Bermuda Reporting Requirements
An overview of statutory and solvency reporting deliverables for general insurers
January 2019
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Commonly used acronyms in the Bermuda reporting regime

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<th>Acronym</th>
<th>Description</th>
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<tr>
<td>BEL</td>
<td>Best Estimate Liability</td>
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<td>BMA</td>
<td>Bermuda Monetary Authority</td>
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<td>BSCR</td>
<td>Bermuda Solvency Capital Requirement</td>
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<td>CISSA</td>
<td>Commercial Insurer’s Solvency Self-Assessment</td>
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<td>CIRA</td>
<td>Commercial Insurer Risk Assessment</td>
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<td>CSR</td>
<td>Capital and Solvency Return</td>
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<td>EBS</td>
<td>Economic Balance Sheet</td>
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<tr>
<td>ECR</td>
<td>Enhanced Capital Requirement</td>
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<tr>
<td>FCR</td>
<td>Financial Condition Report</td>
</tr>
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<td>GSSA</td>
<td>Group Solvency Self-Assessment</td>
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<tr>
<td>LRS</td>
<td>Loss Reserve Specialist</td>
</tr>
<tr>
<td>LRSO</td>
<td>Loss Reserve Specialist Opinion</td>
</tr>
<tr>
<td>MSM</td>
<td>Minimum Solvency Margin</td>
</tr>
<tr>
<td>RM</td>
<td>Risk Margin</td>
</tr>
<tr>
<td>SFS</td>
<td>Statutory Financial Statements</td>
</tr>
<tr>
<td>TP</td>
<td>Technical Provisions</td>
</tr>
</tbody>
</table>
Overview of reporting landscape
Statutory reporting regime

To ensure that Bermuda continues to adhere to international standards and best practices for insurance regulation and supervision, in 2015 the BMA instituted a series of enhancements to its statutory and prudential reporting requirements for commercial insurers.

Statutory Reporting

The BMA recognizes that insurers having varying risk profiles arising from the nature, scale and complexity of their business. As a result commercial insurers have additional reporting requirements, such as:

- Every commercial insurer shall, in addition prepare GAAP financial statements in respect of its insurance business for each financial year. A company can choose to report under US GAAP, Canadian GAAP or another framework (such as IFRS) as their ongoing reporting requirements.

What’s audited?
- Consolidated GAAP Financials
- Consolidated Statutory Financial Statements – New requirement from 2016
- Unconsolidated Statutory Financial Statements

When is it filed?
- Must file within 4 months of the year-end unless an extension is obtained, which is usually issued 1 month at a time, provided that the company is in compliance and there is a valid reason for the request.

Actuarial Opinion
- Commercial classes require an loss reserve specialist opinion on the Technical Provisions on the EBS.

- The principal representative is responsible for obtaining the extension.
Solvency reporting and capital assessment

As a Solvency II equivalent jurisdiction, Bermuda adopts a Three Pillar approach to risk-based supervision. Insurers file a Capital and Solvency Return (CSR) within four months of the financial year end.

**Solvency Reporting**

An overarching objective of Bermuda’s solvency regime over the past decade is to achieve and maintain Solvency II equivalence, which effectively enables Bermuda domiciled insurers to conduct business in the EU on a level playing field as EU domiciled insurers. The BMA is keen to sustain and continue to develop its risk-based regulatory approach that both (a) meets or exceeds international standards and (b) appropriately reflects the nature of the Bermuda market.

To this end, numerous legislation and guidance have been recently issued, that broadly mirror the Three Pillar approach of Solvency II.

**Pillar 1**  
Quantitative Requirements

- Required capital based on Economic Balance Sheet (EBS).
- Bermuda Solvency Capital Requirement (BSCR) computed using standard formula or approved internal model.
- Calibrated to approach but not exceed Solvency II.

**Pillar 2**  
Risk Governance

- Prepare Commercial Insurer’s Solvency Self Assessment (CISSA), assessing risk governance and capital adequacy under normal and stressed conditions.
- Integrate at Group level where multiple legal entities exist.

