

SOLVENCY II – BERMUDA'S REGULATORY FRAMEWORK

Tim Faries

Solvency II, the European initiative to overhaul the capital adequacy regime of the European insurance industry and create an agreed set of capital and risk management requirements, was expected to be in place by January 2013. However, after several delays, Solvency II is now back on the front-burner and is scheduled to come into effect on 1 January 2016.

STRUCTURE

Solvency II will introduce a new regulatory and supervisory framework for Europe's insurance industry. This framework is divided into three pillars: Pillar 1 - Quantitative Requirements (Capital Requirements); Pillar 2 - Governance & Supervision; and Pillar 3 - Disclosure & Transparency.

BENEFIT OF THIRD-COUNTRY EQUIVALENCY

The Solvency II Directive adopted on 25 November 2009 (**Solvency II Directive**), as amended by the Omnibus II Directive adopted on 11 March 2014 (**Omnibus II Directive** and together with the Solvency II Directive, **Directive**) is applicable to the European Union's insurance industry. However, non-European jurisdictions may choose to achieve an equivalency status under Solvency II. Such jurisdictions will be assessed on three levels of equivalency with Solvency II:

- (a) Insurance considerations - treatment of third country insurance (specifically the need to collateralize insurance arrangements with assessments within the European Economic Area);
- (b) Group solvency calculation - ability to use local regulatory capital amounts in the Solvency II capital calculation; and
- (c) Group supervision - reliance on third-country for

group supervision (i.e. European supervisors need only to consider individual entities within their jurisdictions on a stand-alone basis).

As Europe is the world's largest insurance market, with 35% of the global market, non-equivalence with Solvency II would have a dramatic impact on the Bermuda insurance market and, in particular, insurance companies based in Bermuda with subsidiaries or parents in Europe for which compliance with Solvency II is mandatory. Under Solvency II, it is expected that Bermuda companies will have to be consolidated with any European affiliates and the entire group of companies will have to comply with the Solvency II's group requirements.

Equivalence under Solvency II has long been considered by the Bermuda Monetary Authority (**BMA**) as a priority to keep Bermuda as a key jurisdiction in the global insurance industry. In particular, the BMA, with the support of the Bermuda government and the Bermuda insurance industry, has actively sought to ensure that the Bermuda regulatory regime for commercial insurers obtains third-country equivalency under Solvency II. Bermuda, Switzerland and Japan were the first countries to seek equivalency under Solvency II.

BIFURCATED EQUIVALENCY

In 2010, the European Commission (**EC**) tasked the European Insurance and Occupational Pensions Authority (**EIOPA**) to provide a preliminary assessment of the BMA's supervisory regime to determine whether it satisfied the general criteria for third-country equivalency under Solvency II. On 26 October 2011, EIOPA published its report, advising that Bermuda's regulatory framework for commercial insurers is broadly equivalent with the Directive. EIOPA's report did, however, make a distinction between the supervisory regime for Bermuda's commercial sector and the BMA's supervision of the captive sector. This distinction is based on Bermuda's two-tiered approach to regulation of the industry (i.e. "bifurcated equivalency"). In the context of the Bermuda insurance regulatory regime, "bifurcated

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equivalency” means that Solvency II equivalent standards will apply to commercial insurers but not to captive insurers. This is an application of the principle of proportionality, where the weight of regulation applicable to a particular class of regulated entity is proportional to the risks that such entity or class represents.

EIOPA’s assessment of Bermuda regulatory framework was consistent with the BMA’s position that the principle of proportionality should be taken into account when considering the implementation of Solvency II. This position was further confirmed by Karel Van Hulle, Head of Unit for Insurance and Pensions at the European Commission, who indicated that Bermuda will be able to gain third-country equivalency with Solvency II for regulation of its major commercial insurance market without having to apply the more stringent supervision standards to the island’s captive insurance companies. It is also intended that the Bermuda regulatory framework will have less constraining (but risk-appropriate) requirements for special purpose insurers (**SPI**) and captives writing affiliated business with group-owned entities, (collectively, **limited purpose insurers**).

The implementation of Solvency II pursuant to the concept of bifurcated equivalency is intended to preserve the unique component of the Bermuda insurance market as the oldest and largest captive market place, and the premier jurisdiction for the issuance of insurance linked securities by locally domiciled SPIs.

ENHANCEMENT OF BERMUDA’S REGULATORY FRAMEWORK

As a consequence of the implementation of Solvency II, the BMA embarked on a programme of regulatory change to enhance Bermuda’s regulatory framework for commercial insurers to reflect a progressive risk-based approach to regulation. The key elements of the enhancements to Bermuda’s regulatory framework include group supervision and prudential rules, more detailed solvency and financial models framework, and disclosure and transparency requirements for commercial insurers registered in Bermuda. This process was implemented by spreading the enhanced supervisory regimes to all classes of commercial insurers who conduct general and long-term insurance business.

The BMA has spared no effort in changing the Bermuda regulatory environment to a regime that meets the criteria necessary to achieve equivalence with Solvency II which should normally end with EC equivalence decision.

On 19 December 2014, EIOPA published a consultation paper on EIOPA Advice to EC – Equivalence assessment of the Bermuda supervisory system in relation to articles 172, 227 and 260 of the Solvency II Directive, inviting the (re)insurance market participants and (re)insurance stakeholders to provide their comments by 23 January 2015, on the draft Advice to EC regarding the full equivalence assessments of Bermuda. The EIOPA’s Advice is expected to allow EC to make an informed decision in 2015 on whether solvency and prudential regime in Bermuda is equivalent to the Solvency II framework. EIOPA’s assessment is an important signal in the upcoming full equivalence determinations that need to be made by EC in the coming weeks.

CONTACT



Bermuda

Tim Faries
Partner

Group Head, Bermuda | Corporate
Group Team Leader | Insurance
+1 441 298 3216
tfaries@applebyglobal.com