

**Bermuda: Assessment of the Supervision and Regulation of the Financial Sector—  
Volume II—Detailed Assessment of Observance of Standards and Codes**

This detailed assessment of the observance of standards and codes in the financial sector of **Bermuda** in the context of the offshore financial center assessment program contains technical advice and recommendations given by the staff team of the International Monetary Fund in response to the authorities of **Bermuda's** request for technical assistance. It is based on the information available at the time it was completed in **January 2005**. The staff's overall assessment relating to financial sector regulation and supervision can be found in Volume I. The views expressed in these documents are those of the staff team and do not necessarily reflect the views of the government of **Bermuda** or the Executive Board of the IMF.

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**ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE  
FINANCIAL SECTOR**



**Volume II: Detailed Assessment of Observance of  
Standards and Codes**

**Bermuda**

**JANUARY 2005**

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## GLOSSARY

|         |  |
|---------|--|
| AML     | Anti-money laundering  |
| ALC     | Assessment and Licensing Committee                             |
| AML/CFT | anti-money laundering and combating the financing of terrorism |
| BDCA    | Banks & Deposit Companies Act 1999                             |
| BMA     | Bermuda Monetary Authority                                     |
| BMAA    | Bermuda Monetary Authority Act 1969                            |
| BSX     | Bermuda Stock Exchange   |
| BTI     | Banking, Trust and Investment                                  |
| CIS     | Collective Investment Scheme                                   |
| CFT     | combating the financing of terrorism                           |
| CP      | core principles  |
| DTI     | deposit taking institutions                                    |
| GN      | guidance notes   |
| IA      | Insurance Act 1978   |
| IAE     | independent assessment expert                                  |
| IBA     | Investment Business Act 1998                                   |
| OFC     | offshore financial center                                      |
| MFD*    | Monetary and Finance Systems Department                        |
| MOF     | Minister of Finance  |
| NAMLC   | National Anti-Money Laundering Committee                       |
| PCA     | Proceeds of Crime Act 1997                                     |
| PCMLR   | Proceed of Crime (Money Laundering) Regulations 1998           |
| SROs    | self-regulating organizations                                  |
| TRTBA   | Trusts (Regulation of Trust Business) Act 2001                 |

\* The IMF's Monetary and Exchange Affairs Department (MAE) was renamed the Monetary and Financial Systems Department (MFD) as of May 1, 2003. The new name has been used throughout the report.

## **I. BASEL CORE PRINCIPLES**

### **A. General**

1. This assessment of the current state of Bermuda's compliance with the Basel Core Principles for Effective Banking Supervision has been completed as part of the IMF Offshore Financial Sector (OFC) report. Completion of a formal assessment serves several purposes. First, it benchmarks the current state of banking supervision, recognizing that there have been extensive changes in the past few years. Second, it suggests a number of further improvements or changes. Thus, this report provides a key input for the development of an action plan to move toward full compliance with the Core Principles (CP). The assessment team<sup>1</sup> expresses its thanks to Ms. Cheryl-Ann Lister, Chairman and Chief Executive Officer; Mr. D. Munro Sutherland, Superintendent of Banking, Trust and Investment; Ms. Marcia Woolridge-Allwood, Deputy Director of Banking, Trust and Investment; and Mr. Simon Frew, Head of Banking and Trust, who cooperated in the completion of the assessment.

### **B. Information and Methodology Used for Assessment**

2. This assessment of the effectiveness of banking supervision was based on an examination of the legal framework, both generally and as specifically related to the financial sector, the self-assessment of the Core Principles, and extensive discussions with the staff of the Bermuda Monetary Authority, external auditors and the management of commercial banks.

### **C. Institutional and Macprudential Setting, Market Structure—Overview**

3. Bermuda's legislation provides for two types of license—full banks and deposit companies. Deposit companies are specialized local mortgage lenders, which are not permitted to offer current accounts, and which do not operate outside of Bermuda. Currently, there are four licensed banks and one deposit company. Two of the banks, Bank of Bermuda and Bank of N T Butterfield, have extensive specialized international operations, conducted through a mix of branches, subsidiaries, and affiliated companies. Their combined consolidated deposits represent more than 90 percent of the aggregated deposits of the banking sector. The two institutions provide a full range of retail, commercial, and private banking services, including investment and brokerage, custody, trust, and corporate services.

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<sup>1</sup> The team consisted of Mr. R. Barry Johnston (Mission Chief), Ms. Mary G. Zephirin (Deputy Mission Chief), Mr. Ian Carrington, Ms. Jennifer Elliott (all MFD), Messrs. Marcel Maes and Joel Shapiro (Consultants, Banking Supervision), Ms. Pauline Chasseloup de Chatillon and Mr. Wayne C. Metcalf III (Consultants, Insurance Supervision), Mr. Cheong-Ann Png (Consultant LEG), and Ms. Margaret Boesch (Mission Assistant, INS). An independent assessment expert, not under the supervision of the IMF, Assistant Superintendent Erwin Boyce of the Royal Barbados Police Force evaluated the law enforcement sections of the methodology.

4. The small number of licensed deposit-taking institutions in Bermuda are part of the broader financial intermediation sector, which represented 11.8 percent of GDP in 2002. This category includes banking, insurance and pension funding activities in the domestic economy. The insurance industry is by far the biggest contributor. Total employment in the financial sector amounted to 2,885 in 2002.

5. Typically, some 50 to 60 percent of the banks' income is fee based. The value of client assets and the volume of their activities are the main generators of this income. Therefore, in the present environment of sustained weak equity markets new business is being tapped to maintain or expand previous income levels. Fee income remains a key driver of banks' earnings. In 2002, revenue generated by community banking was limited to 18 percent for the largest bank in Bermuda.

6. The commercial banks set Bermuda dollar interest rates for savings accounts, mortgages, and loans. However, with the Bermuda dollar pegged to the U.S. dollar, interest rate changes in Bermuda generally track closely interest rate changes in the United States. Interest margins are also under pressure because of the continued low interest environment. Added pressure on interest rate margins is caused by the high level of liquid assets banks must carry on their balance sheet in the absence of a lender of last resort. In particular, the level of interbank deposits—fully a third or more of bank assets—engenders narrow margins.

7. On the other hand, efforts to reduce employee and occupancy costs that reflect the high cost of doing business on the island are continuing. One such initiative is the outsourcing of operational or back office activities.

8. Notwithstanding these built-in disadvantages, on an aggregate basis, Bermudian banks continue to perform well, principally because of the high profitability of non-traditional banking services. Their earning capacity continues to underpin capital growth, enabling aggregate capital to increase, enhancing the already strong position of the banks' supervisory capital ratios.

9. Liquidity risk is closely monitored by the BMA, especially since there is no lender of last resort or deposit insurance mechanism. The banks maintain highly liquid balance sheets, with limited appetite for traditional bank lending products and extensive portfolios of high quality marketable securities. At the end of September 2002, aggregate loans and advances represented only 22.6 percent of total assets.

10. Only one of the larger banks is engaged to some degree in proprietary trading activities. The three other banks engage in capital markets for hedging purposes or as a customer service. Two of these are small institutions—one with virtually no retail business and the other, which recently upgraded from a deposit company, has a business that is still virtually exclusively domestic in nature.

11. The banking market has been protected for many years, largely because of concern over the potential impact of additional competition on the existing major banks, which are also substantial local employers. Until recently, all banks have had to be local institutions, at



least 60 percent owned by Bermudians. This restriction has now been lifted, opening the way to foreign-owned banks. However, the legislation still provides for the licensing only of local companies not for branches of foreign banks. Moreover, the legislation requires banks to provide certain core products to the domestic market. While the Government has signaled that it would be prepared to see additional licenses granted to a small number of highly reputable international banks, these institutions would have to establish local subsidiaries and offer banking products locally in addition to the international business they would seek to develop.

12. BMA's supervision responsibilities have increased dramatically during the past few years. Its corporate governance structure has adapted to, and, generally, has been able to accommodate the growing workload and to maintain effective management oversight and control of its operations. Noteworthy is the initiation of a risk-focused on-site examination program, greater emphasis on corporate governance issues in its banks, and the issuance of policy statements describing BMA's approach to the prudential manner provision of BDCA's Second Schedule.

#### **D. General Preconditions for Effective Banking Supervision**

13. This assessment of Bermuda's compliance with the Core Principles required judgments by the assessment team. Banking systems differ from one country to another as do their domestic circumstances. Furthermore, banking activities are changing rapidly around the world, and theories, policies, and best practices of supervision are swiftly evolving. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the Bermuda authorities with a reliable measure of the quality of its banking supervision in relation to the Core Principles, which are internationally acknowledged as minimum standards.

14. The assessment of compliance with each principle is made on a qualitative basis. A four-part assessment system is used: compliant; largely compliant; materially non-compliant; and non-compliant. To achieve a "compliant" assessment with a principle, all essential criteria generally must be met without any significant deficiencies. A "largely compliant" assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority's ability to achieve the objective of that principle. A "materially non-compliant" assessment is given when the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance, but substantive progress had been made. A "non-compliant" assessment is given when no substantive progress toward compliance has been achieved. A Core Principle will be considered not applicable whenever, in the view of the assessor, the CP does not apply given the structural, legal, and institutional features of a country.

## E. Principle-by-Principle Assessment

Table 1. Detailed Assessment of Compliance of the Basel Core Principles

|                       |   |
|-----------------------|---|
| <b>Principle 1.</b>   | <p><b>Objectives, Autonomy, Powers, and Resources</b><br/> An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to the authorization of banking establishments and their ongoing supervision; powers to address compliance with laws, as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.</p>  |
| <b>Principle 1(1)</b> | An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.  |
| Description           | <p>The Bermuda Monetary Authority (BMA) is charged under Section 8 of the Banks &amp; Deposit Companies Act 1999 (BDCA) with full responsibility for supervision of the institutions licensed by it.</p> <p>The BMA was established by the Bermuda Monetary Authority Act 1969 (BMAA). The initial primary role of the BMA consisted of administering exchange control and issuing and safeguarding the integrity of Bermuda’s currency. It has evolved in the ensuing years into an entity with the key function of acting as the principal licensing and regulatory authority for Bermuda’s financial services sector.</p> <p>Section 3 of the BMAA lists the principal objects of the BMA. In addition to the monetary responsibilities Section 3 charges the BMA with responsibilities to:</p> <ul style="list-style-type: none"> <li>• supervise, regulate, and inspect any financial institution which operates in or from within Bermuda;</li> <li>• promote the financial stability and soundness of financial institutions;</li> <li>• supervise, regulate, or approve the issue of financial instruments by financial institutions or by residents; and</li> <li>• advise and assist the Government and public bodies on banking and other financial and monetary matters.</li> </ul> <p>Reference to these objectives is made in the annual reports of the BMA. The Amendment Act of 2002 added an additional principal object of assisting with the detection and prevention of financial crime.</p> <p>The BDCA represents the most recent update of the banking law (1999). An external review of the bank supervision process of Bermuda, “the KPMG report” (2000), identified a number of areas where enhancements were considered necessary. The BMA has addressed most of these issues. The only matter still outstanding is the recommended introduction of administrator provisions in insolvency law.</p> <p>Section 8 (2) of the BDCA also directs the BMA to keep under review the developments in the field of deposit-taking that appear to be relevant to the exercise of its powers and the discharge of its duties.</p> |

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|                       | <p>Beyond issues in the KPMG report the BMA has identified a few additional areas of improvement and amendments of the BDCA are presently being prepared.</p> <p>Section 8 (4) instructs the BMA to address an annual report to the Minister of Finance (MOF) and to publish a report on its activities. The annual report and quarterly “Regulatory Update and Notice” (now entitled “Quarterly Update”) informs the public of the financial situation and performance of the industry and of the regulatory, legislative, and other developments. BMA’s latest annual report also underscores the key priority of updating Bermuda’s financial regulatory legislation. A comprehensive BMA website is also available to the public.</p> <p>See also description under Principle 22.</p>  |
| Assessment            | Compliant  |
| Comments              |  |
| <b>Principle 1(2)</b> | Each such agency should possess operational independence and adequate resources.   |
| Description           | <p>The BDCA grants BMA a full licensing and intervention power. While the BMA is accountable to the Minister of Finance (MOF) (who also appoints the BMA’s Board of Directors), the BMA is under the direction of its own Board.</p> <p>According to Section 4 of the BMAA, the board is composed of eleven members. The Bermuda Monetary Authority Amendment (NO 2) Act 2001 stipulates that directors are appointed for a period of not less than three years and not more than five years. Directors can only be removed from office for reasons specified in the law, usually for misconduct and nonperformance.</p> <p>Three of the eleven board members are executive board members: the chief-executive member who is the chairman and who is appointed by the MOF, the Superintendent of Banking, Trust and Investment (BTI) and the Supervisor of Insurance. The BMA’s Board recommends and the MOF appoints the Superintendent and the Supervisor.</p> <p>The Banking &amp; Trust Department is responsible for the supervision of institutions licensed under the BDCA, persons licensed under the Trusts (Regulation of Trust Business) Act to conduct trust business, and Bermuda’s sole credit union. A head, supported by a team of six, manages Banking and Trust supervision operations.</p> <p>Banking and Trust also draws on the support of other areas of the BMA as required, notably the Legal, Authorization &amp; Compliance Division which is responsible for much of the authority’s external vetting of individuals, and which has a particularly close involvement in relation to anti-money laundering policies and practice.</p> <p>The exercise of most formal supervisory powers—licensing, intervention and revocation—is delegated by the Board to the Superintendent of BTI. Cases are considered by an internal body, the Assessment &amp; Licensing Committee, chaired by the Deputy Director and comprising a range of the authority’s management staff. This committee makes recommendations to the superintendent as to action that is to be taken.</p> <p>The MOF is able under the BDCA (Section 10) to give the BMA general policy directions, not inconsistent with the provisions of the Act.</p> <p>The BMA keeps the MOF informed of key issues in relation to its supervisory responsibilities, but the mission has been informed that the MOF is careful not to seek to intervene in matters of prudential judgment.</p> |

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|                       | <p>The BMA is funded from a mix of supervisory fees levied on the different industries, as well as from the income from U.S.-dollar investments held as backing for the issue of the local currency issue of bank notes and coin. The BMA generates positive net income each year, which is shared with the Government's Consolidated Fund in accordance with a formula, agreed with the MOF from time to time.</p> <p>The BMAA makes the BMA accountable to the MOF who has to give approval each year to the expenditure budget.</p> <p>As part of the BMA's transition to become a regulatory body with the degree of independence from government that is seen as necessary to meet fully the relevant international standards, the BMA developed its own self-standing rank and salary arrangements. Its implementation was completed in early 2003, enhancing the BMA's ability to compete in the market place for qualified staff.</p> <p>The annual budget allows for the appointment of professional experts, training, and travel expenses.</p>  |
| Assessment            | Largely compliant  |
| Comments              | <p>The MOF may give the BMA general policy directions, which are not inconsistent with the provisions of the BDCA, as to the performance of its functions and the BMA shall give effect to such directions.</p> <p>The mission has been informed that this power has never been exercised. However, the existence of this power, particularly since it is combined with the mandatory budget approval, may create the impression that its independence is not fully established. It is therefore recommended that the legislation be reviewed to deal with the concern that the MOF's policy direction and budgetary approval powers may intrude on the performance of BMA's functions.</p> <p>BMA keeps the resource requirements for banking supervision under regular review in light of its supervisory responsibilities. While staff resources have been increased to reflect enhancements to the process, notably the increased focus on on-site reviews, it might be prudent to move to a more clearly zero-based approach in estimating ongoing resource requirements.</p> <p>In this context and in view of the limited number of banks and deposit companies, and the constraints of the Bermudian labor market, the existing legal provision that enables the BMA to appoint professional experts, or to employ powers of Section 39 of BDCA more widely, may have to be used more systematically.</p> <p>Notwithstanding these comments, we consider that, broadly speaking, the operational independence of the banking supervisor has not been fundamentally affected in practice.</p> |
| <b>Principle 1(3)</b> | A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.  |
| Description           | <p>Central to the legal framework of banking supervision in Bermuda is the BMA. The BMA was established by the Bermuda Monetary Authority Act 1969 (BMAA).</p> <p>Section 8 of the BDCA charges the BMA with full responsibility for supervision of the institutions licensed by it. The Second Schedule of the BMAA specifies minimum criteria for licensing institutions.</p> <p>Section 9 of the BDCA also requires the BMA to publish a Statement of Principles in accordance with which it is acting or proposes to act in its supervision, licensing, and its power to obtain information, reports, and to require the production of documents. Pursuant to</p>  |

