

# Instructions on Asset and Scenario Based Approach-related Approvals

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# Asset and SBA-related Approvals

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## Requirements, Fees and Process

In terms of the Rules (2024), approval is required for:

1. Use of:
  - a. Non-publicly traded assets;
  - b. Below investment grade assets;
  - c. Residential mortgages;
  - d. Commercial mortgages;
  - e. Structured assets;
  - f. Alternatives;
  - g. Long-term investment credit (“LTIC”) assets; and
  - h. Affiliated assets.
  
2. Default and downgrade costs for the above assets subject to a BMA-prescribed floor.

To obtain approval, for all assets, registrants shall provide the following information:

1. A supporting memo outlining:
  - a. The assets for which approval is required;
  - b. Any other related approvals required e.g., default and downgrade costs; and
  - c. The qualitative and quantitative basis of the application request covering, as relevant, the application requirements for each of 1a and 1b above. These requirements are outlined in the sections that follow.
  
2. Completed Lapse, Liquidity and Scenario Based Approach Return (“LLSBA”)

Review of an application will only commence after it has been confirmed the application is complete i.e., no critical information and data is missing.

For fee purposes, investment grade non-publicly traded assets, mortgage loans and structured assets shall be treated as one application. An aggregate fee of \$20,000 is applicable in line with the Fee Notice<sup>1</sup>. The Fee Notice outlines the fees for below investment grade, LTIC and default and downgrade costs. Affiliated assets are subject to a fee of \$20,000.

As stated in the Instructions Handbook<sup>2</sup>; *“For operational and efficiency purposes, applications for different types of assets (i.e., affiliated assets, assets acceptable on a limited basis, structured assets, other investment grade assets and long-term investment credit) can be made as one application, including a full listing of all assets i.e., those to be used in the SBA and surplus assets. The listing of assets should be on a BMA-provided template. Within the template, the application category under which the assets fall should be clearly identified. Relevant analysis should be provided as applicable to each asset category.”*

## General Requirements

The Instructions Handbook Section E6 (for legal entities) and E7 (for insurance groups) outline the broad

<sup>1</sup> <https://www.bma.bm/viewPDF/documents/2024-01-26-12-02-41-2024-Bermuda-Monetary-Authority-Fees.pdf>

<sup>2</sup> <https://www.bma.bm/viewPDF/documents/2024-05-23-13-22-06-2024-Year-End-Long-Term-Instructions-HandbookFinal.pdf>; <https://www.bma.bm/viewPDF/documents/2024-05-23-12-22-16-2024-Year-End-Insurance-Group-Instructions-HandbookFinal.pdf>

requirements that apply to all asset approvals. Additional requirements specific to each asset class are outlined below.

Companies will use best efforts to provide the requested information. Where specific components cannot be provided, the Company shall describe and demonstrate why the information is not relevant or how it manages risk in the absence of the requested information.

It is the Authority's expectation that for those areas requiring attestation e.g., appropriateness of investment spreads, such attestation shall also be included as part of the application. Guidance on attestations is provided in the Instructions Handbook.

Applications submitted to the Authority are expected to have gone through the insurer's governance system including demonstrating the review, assessment and conclusions from the relevant control functions e.g., the risk function.

## Asset Specific Requirements

### Affiliated Assets

The approval requirements for affiliated assets are outlined in the Instructions Handbook.

Registrants shall ensure the LLSBA return is completed and submitted with the application.

### All Other Investment Grade Assets (i.e., non-publicly traded investment-grade assets)

The approval requirements for all other investment-grade assets are outlined in the Instructions Handbook.

Registrants shall ensure the LLSBA return is completed and submitted with the application.

### Commercial Mortgage Loans ("CMLs")

Registrants shall complete the LLSBA return and at a minimum, populate all critical fields relevant to the risk assessment of CMLs, including the loan to value ("LTV") and Debt Service Coverage Ratio ("DSCR") fields. Applications lacking critical fields will be considered incomplete.

The application shall explicitly split the mortgages into those that the insurer assesses to qualify as investment-grade and those that should be treated as below investment grade, clearly outlining the criteria applied.

### Residential Mortgage Loans("RMLs")

Registrants shall complete the LLSBA return and at a minimum, populate all critical fields relevant to the risk assessment of RMLs including the loan to value ("LTV"), mortgage type/purpose, amortisation status, documentation and credit score (e.g., FICO where relevant) fields. Applications lacking critical fields will be considered incomplete.

The application shall explicitly split the mortgages into those the insurer assesses to qualify as investment grade and those that should be treated as below investment grade, clearly outlining the criteria applied.

### Below Investment-grade Assets

The approval requirements for all below investment grade assets (formerly 258E) are outlined in the SBA Rules and the Instructions Handbook. In addition, the specific regulations for each asset class must be adhered to; for instance, the standards for non-publicly traded assets will also apply to below-investment-grade non-publicly-traded assets.

### Long-term Investment Credit Assets

The approval requirements for all alternative assets are outlined in the SBA Rules and the Instructions Handbook.

