30 August 2024

NOTICE

Bermuda Long-term Insurance Market Reports

The Bermuda Monetary Authority (Authority or BMA) published a paper in December 2023 on, "*Supervision and Regulation of PE Insurers in Bermuda*"[1]. This paper provided a high-level overview of the BMA's regulatory and supervisory experience regarding Private Equity (PE) insurers. This report was followed by the publication in January 2024 of the first Bermuda Long-term Insurance Market Analysis and Stress Testing Report, which highlighted, from a macroprudential viewpoint, the market characteristics of Bermuda's Long-term insurance segment as well as the results of the annual mandatory stress testing exercise.

The BMA received positive feedback and appreciation for sharing its supervisory experience and market information. In the same spirit of transparency, the BMA plans to share its experience and market insights by publishing a series of reports on the Bermuda Long-term (re)insurance market.

The first three reports will cover the following topics:

1. Liquidity Risk in the Bermuda Long-term Insurance Market – will be published today.

2. Collateral Structures in the Bermuda Long-term Insurance Market – will be published in September 2024.

3. Private Credit–Direct Loans, Collateralized Loan Obligations (CLO), and Private Placements – will be published in September 2024.

The publication of these papers is part of an ongoing effort by the BMA to share supervisory experiences and contribute to a better understanding of the risks and potential benefits associated with the structural shifts and trends in the insurance industry, especially the evolution of investment strategies in the global life and annuity sector. These papers address detailed technical issues, observed data and trends that form the basis for a deeper market understanding.

[1] https://www.bma.bm/pdfview/8805

The series will delve into the evolving market and provide additional information on key topics previously discussed in "*Supervision and Regulation of Private Equity (PE) Insurers*" in Bermuda paper. These topics included benefits, risk, supervisory response and regulatory enhancements in Bermuda and other jurisdictions aimed at addressing the challenges and risks stemming from the shifts in the life insurance industry. Additional reports will be published in due course as part of an ongoing series.

This notice offers background on the matters covered in this series and explains how they are interconnected.

Growing Awareness of the Protection Gap

Our engagement with stakeholders shows there is increasing recognition that people and businesses have far less protection than they need. According to the Global Federation of Insurance Associations (GFIA), the global pension protection gap was estimated at USD 51 trillion[2] in 2023. Bermuda, with its broad (re)insurance market, has evolved over the decades in response to and to address various global challenges, including protection gaps. The growth in the Bermuda long-term market has primarily been a response to the 2008 economic crisis and the subsequent lengthy period of extraordinarily low interest rates, tight credit spreads and flat yield curve. During this period, life and annuity insurers faced a lot of pressure to buy back shares, which reduced their capital. McKinsey[3] reported that in the last decade, public life and annuity insurers in Canada and the US gave about $275 billion to shareholders through $190 billion in share buybacks and $85 billion in dividends. A major contributor to the withdrawal of traditional capital was the inability of the life sector to earn the returns to honour guarantees within insurance contracts plus minimally meet the cost of capital. According to Swiss Re[3], the life sector fell short of its cost of capital by almost 5% points per year on average following the global financial crisis.

Strategic Alliances with Asset Management Firms, New Capital, New Risks

To tackle these challenges, insurers sought ways to access capital to continue to play their traditional role of delivering solutions that meet the needs of the policyholders. Insurers in various jurisdictions, including but not limited to Bermuda, responded by forming strategic relationships with asset management firms, bringing in new investment management capabilities and capital (see chart 1 below). Although these alliances helped narrow the protection gap in the life and annuity sector, they also significantly altered traditional investment strategies. Moreover, the alliances introduced unique governance risks, including potential conflicts of interest, which presented 'new' risks and supervisory concerns that require attention.

[2] GFIA, "Global protection gaps and recommendations for bridging them", March 2023.
[3]https://www.swissre.com/dam/jcr:73c636f8-1d47-4779-b757-845023332971/sigma-2-2024-life-annuity-insurance.pdf

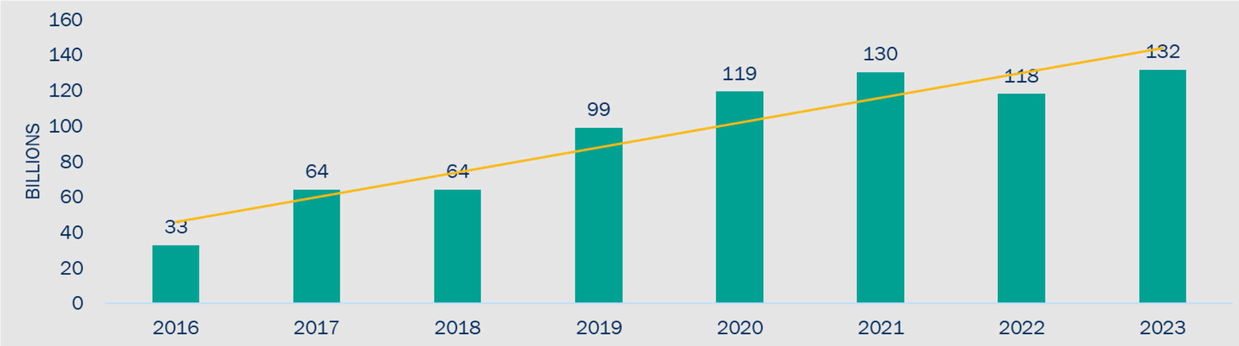

Chart 1: Bermuda Long-term market Statutory Capital & Surplus

Three Reports on the Bermuda Long-term Insurance Market

The three papers aim to provide details on the observed trends in the Bermuda long-term market and insight into how some of the risks arising from these shifts are managed by long-term insurers in Bermuda.

The first paper, "*Liquidity Risk in the Bermuda Long-term Insurance Market*", delves into the liquidity risk of Bermuda long-term insurers. Liquidity risk is an important focus area in light of the trends observed in the global long-term insurance market among them being increased volatility in interest rates, heightened lapses and shifts in investment portfolios. As a result, part of the Bermuda framework enhancements in 2024 included an update of the liquidity management framework. This has enabled the BMA to collect detailed liquidity risk data and stress test results. These are discussed in detail in the report that can be found via the following link https://www.bma.bm/publications/bma-surveys.

The second paper, "*Collateral Structures in the Bermuda Long-Term Insurance Market*", provides a deeper insight into how the largest part of the long-term reinsurance structures in Bermuda are collateralised as well as the benefits and risks of the said structures.

The third paper, "*Private Credit – Direct Loans, CLOs, and Private Placements*", takes a deeper look at credit risks associated with the increased allocation of long-term insurers in private credit assets, providing an overview of some of the relevant asset classes, their historical loss experience, and forward-looking considerations not necessarily captured in the historical data. The report aims to assess private credit more broadly, but using as illustration the asset classes Direct Loans, CLOs, and Private Placements due to importance and relevance, increased public interest and the existence of some publicly available (rating agency) data.

The BMA will continue to contribute through additional publications and work together with stakeholders and regulatory colleagues to enhance our collective understanding of the risks associated with the broader structural shifts in the global life and annuity sector.