



EIOPA-BoS-15/176
31 July 2015

Progress report

**Equivalence assessment of the Bermudian
supervisory system in relation to articles
172, 227 and 260 of the Solvency II
Directive**

Table of Contents

1. Introduction 3
2. Approach 3
3. Broad overview of the changes in relevant Bermudian legislation 4
4. Developments per Principle 5
Annex I: Overall assessment updated report March 2015 17

1. Introduction

By letter of 25 February 2014, the European Commission requested EIOPA to update the equivalence advice for Bermuda (under articles 172, 227 and 260 of the Solvency II Directive) that EIOPA provided in October 2011. In March 2015 the updated report, which was publicly consulted upon, was submitted to European Commission (see Annex I for an overview of the overall assessment and advice in March 2015).

Subsequently, by letter of 4 May 2015, the European Commission came back to EIOPA with a request for a further review. Bermuda is currently making substantial amendments to its supervisory regime applicable to (re)insurers, and consequently the Commission considered that such a review was necessary to determine which classes of (re)insurer are covered by a supervisory regime that is fully, partly or not at all equivalent to Solvency II. The European Commission intends to take further equivalence decisions by autumn of this year, and requested that EIOPA provide its further advice on developments in the Bermudian regime by end of July 2015.

EIOPA acknowledged the importance of such a review, and agreed to provide a progress report depicting the latest developments on the basis of material provided by the Bermuda Monetary Authority (BMA). Given the relatively limited nature of the update, it was agreed that there would be no public consultation process involved.

2. Approach

EIOPA contacted the BMA to initiate the further work requested by the Commission in May. The BMA confirmed its continuing commitment and support for the equivalence review process, originally initiated in 2010, and provided EIOPA with materials which capture the developments to their regime since the March publication of the EIOPA assessment report. EIOPA's analysis has also benefitted from 3 conference calls with senior staff in the BMA during which changes in the supervisory regime were discussed, and from a factual accuracy check of the advice by the BMA.

As described in more detail below in the 'Developments per Principle', many of the legislative changes in Bermuda have just been approved and will not come into force until 1 January 2016. EIOPA has stated in its Equivalence methodology that 'an equivalence judgement can only be made in respect of the regime in existence and applied by a third country supervisory authority at the time of the assessment. Plans and on-going initiatives for changing the national supervisory regime should not be considered an adequate support for a positive equivalence finding until the day of their actual implementation. Nevertheless, these initiatives should be taken into account, with due consideration given to their expected timing and the degree of commitment to them, when performing an equivalence assessment and providing advice to the Commission'.

Taking into account the Bermudian situation, EIOPA has provided in the next chapters a review of the developments to the Bermudian regime since the March 2015 report. No final findings of equivalence (equivalent, largely equivalent, partly equivalent, not equivalent and not applicable) for each Principle have been given with regards to these developments. However for each Principle we provide further advice on the status of the legislative regime, and a view on whether the caveats to full equivalence identified in the March 2015 report have been addressed. It has clearly not been possible to take any view on the application of the regime in practice.

The scope of the review is the same as for the March 2015 report, and thus relates specifically to the supervision of commercial insurers in Bermuda and not to captives or special purpose insurers.

3. Broad overview of the changes in relevant Bermudian legislation

- The Bermudian government has amended the Insurance Act 1978 (the 'Insurance Act') to incorporate, amongst other things:
 - New definitions in section 1 of the Insurance Act to facilitate the implementation of economic capital requirement measures under the statutory economic balance sheet (EBS) framework;
 - A provision allowing the BMA to prescribe prudential standard rules for the preparation and publication of a financial condition report by commercial insurers and insurance groups (section 6A Insurance Act)
 - A head office requirement in Bermuda for all commercial insurers (Section 8C Insurance Act);
 - Notification of disposals of qualifying holdings (Section 30EA Insurance Act);
 - Strengthening of regulatory oversight of the outsourcing of the Chief Executive Officer and Senior Executive Role (Sections 30JA, 30JB and 30JC Insurance Act).

The Insurance Amendment (No.2) Act 2015 containing the revisions of the Insurance Act received its final approval in July 2015. The majority of its provisions are intended to be effective as of 1 January 2016 (other provisions having immediate effect). The Act had earlier been amended to introduce a requirement for Class C and D insurers to file audited GAAP statements (Section 17A Insurance Act¹).

- The Insurance Code of Conduct (the Code) has been amended with effect from July 2015 to:
 - Strictly circumscribe commercial insurers from outsourcing the CEO and senior executive responsibilities to insurance managers (paragraph 17 of the revised Code only envisages outsourcing of these responsibilities by captive class insurers and special purpose insurers).
 - Prevent outsourcing of a function which may adversely affect the insurer's ability to operate in a prudent manner.
- The BMA has tested and embedded in legislation the EBS approach. Amendments to the Bermuda Capital Solvency Requirement ('BSCR') have been approved. These are covered in detail under the developments dealing with Principle 6, 7 and 12 below. The revised prudential rules contain provisions effective as of 1 January 2016, and have been published on the BMA's website. They comprise:
 - Insurance (Group Supervision) Amendment Rules 2015;
 - Insurance (Public Disclosure) Rules 2015;
 - Insurance (Eligible Capital) Amendment Rules 2015;

¹ Introduced by the Insurance Amendment (No.2) Act 2012, but not previously put into effect. The provision will come into force on 1 January 2016 following the issue of a commencement notice in July 2015.