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|                       | <p>Section 9, the BMA has issued such a Statement of Principles.</p> <p>The BDCA was drafted in 1999 and was modeled quite closely on the U.K. Banking Act then in place.</p> <p>Together, the BMAA and the BDCA, which includes the Second Schedule and the Statement of Principles, provide a comprehensive framework for licensing and ongoing supervision of persons conducting a deposit-taking business in or from within Bermuda.</p> <p>In particular, the framework establishes clearly the minimum standards that banks and deposit companies must meet while providing for prudential rules to be set administratively, as required. The details of these procedures and requirements then appear in a series of additional policy papers under the BDCA. The BDCA includes a range of information powers as well as a number of sanctions.</p> <p>Section 11 of the BDCA specifies that no person can carry on a deposit-taking business in or from within Bermuda unless that person is a company incorporated in Bermuda and is licensed by the BMA as a bank or a deposit company.</p>   |
| Assessment            | Compliant   |
| Comments              |   |
| <b>Principle 1(4)</b> | A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws, as well as safety and soundness concerns.   |
| Description           | <p>The BDCA (Sections 35–41) provides a range of information requirements as well as powers to obtain information and reports.</p> <p>There are also additional powers (Section 42) to investigate where more serious concerns arise.</p> <p>The BDCA creates a number of formal offenses and penalties for breaches and non-compliance. It also provides a range of regulatory tools enabling the BMA to intervene when particular concerns may arise.</p> <p>The BDCA (Second Schedule: Minimum Criteria for Licensing) stipulates the minimum prudential criteria, which must be met on an ongoing basis by licensed institutions:</p> <ul style="list-style-type: none"> <li>• fit-and-proper character of all appropriate parties;</li> <li>• “four-eyes principle;”</li> <li>• the presence of non-executive directors;</li> <li>• criteria for business to be conducted in a prudent manner (prudential safety and soundness standards);</li> <li>• consolidated supervision;</li> <li>• integrity and skill in the way operations are conducted; and</li> <li>• minimum net assets.</li> </ul> <p>The effect of the BDCA is to provide the BMA with discretionary powers over when and how to intervene, having regard to its view of the seriousness of any concerns, which may arise.</p> <p>According to Section 17 of the BDCA, the BMA is authorized to restrict a license and impose such conditions as it thinks desirable for the protection of the institution’s depositors or potential depositors and for safeguarding its assets or otherwise. A number of possible</p> |

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|                       | <p>conditions are listed in Section 17 (2) of the BDCA. The description under CP 22 will deal more extensively with them.</p> <p>The legal framework in place is effectively applied by the BMA.</p>  |
| Assessment            | Compliant   |
| Comments              |   |
| <b>Principle 1(5)</b> | A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.   |
| Description           | <p>Section 8(4) of the BDCA provides legal protection for the BMA, its officers, and servants, against damages for acts or omissions in discharge or purported discharge of the regulatory functions, unless bad faith can be shown.</p> <p>There is a corresponding immunity from action, suit, or other proceeding provided under Section 4B of the BMA Act.</p> <p>The BMA’s budget provides for the necessary means to protect its staff against the costs of defending their actions while discharging their duties.</p>   |
| Assessment            | Compliant   |
| Comments              |   |
| <b>Principle 1(6)</b> | Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.   |
| Description           | <p>The BMA is the sole domestic supervisor with responsibilities for the soundness of the financial system.</p> <p>Section 52 of the BDCA prohibits the disclosure of information received under or for the purposes of the BDCA.</p> <p>However, Sections 53 and 54 of the BDCA identify the “gateways” available through which protected information can be passed on, including, in order to assist an overseas supervisory authority. According to Section 54 (3), the BMA must be satisfied that the authority is subject to restriction on further disclosure at least equivalent to those imposed in Sections 52 and 53.</p> <p>Furthermore, Section 55 confirms that the Section 52 disclosure prohibition also applies to information supplied to the BMA by a relevant overseas authority.</p>                    |
| Assessment            | Compliant   |
| Comments              |   |
| <b>Principle 2.</b>   | <b>Permissible Activities</b><br>The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word “bank” in names should be controlled as far as possible.   |
| Description           | <p>Section 14 (5) of the BDCA stipulates that the BMA may grant bank licenses and deposit company licenses.</p> <p>According to the same section, a banking license requires the institution to provide a number of minimum services to the public in Bermuda (demand deposits in Bermuda dollars, payment, and collection of cheques, drafts and orders, savings, or other similar accounts, overdrafts and other loan facilities in Bermuda dollars, loans secured by mortgage of real property in Bermuda, foreign exchange services, and credit or debit card facilities).</p> <p>A licensed deposit company is not authorized to accept deposits on current accounts or on terms that require repayment on demand. These institutions also are to provide the following minimum services to the public in Bermuda:</p> |

|                     |   |
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|                     | <ul style="list-style-type: none"> <li>• saving deposits in Bermuda dollars on terms which require repayment on notice;</li> <li>• loans in Bermuda dollars secured on the mortgage of real property not less than 60 percent of the balance sheet [Section 3 of “The Banks and Deposit Companies (Prescribed Minimum Percentage) Order 1999”].</li> </ul> <p>According to Section 58 of the BDCA, no person carrying on business in Bermuda shall use any name which indicates that he is a bank or banker or is carrying on deposit-taking business authorized under a banking license unless it is a licensed institution.</p> <p>In practice, there is close liaison between the BMA and the Registrar of Companies where concerns arise over proposals to incorporate companies or amend company names.</p>  |
| Assessment          | Compliant   |
| Comments            |   |
| <b>Principle 3.</b> | <p><b>Licensing Criteria</b></p> <p>The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization’s ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.</p>  |
| Description         | <p>Pursuant to Section 14 (2) of the BDCA, the Second Schedule defines the minimum criteria for licensing.</p> <p>According to Section 14 (3) the MOF, acting on the advice of the BMA, may by order amend the Second Schedule by adding new criteria or by amending or deleting existing criteria.</p> <p>Furthermore, according to Section 9 (1), the BMA has published a Statement of Principles in accordance with which it is acting or proposing to act in interpreting the criteria specified in the Second Schedule.</p> <p>The criteria deal with fitness and properness of directors, controllers (including full ownership structure) and senior executives; ‘four-eyes;’ and composition of the Board of Directors. Comprehensive questionnaires for senior executives, controllers, and directors have to be addressed to the BMA.</p> <p>The criteria also deal with business to be conducted in a prudent manner, including adequate capital, provisions, liquidity, systems of control, and record-keeping; consolidated supervision; integrity and professional skills; and minimum net assets of \$10 million in the case of a bank and \$1 million in the case of a deposit company.</p> <p>Additional material on the BMA’s view of the different requirements appears in the Statement of Principles and in the specific papers dealing with capital adequacy, liquidity, auditors, and reporting accountants (which also details internal control requirements), and consolidated supervision.</p> <p>The Statement of Principles also acknowledges the importance of the presence of non-executive directors and the need for audit committees.</p> <p>In practice, the BMA requires applications to include very extensive information on the proposed bank, including full details of ownership and related parties, detailed business plans, and financial projections for at least three years, details of the internal organization and control</p> |

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|                     | <p>systems to be imposed.</p> <p>Applications are analyzed and reviewed initially by the Banking &amp; Trust Department which, once all the necessary information is submitted, prepares a detailed assessment of the application for consideration by the BMA’s Assessment &amp; Licensing Committee (ALC). The ALC in turn makes a recommendation to the Superintendent.</p> <p>Bermuda has only a small number of licensed deposit-taking institutions. The legislation provides for two types of licenses—full banks and deposit companies. Deposit companies are specialized local mortgage lenders, which are not permitted to offer current accounts, and which do not operate outside of Bermuda. Currently, there are four licensed banks and one deposit company.</p> <p>Bermuda has not so far licensed any banks belonging to foreign banking groups. However, the BMA already liaises closely with overseas supervisors where there are entities with ownership connections to overseas institutions, and would not contemplate licensing a subsidiary or affiliate of an overseas bank without prior consent from the home supervisor having been obtained. This is already the case in relation to any proposal by a foreign bank to establish a company or limited partnership in Bermuda.</p> <p>The MOF must also have advised the BMA that he is satisfied that the granting of the license would be in accordance with the economic and financial policy of the government.</p> <p>Even where the BMA is satisfied that the criteria are or can be met, the BMA retains a residual discretion not to grant a license—notably, if it sees reason to doubt that the criteria will be met on a continuing basis, or if it considers that for any reason there might be significant threats to the interests of depositors or potential depositors.</p> <p>Section 18 (d) of the BDCA authorizes the BMA to revoke the license if it has been provided with false, misleading or inaccurate information in connection with an application for a license. The simple provision of inaccurate information renders the power exercisable. However, according to the Statement of Principles (4.6) the BMA would not consider exercising its power unless the inaccuracy was material, or symptomatic of wider prudential concerns.</p> |
| Assessment          | Compliant   |
| Comments            |   |
| <b>Principle 4.</b> | <p><b>Ownership</b><br/>Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.</p>   |
| Description         | <p>Sections 25 through 29 of the BDCA provide for controls over the ownership of banks. Anyone seeking to obtain an ownership interest of 10 percent or more of a licensed institution is obliged to serve written notice on the BMA, which then has three months in which to decide whether or not to object.</p> <p>The BMA can also object to an existing shareholder controller. Moreover, it can place restrictions on shares (e.g., to prevent the exercise of voting rights) in order to deal with a situation in which there is an unsatisfactory controller. Finally, it can apply to the Courts for a sale of specified shares to be ordered.</p> <p>The Banking &amp; Trust Department reviews all cases involving a proposed new controller, with assistance, as appropriate, from the Authorization &amp; Compliance Department. All cases are brought to the Assessment and Licensing Committee for consideration, other than where no effective change in ultimate beneficial ownership is involved, and the change is deemed purely technical, such as part of an internal group restructuring.</p>   |



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|                     | The Statement of Principles published pursuant to Section 9 of the BDCA describes in detail how the BMA deals with shareholder controller issues.  |
| Assessment          | Compliant  |
| Comments            |  |
| <b>Principle 5.</b> | <b>Investment Criteria</b><br>Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.  |
| Description         | <p>The BMA (Financial Institutions) (Control) Regulations 1994, Regulation 3 impose specific obligations on banks and their subsidiaries for the BMA’s prior written consent to be obtained in relation to all proposals to establish new branches or subsidiaries or to open representative offices.</p> <p>These provisions clearly predate the present BDCA. Under the current supervisory approach, the banks are aware that the BMA expects to be kept closely informed of all developments likely to have a material impact on their business, whether involving a new acquisition or establishment.</p> <p>All material proposed changes in business are reviewed for appropriateness, capital impact, and capacity of the institution to manage and control the operation effectively.</p> <p>BMA intends to study the process for requiring formal written notice and approvals to amend the overly administrative approach that exists at present.</p>   |
| Assessment          | Compliant  |
| Comments            |  |
| <b>Principle 6.</b> | <b>Capital Adequacy</b><br>Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.  |
| Description         | <p>Pursuant to Section 14 (2) of the BDCA, the Second Schedule requires licensed banks and deposit companies to maintain an amount of capital which is commensurate with the nature and scale of the institution’s operations and of an amount and nature sufficient to safeguard the interests of its depositors and potential depositors, having regard to:</p> <ul style="list-style-type: none"> <li>• the risks inherent to those operations;</li> <li>• the risks inherent in any operations of related entities so far as they are capable of affecting the institutions; and</li> <li>• any other factors which appear to the BMA to be relevant.</li> </ul> <p>The Statement of Principles that has been published pursuant to Section 9 of the BDCA outlines the BMA’s approach in this regard and “The Measurement of Capital,” a BMA policy paper, specifies the framework.</p> <p>Quarterly prudential returns to the BMA report on the implementation of the capital requirement, and pursuant to Section 39 of the BDCA, the external auditors have been asked to report on these prudential returns.</p> <p>The definition of capital is consistent with the Basel Capital Accord. Risk weightings are assigned to both on-balance sheet and off-balance sheet accounts. Banks are required to</p> |

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|                     | <p>maintain a minimum ratio of 10 percent on a consolidated basis. At the solo level, the standard 8 percent Basel ratio applies.</p> <p>When the new capital requirement was introduced in November 1999, the BMA opted not to develop a specific market risk calculation. This was based on the assessment that Bermudian banks undertake very little own account trading activity and so were unlikely to face material additional capital requirements for market risk at that time.</p> <p>Instead some individual risk asset weightings were increased in order to produce certain proxies for market risk that generate equivalent capital requirements. These involve, specifically, the 10 percent and 20 percent weightings attached to holdings of Zone A government securities and Zone B government securities denominated and funded in local currencies.</p> <p>In order to lessen the risk of the minimum required capital ratios (called “trigger ratios”) being breached, the BMA generally expects each institution to conduct its business so as to maintain its capital ratio at a margin above the trigger ratio. This higher ratio is referred to as the target ratio. Non-compliance with the trigger ratio constitutes an infringement of the minimum criteria for licensing described under Principle 1(4) and must be met on a permanent basis. Remedial measures taken by the BMA are summarized under Principle 22.</p> <p>However, in practice all international banks are operating at capital adequacy levels well in excess of the required 10 percent, so that no target ratios have been fixed up to now. The capital structure is composed almost entirely of Tier 1 components.</p> <p>The BMA intends, in due course, to move away from the standard ratios currently applying onto a more differentiated approach, having regard to the risk profile of individual institutions and the capacity of their management and systems to control the risks incurred. However, in view of the small size of the sector (four banks and one deposit taking institution) and the generally high levels of capital maintained, this has not been seen as a priority.</p> |
| Assessment          | Largely compliant  |
| Comments            | The absence of a specific market risk related capital charge is also commented upon under CP 12.   |
| <b>Principle 7.</b> | <p><b>Credit Policies</b></p> <p>An essential part of any supervisory system is the independent evaluation of a bank’s policies, practices, and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.</p>  |
| Description         | <p>The legal authority for assessing credit risk management policies, practices, and procedures is derived from Section 9 of the BDCA. In accordance with the terms of this Section, BMA has issued the Statement of Principles, which represents an interpretation of criteria for a number of prudential safety and soundness standards contained in the Second Schedule. Under the requirements of the Second Schedule, a bank’s business must be conducted in a “prudent manner,” and several requirements are outlined in the Second Schedule that banks must meet to be considered as conducting their business prudently. However, BDCA is clear that the listing in the Second Schedule is not exhaustive, and that BMA may consider a range of other criteria. One such criterion is policy and practice for credit risk management for the granting of loans and investment decisions.</p> <p>BMA is engaged actively in ensuring that the banks under its supervision have satisfactory policies and practices regarding the credit granting process and for investment decisions. As part of its on-site supervision program, BMA inaugurated periodic evaluations of credit-risk management in the banks under its supervision. The first such evaluations occurred in 2000. As part of its evaluation, BMA conducted an appraisal of each bank’s policy framework, its loan approval and administration procedures, assessment of processes governing analysis of</p>  |