**Pillar 3**  
Risk Disclosure

- Beginning with 2016 year end, prepare Financial Condition Report (FCR).
- Outline performance, risk profile, and organizational governance.
- To be made publicly available on insurer’s website.
Statutory Financial Statements (SFS)
Statutory financials and scope of audit

In order to streamline the process and minimize duplication of effort, the BMA amended statutory accounting valuation standards to be consistent with GAAP valuation, subject to certain prudential filters.

Scope of the Audit

GAAP Financial Statements and Prudential Filters are required to be audited.

The auditor’s opinion is whether the statutory balance sheet, statutory income statement, and statutory capital and surplus have been prepared in accordance with the Act and these Rules.

- Forms 1SFS, 2SFS and 8SFS

<table>
<thead>
<tr>
<th>Some key prudential filters include:</th>
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</thead>
<tbody>
<tr>
<td><strong>Goodwill</strong></td>
</tr>
<tr>
<td>Valued at zero.</td>
</tr>
<tr>
<td><strong>Other intangibles</strong></td>
</tr>
<tr>
<td>Value of future economic benefits flowing to insurer, only if separable and evidence of similar exchange transactions; zero otherwise.</td>
</tr>
<tr>
<td><strong>Prepays and deferred expenses</strong></td>
</tr>
<tr>
<td>Valued at zero.</td>
</tr>
<tr>
<td><strong>Deferred acquisition costs (DAC)</strong></td>
</tr>
<tr>
<td>Valued consistently with GAAP.</td>
</tr>
<tr>
<td><strong>Contingent liabilities</strong></td>
</tr>
<tr>
<td>Expected present value of future cash flows.</td>
</tr>
<tr>
<td><strong>Deferred tax assets/liabilities</strong></td>
</tr>
<tr>
<td>Valued consistently with GAAP.</td>
</tr>
</tbody>
</table>

Source: Bermuda Monetary Authority
Economic Balance Sheet (EBS)
The Economic Balance Sheet framework

Beginning with financial year 2016, the EBS framework forms the basis used to determine capital requirements for Bermuda commercial insurers. The Loss Reserve Specialist is also required to render an opinion on the reasonableness of EBS technical provisions.

**Principles of EBS**

Assets and liabilities are assessed and included on the EBS at fair value in line with GAAP principles, or, if GAAP does not require an economic valuation, following the EBS fair value hierarchy.

Specifically with respect to insurance liabilities, an EBS Technical Provision (TP) is established as the sum of a best estimate liability (BEL) and a risk margin (RM). The BEL represents the value of best estimate cash flows, discounted to reflect the time value of money and appropriate illiquidity adjustment. The RM is included to provision for uncertainty inherent to the underlying cash flows.

When applying the EBS framework, the principle of substance over form is applied, for example when selecting actuarial methodologies.
Unpacking the Technical Provision

The Technical Provision represents the amount required to meet insurance obligations as they fall due, and compensate capital providers for assuming the risk inherent in these obligations.

1. Liability cash flows are projected according to the actuary’s best estimate assumptions for the relevant risk drivers.
2. Cash flows are discounted to reflect time value of money and illiquidity. The BMA provides calibrated discount curves for widely used currencies.
3. A risk margin is added to reflect the inherent uncertainty in the best estimate cash flows. This reflects the amount of compensation required by capital providers for bearing this uncertainty.
4. The EBS Technical Provision is the total liability value recorded for insurance obligations. The Loss Reserve Specialist renders an opinion on the reasonableness of overall TPs.

[Diagram]

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Other EBS considerations

There are several other new concepts in the EBS framework that build on the statutory basis toward a more economically consistent technical provision. Notably, insurers need to calculate a risk margin, adjust reinsurance recoverables for default costs, and render an actuarial opinion on the overall reasonableness of the TPs.

Risk margin

A risk margin is added to the BEL to arrive at the total EBS technical provision. Although the BEL by definition reflects the expected value of insurance benefits payable, there is inherent uncertainty in the underlying cash flows.