- Insurance (Prudential Standards) (Insurance Group Solvency Requirement) Amendment Rules 2015;
- Insurance (Prudential Standards) (Class 4 and 3B Solvency Requirement) Amendment Rules 2015;
- Insurance (Prudential Standards) (Class 3A Solvency Requirement) Amendment Rules 2015; and
- Insurance (Prudential Standards) (Class C, D, and E Solvency Requirement) Amendment Rules 2015

The prudential rules signed by the Chairman of the BMA have now been published in the Official Gazette.

4. Developments per Principle

Principle 1 - Powers and responsibilities of third country supervisory authorities

March 2015 report

Article 172

The BMA was found largely equivalent with regard to its powers and responsibilities as a supervisory authority for Class 3A, 3B and 4 insurers and Class E insurers and to be partly equivalent for Class C and D under Principle 1. Although the BMA has at its disposal a series of powers and reporting obligations, some of the obligations vary according to the insurer's class.

Article 260

The BMA was found equivalent with regard to its powers and responsibilities as a supervisory authority under Principle 1.

Recent developments and legislative changes with regard to the caveats identified

The amendments to the Bermudian legislation introduce an EBS approach across all commercial insurance classes and for insurance groups. The BSCR for the different classes of insurer is based on the application of an EBS. While there remain differences in the application of some governance arrangements (see principle 4) the BMA considers that these are justified on the grounds of proportionality and are subject to their approval and oversight.

Timing

The amendments to the regulatory regime largely take effect from 1 January 2016. This clearly means that EIOPA cannot opine on the application of the new rules in practice through on-site and off-site monitoring.

EIOPA Advice

With the implementation of the new EBS and BSCR provisions, and some strengthening of governance provisions, the principal caveats in respect of Article 172 regarding the legislative regime will have been addressed. EIOPA would expect the BMA to ensure the full application of the new legislative provisions across insurance groups and all classes of commercial insurer, subject to the appropriate application of proportionality principles, through on-site and off-site monitoring. The BMA has confirmed that this is their intention.

Principle 2 - Professional secrecy, exchange of information and promotion of supervisory convergence

March 2015 report

The BMA was found equivalent with regard to its professional secrecy and information exchange obligations under Principle 2.

Recent developments and legislative changes

No changes.

Principle 3 - Taking-up of business

March 2015 report

Article 172

The BMA was found largely equivalent with regard to its authorisation of insurers under Principle 3. The BMA is empowered to obtain all the information necessary for licensing, however there is no legal requirement to ensure that an insurer has its head office situated in the same country as its registered office.

Recent developments and legislative changes with regard to the caveats identified

Commercial insurers² shall be required to establish a head office in Bermuda in accordance with the changes to Section 8C of the Insurance Act 1978 taking effect on 1 January 2016.

The BMA will consider, inter alia, the following matters in ascertaining whether the direction and management is in Bermuda for determining if the head office has been established:

- a. Where the underwriting, risk management and operational decision making of the commercial insurer takes place;
- b. Presence of senior executives who are responsible for and involved in the decision making related to the insurance business of the commercial insurer;
- c. Where board meetings of the commercial insurer are taking place;
- d. The location where management meets to effect policy decisions of the commercial insurer;
- e. The residence of the senior officers, insurance managers or operational employees of the commercial insurer; and
- f. The residence of one or more directors of the commercial insurer.

The head office requirement will not apply to a Class 3A, Class 3B, Class 4, Class C, Class D and Class E insurer which has a permit under section 3 of the Non-Resident Insurance Undertakings Act 1967 or a permit under section 134 of the Companies Act 1981. These provisions cover branch operations in Bermuda of foreign insurers. The insurer is required to appoint a Principal Representative in Bermuda.

Timing

The proposed amendment to the Insurance Act will take effect on 1 January 2016.

² Commercial insurers are Class 3A, Class 3B, Class 4, Class C, Class D and Class E insurers.

EIOPA Advice

On the basis of the amendments to the Insurance Act take effect from 1 January 2016, the previous caveat to full equivalence identified in the March 2015 report regarding Principle 3 will have been fully addressed.

Principles 4 and 10 - System of Governance and Public Disclosure

March 2015 report

Article 227

The BMA was found largely equivalent for Classes 3A, 3B, 4, C, D and E with regard to its governance and public disclosure requirements under Principle 4. EIOPA has identified the following areas where the BMA regime would have to be strengthened or addressed in order to be considered equivalent to Solvency II: outsourcing and public disclosure.

Article 260

The BMA was found largely equivalent for group supervision with regard to its governance and public disclosure requirements under Principle 10. EIOPA has identified the key area where the BMA regime would have to be strengthened or addressed in order to be considered equivalent to Solvency II as public disclosure.