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|                     | <p>borrowers, and internal credit risk exposure grading systems. BMA contemplates conducting these evaluations on a cycle determined by the size and complexity of each institution's credit portfolio and the soundness of its credit risk management policies and procedures.</p> <p>On a more limited basis, external auditors are expected to notify BMA of material deficiencies in credit risk management policy or practice. However, assessments of policies and practices in these areas are not the primary function of the auditors' work.</p> <p>The on-site evaluations are supplemented with direct meetings with senior management of each bank. At these meetings, weaknesses identified from the on-site work or from the results of either internal or external audits are discussed. These meetings are held semi-annually. Senior management is expected to brief BMA on corrective measures in the bank's credit risk management policies and procedures.</p>  |
| Assessment          | Compliant   |
| Comments            | <p>In aggregate, bank loans and advances, were \$3.992 million for the quarter ending September 30, 2002, or approximately 23 percent of total banking assets. The preponderance of banking assets are held for liquidity purposes, principally deposits with banks, and marketable securities.</p> <p>The credit risk assessment program has been designed to address the quality of the credit risk management process in Bermudian banks. The source information requested for review purposes is sound, and examiner judgments appear to be sound.</p>  |
| <b>Principle 8.</b> | <p><b>Loan Evaluation and Loan-Loss Provisioning</b></p> <p>Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan-loss provisions and reserves.</p>   |
| Description         | <p>In the Second Schedule, which is part of the BDCA, banks are required to maintain "adequate provision for depreciation or diminution in the value of assets, including provision for bad and doubtful debts, for liabilities that will or are expected to fall or to be discharged and for any losses which it will or it expects to incur." The provision must account for potential losses arising from guarantees or other off-balance sheet exposure as well. They must be recognized in accordance with generally accepted accounting principles.</p> <p>To monitor the level of its banks' loan loss reserves and provisioning policies, BMA collects information on a quarterly basis on loan classifications and reserves. The regulatory report includes on- and off-balance sheet exposures. These reports provide a reconciliation of the loan loss reserve and a distribution of loans by classification. The classification and provisioning policies, together with the overall quality of assets and sufficiency of loan loss reserves, are reviewed with senior bank management at prudential meetings BMA holds semi-annually with each bank. Provisioning policies and the level and adequacy of reserves also are reviewed by external auditors as part of their year-end audit of the financial statements. As part of their audit work, some testing of internal asset classifications by the external auditors is performed.</p> <p>BMA supplements its monitoring program with its cyclical on-site credit risk management review program. BMA examiners review a sampling of credits for adherence to credit policy and for completeness of credit files with respect to the credit approval process, bank generated credit analysis, and evidence that collateral has been properly recorded. Examiners generally do not assess the internal risk rating assigned by the bank to individual credits, nor do they directly assess the adequacy of loan loss reserves. If an unsafe or unsound banking practice is discovered during an on-site credit review, BMA requires the bank to take corrective measures. On-site credit reviews occur annually for Bermuda's smaller financial institutions and in a range of three to five years for the larger banks. More frequent evaluations would occur if credit quality was perceived to be deteriorating.</p> |

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| Assessment           | Largely compliant   |
| Comments             | <p>As part of its credit risk management examination program, BMA has as a primary objective the determination of the adequacy of credit risk management policies and procedures. BMA has developed criteria for classifying assets, which are reported quarterly on prudential returns. BMA relies heavily on external auditors to determine the level and adequacy of loan loss reserves. Reserves are accounted for in accordance with generally accepted accounting principles.</p> <p>The external auditors, when conducting the audit of the financial statements, review the provisioning policies of the bank and the actual level of provisions. External auditors consider the level of provisioning for off-balance sheet items in their assessment.</p> <p>BMA should consider reviewing the adequacy of a bank's internal loan rating system as part of its evaluation of the loan portfolio and credit risk management examination program. This would enable BMA to gain further perspective on the quality of the bank's credit risk underwriting practices, adherence to loan policy, and the bank's capabilities in managing and monitoring its outstanding loans.</p>  |
| <b>Principle 9.</b>  | <p><b>Large Exposure Limits</b><br/>Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.</p>  |
| Description          | <p>Section 38 of BDCA requires banks to report to BMA each credit risk exposure that represents 10 percent or more of its capital, and to seek prior consent from BMA in the event it proposes to raise its exposure above 25 percent. These restrictions apply equally to a group of connected borrowers. Banks must report both direct and indirect credit risk exposure and off-balance sheet credit risk.</p> <p>To implement Section 38 of BDCA, BMA has issued a policy notice on the implementation of reporting and control of large exposure. The policy statement reminds banks of the need to manage credit concentrations in industries, economic sectors or countries, and that they will have to demonstrate that they have internal systems in place, which will enable them to properly monitor and control these risks.</p> <p>Large exposures are reported to BMA quarterly as part of the required prudential return regimen. Under Section 39 of BDCA, the Large Exposure Report, as with other prudential returns, is subject to a random audit at the request of BMA by a bank's external auditors. Auditors would determine the accuracy of the returns derived from the bank's management information systems. To date, no such audit of the Large Exposure report has yet been directed for any bank.<sup>2</sup></p> <p>Each bank is required to submit to BMA a Board-approved policy addressing its approach and appetite for large credit risk exposures. BMA's examiners review adherence to the policy at on-site credit examinations.</p> |
| Assessment           | Compliant   |
| Comments             |   |
| <b>Principle 10.</b> | <p><b>Connected Lending</b><br/>In order to prevent abuses arising from connected lending, banking supervisors must have in</p>   |

<sup>2</sup> The authorities have reported that subsequent to the mission a large exposure report has been subject to auditor certification.

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|                      | place requirements that banks lend to related companies and individuals on an arm’s-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.  |
| Description          | <p>Under Paragraph 2.5 of the Statement of Principles issued pursuant to Section 9 of BDCA, BMA has broad powers to determine whether a bank is conducting its business in a prudent manner. BMA has interpreted the “prudent manner” provision to include a broad array of considerations, including lending activities.</p> <p>The policy on the Reporting and Control of Large Exposures provides another layer of control over these exposures. The policy statement explicitly directs lending institutions to negotiate connected lending exposures on an arm’s length basis. BMA also has deducted from Tier 1 capital certain types of connected lending—principally capital investment credit—granted by banks for capital adequacy purposes as a means to cause banks to lower the level of such lending. External auditors also review connected lending relationships. Such supervisory tools apparently have been successful in controlling abusive insider lending.</p> |
| Assessment           | Largely compliant   |
| Comments             | BMA’s on-site credit risk examinations did not review connected lending relationships to ensure they were granted on an arms length basis. Such lending should receive special attention during on-site examinations. BMA should consider expanding its policy statement addressing connected lending to ensure greater attention and control by the banks. BMA prudential requirements also could be expanded to require more detailed reporting of connected lending.   |
| <b>Principle 11.</b> | <p><b>Country Risk</b></p> <p>Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring, and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.</p>   |
| Description          | BMA’s policy framework has virtually no specific reference to country risk. In part, this is reflective of the low levels of country risk carried by banks in Bermuda. Most country risk exposure is to the United States, but there are low levels of exposure to countries in Western Europe and elsewhere. At present, there is no formal reporting methodology to BMA for country risk, and it has not been subject to systematic review during the on-site examination process. There has been one review of country risk during the off-site review process. However, a bank’s approach to managing its country risk exposure is gleaned through Board of Director approved policy statements on Large Exposures, which are submitted to BMA. BMA knows the country risk exposures in the banks.  |
| Assessment           | Largely compliant   |
| Comments             | BMA is studying ways to categorize country risk in the banking system at present, and does not plan to require reporting of these exposures until this analysis is completed. <sup>3</sup>  |
| <b>Principle 12.</b> | <p><b>Market Risks</b></p> <p>Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor, and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposure, if warranted.</p>  |
| Description          | <p>The BMA’s minimum licensing criteria require “business to be conducted in a prudent manner.” A number of considerations are taken into account in assessing whether an institution is prudently run.</p> <p>These include the management and corporate governance arrangements, the general strategy</p>   |

<sup>3</sup> Subsequent to the mission the authorities have reported that they are developing an additional element of the bank’s standard reporting package in order to routinely capture country risk.

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|                      | <p>and objectives, the planning arrangements, policies on accounting, lending and other exposures, and policies on interest rate matching.</p> <p>In assessing the institutions risk management capabilities, BMA also takes into account the expertise, experience, and track record of the management of the institution, its size and position in its chosen market.</p> <p>The BMA's policy on Auditors and Reporting Accountants (Annex C) sets out the BMA's requirements as regards banks' control systems, including that they must be able to identify, measure, monitor and control liquidity risk, foreign exchange risk and other market risks across all products. It is also required that relevant and accurate management information covering the exposures that the institution has entered into is provided to appropriate levels of management on a regular and timely basis.</p> <p>In its regular reviews of banks' systems and the internal control environment, the BMA reviews the extent of market risks to which banks are exposed, together with the systems in place to monitor and control these risks.</p> <p>This is a particular focus because the BMA has not so far amended its capital adequacy rules to include a specific charge for market risk (apart from open foreign exchange positions, which are risk weighted within the credit risk framework).</p> <p>This reflects the fact that the Bermudian banks have in the past had only limited exposure to other market risks, since they undertake very little trading activity.</p> <p>As a result, and as stated under CP 6, the BMA has applied certain additional weightings within the credit risk framework, to operate as a proxy for market risk.</p> |
| Assessment           | Largely compliant   |
| Comments             | <p>The BMA acknowledges that one bank has designated a material portion of its marketable portfolio as a trading portfolio. For that reason, the present proxy system for market risk will have to be replaced by a more appropriate system to define the capital charge for market risk.</p> <p>Pending the introduction of such a system the BMA is advised to continue the monitoring of market risk and prepare for the more fundamental changes that will have to be envisaged on the occasion of the introduction of the Basel II Accord.</p> <p>In the meantime, possible significant developments in the market risk of banks in Bermuda should lead the BMA to reflect on the introduction of alternative approaches (for example the introduction of an arbitrary extra capital requirement; the limitation of the volume of trading activities).</p>   |
| <b>Principle 13.</b> | <p><b>Other Risks</b></p> <p>Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks.</p>  |
| Description          | <p>The Second Schedule under BDCA requires banks to maintain adequate liquidity, measuring their liquid assets against actual and contingent liabilities. The Statement of Principles outlines specific factors that must be considered in maintaining adequate liquidity, including the quality of management, adequacy of internal control systems, market position, diversity of funding sources, matching policies, and the institution's borrowing capacity. BMA has issued a policy statement on prudential liquidity. Banks are expected to place their assets and liabilities in time bands depending on their remaining time to maturity. To ensure that banks have adequate</p>   |

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|            | <p>liquidity to meet their obligations, a maturity mismatch approach is adopted and banks' excess liabilities over assets in specified time bands are measured as a percentage of total deposit liabilities. Mismatches are monitored for all currencies, and no common standard or limit is applied to all institutions. Individual mismatch guidelines have been set for each institution. Banks are required to monitor their liquidity position on a daily basis and submit a liquidity return to BMA on a quarterly basis. As a memorandum item, details of banks' net-open positions in foreign currencies are reported on the liquidity return.</p> <p>Under Section 39 of BDCA, external auditors can verify the accuracy of the liquidity report at the discretion of BMA, or review processes for managing other types of risk as well. Audited financial statements contain tables providing interest rate sensitivity gap analysis, foreign exchange and interest rate contracts and currency exposure, and other information on derivative financial instruments. BMA examiners review bank policy statements on the risks inherent in these activities, discuss issues related to managing these risks at prudential meetings, and perform some on-site examination work in this area, principally of internal control processes.</p> <p>During on-site examinations, BMA examiners review and assess the adequacy of internal controls and operational risk in targeted aspects of a bank's operations. In addition, BMA relies on the work of internal and external auditors and its prudential meetings with senior management</p> <p>BMA has the authority, in accordance with the Second Schedule, to require a bank to hold capital against any risks. The Statement of Principles relates that in assessing capital adequacy, BMA will measure capital against foreign exchange risk, interest rate and position risk, and liquidity risk. At present, this is an important line of defense for BMA in ensuring banks manage interest rate and market risk satisfactorily.</p> |
| Assessment | Largely compliant   |
| Comments   | <p>Banks in Bermuda are not aggressive position takers. Banks are primarily deposit gatherers, whose business strategies result in relatively low positions in foreign exchange and low levels of interest rate risk. Nevertheless, these risks exist. While bank limits and internal control processes are reviewed by BMA examiners during on-site examinations, BMA also should consider augmenting on-site examination techniques and practices pertaining to these risks. These examination processes should be designed to confirm the existence and application of an effective and comprehensive risk management process for interest rate risk and financial derivative instruments. For example, a review of the bank's stress testing capabilities and techniques would provide BMA with a more robust understanding of banks' management of these activities</p> <p>It has become established practice in some business lines, particularly those related to capital markets activities, to outsource certain aspects of the business—especially operational and back office work—to third party service providers. To reduce costs and increase efficiency, banks are exploring possible ways of outsourcing additional non-revenue generating operations. On a case-by-case basis, BMA has given a non-objection to the outsourcing of operations. While not yet at a high level, BMA should consider issuing a policy covering the standards banks should consider in outsourcing operations, and reiterate that BMA may conduct on-site examinations of</p>   |

<sup>4</sup> Subsequent to the mission the authorities developed a policy on outsourcing and report that the policy has been implemented.

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|                      | the service provider in areas pertaining to the servicing of BMA’s constituent financial institutions. <sup>4</sup>   |
| <b>Principle 14.</b> | <p><b>Internal Control and Audit</b><br/> Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls, as well as applicable laws and regulations.</p>   |
| Description          | <p>The Second Schedule under BDCA stipulates that “an institution shall not be regarded as conducting its business in a prudent manner unless it makes or, as the case may be, will maintain adequate accounting and other records of its business and adequate systems of control of its business and records.” Paragraph 4(7) and 4(8) of the Statement of Principles states the records and systems in a bank must be such that the institution is able to fulfill the various other elements of the prudent conduct criteria and to identify threats to the interests of depositors and potential depositors. BMA also has issued a policy statement on the Relationship with Auditors and Reporting Accountants of Banks and Deposit Companies. The policy stipulates the BMA’s requirements for adequate accounting, records, and internal control systems. The requirements address accounting and other records, management information, internal control systems, and the control environment and corporate governance. Features of control systems are expected to include: organizational structure, monitoring procedures, segregation of duties, authorization and approval, completeness and accuracy, and safeguarding of assets.</p> <p>BMA reviews internal control systems as part of the on-site examination program. In the course of these reviews, BMA examiners test the efficacy with which they are performed and adherence to policy and procedure. In addition, external auditors, in connection with their annual audit and certification of a bank’s financial statements, reach an opinion on whether the internal control system is adequate for the nature and scale of the bank’s business. Management letters are issued by the external auditors for the benefit of bank management describing weaknesses that must be corrected. BMA receives a copy of the management letter, and the issues raised in the letter are discussed at the trilateral meeting.</p> <p>Internal audit is viewed as a valuable part of the compliance function in banks. BMA, during the course of on-site examinations, reviews the adequacy and efficiency of the internal audit function, including unfettered access to bank information and independence and reporting lines. BMA seeks to ensure that issues raised by internal auditors are resolved by bank management.</p> <p>During the past two years, BMA has placed renewed emphasis on the importance of a capable internal audit function. BMA has used moral suasion to cause banks to raise the competence and independence of internal auditors. BMA also has required banks to enhance its corporate governance in this area by requiring banks to establish, expand, and enhance the authority of Board of Director Audit Committees. BMA requires that these Committees be comprised solely of non-executive directors; that they have formal terms of reference; meet frequently with the internal auditor and, at least annually, with the external auditor; and that they have explicit authority to investigate matters within its terms of reference and have access to information.</p> <p>The supervisory review process includes meetings with bank management and external auditors. The nature of these trilateral meetings is to review issues raised during the audit process and to review management initiatives to resolve issues.</p> |
| Assessment           | Compliant   |
| Comments             |   |