Conceptually, the risk margin represents the compensation required by the insurer to bear this uncertainty. The preferred methodology is the Cost of Capital approach, but certain approximations are permissible. Under this approach, the insurer calculates the cost of holding its required capital over the lifetime of its insurance obligations, as follows:

\[ RM = CoC \times \sum \frac{ECR_t}{(1 + r_{t+1})^{t+1}} \]

- \( ECR_t \) is the insurers required capital at time \( t \), per the standard formula or its own internal model.
- \( r_t \) is the risk-free discount rate
- \( CoC \) is the cost of capital – currently 6%

Counterparty default

Under the EBS framework, reinsurance recoverables must be adjusted for expected losses due to counterparty default. The preferred methodology mirrors widely used expected credit loss approaches.

Bound But Not Incepted (“BBNI”) Business

Provisions must also be set aside for business to which the insurer is bound to as at the valuation date, even though the underlying contracts may not yet have incepted.

Actuarial opinion

Under the new reporting regime, an actuarial opinion is required on the reasonableness of EBS TPs.

The Loss Reserve Specialist should specifically discuss the following:

- Commentary on data underlying the EBS TPs
- Discussion of how Events Not In Data (ENIDs) are incorporated into their actuarial estimates
- Discussion of how the Loss Reserve Specialist arrived at their actuarial estimates of the insurer’s aggregate TPs
- Commentary on the methodology used to arrive at the adjustment included in the best estimate of reinsurance recoveries that was made to reflect expected losses due to counterparty default
Bermuda Solvency Capital Requirement (BSCR)
Capital requirements

Insurers are required to demonstrate capital adequacy with respect to the Bermuda Solvency Capital Requirement (BSCR), which is computed per the BMA’s standard capital model or an approved internal capital model.

Risk categories

General insurers must calculate capital requirements with respect to the categories to the right. Most capital calculations are determined by multiplying the prescribed capital factor by some defined exposure amount. Some key factors include:

- **Premium**: ranges from 15-55% of diversified net written premium with concentration adjustment
- **Reserve**: ranges from 12-52% of diversified EBS BEL with concentration adjustment
- **Catastrophe**: Net PML less CAT premium less credit risk charge on reinsurance recoverable
- **Market**: generally, market value x factor ranging by riskiness of asset

Aggregation

Capital requirements are aggregated in a straightforward manner, applying a very simple dependency structure as follows:

- Half the credit risk charge is perfectly correlated with reserve risk
- All other pairs are independent of each other
- Operational risk and capital adjustments are added on post diversification
# BSCR Individual Charges

Below we explain in more detail the risk charges associated with Bermuda’s BSCR framework for general insurers

## Summary of BSCR Risk Charges

<table>
<thead>
<tr>
<th>Risk Module</th>
<th>Bermuda BSCR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Income Investment Risk</td>
<td>Applies to all fixed income investments, and charges vary by asset class (corporate bonds, mortgages, etc.) and BSCR rating.</td>
</tr>
<tr>
<td>Equity Investment Risk</td>
<td>Applies to all equity investments and varies by various factors. Includes common equity, preferred equity, and real estate.</td>
</tr>
<tr>
<td>Credit Risk</td>
<td>Applies to reinsurance exposure balances, as well as accounts receivables.</td>
</tr>
<tr>
<td>Interest and Liquidity Risk</td>
<td>Applies to total market value of assets, and based on net duration gap.</td>
</tr>
<tr>
<td>Concentration Risk</td>
<td>Applies to top 10 asset exposures. Effectively, the insurer must hold double the asset risk charge on these 10 exposures; however the additional charge is diversified with other risk modules.</td>
</tr>
<tr>
<td>Premium Risk</td>
<td>Applies by BMA Line of Business. Written premium applicable for each line is used to arrive at a premium risk charge by multiplying the relevant premium by an associated pre-defined risk factor.</td>
</tr>
<tr>
<td>Reserve Risk</td>
<td>Applies by BMA Line of Business. Takes the claims provision component of the TPs by Line of Business, and arrives at a reserve risk charge by multiplying the claims provision by an associated pre-defined risk factor.</td>
</tr>
<tr>
<td>Catastrophe Risk</td>
<td>Catastrophe risk exposures by peril / region are multiplied by risk factors and aggregated in order to arrive at an overall catastrophe risk charge.</td>
</tr>
<tr>
<td>Diversification Credit</td>
<td>Applied using a straightforward covariance approach prescribed by the BMA.</td>
</tr>
<tr>
<td>Operational Risk</td>
<td>Applies as a surcharge to diversified BSCR, based on the insurer’s self assessment of their risk controls and governance.</td>
</tr>
<tr>
<td>Taxes</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Solvency ratios and eligible capital