Recent developments and legislative changes with regard to the caveats identified

Outsourcing

In respect of outsourcing, Sections 30JA and 30JB of the Insurance Act require insurers to notify the BMA prior to outsourcing all or a material part of their underwriting activity, or all or substantially all of their actuarial, risk management, compliance and internal audit functions. Section 30JA has now been amended specifically to include outsourcing of the CEO and senior executive functions as a material change that requires the BMA's approval³.

Paragraph 17 of the revised Code, published on 29 July 2015, explicitly refers to the possibility that captive class insurers and special purpose insurers may outsource the chief and senior executives' responsibilities to an insurance manager⁴. In effect this restricts commercial class insurers covered by this report from doing so. In the previous revision to the Code, this restriction applied only to large commercial insurers (Classes 3B, 4 and E). The new Code has immediate effect, but there is a transitional period until 31 December 2015 for firms to comply with the new provisions.

Paragraph 61 of the revised Code is a new provision stating that an insurer should not outsource a function which may adversely affect the insurer's ability to operate in a prudent manner. The considerations the Board is required to assess in its initial decision on outsourcing, and on a continuing basis thereafter, include:

- Where outsourcing may adversely affect the insurer's governance and risk management structures;
- Where outsourcing has increased operational risk;

³ The Insurance Amendment (No.2) Act 2015

⁴ http://www.bma.bm/document-centre/policy-and-guidance/_layouts/mobile/dispform.aspx?List=350c2062%2D96c9%2D4353%2Da725%2D1e29aa946dd1&View=5e0094e2%2D2dc2%2D4b88%2Dac46%2D83e38b0a8ad1&ID=50

- Where outsourcing may affect the Authority's ability to effectively supervise the insurer; and
- Where outsourcing adversely affects policyholder's interests.

The approved auditor is required, under section 16A of the Insurance Act, to disclose to the BMA any material matter that falls under the purview of its supervisory responsibilities. This would include material control weakness and conflicts of interest in respect of which the Code's provisions are relevant. The BMA takes into consideration failure to comply with the Code as part of its assessment of the insurer's compliance with the Insurance Act.

The BMA has previously reported that it was not their policy to allow commercial insurers to outsource the CEO and senior executive functions, and that no commercial insurers have outsourced these functions⁵. BMA has subsequently informed EIOPA that a few small commercial insurers, managed by insurance managers, have the insurance manager carrying a senior executive title. These insurance managers have an individual appointed to the insurer's Board, with the Board driving the direction of the insurer and exercising the control function. In these limited instances, the Board in effect is performing the substantive role of the CEO/senior executive.

Public disclosure

The Insurance Amendment (No 2) Act 2015 provides the BMA with new powers to set standards on public disclosure (amendment to section 6A Insurance Act). The provision has immediate effect.

Using this power, the BMA requires all commercial insurers and insurance groups to prepare and publish a Financial Condition Report (FCR) on their websites. In addition, the BMA has developed prudential rules defining the content that the FCR shall cover and which has to be disclosed. This content mainly corresponds to those to be published in the FCR under the Solvency II. According to the BMA guiding principles on public disclosure, an obligation to disclosure exist only if it would not compromise competitive advantage and confidentiality and if being proportional to size, business mix, complexity and risk profile. Similar provisions exist within Solvency II. The BMA has discretion in granting exemptions.

It is also noted that where an insurer does not have a website they must provide a copy of the Financial Condition Report within 10 days of a request being made in writing.

Other relevant recent developments and legislative changes

The March 2015 report noted that changes were to be introduced in regard to key functions, namely the internal audit and actuarial functions.

Internal audit function

The independence of the internal audit function was consulted on and adopted in the Code in 2014, and became applicable from July 2015. The internal audit function is to be segregated and staffed by persons independent from other functions (paragraph 51 of the Code).

Actuarial function

The Insurance (Prudential Standards) (Insurance Group Solvency Requirement) Amendment Rules 2015 (the "Rules") cover the requirements for the Group Actuary's Opinion on the EBS technical provisions, establishing that the group actuary's opinion must state whether or not, in the opinion of the group actuary, the aggregate amount

⁵ Paragraph 140 EIOPA's March 2015 updated advice to the Commission.

of technical provisions in the Group Statutory Economic Balance Sheet as at the end of the relevant financial year:

- meets the requirements of the Insurance Act 1978 and related rules and regulations;
- makes reasonable provision for the total technical provisions of the group under the terms of its insurance contracts and agreements.

These changes will strengthen the actuarial function in respect of groups. The prudential rules were signed by the Chairman of the BMA and published in the Official Gazette. The process was completed on 17 July 2015. The prudential rules will come into effect in 2016 and are also posted on the Authority's website.

Timing

The Insurance Amendment (No 2) Act 2015 was signed by the Governor in July 2015. The power to set standards on public disclosure has immediate effect. However, the detailed rules and Code changes governing outsourcing shall apply as from 1 January 2016.

EIOPA Advice

The BMA has addressed the caveats on outsourcing and disclosure.

Regarding outsourcing, we note that it is no longer permitted that commercial insurers outsource chief and senior executives' responsibilities. The BMA has confirmed that the provision will be fully applied to all new insurers.