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| <b>Principle 15.</b> | <p><b>Money Laundering</b><br/>Banking supervisors must determine that banks have adequate policies, practices, and procedures in place, including strict “know-your-customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.</p>  |
| Description          | <p>The Proceeds of Crime Act 1997 (PCA) and the Proceeds of Crime (Money Laundering) Regulations 1998 (PCMLR) comprise Bermuda’s anti-money laundering legislation.</p> <p>As provided in Section 49 (1)(b) of the PCA, the National Anti-Money Laundering Committee (NAMLC) has issued Guidance Notes (GN) on the Prevention of Money Laundering. These GN, which are based on similar GN issued by other jurisdictions, are not mandatory but represent good practice. The trial court may take account of any relevant guidance issued by the NAMLC.</p> <p>The BMA acknowledges that the primary consequences of any significant failure to measure up to these GN will be legal ones. However, it has informed the NAMLC that it is entitled to take, and will take, such failure into consideration in the exercise of its supervision, regulation, and inspection of financial institutions.</p> <p>Part II of the GN is addressed to regulated institutions generally, whereas Part III sets out additional guidance for different types of financial services.</p> <p>The GN requires the regulated institutions to perform their duty of vigilance for the purpose of money laundering by having in place a number of appropriate procedures covering the following elements:</p> <ul style="list-style-type: none"> <li>• verification;</li> <li>• recognition and reporting of suspicious transactions;</li> <li>• keeping of records; and</li> <li>• training.</li> </ul> <p>For the past 2 years, banks’ adherence to the requirements imposed on financial institutions under the PCMLR (and the related detailed GN) has been one of the aspects that is specifically reviewed by the BMA in each of its on-site inspection visits.</p> <p>Prior to these on-site examinations the bank has to complete and submit to the BMA Form POC (Proceeds of Crime). This document facilitates review of compliance with the POC legislation. Each bank has to attach a copy of its anti-money laundering procedures for review by the BMA.</p> <p>The authority conducts testing of compliance through interviews with relevant staff and sample testing of client files to ensure that policies are adhered to and necessary information and documentation is held.</p> <p>Sections 44 (3) and 46 (1) of the POC provide a safe harbor from any duty of confidentiality for bona fide disclosures of information.</p> |
| Assessment           | Compliant  |
| Comments             |  |
| <b>Principle 16.</b> | <p><b>On-Site and Off-Site Supervision</b><br/>An effective banking supervisory system should consist of some form of both on-site and off-site supervision.</p>   |
| Description          | Sections 39, 40, and 41 of BDCA provide the legal basis for collecting supervisory information   |

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|            | <p>and to perform on-site supervision work. Section 39 enables BMA to obtain information and reports and establishes the ability to obtain prudential returns. Section 40 has an explicit provision that underpins BMA’s ability to obtain information on a consolidated basis—specifically from a parent company, subsidiary, or related company. Section 41 provides right of entry to obtain information and documents and establishes the authority for the performance of on-site examinations</p> <p>BMA conducts risk-focused on-site examinations. Pre-examination planning consists of analysis of information received from prudential returns, from the results of meetings with bank senior management, and from the results of internal and external audits. Examiners assess the risks and issues and determine the scope of on-site work for the year. The institution is notified of the examination work that will be performed during the year, and prior to the examination, BMA examination staff obtains policy and procedure manuals and other information that is reviewed prior to the on-site phase of the examination.</p> <p>On-site examinations are used to: check for compliance by the bank with the law; provide independent verification that adequate risk management and internal control systems are in place and are working; determine that information provided to bank management is reliable; and evaluate the condition of a bank and its prospects. Where other regulatory disciplines, principally trust services are involved, examiners with experience in those disciplines participate in the examination to assist with better understanding of the overall risk profile of the bank.</p> <p>On-site risk focused examinations have focused on credit and treasury functions, anti-money laundering policies and practices, and internal control systems. Perceived high-risk areas are examined more frequently. BMA also may conduct ad hoc on-site examinations, at such time as the need arises, with respect to special issues. Examination findings are reported to senior bank management.</p> <p>External auditors are used to determine that prudential and statistical data provided by banks is reliable. As part of the annual audit, BMA also expects the external auditors to perform a review of the internal control systems and risk-management processes in each bank to the degree the auditors feel is warranted in connection with the audit process.</p> <p>Off-site monitoring involves the submission of various periodic returns such as quarterly reporting of capital adequacy, liquidity, monitoring of large credit exposure and foreign exchange positions, and consolidated financial statements. The returns are reviewed for compliance with requirements for large exposures and capital requirements. It also ensures that they are meeting their requirements to produce audited accounts in a manner and time determined by BMA.</p> <p>Other off-site supervision includes monitoring media and the market place, exchanging information with other supervisors, and visits from overseas personnel, directors, compliance officers, external auditors, and host country regulators. Regularly scheduled meetings with senior management of each bank held at least three times per year, together with trilateral meetings involving bank management and external auditors, enhance communication and the exchange of information on each bank.</p> |
| Assessment | Largely compliant   |
| Comments   | <p>BMA should be commended in its efforts to enhance the structure and approach to on- and off-site supervision. In particular, the adoption and application of a risk-focused examination approach has enabled BMA to concentrate resources on high-risk areas in the banking system. The series of meetings with bank management has proven to be a valuable source of information and means to assess competency of management and resolution of outstanding</p>   |

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|                             | <p>supervisory issues. Nevertheless, BMA recognizes there are areas that are in need of strengthening.</p> <p>The examination objective, that is, to ensure that higher-risk banking areas are subject to more in-depth supervision on a timely basis, may be difficult to achieve with the existing complement of staff. While staff employed is well qualified, there is a resource deficit, and BMA staff may be unable to devote sufficient time and resources to assessment of some areas of risk. At present, interest- rate risk, derivative instruments and hedging activities, and information technology are areas of risk that need greater on-site attention. Credit risk management in the larger institutions is examined once every three to five years for the two larger institutions. Outside expertise in specialized areas should be brought in to supplement work performed by BMA examiners.</p> <p>A comprehensive manual covering on-site supervision policy and examination procedure does not exist. Such a manual would preserve current examination practice in writing, would reflect BMA policy, and would ensure continuity in application of procedures as staffing changes. The manual also would serve as a basis for modifying or enhancing examination procedures as the industry changes, and new business lines are introduced, and other high risk areas are identified.</p> <p>A more standardized regimen to document examination conclusions also is warranted. At present, working papers reflecting the work done in an area subject to examination are limited. A work paper regimen documenting conclusions, in addition to the memoranda describing examination results, provides evidentiary support for examination conclusions, and also documents the work that was completed during the examination.</p> <p>While a degree of analysis of prudential returns has occurred, this data has not been as fully exploited as possible in a proactive manner. Use of the data collected to analyze trends and to compare the two larger banks in the system would be a very useful supervisory tool.</p> |
| <p><b>Principle 17.</b></p> | <p><b>Bank Management Contact</b><br/>Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.</p>   |
| <p>Description</p>          | <p>Sections 39, 40, and 41 of BDCA provide the legal basis for conducting meetings with management at all levels of the banking organization.</p> <p>Semi-annual prudential meetings with senior bank management are held with all four licensed banks. Operational matters such as group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management, and outstanding supervisory issues are discussed at these meetings. In addition, an annual meeting is held with management to review strategic plans and budgetary issues. Meetings are held as well at the conclusion of on-site examinations.</p> <p>BMA's understanding of its banks clearly is enhanced by the series of meetings it conducts. Furthermore, the close physical proximity of BMA to all the banks and their management allows BMA to monitor industry and systemic issues in a timely manner.</p> <p>BMA has imposed certain information conditions on its banks. Specifically, senior management must inform BMA of significant changes in the nature of its business prior to its implementation and of changes in senior management and the Board of Directors. Further, senior management must notify BMA as soon as they become aware of any material adverse development in the bank's operations.</p> <p>In addition, external auditors are required to communicate to BMA on significant issues that come to their attention in the course of their audit work. A trilateral meeting involving BMA,</p>  |

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|                      | bank management, and the external auditor is held annually to review the results of the external audit.   |
| Assessment           | Compliant   |
| Comments             |   |
| <b>Principle 18.</b> | <b>Off-Site Supervision</b><br>Banking supervisors must have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.  |
| Description          | <p>The prudential returns require statistical data, both on- and off-balance sheet for assets and liabilities, profitability, capital adequacy, liquidity, large exposures, loan loss provisioning, foreign currency positions, and loan classifications. Information on industry segmentation of assets and liabilities also is required.</p> <p>Instructions for the prudential returns state that each return must be submitted to BMA within 20 working days of each quarter end. Returns are required to be signed by a person considered to be senior enough to commit the bank. On a routine basis, returns for capital adequacy and large exposures are reported to BMA both on a consolidated and unconsolidated basis. Liquidity and foreign exchange exposure returns are reported on an unconsolidated basis. BMA relies on liquidity reporting mandates by local supervisory agencies for reporting of liquidity at overseas offices of its banks and relies on exchanges of information with those authorities to keep informed of material events or adverse circumstances relating to liquidity. Foreign exchange exposures for overseas offices of Bermudian banks are reported on a net basis for each currency on the capital adequacy return.</p> <p>Quarterly returns are verified on a sample basis by external auditors at the direction and discretion of BMA. During 2002, external auditors were directed to review the Capital Adequacy Return for accuracy. Inaccurate returns would be required to be re-submitted if errors are significant. Materially inaccurate returns or failure to submit returns on a timely basis could subject the bank to levying of money penalties by a court of law.</p> <p>As a general rule, returns are reviewed for compliance with law, regulation, and BMA policy. At present, little ratio or trend analysis is performed. Information from the returns is used in preparation for discussions with management.</p> |
| Assessment           | Largely compliant   |
| Comments             | <p>The collection of supervisory information on prudential returns is reasonably detailed, but BMA does not take full advantage of the data collected for analytical purposes. As a result, BMA does not have a comprehensive and fully integrated off-site supervision function. In part, this weakness results from inadequate in-house information technology capabilities, which are being addressed. Limited resources also contribute to the problem.</p> <p>BMA collects sufficient data to create a peer group for its two larger banks, which would enable BMA to compare performance more easily and to follow trends from one financial period to another in all four banks, at least for their domestic operations. A rudimentary early warning system also could be created. As part of such an elevated off-site function, BMA also would have the performance data to assign internal ratings to each of its banks, which could be utilized by the on-site examination function as part of its targeted examination program.</p>   |
| <b>Principle 19.</b> | <b>Validation of Supervisory Information</b><br>Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.   |
| Description          | Sections 39, 40, and 41 of BDCA are the relevant legal authority under which there are no restrictions on BMA's access to information about any aspect of a bank's business. In practice, BMA uses a combination of on-site examinations of targeted risk areas and the work of external and internal auditors. These aspects of the supervisory process have been described in greater   |

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|                      | <p>detail in Principles 14, 16, and 18.</p> <p>The on-site supervisory program concentrates on reviewing the areas in a bank’s operations that are considered to be of higher risk. Examination resources are devoted to identifying and monitoring those risks, and on-site work has the objective of ensuring that risk-management processes in each bank are satisfactory.</p> <p>Supervisory work carried out by external auditors on behalf of BMA, with the exception of the annual audit, always is performed under special request of BMA and has been limited to a verification of a prudential return or a special investigation. Only international audit firms with an appropriately skilled work force in Bermuda are permitted to provide audit services to banks. The audit work is supplemented by trilateral meetings held with bank management and the auditors. External auditors also are obligated under Section 49 of BDCA to report matters of significant supervisory importance to BMA.</p>   |
| Assessment           | Largely compliant  |
| Comments             | <p>BMA’s policies and practices reflect high levels of validation of supervisory information. An important degree of reliance is being placed on the work and opinions provided by external auditors.</p> <p>It would be useful for BMA to employ the provisions of Section 39 of BDCA more widely as a means to increase the synergies with external auditors. Under this Section, BMA could request the external auditors to broaden the scope of their work to include business lines or operations where BMA has not focused resources, in part, because of staffing restraints and, in part, because it lacks the in-house capabilities. Thus, external auditors could further supplement the work of BMA examiners. Alternatively, outside experts may be retained by BMA on an ad hoc basis.</p>  |
| <b>Principle 20.</b> | <p><b>Consolidated Supervision</b><br/>An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.</p>   |
| Description          | <p>The Second Schedule, Paragraph 5, of BDCA requires BMA to be satisfied that institutions that are members of wider groups or have ownership links with other entities are not constructed in such a way as to obstruct the conduct of effective consolidated supervision. The Statement of Principles indicates that this “reflects the fact that BMA conducts its prudential supervision on both a solo and consolidated basis in order to ensure that any risks to an institution arising as a result of its membership of a wider group are fully taken into account.” BMA, therefore, undertakes an overall evaluation—both quantitative and qualitative—of the strength of a group to which an institution belongs. BMA also has issued a policy statement articulating its approach to consolidated supervision.</p> <p>As part of its on-site examination program, BMA targets branches and subsidiaries located in overseas locations for targeted on-site examinations. The examinations leverage off work performed by the external auditors, the bank’s internal auditors, and the host country supervisor. Ultimately, the examination is intended to assist BMA in taking a view on the ability of the bank to manage its business risks globally, and to ensure that management-information systems provide sufficient and accurate information from which management decisions, both operational and strategic, must be made.</p> <p>Banks are required to produce annual audited accounts containing consolidated financial information on all aspects of their business globally. Typically, the same audit firm, retained by the bank as auditors in Bermuda, is charged with performing work globally and prepares the consolidated audit reports.</p> |

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|                      | <p>All activities of the banks are discussed during semi-annual prudential meetings. Investment or fiduciary business conducted by the banks requires a separate license from BMA and also is regulated by BMA. The Banking and Trust Division works closely with other supervision units in BMA to gain an understanding of the risks these activities have for the bank and to gain a perspective of risk for the institution on a consolidated basis.</p> <p>Prudential returns for capital adequacy, for financial statements, and for large exposures are reported on a consolidated basis, and BMA measures capital on a consolidated basis.</p> <p>BMA has an ongoing and continuous dialogue and exchange of information with host country supervisors concerning the affairs of branches and subsidiaries in host countries. The dialogue concerns supervisory issues and market intelligence.</p>   |
| Assessment           | Compliant   |
| Comments             |   |
| <b>Principle 21.</b> | <p><b>Accounting Standards</b><br/>Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.</p>  |
| Description          | <p>The Companies Act of 1981 requires banks to be audited by a reputable accounting firm in accordance with generally accepted accounting principles. Sections 46, 47, and 48 of BDCA set standards for the appointment of auditors, the duty to audit, and the submission of audit reports to the bank. In accordance with BDCA, every institution must appoint annually an approved auditor to audit the institution's financial statements; an annual audit of the financial statements must be performed, and the results must be reported to the institution. Audited financial results also must be reported to BMA within four months after the end of each financial year. As a practical matter, the MOF has recognized the Institute of Chartered Accountants in Bermuda, which through its professional rules, imposes on its member firms accounting standards and generally accepted accounting principles accepted in the United States and Canada.</p> <p>BMA has published a policy statement describing BMA's requirements for adequate accounting, records and internal control systems. The statement is part of a broader policy statement describing BMA's relationship with auditors and reporting accountants of banks and deposit companies. In accordance with the policy, banks are required, inter alia, to "capture and record on a timely basis and in an orderly fashion, every transaction and commitment which the institution enters into...provide details, as appropriate, for each transaction and commitment,...and maintain financial and business information in such a manner as to enable management to identify, measure, monitor and control risk." BMA requires banks to appoint auditors, which it expects will be from an internationally recognized accounting firm. An approved auditor is defined as a person approved by the MOF for the purposes of the BDCA. The BMA has to approve the reporting accountant and can decline to approve a firm in the event questions arise about the abilities, qualification, or integrity of a particular firm. Under these circumstances, BMA may proceed to commission additional audit-related work from a reporting accountant at the bank's expense.</p> <p>Banks are all subject to an annual audit and are periodically subject to on-site examinations by BMA. Audits are conducted on a consolidated basis in accordance with generally accepted accounting principles, and the auditor's opinion must express the fact that the bank's accounts are prepared in accordance with these principles. Examinations determine, in part, that accounting processes and internal control systems are in accordance with BMA policy. Quarterly prudential returns have to be verified by external auditors to ensure that the data have been extracted correctly from the bank's records and compiled in conformity with the BMA's</p> |

