Tuesday, 31 December, 2024

CONSULTATION PAPER

Proposed Prudential Rules and Technical Standards for Class IILT Insurers, Enhancements for Class IIGB Insurers, Insurance Accounts Regulations 1980 and Insurance Returns and Solvency Regulations 1980

Comments to be received by Friday, 28 February 2025

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I. INTRODUCTION

1. This Consultation Paper (CP) sets out the Bermuda Monetary Authority's (Authority or BMA) proposed regulatory regime for Class IILT insurers and a number of enhancements to the regulatory regime for Class IIGB insurers.

2. The BMA introduced the Class IIGB and Class IILT license classes under the Insurance Act 1978 in 2019 and 2022, respectively. The Authority proposes to formalise the regulatory framework (i.e., annual return filing requirements) applicable to Class IILT insurers by exercising the power conferred to it by section 6A of the Insurance Act 1978 (the Act).

3. This CP also includes a number of housekeeping enhancements for the Insurance Accounts Regulations 1980 and Insurance Returns and Solvency Regulations 1980.

4. The BMA invites the insurance industry and other interested persons to share their views on the proposals set out in this paper. Comments should be sent to the Authority, addressed to RiskAnalytics@bma.bm, no later than 28 February 2025.

II. BACKGROUND

5. The BMA has seen in the last few years a number of market developments, including the convergence of insurance, capital markets, artificial intelligence and distributed ledger technology (such as blockchain and web3 applications), both with and without the use of digital assets. While still nascent at this stage, the BMA foresees that the insurance sector will progressively adopt the token economy to improve liquidity and risk transfer efficiency. Additionally, the current insurance capacity for digital asset businesses remains limited.

6. As more jurisdictions continue to implement regulatory frameworks for digital asset businesses, akin to Bermuda's Digital Asset Business Act 2018 (DABA) and the Digital Asset Issuance Act 2020 (DAIA), and as Bermuda's Digital Asset Business (DAB) sector continues to mature, the demand for insurance indemnity coverage in the long-term sector is expected to grow. It is, therefore, important that the BMA continues to build upon its previous works to enhance the legislative and regulatory frameworks to allow these businesses to operate in a responsible manner.

7. The introduction of Class IILT is in response to the innovations seen by the Authority in running its regulatory sandbox and innovation hub regimes since 2019. In May 2022, the BMA released a CP proposing new classes of insurers, including an innovative class for long-term insurers (Class IILT) as a counterpart to the innovative class for general business insurers (Class IIGB). This new class aimed to provide a suitable category for companies emerging from the sandbox, especially those with business models that do not align with traditional classes. The proposal aligns with the BMA's objective of safeguarding policyholders while fostering an environment conducive to innovation.

8. Class IILT is designed for innovative business models in the life insurance sector, such as but not limited to insurers utilising digital assets to receive life policy premiums, pay policy claims, and provide capital to support their insurance business.

9. It is important to note that this class will not be used as a means to circumvent legal and regulatory requirements or to allow an insurer to benefit from regulatory arbitrage. To achieve this, Class IILT insurers will follow the same regulatory framework as Class IIGB insurers, with full consideration of the unique risks in running a long-term business.

10. As emphasised in the previous CPs, while the regulatory approaches for Class IILT and Class IIGB are designed to meet the international insurance regulatory standards adopted by the International Association of Insurance Supervisors, these classes do not fall under commercial insurance frameworks. Instead, they align with the objectives of Limited Purpose Insurers, offering a fit-for-purpose framework that is appropriate for the nature, scale and complexity of the proposed business.

11. Consistent with the May 2022 CP, Class IILT insurers who also engage in activities licensable under the DABA and DAIA as part of their business model in Bermuda will be required to apply for the appropriate license in addition to an insurance license. In such instances, the Authority will exercise consolidated supervision to ensure a comprehensive understanding of the business risks and to enable the effective and efficient application of the respective regulatory frameworks.

III. PROPOSED REGULATORY FRAMEWORK FOR CLASS IILT

12. Similar to Class IIGB insurers, the BMA proposes that Class IILT insurers apply an appropriate internationally recognised accounting standard, such as the US, UK or Canadian (Generally Accepted Accounting Principles (GAAP), the International Financial Reporting Standards or any other accounting standards recognised by the Authority, as a starting point. Insurers then apply prudential filters to account for non-admitted assets to derive the statutory financial statements, which are audited by an approved auditor as required under Section 16 of the Act.

13. In cases where the GAAP has not provided valuation standards for digital assets, the BMA proposes to prescribe valuation and reporting standards. These will be outlined in the proposed prudential and technical rules and schedules, which will include appropriate disclosure requirements on the sources and methods of valuation.

14. Similar to traditional long-term classes, Class IILT insurers will also be required to appoint an approved actuary to opine on the adequacy of the company's long-term insurance reserves on an annual basis.

15. The Authority proposes that Class IILT insurers be required to meet the head office requirements of section 8C of the Act.