While the outsourcing of CEO and senior management positions is not prohibited under Solvency II, where this occurs it can raise questions regarding the governance exercised within the insurer. The BMA has told EIOPA that in the existing cases where senior executive roles may be considered to have been outsourced, the insurer's full Board has assumed the responsibilities of the Administrative, Management and Supervisory Body under Solvency II.

On public disclosure the requirement on commercial insurers and groups to publish a FCR largely mirrors the provisions in Solvency II. Exemptions for disclosure can be granted, including where the BMA is satisfied that the disclosure of certain information will result in competitive disadvantage. The BMA has confirmed that it is not intended to allow a complete exemption from the Capital Management section of the FCR based on competitive disadvantage or confidentiality arrangements between the insurer or insurance group and policyholders/counterparties. To ensure clarity, the BMA is in the process of further modifying the relevant provisions to make this approach more explicit. The amended rules have been drafted, but are subject to a consultation period of 28 days before they can come into effect. The consultation commenced on 27 July. The rule making power is invested in the BMA, so the new wording will not have to go before Bermudian Parliament.

Principles 5 and 11 - Changes in business, management or qualifying holdings

March 2015 report

Articles 172 and 260

The BMA was found largely equivalent with regard to its requirements around changes in business, management and qualifying holdings under Principles 5 and 11. EIOPA noted that further changes to the IA that are proposed for Q4 2014 are likely to

address the residual concern over the lack of any requirements covering disposals of qualifying holdings.

Recent developments and legislative changes with regard to the caveats identified

The IA has been amended to include a new provision after section 30E (section 30EA) requiring the notification by shareholder controllers of disposal of shares in public and private companies. The provisions apply in respect of holdings in all commercial insurers, and the thresholds for notification are disposals bringing the proportion of voting rights held by the shareholder controller below 10%, 20%, 33% or 50%.

Timing

The proposed amendment to the Insurance Act will take effect on 1 January 2016.

EIOPA Advice

With the entry into force of the amendments to the Insurance Act, the caveat previously identified in the March 2015 report in relation to principles 5 and 11 will have been fully addressed.

Principles 6, 7 and 12 – Solvency Assessment

March 2015 report

Article 172

With regard to their solvency regime for reinsurance undertakings under Principle 6:

a. We find the BMA's supervision of Class 3B and 4 insurers largely equivalent under the currently applicable rules. For these and other classes EIOPA cannot positively conclude on the present valuation framework, since it is possible for insurers to adopt a variety of different valuation standards. Consequently, there is no comparability between insurers.

We note that the valuation issue is intended to be addressed if the proposed revision of the valuation standards are implemented and enter into force on the 1st of January 2016. For dual licence insurers in Classes 3B and 4 there is an additional dependency that Solvency II rules are adopted for their life business. The BMA has also indicated that it intends to make further enhancements to BSCR in 2015 to include currency and concentration risks.

b. We find the BMA's supervision of Class 3A largely equivalent under the currently applicable rules.

We note that the BMA is working on the extension of the EBS to Class 3A with appropriate simplifications, but this will not be implemented until 1 January 2017.

c. We find the BMA's supervision of Class E life insurers partly equivalent under currently applicable rules. EIOPA is unable to conclude on the equivalence of the BMA's proposed valuation standards for assets and liabilities in respect of all commercial life classes given the material uncertainties which remain around the EBS framework being developed. The MSM is not currently risk-based.

We note that the BMA will apply the floor of 25% of the ECR to all commercial life insurers with effect from 1 January 2017.

d. We find the BMA's supervision of Class C and Class D life insurers under the currently applicable rules is partly equivalent. In addition to the caveats noted for Class E, Class C and D insurers are not currently required to provide GAAP financial

statements. There are no provisions requiring Class C and D insurers to maintain available statutory capital and surplus of a particular quality that equals or exceeds the value of the MSM.

We note that the BMA has stated that statutory capital and surplus requirements will be in place from year-end 2015.

Article 227

With regard to their solvency regime for insurance undertakings under Principle 7:

a. We find the BMA's supervision of Class 3B and 4 insurers largely equivalent under the currently applicable rules. For these and other classes EIOPA cannot positively conclude on the present valuation framework, since it is possible for insurers to adopt a variety of different valuation standards. Consequently, there is no comparability between insurers.

We note that the valuation issue is intended to be addressed if the proposed revision of the valuation standards are implemented and enter into force on the 1st of January 2016. For dual licence insurers in Classes 3B and 4 there is an additional dependency that Solvency II rules are adopted for their life business. The BMA has also indicated that it intends to make further enhancements to BSCR in 2015 to include currency and concentration risks.

b. We find the BMA's supervision of Class 3A largely equivalent under the currently applicable rules.

We note that the BMA is working on the extension of the EBS to Class 3A with appropriate simplifications, but this will not be implemented until 1 January 2017.

c. We find the BMA's supervision of Class E life insurers partly equivalent under currently applicable rules. EIOPA is unable to conclude on the equivalence of the BMA's proposed valuation standards for assets and liabilities in respect of all commercial life classes given the material uncertainties which remain around the EBS framework being developed. The MSM is not currently risk-based.