## Alternative Assets

The approval requirements for all alternative assets are outlined in the SBA Rules and the Instructions Handbook.

## Structured Assets

The aim is to collect and assess structured asset exposure data on a deal-by-deal basis aggregated by asset type. If more detailed information is required for a specific deal, the BMA may request additional information e.g., on underlying collateral characteristics.

Registrants seeking approval for structured assets investments are required to:

1. Complete and submit the LLSBA return; and
2. Provide a memo addressing the requirements and expectations set out below.

## Requirements Specific to Structured Assets

### 1. Market Conditions and Spreads Overview

- 1.1. Describe the company's assessment of the state of the market for structured assets;
- 1.2. Describe the company's assessment of current spreads and its ability to continue earning SBA assumed spreads over the life of the liabilities; and
- 1.3. Discuss any trends and counter-trends observed in the structured assets market and the potential impact on the quality of assets held and to be held.

### 2. Investment Policy, Thesis and Risk Appetite

- 2.1. Describe the company's investment philosophy and compliance with the prudent person principle;
- 2.2. Describe the company's structured assets investment thesis and how the asset class fits into its broader investment philosophy;
- 2.3. Provide further detail on how the company's risk appetite is applied in the context of investing in structured assets and which factors are considered when making investment decisions for each structured asset class;
- 2.4. Describe how the company's investments in structured assets contribute to the objective of meeting the obligation of its liabilities.
- 2.5. Describe how the appropriateness of the allocation to structured assets is evaluated?;
- 2.6. Describe what factors and considerations influence the company's approach to use of structured assets e.g., whether they should be held to maturity or sold to raise liquidity. ; and
- 2.7. Outline the insurer's minimum visibility/transparency requirements of the underlying collateral that must be met before investing in structured assets.

### 3. Asset Listing and Portfolio Overview

- 3.1. Include an asset summary based on the asset listing in the attached spreadsheet – "Lapse, Liquidity and SBA Return";
- 3.2. Structured assets approval is provided in the context of the whole investment portfolio, i.e., it will not be reviewed in isolation. Therefore, it is important to first provide sufficient detail on the investment portfolio as a whole and then zoom in on structured assets;
- 3.3. Identify risk factors present in the company's investment portfolio for each structured asset class and, as applicable, provide the distribution of exposure to these structured asset risk factors for each structured asset class; and
- 3.4. As appropriate for each structured asset class, provide the distribution of exposure to various collateral characteristics, structures and risks.

### 4. Stress Testing

- 4.1. Materiality quantitative assessment: Discuss the impact on the SBA Best Estimate Liability (BEL) if the spreads from structured assets were replaced with spreads from other acceptable assets upon reinvestment. This is to assess any vulnerabilities that structured assets may introduce in SBA BEL and determine the extent of the impact. As part of supporting stress testing, the company must provide a brief description of how any such risk is mitigated/managed;
  - 4.2. Provide a quantitative assessment of the BEL and BSCR impact of downgrade risk, with a special focus on A-rated and below-rated assets. The assessment could include a combination of shocks to ratings as well as stresses to pricing/rating assumptions on default, correlation and recovery. The risk of SBA ineligibility (and impact) post-downgrade should also be assessed.
  - 4.3. Discuss the company's structured asset-specific stress testing and how/why this is assessed to be adequate.
  - 4.4. Provide the company's assessment of concentration risk for structured assets and key risk factors that affect their performance.
5. Attestation
- 5.1. Clear priority of payment exists (senior, mezzanine, equity);
  - 5.2. Bankruptcy risks are remote;
  - 5.3. Securitisation rules are compliant with industry standards; and
  - 5.4. Relevant audit work has been carried out on the deal/manager/collateral.

## SBA-specific Considerations

Provide details on how structured assets proposed to be used in the SBA satisfy the "predictable and stable cashflows" requirement. In addition, provide details on the assumptions used in modelling structured assets in the SBA, including:

1. Callability and Prepayments;
2. Liquidity, Matching and Cashflow Modelling;
3. Spreads and Reinvestment Risk;
4. Defaults and Downgrades (D&D); and
5. Fees and Expenses.

Where some structured assets are considered highly liquid by the applicant and the company wishes to request to treat these as sellable in the SBA, a broader assessment of the registrant's liquidity position should be provided and complemented with detailed supporting data and liquidity analysis specific to the respective structured asset class segment.

## Default and Downgrade Costs

The application for default and downgrade costs shall be included as part of the asset application including all the supporting analysis. For example, the default and downgrade costs for structured assets and mortgage loans shall be included in the application for structured assets and mortgage loans, respectively.

The Authority will review default and downgrade costs alongside the proposed assets, ensuring one review informs the other. Asset approval applications without an accompanying assessment and application for default and downgrade costs are considered incomplete and therefore will not be processed.

The Rules and the relevant sections of the Instructions Handbook outline the requirements applicable to default and downgrade costs, including the prescribed floors.