16. Class IILT insurers would be subject to a risk-based regulatory capital requirement based on a model similar to the Bermuda Solvency Capital Requirement-Small and Medium-Sized Entities (BSCR-SME). This model accounts for all material risks at 99% tail value at risk over a one-year

time horizon. The Enhanced Capital Requirement (ECR) will adhere to a minimum margin of solvency floor, comparable to the Class C requirement.

17. In the case of insurers incorporating digital assets into their business models, the Class IILT regulatory framework will provide the ability for the BMA to issue supervisory directions to tailor requirements to suit the characteristics of the business model proposed.

18. When a Class IILT insurer enters into an insurance contract that permits claims to be settled with a digital asset, the Authority will generally require that premiums and additional capital are collected in the same digital asset to mitigate basis risk.

19. Nevertheless, the proposed Class IILT BSCR model will include capital factor charges where assets and liabilities are mismatched while allowing for reasonable credits for naturally hedged and ring-fenced policies, subject to a floor charge. The BSCR model further includes capital charges for digital assets held by third-party custodians, as well as appropriate operational risk charges for insurers that opt for self-custody of digital assets. In addition to insurance-specific risks, the proposed model accounts for all other risks stemming from the use of digital assets, including but not limited to volatility and liquidity risks, counterparty, operational and technological risks, and regulatory and compliance risks.

20. Class IILT insurers are required to demonstrate, on an ongoing basis, a robust risk management framework to address related risks effectively, with emphasis on ongoing compliance with the Insurance and Cyber Risk Management Codes of Conduct and the Digital Assets Business Custody Code of Practice, as appropriate.

21. Further, Class IILT insurers will also be required to disclose sufficient information in the notes to their statutory financial statements, outlining their governance and risk management mechanisms covering the risks from the insurance and digital assets aspects of their business. A number of qualitative reports are also required to be attached to their filings, including but not limited to details around underwriting and investment strategy and policies, asset-liability matching policies, the risk management programme and current risk registers, digital asset custody policy, governance policies on the use of Artificial Intelligence (if applicable) and stress and scenario testing results among others.

22. A Solvency Self-Assessment (SSA) report will also be required to be submitted to the Authority as part of its annual filing requirements.

23. Consistent with other long-term classes, all Class IILT insurers are subject to sanctions and suspicious activity reporting regulations and, where applicable, will be considered as "anti-money laundering/anti-terrorist financing regulated financial institutions" under section 42A(c) of the Proceeds of Crime Act 1997.

24. The BMA also proposes that Class IILT insurers submit a quarterly financial report to provide interim supervisory information to the BMA, in addition to the annual filing requirements. Nonetheless, the Authority reserves the right to exercise enhanced supervision to allow for more frequent or real-time monitoring on a case-by-case basis.

25. Similar to other long-term classes, the registration and annual business fees for Class IILT insurers will be based upon total assets subject to a floor. Applications for modifications allowed within other regulatory frameworks will be permitted under the Class IILT regulatory framework using the same application process applicable to traditional classes.

IV. HOUSEKEEPING AMENDMENTS TO CLASS IIGB

26. In its regular review and in consideration of its ongoing engagement with the market in running its regulatory sandbox and innovation hub frameworks, the BMA identified a number of enhancements that need to be addressed in the regulatory framework for Class IIGB insurers. These proposed changes will ensure consistency of the legislative requirements applied to Class IIGB insurers in light of the proposed Class IILT regulatory framework.

27. Below is an outline of the key proposed amendments:

    a. Amend definitions, specific lines of the Statutory Financial Statements and Notes to the Statutory Financial Statements, and other reporting requirements to closely align with the Class IILT and commercial classes where appropriate;

    b. Distinguishing the digital asset risk incurred due to assets held by the insurer compared to assets held by a third-party custodian;

    c. Amendment of the definition relating to recognised stablecoins for the purposes of Class IIGB and Class IILT insurers;

    d. Introduction of a new Schedule IIG to reflect counterparty risks on digital assets held by custodians; and

    e. Obtain more information on digital assets and liabilities that are ring-fenced via Segregated and Separate Account structures.

V. HOUSEKEEPING AMENDMENTS TO INSURANCE RETURNS AND SOLVENCY REGULATIONS 1980 AND INSURANCE ACCOUNTS REGULATIONS 1980

28. The proposed amendments to the Insurance Returns and Solvency Regulations 1980 and the Insurance Accounts Regulations 1980 (together referred to as 'Regulations') are being put forth to amend the disparity noted between these Regulations and the Electronic Statutory Financial Return (ESFR) System. All proposed revisions will align these Regulations with the current ESFR requirements for all insurers utilising the ESFR System. The changes will capture areas that were

previously omitted and errors that were not highlighted during past reviews. The revisions will not impose any new filing requirements for the ESFR users.

29. Further, as a housekeeping exercise, the Insurance Accounts Regulations 1980 requires the removal of references to "innovative insurers”. The Authority did not intend for sandbox companies to file annual returns or be subject to cyclical prescriptive filing requirements. Instead, the BMA establishes tailored and more frequent regulatory and supervisory requirements for these companies, guided by their nature, scale, and complexity, to address the risks identified during the sandbox stage more effectively. This amendment will align the legislation with the current supervisory practice and eliminate confusion in the market.

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