We note that the BMA will apply the floor of 25% of the ECR to all commercial life insurers with effect from 1 January 2017.

d. We find the BMA's supervision of Class C and Class D life insurers under the currently applicable rules is partly equivalent. In addition to the caveats noted for Class E, Class C and D insurers are not currently required to provide GAAP financial statements. There are no provisions requiring Class C and D insurers to maintain available statutory capital and surplus of a particular quality that equals or exceeds the value of the MSM.

We note that the BMA has stated that the statutory capital and surplus requirements will be in place from year-end 2015.

Article 260

We find the BMA's supervision of groups largely equivalent under the currently applicable rules, with regard to their solvency regime for groups under Principle 12. We note that the valuation issue is intended to be addressed if the proposed revision of the valuation standards are implemented and enter into force on the 1st of January 2016. For groups including life insurers there is an additional dependency that Solvency II rules are adopted for their life business. The BMA has also indicated that it intends to make further enhancements to BSCR in 2015 to include currency and concentration risks.

Recent developments and legislative changes with regard to the caveats identified

Economic Balance Sheet – Trial run

In the period April-May 2015, the BMA carried out a trial run of its proposed EBS framework open to the participation of all commercial insurers and groups. The EBS used the insurer's existing audited GAAP balance sheet as a starting point. Those insurers that at the time of the trial run did not have a GAAP balance sheet (certain C and D life insurers) were invited to contact the Authority for further guidance on how to approach the trial run. Assets and other liabilities were mainly to be valued using market values or the fair value option within GAAP. Insurance technical provisions were to be valued based on best estimate cash flows, adjusted to reflect the time value of money using a risk free discount rate term structure with an appropriate illiquidity adjustment. In addition technical provisions were to include a risk margin calculated on the "Cost of Capital" method. Certain intangible assets were disallowed⁶. A detailed specification was published.

The BMA received submissions from 65 entities, of which 10 were groups (3 of which included long-term insurance business); 33 property and casualty (P&C) insurers; and 22 long-term insurers. Although the participation rate was relatively modest compared to the number of commercial insurers and groups licensed in Bermuda, the BMA's analysis of the results determined that solvency ratios looked acceptable. Insurance groups generally showed modest increases in solvency ratios, while P&C insurers showed significant decreases. P&C results were affected by insurers producing the information on a consolidated basis and effectively having a capital charge applied to their insurance subsidiaries. Life insurers showed a mixed position – but further investigation did not indicate any fundamental or widespread issues with the proposals. The trial run did not apply transitional arrangements to long-term technical provisions, so the results reflected the full impact of the EBS⁷.

Nine submissions produced results using the scenario-based approach, within which there is a base scenario described as broadly equivalent to the Solvency II matching adjustment, and a range of other scenarios designed to stress the degree of asset-liability mismatch with the highest result being taken.

Based on the trial run results and industry feedback the BMA concluded that the EBS framework and proposed BSCR rules formed a sound basis on which to proceed.

The Insurance Act, as amended, together with the prudential solvency rules⁸ now provide that an EBS requirement shall apply across all commercial insurers and insurance groups from 1 January 2016. The changes in the prudential rules approved by the BMA in July 2015 related to the requirements for the EBS will become effective for submissions made following the end of the financial year starting on or after 1st January 2016.

Valuation under the new EBS regime

Under the prudential rules assets and liabilities shall be assessed and fair-valued in line with the GAAP principles adopted by the insurer, as notified to and agreed by the Authority. US GAAP and IFRS are mostly used.

⁶ BMA Notice "Commencement of the Economic Balance Sheet (EBS) framework trial run".

⁷ BMA Economic Balance Sheet & Bermuda Solvency Capital Requirement Trial Run Report 2015 – 2 July 2015.

⁸ Insurance (Prudential Standards)(Insurance Group Solvency Requirement) Amendment Rule 2015
Insurance (Prudential Standards) (Class 4 and 3B Solvency Requirement) Amendment Rules 2015
Insurance (Prudential Standards) (Class 3A Solvency Requirement) Amendment Rules 2015
Insurance (Prudential Standards) (Class C, D, and E Solvency Requirement) Amendment Rules 2015

For cases where the GAAP principles permit both a fair value model and a non-economic valuation model for valuing an asset or liability, the insurer shall apply the fair value model. For cases where the GAAP principles do not require an economic valuation the Group shall fair value the asset or liability using the hierarchy of high level principles of valuation of assets and liabilities determined in the Bermudian law (the prudential solvency rules).

Technical provisions are valued on the same basis as proposed in the trial run (see above)⁹. Subject to prior approval of the Authority, insurers and groups may elect to make use of transitional arrangements for long-term business only to calculate some or all of their technical provisions in the standard approach. Under the transitional arrangement, the insurer or group would calculate technical provisions using the EBS approach described above (and using the standard approach for the risk free discount rate), and also using approaches consistent with the current approach (defined as the valuation approach in force at 31 December 2015). The insurer or group would then interpolate linearly between the 2 values, such that the current approach applies for year end 31 December 2016 and the full EBS approach would apply 16 years later at the end 31 December 2032¹⁰.