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|                      | <p>instructions for the reporting of data.</p> <p>There is regular and open communication between BMA and external auditors, including an annual meeting to review audit results, the audit process, and the suitability of significant accounting policies. Audited accounts and auditor’s management letters are submitted to BMA each year.</p>  |
| Assessment           | Compliant   |
| Comments             |   |
| <b>Principle 22.</b> | <p><b>Remedial Measures</b></p> <p>Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.</p>   |
| Description          | <p>BMA has powers under BDCA Sections 17 and 18 to restrict bank activity or a license or to revoke a bank license. Under Section 17, “BMA“ may restrict a license by imposing such conditions as it thinks desirable for the protection of the institution’s depositors, and for safeguarding its assets...” To do so, BMA may:</p> <ul style="list-style-type: none"> <li>• require the institution to take certain steps or to refrain from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way;</li> <li>• impose limitations on the acceptance of deposits, the granting of credit, or the making of investments;</li> <li>• prohibit the institution from entering into any other transactions or class of transactions;</li> <li>• require the removal of any director, controller, or senior executive; and</li> <li>• specify requirements to be fulfilled otherwise than by action taken by the institution.</li> </ul> <p>BMA may revoke an institution’s license in the event it has not fulfilled all the criteria outlined in the Second Schedule. These criteria address certain safety and soundness standards, which banks must perform in a prudent manner and include maintaining adequate capital, adequate liquidity, adequate provisions for depreciation or diminution in the value of assets, and adequate accounting systems, records and internal control systems.</p> <p>BMA also has powers to object to potential controllers or shareholders of banks and to existing controllers or shareholders under Sections 25, 26, and 27 of BDCA.</p> <p>In practice, BMA seeks remedial action through informal means, principally, through the use of moral suasion. Prudential meetings and examination results are the principal vehicles employed by BMA to ensure compliance with prudential standards. In certain circumstances, BMA has the power to require a court of law to impose money penalties under BDCA for non-compliance with certain criteria. BMA is able to apply sanctions against management and the board of directors.</p> |
| Assessment           | Largely compliant   |
| Comments             | Legal provisions are in place enabling BMA to take regulatory action against a noncompliant bank. However, the law is silent regarding the actions that may be taken in the event of an impending bank failure or should there be cause to intervene for some other reason relative to  |

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|                             | <p>its financial condition. Revocation of the bank license does not resolve this problem. Under such circumstances, it would be appropriate for current legislation to be amended that would provide BMA with more direct intervention tools over such a bank in the interests of depositors—and more broadly—in the interests of financial stability. The intervention tools, inter alia, should enable BMA to facilitate the survival of the institution as a going concern or a more advantageous realization of its assets than would be achieved in its liquidation.</p> <p>During this stage, it would not be possible for creditors or others to force the bank into liquidation or receivership, or to take or continue with legal proceedings against the bank. The enactment of such legislation would provide for an important modern legal tool.</p> <p>BMA also should consider presenting the results of on-site examinations and efforts to enforce compliance with the prudential manner standards to each bank’s Board of Directors or its Audit Committee.<sup>5</sup> Ultimately, it is the Board of Directors that is responsible for the bank being operated prudentially. In this connection, examination reports should be addressed to the Board or the Audit Committee, and this body should be required to respond to supervisory issues contained in the examination report. If there are on-going supervisory issues that BMA must cause the bank to resolve, and cumulatively are material in nature, the Board must be informed directly through one of its regularly scheduled meetings or at a special meeting. BMA is able to apply sanctions against management and the Board of Directors.</p>   |
| <p><b>Principle 23.</b></p> | <p><b>Globally Consolidated Supervision</b><br/>Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures, and subsidiaries.</p>  |
| <p>Description</p>          | <p>As indicated in Principle 20, the Second Schedule, Paragraph 5, of BDCA requires BMA to be satisfied that institutions that are members of wider groups or have ownership links with other entities are not constructed in such a way as to obstruct the conduct of effective consolidated supervision. The Statement of Principles indicates that this “reflects the fact that BMA conducts its prudential supervision on both a solo and consolidated basis in order to ensure that any risks to an institution arising as a result of its membership of a wider group are fully taken into account. BMA, therefore, undertakes an overall evaluation—both quantitative and qualitative—of the strength of a group to which an institution belongs. BMA also has issued a policy statement articulating its approach to consolidated supervision. The policy is applied to Bermuda’s banks on a globally consolidated basis. The Statement of Principles addresses this issue by indicating that “supervision of banks engaged in international business is a shared responsibility, and BMA has regard to the general allocation of responsibilities which has been agreed between home and host authorities under the Basel (Core) Principles.”</p> <p>BMA has applied the policy statement by undertaking on-site examinations of the branches and subsidiaries of Bermudian banks located overseas, engaging in on-going dialogues with host country supervisors on a range of issues related to Bermudian banks in the host country jurisdictions, requiring most prudential returns to be prepared and reported on a consolidated basis (incorporating the activities of overseas locations), having financial statements of its banks audited on a consolidated basis (with the audit firm retained performing audits of the overseas</p> |

<sup>5</sup> The authorities have reported that the practice of communicating exam findings and compliance actions to members of the banks’ boards of directors was adopted subsequent to the mission.



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|                      | <p>locations), and as part of prudential meetings with senior management.</p> <p>On-site examinations seek to verify the adequacy of the internal control environment, of compliance issues, the quality of management information and adherence to bank policy and procedure. The underlying objective of these examinations is to ascertain whether senior management in Bermuda is managing the risks of the institution appropriately both in the overseas office and on a consolidated basis. Thus, BMA ensures that sufficient management information is provided to the bank's head office. These examinations utilize the results of internal and external audits, meetings with management, and on-site work done by the host country supervisor.</p> <p>On an annual basis, BMA meets with all officers in charge of the material overseas operations in a single meeting to discuss strategic plans, financial results, market conditions, and supervisory issues. This meeting is, in addition to the semi-annual prudential meetings, held with senior management located in Bermuda.</p> <p>BMA staff obtains information on the senior management of subsidiaries and branches of Bermudian banks to satisfy themselves that they are fit and proper. Active subsidiaries and branches are required to have available for BMA their audited financial statements.</p> <p>Under its licensing regimen, the establishment of a branch or subsidiary (or its acquisition) must be approved by BMA prior to its commencing business activities. While BMA has no express powers to close overseas offices, it could threaten action against the institution in the event of an impediment to consolidated supervision, a breach of the prudent manner criterion, or other provisions in the Statement of Principles.</p> |
| Assessment           | Compliant   |
| Comments             |   |
| <b>Principle 24.</b> | <p><b>Host Country Supervision</b><br/> A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.</p>   |
| Description          | <p>Bermuda banks have overseas operations in Western Europe, North America, the Caribbean, and the Far East. BMA has by necessity developed good working relationships with supervisors in these jurisdictions.</p> <p>Bilateral meetings are held regularly with host country supervisors concerning specific offices in the host countries, the overall framework of supervision in which the banking group operates, and significant supervisory problems if they occur. BMA presently has two Memoranda of Understanding in operation governing the exchange of information with host country supervisors. In all other cases, information exchanges and the overall relationship with other host country supervisors are conducted informally, but equally successfully. BMA prefers to conduct these relationships without a Memorandum of Understanding, maintaining that these documents can serve to make the relationship more restrictive in nature, but are receptive to these arrangements if other jurisdictions so desire.</p> <p>When on-site examinations occur in the host country jurisdiction, BMA examiners meet with the supervisor to explain the examination scope and discuss results of the examination.</p> <p>BMA serves on a number of multilateral committees and belongs to several multilateral organizations on which other bank supervisors are members. Membership facilitates the exchange of supervisory information, discussion of international best practices in bank supervision and prudential bank management.</p>   |

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|                      | BMA only permits its banks to operate in countries where it can have an exchange of information on supervisory issues that may affect its banks.  |
| Assessment           | Compliant   |
| Comments             |   |
| <b>Principle 25.</b> | <b>Supervision Over Foreign Banks' Establishments</b><br>Banking supervisors must require the local operations of foreign banks to be conducted with the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.   |
| Description          | At the time of the mission there were no banks licensed in Bermuda that were part of foreign banking groups. BDCA does not preclude the licensing of subsidiaries of foreign banks, and BMA would be amenable to a small number of foreign banks establishing operations in Bermuda. These banks would have to comply with the requirement to service the local market, and would therefore have to introduce retail products and compete in the retail market.<br><br>The operations of foreign-owned banks in Bermuda would be subject to the identical BDCA provisions applying to Bermudian banks and to the same supervisory regime. As noted previously, BDCA makes full provision for the passing of relevant information to a home country supervisor with a view to the conduct of globally consolidated supervision. There also is no obstacle to on-site visits to Bermuda by relevant home country supervisors. |
| Assessment           | Not applicable  |
| Comments             |   |

Table 2. Summary Compliance of the Basel Core Principles

| Core Principle                                     | C <sup>1/</sup> | LC <sup>2/</sup> | MNC <sup>3/</sup> | NC <sup>4/</sup> | NA <sup>5/</sup> |
|--|-----------------|------------------|-------------------|------------------|------------------|
| 1. Objectives, Autonomy, Powers, and Resources     |                 |                  |                   |                  |                  |
| 1.1 Objectives                                     | X               |                  |                   |                  |                  |
| 1.2 Independence                                   |                 | X                |                   |                  |                  |
| 1.3 Legal framework                                | X               |                  |                   |                  |                  |
| 1.4 Enforcement powers                             | X               |                  |                   |                  |                  |
| 1.5 Legal protection                               | X               |                  |                   |                  |                  |
| 1.6 Information sharing                            | X               |                  |                   |                  |                  |
| 2. Permissible Activities                          | X               |                  |                   |                  |                  |
| 3. Licensing Criteria                              | X               |                  |                   |                  |                  |
| 4. Ownership                                       | X               |                  |                   |                  |                  |
| 5. Investment Criteria                             | X               |                  |                   |                  |                  |
| 6. Capital Adequacy                                |                 | X                |                   |                  |                  |
| 7. Credit Policies                                 | X               |                  |                   |                  |                  |
| 8. Loan Evaluation and Loan-Loss Provisioning      |                 | X                |                   |                  |                  |
| 9. Large Exposure Limits                           | X               |                  |                   |                  |                  |
| 10. Connected Lending                              |                 | X                |                   |                  |                  |
| 11. Country Risk                                   |                 | X                |                   |                  |                  |
| 12. Market Risks                                   |                 | X                |                   |                  |                  |
| 13. Other Risks                                    |                 | X                |                   |                  |                  |
| 14. Internal Control and Audit                     | X               |                  |                   |                  |                  |
| 15. Money Laundering                               | X               |                  |                   |                  |                  |
| 16. On-Site and Off-Site Supervision               |                 | X                |                   |                  |                  |
| 17. Bank Management Contact                        | X               |                  |                   |                  |                  |
| 18. Off-Site Supervision                           |                 | X                |                   |                  |                  |
| 19. Validation of Supervisory Information          |                 | X                |                   |                  |                  |
| 20. Consolidated Supervision                       | X               |                  |                   |                  |                  |
| 21. Accounting Standards                           | X               |                  |                   |                  |                  |
| 22. Remedial Measures                              |                 | X                |                   |                  |                  |
| 23. Globally Consolidated Supervision              | X               |                  |                   |                  |                  |
| 24. Host Country Supervision                       | X               |                  |                   |                  |                  |
| 25. Supervision Over Foreign Banks' Establishments |                 |                  |                   |                  | X                |

<sup>1/</sup> C: Compliant.

<sup>2/</sup> LC: Largely compliant.

<sup>3/</sup> MNC: Materially non-compliant.

<sup>4/</sup> NC: Non-compliant.

<sup>5/</sup> NA: Not applicable.

## F. Recommended Action Plan and Authorities' Response to the Assessment

### Recommended action plan

Table 3. Recommended Action Plan to Improve Compliance of the Basel Core Principles

| Reference Principle                          | Recommended Action   |
|--|--|
| 1.2 Independence                             | <p>The MOF's powers to give directions to the BMA and the budgetary approval procedure have the potential of intruding on the operational independence of the latter. It is recommended that the law be reviewed to deal with any concern about the independence of BMA.</p> <p>An in-depth analysis of the resources required to fulfill the supervisory objectives is recommended, together with an action plan describing implementation of the objectives.</p> |
| 6 Capital adequacy and<br>12 Market risk     | <p>Envisage the replacement of the present proxy system for trading risk by a more appropriate capital requirement system.</p>   |
| 8 Loan Evaluation and Loan Loss Provisioning | <p>BMA relies principally on external auditors to evaluate the quality of assets and the adequacy of provisioning. BMA should consider reviewing the adequacy of a bank's internal rating system as part of its evaluation of the loan portfolio and credit risk management examination program. Prudential reporting of connected lending by banks needs to be improved and further enhancements to corporate governance in this area are warranted.</p>          |
| 10 Connected Lending                         | <p>BMA should enhance its current policy addressing connected lending to ensure that banks monitor and control these exposures satisfactorily.</p> <p>BMA examiners should routinely review these relationships as part of the on-site examination program.</p>  |

| Reference Principle                 | Recommended Action  |
|-------------------------------------|---|
| 11 Country Risk                     | BMA should establish a formal reporting methodology to facilitate the monitoring of country risk exposure in its banks.   |
| 13 Other Risks                      | <p>BMA should consider augmenting on-site examination techniques and practices designed to confirm the existence and application of an effective and comprehensive risk management process for interest rate risk and financial derivative instruments, and the adequacy of information technology systems.</p> <p>Issuance of a policy on outsourcing of bank operations also should be considered.<sup>6</sup></p>  |
| 16 On-site and Off-site Supervision | <p>Staffing issues are of concern in view of the bank supervision mandate assigned to BMA, an increase in the number of professionals and the breadth of their expertise should be considered. Alternatively, the use of outside professional experts could be explored.</p> <p>A comprehensive examination manual reflecting bank supervision policy and examination procedure is warranted to preserve current examination practice, reflect BMA bank supervision policy and ensure continuity in application of procedures as staffing changes.</p> <p>A more standardized regimen to document examination conclusions also is warranted by adopting a more formalized system of working papers reflecting the work performed during on-site examinations.</p> |
| 18 Off-site Supervision             | <p>BMA should consider enhancing the off-site supervision function by analyzing the data obtained in prudential returns more vigorously, in addition to utilizing the data for checking compliance with law and regulation.</p> <p>The data can be used to compare performance of the banks in the system, analyze trends, and to create an early warning system.</p>   |

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<sup>6</sup> Subsequent to the mission the authorities developed a policy on outsourcing and report that the policy has been implemented.

| Reference Principle                      | Recommended Action   |
|--|--|
| 19 Validation of Supervisory Information | It would be useful for BMA to employ the provisions of Section 39 of BDCA more widely as a means to increase BMA's synergies with external auditors. BMA should consider the use of external auditors for additional work to complement BMA's examination regimen in capital markets activities, information technology, or in other predetermined areas. This would enable BMA to capitalize on strengths the auditing firms have in disciplines such as information technology, and permit BMA to allocate its examination resources still more efficiently. |
| 22 Remedial Measures                     | It would be appropriate for current legislation to be amended that would provide BMA with more direct intervention tools in the event of an impending bank failure.<br><br>BMA also should consider communicating examination results and efforts to enforce compliance with the prudential manner standards to each bank's Board of Directors or its Audit Committee. <sup>7</sup>  |

### Authorities' response

The BMA welcomes the assessors' recognition of the quality of Bermuda's banking legislation, the effectiveness of the supervisory framework that has been put in place and the resulting high degree of compliance with the relevant international standards. Bermuda's provisions are kept under regular review to ensure that they remain adequate. Currently, the BMA (in common with banking regulators in many other jurisdictions) is engaged with the banking industry in a detailed review of aspects of the current approach as part of its preparations for implementing the Basel II capital accord framework on which international agreement has recently been reached. The assessors have endorsed the BMA's view that the present supervisory framework offers a strong foundation which can continue to be adapted and developed to provide the types of enhancements that will be required in the future. The BMA has reviewed with great interest the specific recommendations of the assessors for enhancements to current processes. As part of its consultation with industry on the continuing development of the supervisory framework, therefore, the BMA will be advancing particular proposals intended to deal with various of the matters identified by the assessors as warranting some further enhancement.