Financial instruments may qualify into one of three tiers according to their permanence and subordination. The BMA further enforces constraints on the quality of capital supporting the MSM and ECR.

**MSM and ECR**

The Minimum Solvency Margin (MSM) is a prescribed regulatory capital floor as a function of business volume. The Enhanced Capital Requirement (ECR) is the maximum of the MSM and BSCR requirements. The BMA imposes a target ECR coverage ratio of 120%. BSCR will almost always be greater than the MSM and will hence drive the ECR.

The minimum capital requirements are intended to reflect a 0.5% probability of insolvency, generally considered commensurate to a BBB-rated company. Companies targeting higher credit ratings would target higher coverage ratios as defined in their risk appetite.

**Eligible capital**

The general criteria for an instrument to qualify into one of the three capital tiers are outlined in the table to the right.

In the case where certain assets are encumbered due to the nature of a particular reinsurance structure, any excess encumbrances are classified as either Tier 1 or Tier 2.

<table>
<thead>
<tr>
<th>Tier</th>
<th>Constraints</th>
<th>General criteria for eligibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>At least 80% of MSM</td>
<td>Perpetual, unencumbered, non-redeemable, non-callable and the highest level of subordination.</td>
</tr>
<tr>
<td></td>
<td>At least 50% of ECR</td>
<td></td>
</tr>
<tr>
<td>Tier 2</td>
<td>At most 25% of MSM</td>
<td>Relaxes some Tier 1 criteria to allow callable hybrids and some other non-perpetual instruments available under a going concern, and certain approved letters of credit/guarantees.</td>
</tr>
<tr>
<td></td>
<td>At most 50% of ECR</td>
<td></td>
</tr>
<tr>
<td>Tier 3</td>
<td>Ineligible for MSM</td>
<td>Further relaxes criteria to allow more non-perpetual instruments, and certain approved letters of credit/guarantees.</td>
</tr>
<tr>
<td></td>
<td>At most 15% of ECR</td>
<td></td>
</tr>
</tbody>
</table>
Governance and disclosure
Pillar 2 reporting

Commercial insurers are required to submit certain qualitative and quantitative reporting deliverables with respect to their risk governance. Notably, insurers must complete a Commercial Insurer’s Solvency Self Assessment (CISSA), as well as report the Pillar 1 quantitative impacts as a result of a set of prescribed and self-identified stress tests.

CISSA

The insurer must self-assess its capital requirements with respect to the key risk categories identified by the BMA, and provide commentary on why its self-assessment differs from the BSCR.

The insurer must additionally disclose contingency plans with respect to maintaining capital adequacy under stress.

Insurers with value-added CISSAs incorporate the results from the self-assessment into its key strategic decisions. Common areas where CISSA results are integrated into business decisions include:

• Strategic planning
• Defining risk appetite
• Capital allocation
• Rating agency considerations
• Reinsurance strategy
• Profitability measurement
• M&A

As part of the CISSA, the Board must review risk governance policies and processes.

Stress Testing

Commercial insurers are also required to submit supplementary quantitative analysis describing the impacts of certain stresses on statutory surplus. The scenarios under consideration are a combination of those prescribed by the BMA, insurer-specific underwriting scenarios, and reverse stress tests.

