its own solvency regulation capital standard, a draft to be proposed in mid-2007.

In addition, the recently issued G30 Report has called for the major reinsurance regulatory jurisdictions to further develop requirements for risk disclosure, scenario and stress testing and economic capital analysis as part of a movement towards a harmonized reinsurance regulatory framework.

These worldwide actions will affect regulation in all the major insurance markets. As a significant player in international reinsurance, strengthening Bermuda’s regulation of Class 4 insurers will help to maintain its position in the global marketplace. The regulatory enhancements being proposed for the Bermuda market with respect to capital adequacy are consistent with these global changes in insurance regulation.

When the Authority was last reviewed by the International Monetary Fund in 2003 as part of the assessment of insurance and reinsurance jurisdictions, the Bermuda rules were found to be “observed” with regard to capital adequacy and solvency regulation. It was noted that the solvency margin requirements for large commercial re-insurers were “stringent.”

The current requirements, as imposed by the Insurance Returns and Solvency Regulations, require Class 4 re-insurers to maintain a minimum capital requirement the greater of: 1) \$100 million; 2) 50% of net premium written with a partial deduction for credit for reinsurance; or 3) 15% of loss reserves. The solvency margin requirement applied to Bermuda's Class 4 re-insurers, when originally introduced, compared favourably with the minimum capital requirements for the most significant re-insurance markets. However, although Bermuda re-insurers have shown tremendous resilience and strength there is now a need to incorporate a more progressive method of capital assessment as a function of the particular risk profile of individual companies. The intention is clearly to reinforce further the effectiveness of the Authority's regulatory framework for this business. The Authority's preliminary work therefore took into consideration the following options for introducing new risk-based capital requirements for the Class 4 sector:

1. Adopt a static risk-based based capital formula.
2. Maintain the solvency margin formula but apply an individual company economic capital analysis on top of the solvency margin.
3. Adopt an individual company assessment approach that couples a static risk-based capital formula with a required individual company economic capital analysis, which then becomes subject to regulatory review and adjustment.
4. Create a unique approach that includes a static risk-based capital formula coupled with mandatory stress and scenario testing; a follow on Stage 2 project would be the development of an optional economic capital modeling component that would allow insurers to use internal capital models which they have developed and maintained.

This proposed new measurement framework would continue to represent one facet of the Authority's prudential oversight of the Class 4 sector, supplemented by off-site analysis of financial data and prudential meetings with senior management.

Consequently, the introduction of a risk-based capital approach can be regarded as the next step in the evolution of Bermuda's framework for insurance regulation. Applying this approach, together with the continued roll-out of the Authority's on-site examination programme and the proposed amendments to the Insurance Act 1978 — which include more clearly defined minimum standards for fitness and propriety and new regulatory authority over changes in shareholder control — will serve to establish a more expansive regulatory agenda. The Bermuda Monetary Authority remains fully committed to taking the steps needed to preserve its reputation as a sound insurance regulator, and Bermuda's leadership position as a major jurisdiction in the global re-insurance market.