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<sup>7</sup> The authorities have reported that the practice of communicating exam findings and compliance actions to members of the banks' boards of directors was adopted subsequent to the mission.

## II. ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

### A. General

#### Information and methodology used for the assessment

15. A detailed assessment of the anti-money laundering (AML) and combating the financing of terrorism (CFT) regime of Bermuda was prepared by a team of assessors that included staff of the International Monetary Fund (IMF), an expert under the supervision of the IMF and an expert not under the supervision of the IMF who was selected from a roster of experts in the assessment of criminal law enforcement and non-prudentially regulated activities. IMF staff and the expert under the supervision of the IMF reviewed the relevant AML/CFT laws and regulations, and supervisory and regulatory systems in place to deter money laundering (ML) and financing of terrorism (FT) among prudentially regulated financial institutions. The expert not under the supervision of the IMF reviewed the capacity and implementation of criminal law enforcement systems.

16. The team consisted of Messrs. Ian Carrington (MFD), Cheong-Ann Png (Legal Consultant) working under the supervision of the IMF, and Assistant Superintendent Erwin Boyce of the Barbados Police Force (IAE).

17. This assessment is based in part on discussions on AML/CFT issues with the representatives of the following organizations, all of whom were most helpful and cooperative in the preparation of this assessment: the Ministry of Finance; the Bermuda Monetary Authority; the National Anti-Money Laundering Committee; the Attorney General's Chambers; the Office of Director of Public Prosecutions; the Bermuda Police Service; the Financial Investigation Unit; and the Collector of Customs.

18. Information used for this assessment is obtained from: the Proceeds of Crime Act 1997 (PCA); the Proceed of Crime (Money Laundering) Regulations 1998 (PCMLR); the Guidance Notes on the Prevention of Money Laundering (1998) ("1998 Guidance Notes"); the Guidance Notes on the Prevention of Money Laundering (Fiscal Offences) (2001) ("2001 Guidance Notes," the 1998 Guidance Notes and the 2001 Guidance Notes together "NAMLC Guidance Notes;" see below for the definition of NAMLC); the Revenue Act 1898 ("RA"); the Criminal Justice (International Cooperation) (Bermuda) Act 1994 ("CJICBA"); the Terrorism (United Nations Measures) (Overseas Territories) Order 2001 ("Terrorism Order"); the Bermuda Monetary Authority Act 1969 ("BMAA"); the Banks and Deposit Companies Act 1999 ("BDCA"); the Insurance Act 1978 ("IA"); the Insurance Amendment Act 2001 ("IAA"); the Investment Business Act 1998 ("IBA"); the Trusts (Regulation of Trust Business) Act 2001 ("TRTBTA"); the Credit Unions Act 1982 ("CUA"); and the Companies Act 1981 ("CA").

19. For the purpose of this assessment, financial institutions ("FIs") are: any deposit-taking institutions (namely bank or deposit company) as defined in the BDCA; any insurer as defined in the IA; any investment services provider as defined in the IBA (as well as

collective investment scheme); any trust service provider as defined in the TRTBA; the BIU Members' Credit Union Co-Op Society ("Credit Union"); the business of company service provider and the business of bureau de change.

### **Overview of measures to prevent money laundering and terrorism financing**

20. Bermuda was established in 1612 and comprises seven main islands connected by bridges and a large group of coral islands in the Atlantic Ocean about 650 miles east of Cape Hatteras, North Carolina. It is an Overseas Territory of the United Kingdom and is the oldest self-governing territory of the Commonwealth. The Bermuda Constitution Order 1968 establishes the current parliamentary system and maintains Bermuda's status of self-government with a high degree of control over its own affairs, save for defense, internal security and international affairs where it relies on the United Kingdom to extend to it relevant provisions, including provisions from international conventions and treaties, (for instance, Bermuda is not a member of the United Nations and relevant orders are extended to Bermuda under the United Kingdom United Nations Act 1946). Bermudian legislation should comply with the same obligations to which the United Kingdom is subject.

#### ***Legal and institutional framework***

21. At the international level, the United Kingdom extended to Bermuda its ratification of the UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1998) ("Vienna Convention") and the United Nations Security Council Resolution 1373 (2001) ("UN Resolution 1373"). Bermuda is a member of the Caribbean Financial Action Task Force ("CFATF"). Its Financial Investigation Unit ("FIU") is a member of the Egmont Group of Financial Intelligence Units.

22. At the national level, the principal AML/CFT legislation includes the PCA, the PCMLR, the PCAA, the NAMLC Guidance Notes, the RA, the CJICBA, and the Terrorism Order. The PCA criminalizes the offense of money laundering and provides practical measures for its enforcement. The scope of predicate offenses under the PCA as amended includes any indictable offense in Bermuda other than a drug trafficking offense and any act or omission which, had it occurred in Bermuda, would have constituted an indictable offense other than a drug-trafficking offense. The PCMLR and the 1998 Guidance Notes impose requirements for customer due diligence, record keeping and suspicious transaction reporting and the 1998 Guidance Notes provide further details. The 2001 Guidance Notes provide guidance for circumstances where the predicate offense involves tax evasion. The CJICBA provides for mutual legal assistance between Bermuda and other countries and territories.

23. The Terrorism Order was passed by the Crown under the United Nations Act 1946 to extend the provisions under the UN Resolution 1373 to its Overseas Territories, including Bermuda, and to the sovereign base areas of Akrotiri and Dhekelia. In general, legislation for international affairs for Bermuda is reserved to the Crown pursuant to the Constitution of Bermuda, and Section 1 of the United Nations Act 1946 provides for the Crown to pass appropriate provisions by way of Order in Council to its Overseas Territories and sovereign



bases wherever the UN Security Council calls upon the United Kingdom to apply measures to give effect to a decision of the Council. The Terrorism Order is applicable in Bermuda without incorporation under local law. The Terrorism Order serves as Bermuda's CFT legislation to prohibit the collection and provision of funds, making available funds or financial services and holding of funds for the purpose of terrorism, and the facilitation of the foregoing (Terrorism Order, Sections 3, 4, 5, and 6). At the time of the mission terrorism per se however is not criminalized in Bermuda as an offense under the penal legislation and therefore is not a predicate offense for the purpose of the AML legislation. There was work underway to determine whether specific offenses are needed for terrorism (cf NAMLC, Amendments to Proceeds of Crime Legislation and Guidance Consultation Paper, December 2001 ("Consultation Paper")).<sup>8</sup>

24. The PCA is a penal legislation and is of general application. It replaces its predecessor, the Drug Trafficking Suppression Act 1988. The PCMLR is applicable to certain regulated institutions as set out in the PCMLR ("Regulated Institutions"), namely any licensed deposit-taking institution,<sup>9</sup> any registered insurer<sup>10</sup> to the extent that it is carrying out long-term insurance (but not reinsurance) business within the meaning of the IA other than life insurance or disability insurance; an investment provider licensed under the IBA; any trading member of the Bermuda Stock Exchange resident or with a place of business in Bermuda;<sup>11</sup> any trading member of the Bermuda Commodities Exchange ("BCX") or

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<sup>8</sup> Subsequent to the mission a draft bill "the Anti- Terrorism (Financial and other Measures) Act 2004," which addresses a number of the above-mentioned concerns, was laid in Parliament in July 2004.

<sup>9</sup> Deposit-taking institutions are required to be companies incorporated in Bermuda and hold either a banking license or a deposit-company license granted by the BMA (BDCA, Section 11(1)). Exemptions under the Banks and Deposit Companies (Exemption) Order 2001 include any person carrying on deposit-taking business who is registered under the IA or who is licensed under the IBA, provided that accepting deposits is in the course of the business which the person is registered or licensed for. Deposit-taking institutions are supervised by the BMA.

<sup>10</sup> Insurers are required to be registered as long-term business insurers or general business insurers and to maintain a principal office in Bermuda (IA, Section 3). Licensing was previously under the ROC, an office of the Ministry of Finance, but has since been transferred to the BMA under the Insurance Amendment Act 2001. Insurers used to be supervised by the Ministry of Finance but have since the transfer of licensing to the BMA been supervised by the BMA.

<sup>11</sup> In general, investment service providers are required to hold a license granted by the BMA (IBA, Section 3). Exemptions under the Investment Business (Exemption) Order 1999 are (i) a person who is not a market intermediary and provides investment services exclusively for a sophisticated private investor, a high net worth private investor and a high income investor (together described in this report as "High-End Investors"); (ii) a body corporate in which all the shareholders are High-End Investors; (iii) a partnership in which all the partners are High-End Investors; (iv) a trust in which all the beneficiaries are High-End Investors; (v) a body corporate with minimum net assets of \$5 million; (vi) an unincorporated association or a trust with minimum net assets of \$5 million; (vii) or a collective investment scheme approved under the BMA (Collective Investment Scheme Classification) Regulations 1998 (together described in this report as "Exempt Investment Service Providers"). Investment service providers are supervised by the BMA.

member of the Bermuda Commodities Exchange Clearing House (“BCECH”),<sup>12</sup> resident or with a place of business in Bermuda; any person processing subscriptions or redemption related to a collective investment scheme; any licensed trust service provider;<sup>13</sup> the Credit Union;<sup>14</sup> any person authorized by the BMA to offer currency exchange services; any person whose application to be a voluntary regulated institution has been approved under the PCMLR (“Voluntary Regulated Institution”); (PCMLR, Regulation 2(2)).

25. The PCMLR is not applicable to long-term insurers providing reinsurance, life insurance and disability insurance, as well as general business insurers<sup>15</sup> (together “Exempt Insurers”) (see also discussion under Criterion 44 for Analysis of Effectiveness); Exempt Investment Service Providers (as defined in Footnote 4); service providers for companies, partnerships and limited partnerships (together “Company Service Providers”); and professionals such as accountants and lawyers (see the discussion under Criterion 44).

26. NAMLC Guidance Notes are applicable to the regulated institutions, which means that they are only applicable to the same categories of persons to which the PCMLR is applicable (as set out above). The Guidance Notes do not, strictly speaking, fall within the scope of legislation, decree, regulation or other rule that is mandatory and for which sanctions are imposed for non-compliance. They are distinguished from subsidiary legislation, such as regulations passed pursuant to Section 30 of the BMAA or Sections 49(3) and 65 of the PCA. They were issued by the NAMLC as guidance under Section 49(1)(b) of the PCA in recognition of the risk to which the financial services industry in Bermuda is exposed by money laundering and represent the standard expected of regulated institutions. The NAMLC Guidance Notes are therefore not regarded as “law” in the formal sense and not treated as having the force of law for the purpose of assessing the legal and institutional

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<sup>12</sup> It should be noted that the BCX and the BCECH are no longer in operation.

<sup>13</sup> Trust service providers are required to hold either (i) in the case of a company, an unlimited trust license; or (ii) in the case of a partnership or an individual, a limited trust license (TRTBA, Section 9(1)). The exceptions provided under the Trusts (Regulation of Trust Business) Exemption Order 2002 (“TRTB Exemption Order”) include (i) a trust company authorized to provide the services of a trustee only to the trusts specified in its constitution (i.e., a trust company with a private trust business); (ii) a trustee who is a member of a recognized professional body and holds a certificate from the professional body for the purpose of the exemption; (iii) a trustee who is a co-trustee of a trust and at least one of the other co-trustees is licensed under the TRTBA; and (iv) a trustee who is a professional person who appoints a specified licensed trust company to maintain the records of the trust of which he is a trustee (together “Exempt Trust Service Providers”). Trust service providers are supervised by the BMA.

<sup>14</sup> Credit unions are required to be registered under the MOF (CUA, Section 3). The Credit Union is supervised by the BMA.

<sup>15</sup> The IA distinguishes long-term business insurance and general business insurance on the basis that long-term business insurance generally deals with life and personal injury insurance whilst general business insurance deals with insurance business that is not long-term insurance, to the extent that insurers providing long-term insurance are not precluded from providing general business insurance and vice versa, (IA, Section 1).

framework under the AML/CFT Methodology, although they are relevant for the implementation aspects of the Methodology.

27. Whilst the requirements under the NAMLC Guidance Notes are not mandatory, the courts in determining whether a regulated institution has complied with the PCMLR would take into account the NAMLC Guidance Notes and any other relevant guidance issued by the NAMLC (PCMLR, Regulation 8(2)). Non-compliance with the NAMLC Guidance Notes would weigh against a regulated institution in any alleged non-compliance with the PCMLR. It should be regarded as evidence of non-compliance with the PCMLR and be allocated relevant weight against the regulated institution depending on the circumstances in issue, but not non-compliance per se.

28. The 1998 Guidance Notes provide, for the purpose of “Foreign Regulated Institutions,” a list of jurisdictions whose AML regulation is at least equivalent to the PCMLR (1998 Guidance Notes, Appendix A). The jurisdictions are Australia, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Guernsey, Hong Kong, Iceland, Ireland, Isle of Man, Italy, Japan, Jersey, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States of America.

29. The Government of Bermuda set up the National Anti-Money Laundering Committee (“NAMLC”) in 1997 to direct government AML policy and provide guidance with compliance with the AML regime and coordination amongst the relevant government authorities and agencies. The NAMLC consists of the Financial Secretary (chairman); the Attorney General; the Permanent Secretary of the Ministry of Labour, Home Affairs and Public Safety; the Chairman and CEO of the BMA; the Commissioner of Police; and such person appointed by the MOF.

30. The BMA was established under BMAA. It is responsible for the regulation and supervision of any licensed deposit-taking institution; any licensed insurer; any collective investment scheme; any licensed investment services provider; the BSX, any licensed trust service provider; and the Credit Union. Exempt Insurers, Exempt Investment Service Providers, Exempt Trust Service Providers and Company Services Providers are not regulated nor supervised by the BMA. There is currently no licensing requirement for bureaux de change although they are subject to some degree of oversight by the BMA. Professionals such as accountants and lawyers are regulated under their professional associations. The BMA also plays an important role in the scrutiny of beneficial owners of entities that are to be registered in Bermuda and in the case of licensed institutions, the scrutiny extends to directors and senior executives. The BMA must be satisfied that such persons are fit and proper before registration is recommended. A similar procedure is undertaken by the BMA where there is a transfer of beneficial ownership in Bermudian entities.

31. The FIU was set up in 1998 as part of the Commercial Crime Department of the Bermuda Police Services (“Police”). The other part of the Commercial Crime Department is

the Fraud Squad. Prior to that, the Commercial Crime Department, which was principally responsible for investigating white-collar crimes, was tasked with receiving and investigating suspicious activity reports (“SARs”). Under the RA, HM Customs is responsible for the monitoring of cross-border movements of currency and goods. All information relating to customs offenses or suspicious cross-border movements of currency and goods are forwarded to the Passenger Analysis Unit (“PAU”), which is a multidisciplinary agency comprising the Police, HM Customs and U.S. Customs. The PAU controls the collecting, collating and dissemination of revenue and drug intelligence to the relevant authorities. The Office of the Director of Public Prosecutions is responsible for prosecution of offenses and related matters under the PCA and the Terrorism Order. The Attorney-General’s Chambers deal with the non-criminal aspects of the AML/CFT regime. There has not been any prosecution for ML or FT pursuant to the PCA and the Terrorism Order to date.

## B. Detailed Assessment

32. The following detailed assessment was conducted using the October 11, 2002 version of Methodology for assessing compliance with the AML/CFT international standard, i.e., criteria issued by the Financial Action Task Force (FATF) 40+8 Recommendations (the Methodology).