The BMA intends to supply risk free discount curves for a number of the major currencies, including an adjustment partially to reflect the illiquidity premium implicit in typical underlying assets, as well as to make allowance (in the standard approach) for the prevention of pro-cyclical investment behaviour. The BMA provided EIOPA with a comparison between the discount rates used for the trial run for the US\$ at 31 December 2014 and the equivalent EIOPA rates, showing little difference up to the last liquid point at year 30. Beyond year 30 the differences were attributed to the method used to interpolate up to an UFR of 4.2% at year 60.

The prudential solvency rules establish that subject to prior approval of the Authority, commercial class insurers and groups may elect to produce some or all of their EBS using Solvency II principles, or such other economic valuation principles that the Authority has approved in advance for this purpose.

BSCR

The Insurance Act lays down two capital requirements for insurers other than captive insurance companies: the Minimum Solvency Margin (MSM) and the Enhanced Capital Requirement (ECR), applicable to both commercial life and non-life insurers. The ECR is determined from the relevant BSCR according to a standard formula or the insurer's approved internal capital model provided that the ECR is at least equal to the insurer's MSM. The BSCR standard formulas for all commercial insurers and groups have been amended to take into account new requirements for the inclusion of currency and concentration risks under the square root rule aggregating various risks. Qualifying capital rules differ for different categories of insurers only to the extent that Class 4 and Class 3B insurers must hold a minimum of 60% Tier 1 capital. The other classes must hold a minimum of 50% Tier 1 capital. All other elements are identical.

Currency risk

The BMA's report on the results of the trial run of the EBS framework identified that, while the proposed approach for currency risk was well received, there were concerns raised over the two levels of charges originally intended, and in particular the lack of allowance for currency hedging arrangements in the BSCR model. The BMA agreed

⁹ The full EBS is not audited. Technical provisions are reviewed by an approved actuary or loss reserve specialist who must provide an actuarial opinion to give assurance over these areas in the EBS.

¹⁰ These transitional measures are intended to reflect the transitional measures on technical provisions in Article 308d Solvency II (introduced through Omnibus II).

with the concerns and has amended the proposed prudential rules governing the BSCR to simplify the charges and make it clear that hedging arrangements that meet certain requirements can be taken into account.

The resulting simplified currency risk charge equates to 25% of any shortfall of assets in a currency compared to the liabilities plus a notional BSCR for that currency. The proxy for a notional BSCR in a currency is based on the insurer's previous BSCR capital requirement expressed as a percentage of liabilities. The assumption is that this factor applies equally to all currencies. The formula effectively assumes additional assets would be needed to be transferred into the currency in question from surplus assets held in another currency, and at the time the transfer is needed the relevant foreign exchange rate had moved adversely by 25%. The BMA considers that this is a reasonable first approximation and that any anomalies can be dealt with during the annual review of the insurer's filings by way of a capital adjustment. It is acknowledged that the approach does not follow the model adopted in Solvency II, although the 25% charge is consistent with the Solvency II charge in the standard formula.

The BMA has also recognised that there is a need to incorporate hedging arrangements directly within the currency risk module. Although this has been reflected in the legislation (the value of assets and liabilities corresponding to the currency are adjusted to allow for currency hedging arrangements) further work with the industry is planned to formulate appropriate guidance, in particular with regard to the extent that rolling foreign exchange hedges can be included in the assessment.

The BMA will also give further consideration to reduced charges for currencies pegged to other currencies in certain circumstances, although this has not been reflected in the current rules.

Any changes will be reflected in guidance or changes to the prudential rules.

For new insurers in their first year of operation an iterative approach to determining the currency risk will be adopted.

Concentration risk

The BMA's proposals in this area involve incentivising firms to comply with the provisions in the Insurance Code of Conduct (s 5.1.2 on strategic risk and paragraph 33 which specifically covers concentration risk). Insurers are required to identify their 10 largest independent exposures relating to all instruments (asset side). The risk charge only applies to invested assets. The concentration risk charge is an addition to existing BSCR market and/or credit risk charge contributed by these exposures. The need to address currency risk is also referred to in the Code.

Class 3A – application of the new solvency regime

The EBS regime is now intended to be operative for class 3A insurers as for other commercial non-life classes from 1 January 2016, and apply to submissions following the financial year starting on or after 1st January 2016.

Minimum Solvency Margin – life insurers

The BMA has applied a floor of 25% of the ECR to all commercial class life insurers to come into effect from 1 January 2017¹¹.

Classes C and D – GAAP statements, statutory capital and surplus

Changes to the Insurance Act have now been implemented to require all Class C and D insurers to prepare GAAP statements with effect from 1 January 2016. The EBS

¹¹ Insurance Returns and Solvency Regulations 1980 (as amended)

approach will also apply to all commercial life classes from 1 January 2016. The prudential rules for commercial life insurers are set out in the Insurance (Prudential Standards) (Class C, D, and E Solvency Requirement) Amendment Rules 2015. Eligible capital provisions apply.