When quantifying the financial impact of a particular stress test, it is important to consider the following key dimensions:

Business Strategy:
Changes to volume of exposure

Risk Strategy:
Changes to allocation of risk portfolio

Financial Strategy:
Changes to capital structure

Environment:
Progression along business/market cycles
Pillar 3 reporting

Beginning with financial year 2016, commercial insurers are required to submit a Financial Condition Report (FCR), which is to be made publicly available. The report provides risk disclosure with respect to five key areas.

Financial Condition Report

The FCR requires the insurer to discuss its risk management function and overall business operations with respect to five key areas: business & performance, system of governance, risk profile, solvency valuation, and capital management. This structure is analogous to similar disclosure requirements under Solvency II.

- Business & Performance
  - Ownership
  - Group structure
  - Insurance business
  - Investment portfolio

- System of Governance
  - Board and senior management
  - Fitness and propriety
  - Key functions
  - CISSA
  - Outsourcing

- Risk Profile
  - Material risks
  - Risk mitigation
  - Concentrations
  - Prudent person principle
  - Stress testing

- Solvency Valuation
  - Valuation bases
  - Recoverables

- Capital Management
  - Eligible capital
  - Regulatory capital
  - Internal capital modeling
  - Partial model integration

- Other
  - Subsequent events
Transition to new regime
Transition to new regime

In its continued effort to maintain Solvency II equivalence, the BMA planned several refinements to the BSCR standard model which were recently field-tested prior to implementation. The changes came into effect 1/1/2019 and phased-in over a ten year period for long-term insurers.

<table>
<thead>
<tr>
<th>Area</th>
<th>Anticipated change</th>
</tr>
</thead>
</table>
| **Equity risk**    | In the current regime, equity risk charges range from 5% to 55% by type of holding. The new regime introduces various changes to these charges, notably increasing the charge on common stocks from 14.4% to 35%. Additionally, strategic or duration based holdings are now charged 20%. Short positions used for hedging purposes may be netted.  
Additionally, equity holdings are classified into three buckets, which are assumed to be 75% pairwise correlated, as opposed to perfect correlation in the current framework. |
| **Risk aggregation** | In the current regime, risks are generally considered to be independent, with a few exceptions, leading to generous diversification benefits. The new regime uses multiple layers of correlation matrices, consistent with the Solvency II approach. |
| **Operational risk** | In the current regime, the operational risk surcharge ranges from 1% to 10% according to the insurer’s score on the CIRA. The scoring process is unchanged; however, the new regime changes the associated range of surcharges to 1% to 20%, and steepening the scale such that insurers are further incentivized to implement comprehensive operational risk frameworks. |
| **Deferred taxes**  | The BMA recognizes that certain Bermuda-licensed insurers pay taxes in a foreign jurisdiction, and consequently any loss absorbing capacity resulting from such should be deducted from the insurer’s capital requirements. The new regime sets adjustment limits based on a combination of carried-back losses, current net DTL position, and anticipated carried-forward losses. |
## Transition to new regime (cont’d)

<table>
<thead>
<tr>
<th>Area</th>
<th>Anticipated change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Premium risk</strong></td>
<td>In the current regime, premium risk exposure only considers net written premiums for the current reporting year. To better align with Solvency II, the scope for premium risk charge is expanded to include potential growth in earned premium over the following year, as well as future earned premiums on multi-year contracts.</td>
</tr>
<tr>
<td><strong>Risk mitigation</strong></td>
<td>The BMA recognizes that risk mitigation techniques are central to many insurers’ business strategies, and will allow adjustments to capital requirements subject to certain criteria on the permanence and legal enforceability of such mitigation.</td>
</tr>
<tr>
<td><strong>Look through</strong></td>
<td>In the current regime, risk charges for investments in collective investment vehicles or funds are evaluated on a total basis. The new regime requires “looking through” to the underlying assets within the fund and determining risk charges on an individual basis.</td>
</tr>
</tbody>
</table>

**Phase-in**

Proposed changes will be linearly graded in over three reporting years beginning with the 2019 year-end filings.
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