### Assessing criminal justice measures and international cooperation

Table 4. Detailed Assessment of Criminal Justice Measures and International Cooperation

| I—Criminalization of ML and FT<br>(compliance with criteria 1-6)  |
|---|
| Description   |
| <p>1. The United Kingdom extended to Bermuda its ratification of the Vienna Convention and the UN Resolution 1373. The provisions of the Vienna Convention were incorporated under the PCA and the CJICBA, whilst the provisions of the UN Resolution 1373 were extended to Bermuda by way of the Terrorism Order 2001. The UN International Convention for the Suppression of Terrorism (1999) and the UN Convention Against Transnational Organized Crime (2002) have not been extended to Bermuda.</p> <p>2. ML is an offense under Sections 43, 44 and 45 of the PCA.</p> <p>A person is guilty of</p> <p>(i) <b>an offense of concealing or transferring his proceeds of criminal conduct</b> if (a) he conceals or disguises any property which is, or in whole or in part directly or indirectly represents his proceeds of criminal conduct; or (b) converts or transfers that property or removes it from Bermuda, for the purpose of avoiding prosecution for a drug trafficking offense or relevant offense or the making or enforcement of a confiscation order (PCA, Section 43(1)); (ii) <b>an offense of concealing or transferring the proceeds of criminal conduct of another person</b> if knowing or having reasonable grounds to suspect any property which is, or in whole or in part directly or indirectly represents another person’s proceeds of criminal conduct, he (a) conceals or disguises that property; or (b) converts or transfers that property or removes it from Bermuda, for the purpose of assisting any person to avoid prosecution or a drug trafficking offense or relevant offense or the making or enforcement of a confiscation order (PCA, Section 43(2)); (iii) <b>an offense of assisting another to retain the proceeds of criminal conduct</b> if he enters into or is otherwise concerned in an arrangement whereby (a) the retention or control by or on behalf of another person of that person’s proceeds of criminal conduct is facilitated; or (b) that person’s proceeds of criminal conduct are used to secure that funds are placed at that person’s disposal or are</p> |

used for that person's benefit to acquire property by way of investment, and he knows or suspects that that person is a person who is or has been engaged in or has benefited from criminal conduct (PCA, Section 44(1)); and (iv) **an offense of acquiring, possessing or using the proceeds of criminal conduct of another person** if knowing that any property which is, or in whole or in part directly or indirectly represents another person's proceeds of criminal conduct, he acquires or uses that property or has possession of it (PCA, Section 45(1)).

The scope of predicate offenses for the purpose of the PCA as defined by reference to "criminal conduct" includes (i) a drug trafficking offense; and (ii) a "relevant offence", which includes any indictable offense in Bermuda other than a drug trafficking offense or any act or omission which had it occurred in Bermuda would have constituted an indictable offense other than a drug trafficking offense (PCA, Section 3 as amended).

3. The Terrorism Order provides that a person is guilty of an offense if (i) he invites another to provide funds and intends that they should be used or knows that they may be used for the purposes of terrorism; (ii) he receives funds and intends that they should be used or knows that they may be used for the purposes of terrorism; (iii) he provides funds and intends that they should be used or knows that they may be used for the purposes of terrorism; and (iv) he (other than in accordance with the terms of a specific license issued by the Governor) makes any funds or financial services available directly or indirectly to or for the benefit of a person who commits, attempts to commit, facilitates or participates in the commission of acts of terrorism (or a person controlled or owned directly or indirectly by, or acting on behalf of or under the direction of, such person) (Terrorism Order, Articles 3 and 4). Under the Terrorism Order, "terrorism" means the use or threat of action: (i) where the action involves serious violence against a person, serious damage to property, endangers a person's life (other than that of the person committing the action), creates a serious risk to the health or safety of the public or a section of the public, or is designed seriously to interfere with or seriously disrupt an electronic system (including such action which involves the use of firearms or explosives whether or not it involves serious damage to property); (ii) designed to influence the government or intimidate the public or a section of the public; and (iii) for the purpose of advancing a political, religious or ideological cause, such action is to include action outside Bermuda (Terrorism Order, Article 2).

4. Under the PCA (i) the mens rea<sup>16</sup> for the offenses under Section 43(1) and Section 45(1) are "intention or knowledge" and "knowledge" respectively; (ii) the offense under Section 43(2) requires the defendant to have either known or have reasonable grounds to suspect that he was concealing or transferring proceeds of criminal conduct; and (iii) the offense under Section 44(1) requires the defendant to have either known or suspected that the person he was assisting had been engaged in or had benefited from criminal conduct. The respective FT offenses under the Terrorism Order require the proof of either knowledge or intent.

The offenses under the PCA and the Terrorism Order can be committed by body corporates (PCA, Section 56; Terrorism Order, Article 1).

5. For ML, a person guilty of an offense under Sections 43(1), 43(2), 44(1), and 44(2) of the PCA shall be liable (i) on summary conviction to maximum imprisonment of 5 years or a maximum fine of \$50,000 or both; and (ii) on conviction on indictment to maximum imprisonment of 20 years or to an unlimited fine or to both. For FT, a person guilty of an offense under Articles 3 and 4 of the Terrorism Order shall be liable (i) on a summary conviction to maximum imprisonment of 6 months or a maximum fine of \$5,000 or both; and (ii) on conviction on indictment to maximum imprisonment of 7 years or to a fine or both (Terrorism Order, Article 11).

*6. The legal means are adequate but the resources have been inadequate to enable a fully effective implementation of the money laundering and financing of terrorism laws. The legal infrastructure is there but the human resources at the intelligence / investigative level is inadequate. The Bermuda Police Service provides*

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<sup>16</sup> "Mens rea" denotes the mental element of a criminal offense that generally needs to be established against a defendant for the purpose of a prosecution in addition to the physical elements of the offense.

*the human resource component for the intelligence / investigative purposes and because of the general manpower constraints within the Service; it has not been able to address the matter of the adequacy of resources in a timely manner.*

#### Analysis of Effectiveness

1. The PCA, the CJIBA and the Terrorism Order are the principal legislation for the purpose of the Vienna Convention and the UN Resolution 1373. The UN International Convention for the Suppression of Terrorism (1999) and the UN Convention Against Transnational Organized Crime (2002) have not been extended to Bermuda.

2. The PCA provides for (i) the criminalization of ML; and (ii) the scope of predicate offenses to be extended to relevant indictable offenses as well as drug trafficking offenses; and (iii) the ML offenses to be applicable to persons who have committed the ML offense and persons who have committed both the ML and the predicate offenses.

3. The Terrorism Order provides for the prosecution of the collection, receipt and provision of funds for terrorism. It does not however criminalize terrorists acts nor provide for terrorist organizations (although financing of terrorism could be committed by bodies corporate for the purpose of the Terrorism Order), although it provides for prosecution when the terrorist acts take place outside Bermuda. Terrorist acts are therefore not predicate offenses for the purpose of the AML legislation.

4. For the ML offenses under PCA, it seems that the mens rea requirement ranges from “intention”, “knowledge”, “suspicion” and “reasonable” grounds to suspect”, with “knowledge” being the common requirement amongst the 4 offenses. The tests for “intention”, “knowledge” and “suspicion” are subjective to the extent that it would be necessary to determine what was in the mind of a person in order to ascertain whether or not the person should be guilty of one of the ML offenses. The test for “reasonable grounds to suspect” as expressly set out in the case of the Section 43(2) offense (and as suggested by the authorities to also extend to the Section 44(1) offense) has both subjective and objective elements in the sense that it would be necessary for the prosecution to show that the person should have been suspicious in the particular instance and that a reasonable person would have found grounds for suspicion in that instance. Nonetheless, given that there has been no prosecution of the ML offenses to date, it remains to be seen how the courts would approach the mens rea requirement of these offenses.

5. It would seem that the criminal sanctions under the PCA are dissuasive although the terms of imprisonment under the PCA may be rather rigorous given that punishment for some of the predicate offenses may be lower than the ML offenses. The maximum fine for summary conviction under the Terrorism Order is rather low.

*6. While the Bermuda Police Service has been responding relatively well to the general crime situation and has had a clear-up rate within the last five years averaging 50 percent, the unit assigned to the responsibility of investigating matters relating to ML and FT, has been inundated by the number of SARs requiring active investigation and consequently has not been able to carry out thorough investigations and enable prosecutions.*

#### Recommendations and Comments

3. Authorities should expedite current initiatives to introduce provisions for terrorist offenses per se and related matters.

4. The authorities may wish to consider whether to incorporate an objective test to the mens rea requirement for the offenses under Sections 43(1) and 45(1), and indeed for the Section 44(1) offense.

5. The authorities may wish to consider whether civil sanctions for ML and FT are suitable for the jurisdiction.

*6. There is the need to assign adequate resources to the intelligence / investigative units and there must be clearly defined roles; that is, a team for specific data entry and basic information gathering and a team of investigators for the sole purpose of investigating matters and enabling prosecutions.*

| Implications for compliance with FATF Recommendations 1, 4, 5, SR I, SR II  |
|---|
| <p>1. Bermuda is compliant with Recommendation 1. It is materially non-compliant with Special Recommendations I to the extent that the UN International Convention for the Suppression of Terrorism (1999) has not been extended to Bermuda, although the Terrorism Order has been extended to Bermuda and the extent to which these conventions and treaties of these order are extended to Bermuda is dependent on the approach of the United Kingdom Government.</p> <p>2. Bermuda is compliant with Recommendation 4.</p> <p>3. Bermuda is materially non-compliant with Special Recommendation II, although there is currently work underway for legislation that provides for terrorist offenses per se and related matters.</p> <p>4. Bermuda is largely compliant with Recommendation 5 to the extent that whilst the proof of “knowledge” is a common requirement of the ML offenses under the PCA, the approach to the test for knowledge is subjective. The authorities may wish to consider whether to incorporate an objective test to the mens rea requirement of the offenses under Sections 43(1) and 45(1), and indeed for the Section 44(1) offense.</p>  |
| II—Confiscation of proceeds of crime or property used to finance terrorism (compliance with criteria 7-16)  |
| Description   |
| <p>7. For ML, the court may grant a confiscation order where (i) a defendant to be sentenced for one or more drug trafficking offense is deemed by the court to have benefited from drug trafficking; and (ii) where a defendant to be sentenced for one or more relevant offenses has benefited from the relevant offense (or any other relevant offense from which the defendant had benefited ) (PCA, Sections 9 and 10). The amount to be recovered under a confiscation order shall be the amount the court assesses to be the value of the defendant’s proceeds of drug trafficking or benefit from relevant offenses (provided that where the amount that might be realized at the time the confiscation order is made is less than the amount the court assesses to be the value of the defendant’s proceeds of the drug trafficking or benefit from relevant offenses, the amount to be recovered under the confiscation order shall be the amount appearing to the court to be the amount that might be so realized) (PCA, Sections 15(1) and (3)).</p> <p>For ML, where proceedings have been instituted against a person for a drug trafficking offense or relevant offense and the proceedings have not been concluded but there is reasonable cause to believe the person had benefited from drug trafficking or from a relevant offense, the court may grant (i) a restraint order to prohibit any person from dealing with any realizable property whether or not the property is described in the order or not; or (ii) a charging order on any such realizable property for securing payment to the Crown either an amount not exceeding the amount payable under a confiscation order if it has been issued or an amount equivalent to the value of the charged property (PCA, Sections 27(1), 28(1) and (2), and 29(1)). Application for a restraint order or a charging order may only be made by the Attorney-General and on an ex parte basis to a judge in chambers (PCA, Sections 28(4) and 29(3)). Under the PCA, “realizable property” is defined as any property held by the defendant other than property in respect of which there is in force a forfeiture order under the Misuse of Drugs Act 1972 and any property held by a person to whom the defendant has directly or indirectly made a gift (PCA, Section 3). There is currently no provision for civil forfeiture (confiscation without conviction) for ML.</p> <p>The above provisions would appear to apply to the offenses under the Terrorism Order where the offenses under the Terrorism Order are deemed triable by indictment (as the offenses therein are both summary and triable on indictment) and therefore “relevant offences” for the purpose of the PCA. In addition, the Terrorism Order provides that where the Governor has reasonable grounds for suspecting that the person for or on behalf of whom any funds are held is or may be a person who commits, attempts to commit, facilitates or participates in the commission of acts of terrorism; or a person controlled or owned directly or indirectly by, or acting on behalf of or under the direction of, such person, the Governor may by notice direct that those funds are not to be made to any person except with the authority of a license granted by the Governor (Terrorism Order, Article 5(1)).</p> <p>8. For the purpose of an investigation into a drug trafficking offense, whether any person has benefited from</p> |

criminal conduct or the whereabouts of any proceeds of criminal conduct, a police officer may apply to the Supreme Court for a production order in relation to particular material or material of a particular description (PCA, Section 37(1)). For the production order to be granted, it has to be shown that there are reasonable grounds for (i) suspecting that a specified person has carried on drug trafficking or has benefited from criminal conduct; (ii) suspecting that the material to which the application relates is likely to be of substantial value to the investigation for the purpose of which the application is made and does not include items subject to legal privilege; and (iii) believing that it is in the public interest having regard to the benefit likely to accrue to the investigation if the material is so obtained and to the circumstances under which the person in possession of the material holds it, that the material should be produced or that access to it should be given (PCA, Section 37(4)).

9. Where an application is made for a confiscation order under the PCA, a person who asserts an interest in a realizable property may apply to the court before the confiscation order is made for an order declaring the nature, extent and value of his interest, on the basis that he was not in any way involved in the defendant's criminal conduct and that he acquired the interest for sufficient consideration and without knowing or having reasonable grounds to suspect that the property was at the time he acquired it property that was involved in or the proceeds of criminal conduct (PCA, Sections 16(1) and (2)).

10. Not available in Bermuda.

11. *The general structure to enable the keeping of statistics is in place at the Financial Investigative Unit.*

12. *Training is critical to the success of the program. Thus, all segments involved in the process must be trained. Members of the investigative, prosecutorial and administrative segments have been exposed to training or awareness programs by either attending structured training programs particularly those offered by CALP or through their attendance at seminars and conferences. It is evident that there is some in-house and on-the-job training being undertaken at the investigators' level by an 'in-house' consultant from the United Kingdom. All of the investigators have undergone attachments at FIUs in the United Kingdom.*

13. The Terrorism Order provides that where the Governor has reasonable grounds for suspecting that the person for or on behalf of whom any funds are held is or may be a person who commits, attempts to commit, facilitates or participates in the commission of acts of terrorism; or a person controlled or owned directly or indirectly by, or acting on behalf of or under the direction of, such person, the Governor may by notice direct that those funds are not to be made to any person except with the authority of a license granted by the Governor (Terrorism Order, Article 5(1)).

*13.1 There are the provisions for the keeping of such statistics within the FIU of the Bermuda Police Service. There has been no freezing of property in respect of FT.*

14. The Terrorism Order provides that where the Governor has reasonable grounds for suspecting that the person for or on behalf of whom any funds are held is or may be (i) a person who commits, attempts to commit, facilitates or participates in the commission of acts of terrorism; or (ii) a person controlled or owned directly or indirectly by, or acting on behalf of or under the direction of, such person, the Governor may by notice direct that those funds are not to be made to any person except with the authority of a license granted by the Governor (Terrorism Order, Article 5(1)).

15. The PCAA provides for the establishment of the Consolidated Assets Fund ("CAF") for receiving (i) proceeds of criminal conduct recovered under a confiscation order under the PCA; (ii) cash forfeited under the PCA; (iii) money forfeited under the Misuse of Drugs Act 1972; and (iv) money paid to the Government by a foreign jurisdiction in respect of confiscated assets whether under a treaty or arrangement providing for mutual assistance in criminal matters or otherwise (PCA Section 55A, as introduced by PCAA, Section 5(1)). The MOF may after consulting with the NAMLC authorize payment to be made out of the CAF for purposes relating to, inter alia, (i) law enforcement, including the investigation of suspected cases of drug trafficking and money laundering; (ii) treatment and rehabilitation of drug addicts and public education of drug abuse; (iii) satisfy an



obligation of the Government to a foreign jurisdiction in respect of confiscated assets; (iv) meet the expenses of the NAMLC; and (v) cover costs associated with the administration of the CAF.

16. Payments may be made from the CAF to satisfy an obligation of the Government to a foreign jurisdiction in respect of confiscated assets whether pursuant to a treaty or arrangement providing for mutual assistance in criminal matters or otherwise.