Other relevant recent developments and legislative changes

Eligible capital

The BMA has amended the Insurance (Eligible Capital) Rules 2012 and the Insurance (Group Supervision) Rules 2011 by deleting the requirement for certain capital to be "paid up or called" to now be required to be "paid up" only. This is intended to align with international standards and ensure that the relevant capital instruments are perpetually available to meet policyholder obligations and can therefore qualify for meeting its tier 1 capital requirements.

Geographical diversification

BMA originally proposed to allow property and casualty (P&C) firms to choose whether to use this feature, based on Solvency II provisions, and to decide what lines of business to apply it to. Of the 10 P&C insurers using this option in the trial run there was an overall reduction in total BSCR of 4%. Following the trial run, there is likely to be a simplification of the geographical zoning along regional lines allowed through the introduction of further guidance. Geographical diversification for long-protection business will also be considered.

Charge for cash and cash equivalents

BMA will recognise explicitly the ratings of individual exposures in a similar manner to that used for other fixed interest investments and reinsurance counterparties. A diversification reduction of up to 40% of the base charge for cash and cash equivalents will be available driven by the ratio of the largest holding to the total of all holdings in the sub-module. Cash deposits and short-term debt issued by a country that is AA- or better in its own currency shall be classified under BSCR rating class 0, attracting no capital requirement.

Interest rate and liquidity risk capital assessment

With the move to an EBS approach all fixed income investments will now be included in the interest rate and liquidity risk capital assessment, for both P&C and long-term insurers.

Code of conduct – clarity re investments

The concentration risk element now reads: "The concentration risk component of the insurer's risk management framework should include developing strategies and policies to identify, measure, respond to, monitor, mitigate, and report credit risk arising from an individual risk exposure or from a combination of risk exposures such as credit, market, underwriting, and liquidity.

Timing

The financial supervision (new approach) is intended to be effected in 2016 and, unless stated otherwise, will apply to all commercial insurers and insurance groups.

The full EBS approach, taking into account technical provision transitionals on the life side, would apply 16 years later at year end 31 December 2032.

EIOPA Advice

With the implementation of the new EBS and BSCR provisions the principal caveats in respect of the legislative regime will have been addressed. EIOPA would expect the BMA to ensure the full application of the new legislative provisions across insurance

groups and all classes of commercial insurer, subject to the appropriate application of proportionality principles, through on-site and off-site monitoring. Again the BMA has confirmed that this is their intention.

Principle 8 - Parent undertakings outside the Community: scope of group supervision

March 2015 report

The BMA's regulatory framework was found equivalent with regard to the scope of its group supervision under Principle 8.

Recent developments and legislative changes with regard to the caveats identified

Not applicable.

Other relevant recent developments and legislative changes

The Insurance (Group Supervision) Amendment Rules 2015 (the "Rules") have been modified requiring insurance groups to report to the Authority on a statutory economic capital and surplus basis, adding a new definition for "group statutory economic balance sheet" and "insurance technical provisions."; to complete the Eligible Capital schedule on a statutory economic capital and surplus basis and requiring the group actuary to submit the group actuary opinion under the Insurance (Prudential Standards) (Insurance Group Solvency Requirement) Rules 2011.

Timing

The Authority proposes for the aforementioned amendment to commence on 1 January 2016 and apply to financial years commencing on or after that date.

EIOPA Advice

No changes.

Principle 9 - Parent undertakings outside the Community: cooperation and exchange of information between supervisory authorities

March 2015 report

The BMA was found equivalent with regard to its co-operation and exchange of information with other supervisory authorities under Principle 9.

Recent developments and legislative changes

No changes.

Annex I: Overall assessment updated report March 2015

EIOPA advice on Bermuda's equivalence under Article 172

40. EIOPA's advice is that Bermuda meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II for insurers of Classes 3A, 3B, 4, C, D and E, but with certain caveats set out below.

41. We find the BMA largely equivalent with regard to its powers and responsibilities as a supervisory authority for Class 3A, 3B and 4 insurers and Class E insurers and to be partly equivalent for Class C and D under Principle 1. Although the BMA has at its disposal a series of powers and reporting obligations, some of the obligations vary according to the insurer's class.

42. We find the BMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2.

43. We find the BMA largely equivalent with regard to its authorisation of insurers under Principle 3. The BMA is empowered to obtain all the information necessary for licensing, however there is no legal requirement to ensure that an insurer has its head office situated in the same country as its registered office.

44. We find the BMA largely equivalent for Classes 3A, 3B, 4, C, D and E with regard to its governance and public disclosure requirements under Principle 4. EIOPA has identified the following areas where the BMA regime would have to be strengthened or addressed in order to be considered equivalent to Solvency II: outsourcing and public disclosure.

45. We find the BMA largely equivalent with regard to its requirements around changes in business, management and qualifying holdings under Principle 5. We note that further changes to the IA that are proposed for Q4 2014 are likely to address the residual concern over the lack of any requirements covering disposals of qualifying holdings.

46. With regard to their solvency regime for reinsurance undertakings under Principle 6:

a. We find the BMA's supervision of Class 3B and 4 insurers largely equivalent under the currently applicable rules. For these and other classes EIOPA cannot positively conclude on the present valuation framework, since it is possible for insurers to adopt a variety of different valuation standards. Consequently, there is no comparability between insurers.

We note that the valuation issue is intended to be addressed if the proposed revision of the valuation standards are implemented and enter into force on the 1st of January 2016. For dual licence insurers in Classes 3B and 4 there is an additional dependency that Solvency II rules are adopted for their life business. The BMA has also indicated that it intends to make further enhancements to BSCR in 2015 to include currency and concentration risks.

b. We find the BMA's supervision of Class 3A largely equivalent under the currently applicable rules.

We note that the BMA is working on the extension of the EBS to Class 3A with appropriate simplifications, but this will not be implemented until 1 January 2017.

c. We find the BMA's supervision of Class E life insurers partly equivalent under currently applicable rules. EIOPA is unable to conclude on the equivalence of the BMA's proposed valuation standards for assets and liabilities in respect of all

commercial life classes given the material uncertainties which remain around the EBS framework being developed. The MSM is not currently risk-based.

We note that the BMA will apply the floor of 25% of the ECR to all commercial life insurers with effect from 1 January 2017.

d. We find the BMA's supervision of Class C and Class D life insurers under the currently applicable rules is partly equivalent. In addition to the caveats noted for Class E, Class C and D insurers are not currently required to provide GAAP financial statements. There are no provisions requiring Class C and D insurers to maintain available statutory capital and surplus of a particular quality that equals or exceeds the value of the MSM.

We note that the BMA has stated that statutory capital and surplus requirements will be in place from year-end 2015.

EIOPA advice on Bermuda's equivalence under Article 227

47. EIOPA's advice is that Bermuda meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II for insurers of Classes 3A, 3B, 4, C, D and E, but with certain caveats set out below.

48. We find the BMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2.

49. With regard to their solvency regime for insurance undertakings under Principle 7:

a. We find the BMA's supervision of Class 3B and 4 insurers largely equivalent under the currently applicable rules. For these and other classes EIOPA cannot positively conclude on the present valuation framework, since it is possible for insurers to adopt a variety of different valuation standards. Consequently, there is no comparability between insurers.

We note that the valuation issue is intended to be addressed if the proposed revision of the valuation standards are implemented and enter into force on the 1st of January 2016. For dual licence insurers in Classes 3B and 4 there is an additional dependency that Solvency II rules are adopted for their life business. The BMA has also indicated that it intends to make further enhancements to BSCR in 2015 to include currency and concentration risks.

b. We find the BMA's supervision of Class 3A largely equivalent under the currently applicable rules.

We note that the BMA is working on the extension of the EBS to Class 3A with appropriate simplifications, but this will not be implemented until 1 January 2017.

c. We find the BMA's supervision of Class E life insurers partly equivalent under currently applicable rules. EIOPA is unable to conclude on the equivalence of the BMA's proposed valuation standards for assets and liabilities in respect of all commercial life classes given the material uncertainties which remain around the EBS framework being developed. The MSM is not currently risk-based.

We note that the BMA will apply the floor of 25% of the ECR to all commercial life insurers with effect from 1 January 2017.

d. We find the BMA's supervision of Class C and Class D life insurers under the currently applicable rules is partly equivalent. In addition to the caveats noted for Class E, Class C and D insurers are not currently required to provide GAAP

financial statements. There are no provisions requiring Class C and D insurers to maintain available statutory capital and surplus of a particular quality that equals or exceeds the value of the MSM.

We note that the BMA has stated that the statutory capital and surplus requirements will be in place from year-end 2015.

EIOPA advice on Bermuda's equivalence under Article 260

50. EIOPA's advice is that Bermuda meets the criteria set out in EIOPA's methodology for equivalence assessments under Solvency II for group supervision but with certain caveats set out below.

51. We find the BMA equivalent with regard to its powers and responsibilities as a supervisory authority under Principle 1.

52. We find the BMA equivalent with regard to its professional secrecy and information exchange obligations under Principle 2.

53. We find the BMA's regulatory framework equivalent with regard to the scope of its group supervision under Principle 8.

54. We find BMA equivalent with regard to its co-operation and exchange of information with other supervisory authorities under Principle 9.

55. We find the BMA largely equivalent for group supervision with regard to its governance and public disclosure requirements under Principle 10. EIOPA has identified the key area where the BMA regime would have to be strengthened or addressed in order to be considered equivalent to Solvency II as public disclosure.

56. We find the BMA largely equivalent with regard to its requirements around changes in business, management and qualifying holdings under Principle 11. We note that further changes to the IA that are proposed for Q4 2014 are likely to address the residual concern over the lack of any requirements covering disposals of qualifying holdings.

57. We find the BMA's supervision of groups largely equivalent under the currently applicable rules, with regard to their solvency regime for groups under Principle 12. We note that the valuation issue is intended to be addressed if the proposed revision of the valuation standards are implemented and enter into force on the 1st of January 2016. For groups including life insurers there is an additional dependency that Solvency II rules are adopted for their life business. The BMA has also indicated that it intends to make further enhancements to BSCR in 2015 to include currency and concentration risks.