#### Analysis of Effectiveness

7 and 8. There is currently no provision for civil forfeiture for the purpose of ML offenses. The scope for the application of Section 39(1) of the PCA should extend to investigation of relevant offenses as defined under the PCA and not merely with regard to drug trafficking offenses, a person has benefited from criminal conduct and the whereabouts of any proceeds of criminal conduct. It is also unclear what is meant by the need to show as one of the limbs of the criteria to be satisfied before the production order is granted, that “it is in the public interest having regard to the benefit likely to accrue to the investigation if the material is so obtained, as well as (ii) the circumstances under which the person in possession of the material holds it”, (i.e., whether the requirement would unduly impede the application for production orders in practice).

9. Sections 16(1) and (2) of the PCA provide for the protection of third parties in this regard.

10. There is currently no provision for rendering contracts void or unenforceable on the basis that parties to the contracts knew or should have known that authorities would, as a result of the contracts, be prejudiced in their ability to recover financial claims under the AML/CFT regime.

11. *The present system allows for the tracing of reports, property frozen, seized and confiscated and is quite adequate.*

12. *Generally speaking, there is an understanding of the requirements expected at all levels.*

13. The Terrorism Order does not have provisions that deal with seizure and confiscation of property that is the proceeds of or are to be used for terrorism, terrorist acts or by terrorist organizations.

13.1/14 Article 5(1) of the Terrorism Order provides for the restraint of funds and property in this regard.

15. Section 55A of the PCA provides for the establishment of such an asset forfeiture fund (the CAF).

16. The asset forfeiture fund (the CAF) established under Section 55A of the PCA provides for such asset-sharing mechanism.

#### Recommendations and Comments

7 and 8. The authorities may wish to consider whether to introduce provisions for civil forfeiture. The scope for the application of Section 39(1) of the PCA should extend to investigation of relevant offenses as defined under the PCA and not merely with regard to drug trafficking offenses, whether a person has benefited from criminal conduct and the whereabouts of any proceeds of criminal conduct.

10. The authorities may wish to consider incorporating relevant provisions for rendering contracts void or unenforceable on the basis that parties to the contracts knew or should have known that authorities would, as a result of the contracts, be prejudiced in their ability to recover financial claims under the AML/CFT regime.

11. *There is a need to limit access to the database to FIU personnel only.*

12. *There is the need for refresher training for the staff of the FIU. Consideration should also be given to awareness raising programs for prosecutors and the judiciary. There is the need for investigators to have relevant accreditation. Specific training plans ought to be included in the overall training program and accordingly budgeted for.*

| Implications for compliance with FATF Recommendations 7, 38, SR III   |
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| <p>7, 8, 10, and 13.1 Bermuda is largely compliant with Recommendations 7 on the basis that there is currently no provision for knowing that authorities would, as a result of the contracts, be prejudiced in their ability to recover financial claims under the AML/CFT regime. It is materially non-compliant for Special Recommendation III although there is currently work underway for legislation that provides for terrorist offenses per se and related matters.</p>   |
| <p>III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels<br/>(compliance with criteria 17-24)</p>   |
| <p>Description</p>  |
| <p>17. The Commercial Crime Department of the Police is comprised of the Fraud Squad and the FIU. The Fraud Squad continues to carry out its mandate under the Commercial Crime Department in investigating white-collar crimes whilst the FIU, since its establishment in 1998, is tasked with receiving and investigating suspicious transactions reports (“SARs”) and conducting investigations and disseminating financial information and intelligence for FT and ML purposes. The FIU is a member of the Egmont Group.</p> <p>The requirement under the PCMLR is for reporting officers (“MLROs”) of regulated institutions to file SARs to a police officer and not necessarily a police officer of the FIU (PCMLR, Regulations 6(1)(d)), although, 1998 Guidance Notes provide for the filing of SARs and communication with respect to the SARs to be made with the FIU. There is currently no requirement for reporting of currency transactions that exceed certain values. The NAMLC through the 1998 Guidance Notes provides guidance in the identification of activities whereby SARs should be filed.</p> <p>The PCMLR provides for the internal reporting procedures to be established for regulated institutions, which include (i) identifying a MLRO to whom a report is to be made of any information or other matter which comes to the attention of an employee and which in the opinion of the employee gives rise to a knowledge or suspicion that another person is engaged in ML; (ii) requiring any such report to be considered by the MLRO in the light of all relevant information for the purpose of determining whether or not the relevant information gives rise to a knowledge or suspicion; (iii) allowing the MLRO to have access to any information which may be of assistance to him in considering the report; and (iv) requiring the MLRO to file a SAR where he knows or suspects that a person is engaged in ML. The 1998 Guidance Notes provide a pro forma SAR form.</p> <p>18. The FIU is able to obtain additional information from regulated institutions by way of the production orders and monitoring orders provided under the PCA (PCA, Sections 37 and 41).</p> <p>19. The FIU has access to financial information from Regulated Institutions by way of the production orders and monitoring orders provided under the PCA (PCA, Sections 37 and 41) and to information relating to a person who has at any time held a realizable property from a Government department by way of a disclosure order under the PCA (PCA, Sections 40). The FIU has access to the database maintained by the Customs Department as police officers have powers that are equivalent to customs officers for the enforcement of the RA.</p> <p>20. A financial institution which does not comply with the reporting requirements under the PCMLR is liable on summary conviction to a fine of \$10,000 and on indictment to a fine of \$50,000 (the fine for a second or subsequent indictment is \$100,000) (PCMLR, Regulation 8(1)). The FIU and the BMA have no general power to levy fines.</p> <p>21. The FIU has been empowered to disseminate financial information and intelligence to domestic authorities for investigation or action, although the authority is not expressly provided under the PCA or the PCMLR and it is preferable for the authority to be provided under the AML/CFT legislation.</p> <p>22. The FIU is authorized to share financial information and intelligence with its foreign counterparts, either through its own initiative or upon request, through its membership of the Egmont Group. The FIU is obliged not to disclose any financial information or intelligence save for the purpose of carrying out its functions or when</p> |

required by the law or the courts (PCA, Section 58(1)).

*23. The FIU maintains the statistics to show inter alia the number of SARs received, investigations carried out and cases realized. Since the creation of the unit, it has received in excess of ten thousand SARs according to the statistics and has developed nine money laundering matters.*

*24. The FIU is understaffed. Presently it has four full- time officers. Cabinet has endorsed a business plan which among other things proposes an increase in both police and civilian resources for the FIU. The increase will include a trained analyst.*

*Although the FIU can be perceived as a self autonomous unit, administratively it is under the Crime Support Division. It shares office space with the Fraud unit and there is a common access. In respect of security, access to the building is limited to staff only and on invitation. Generally documents and files are kept in a secure place. Recommendations have been made for the FIU to have purpose-designed and more secure office space in the new Hamilton Police Station complex.*

*Some information on the FIU's activities is published in the Annual Police Report. The FIU also has a program of speaking engagements with financial institutions and other entities.*

#### Analysis of Effectiveness

17. Whilst the 1998 Guidance Notes have provided for the FIU to deal with SARs and the PCMLR provides for SARs to be made to police officers, the law does not expressly set out the role of the FIU in receiving, analyzing and disseminating information and intelligence relating to ML and FT activities (for instance, police officers are to include officers from the Customs Department for the purpose of the PCA (PCA, Section 57(1)). Given that the FIU is deemed to be the competent authority for the purpose of carrying out the function of a financial intelligence unit and has been established as such, the authorities may wish to consider stating this more clearly in the legislation. This is particularly when civilians may eventually be recruited to bring additional expertise to the FIU and civilians are not subject to the same obligations as police officers (such as that relating to disclosure of information, which is integral to the work of the FIU), and to mitigate challenges against the FIU on its authority to carry out its functions as a financial intelligence unit.

18. It is important for the FIU to be able to obtain the production orders and the monitoring orders efficiently in order for its work to be effective in practice, especially given the question that is currently being considered in court of whether orders of these nature which involve the non-criminal aspects of the PCA should be properly advised by the Attorney-General's Chambers (which deals with the non-criminal aspects of the AML/CFT regime) or the Office of the Director of Prosecutions.

19. See analysis for Criterion 18.

20. The FIU and the BMA do not have powers to impose sanctions or penalties under the AML/CFT regime.

21. Whilst the FIU has been empowered to disseminate financial information and intelligence to domestic authorities for investigation or action, the authority is not expressly provided under the PCA or the PCMLR and it is preferable for such authority to be provided under the AML/CFT legislation.

22. The FIU has the power to share financial information and intelligence with its foreign counterparts provided that it does not to disclose any financial information or intelligence save for the purpose of carrying out its functions.

*23. Many SARs relate to small-scale money transmission activity. The FIU can account for, trace, and show the status of all reports received.*

*24. Presently, the situation at the FIU is not very effective as much of the work involves data entry.*

#### Recommendations and Comments

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| <p>17. The authorities may wish to consider amending the PCA or related legislation to establish the FIU formally.</p> <p>20, 21, and 22. The authorities may wish to consider stating more explicitly the powers of the FIU.</p> <p><i>24. It is recommended that the FIU be allocated separate offices properly secured and in an accessible location to the commercial centre. Authorities indicated that efforts are on-going to find appropriate accommodation.</i></p> <p>While careful dissemination of information is vital, the FIU should endeavor to publish information relating to trends and typologies.</p>  |
| <p><b>Implications for compliance with FATF Recommendations 14, 28, 32</b></p>  |
| <p>17, 18, 19, 20, 21, and 22. Bermuda is compliant with Recommendations 14 and 28. It is largely compliant with Recommendation 32 on the basis that the safeguards for confidentiality of the information received by the FIU could be enhanced by (i) setting out in the law the FIU as the competent authority for receiving SARs; and (ii) ensuring that access to the database of the FIU is restricted only to the staff of the FIU.</p>  |
| <p><b>IV—Law enforcement and prosecution authorities, powers and duties (compliance with criteria 25-33)</b></p>  |
| <p><b>Description</b></p>   |
| <p><i>25. The FIU has been set up to deal with matters relating to the proceeds of crime including money laundering offenses. The current status at the unit does not allow for consistent investigations. The type of investigations undertaken can be deemed reactive rather than proactive because of the staff shortage. The assistance of the other strategic units, e.g., Special Branch, the Narcotics and Intelligence unit can be co-opted.</i></p> <p>26. With the exception of wire-tapping, which has a statutory basis, investigative techniques of the Police, such as controlled delivery and surveillance, are regarded as part of the general powers of the Police.</p> <p>26. The technique most often used by the unit is that of surveillance. Controlled deliveries techniques are used by the Narcotic Unit.</p> <p>27. Law enforcement authorities are able to obtain information by way of production orders, monitoring orders and search warrants (PCA, Sections 37, 41, and 39).</p> <p><i>28. NAMLC ensures cooperation and to some extent information sharing among government departments. The committee includes the Financial Secretary.(Chairman) Attorney General, the Permanent Secretary of the ministry responsible for the Police, the Commissioner of Police, the General Manager of the Bermuda Monetary Authority, and such persons as the MOF may appoint from time to time. There are also joint operations between the HM Customs and the Police.</i></p> <p><i>29. The FIU has a staff of four police officers paid by the government of Bermuda. In addition a constable on secondment from the United Kingdom also works with the FIU. The current structure does not effectively separate administrative and investigative functions. It is recognized that there must be additional staff if the unit is to become more effective. Additional training is necessary at all levels.</i></p> <p>30. <i>Statistics are maintained in an efficient manner.</i></p> <p>31. <i>Generally information is exchanged orally between police officers in relation to trends and typologies. However, the FIU is subsumed with the Commercial Crime unit and is not as an independent unit.</i></p> <p>32. <i>While all of the officers have had the basic training, there is still need for refresher training. As already mentioned, training must be ongoing and must be budgeted for.</i></p> <p>33. <i>The FIU appears to be experience some difficulties with the process for obtaining relevant court orders. For instance, it seems to be unclear to what extent non-criminal orders such as restraint orders or monitoring orders</i></p> |

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| <p><i>should be dealt with by the Office of the Public Prosecution or by the Attorney-General's Chambers; a matter that is currently being addressed in a proceeding. A ramification of this uncertainty is undue delays in the application of such orders, which in turn hampers the efficacy of investigations.</i></p>  |
| <p><b>Analysis of Effectiveness</b></p>  |
| <p>26. The general powers of the Police provide for the use of relevant investigative techniques.</p> <p>27. The relevant powers under the PCA allow law enforcement authorities to obtain information by way of the relevant orders.</p>  |
| <p><b>Recommendations and Comments</b></p>   |
| <p>26.1 The FIU needs to enhance its intelligence cell and continued to work with other units. It also needs to build and utilize informants more. The increase in staffing levels should assist in this regard.</p> <p>29. <i>Separate provisions must be made in the budget for training.</i></p> <p>31. <i>There is need to intensify the Police's awareness of the FIU in order to facilitate further exchange of information.</i></p> <p>33. <i>There is need for clarification in respect of the role the offices of the DPP and the Attorney General in relation to confiscation restraining and monitoring orders.</i></p>   |
| <p><b>Implications for compliance with the FATF Recommendation 37</b></p>  |
| <p>Bermuda is materially non-compliant in Recommendation 37 on the basis that there is no provision for search and seizure under the CJICBA.</p>   |
| <p><b>V—International Co-operation<br/>(compliance with criteria 34-42)</b></p>  |
| <p><b>Description</b></p>  |
| <p>34. Where overseas evidence is required for use in Bermuda, an application may be made requesting assistance in obtaining such evidence (evidence to include documents and other articles) on the basis that an offense has been committed or that there are reasonable grounds for suspecting that an offense has been committed, and that proceedings in respect of the offense have been instituted or that the offense is being investigated (CJICBA, Section 5(1)). Where Bermudian evidence is required for use overseas by way of a request for assistance from a court or tribunal exercising jurisdiction in a country or territory outside Bermuda or a prosecuting authority in such country or territory (or another authority in such a country or territory which appears to have the function of making such requests), the Attorney-General may nominate a court in Bermuda to receive such evidence if he is satisfied that (i) an offense under the law of the country or territory in question has been committed or that there are reasonable grounds for suspecting that such an offense has been committed; and (ii) proceedings in respect of that offense have been instituted in that country or territory or that an investigation into that offense is being carried on there (CJICBA, Section 6(1)).</p> <p>35. <i>The CJICB Act provides for matters relating to mutual assistance. The CJICB Act does not require that the offense in question be an offense under domestic law. If the Attorney-General is satisfied that an offense has been committed or that there are reasonable grounds for suspecting that such an offense has been committed then the Attorney-General may offer legal assistance. However, where the offense is a fiscal offense, the Attorney-General must be satisfied that the conduct constituting the offense would be an offense of the same or a similar nature if it had occurred in Bermuda (Section 6(3)).</i></p> <p>36. As an Overseas Territory, Bermuda cannot directly engage in international treaties or conventions. Exceptions are bilateral arrangements between Bermuda and another country or territory whereby the Governor of Bermuda may seek consent from the United Kingdom in entering into such arrangements for the U.K. Government on behalf of Bermuda. The CJICBA provides for direct request for mutual legal assistance between Bermuda and another country or territory.</p> |

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| <p>37. The law enforcement authorities exchange information with their international counterparts on an agency-to-agency basis.</p> <p>38. The CJICBA does not specifically provide for co-operation in investigations, however there is nothing that prevents the law enforcement authorities from cooperating on an agency-to-agency basis.</p> <p>39. <i>Section 55A of the Proceeds of Crime Act 1997 establishes a Confiscated Assets Fund which can receive or disburse shared funds as appropriate. The law provides for freezing, seizure and confiscation of assets (the CJICB Act, Proceeds of Crime Act 1997, and The Terrorism (United Nations Measures) (Overseas Territories) Order 2001).</i></p> <p><i>According to the records, a confiscation order was granted by the crown in 2001. However the funds have not been collected. Consequently, the Confiscated Assets Fund has not yet received or disbursed any shared funds and so an analysis of effectiveness cannot be undertaken.</i></p> <p>No assets were shared in recent times.</p> <p>40. Extradition law in Bermuda is provided by the Extradition Act 1877 and the extension to Bermuda by the U.K. Government the Extradition Act 1870 and Extradition Act 1989, which allows for the extradition by the Bermudian Government of persons who have committed offenses that are regarded as “extradition crimes” to such countries which have extradition arrangements with the U.K. Government. The Extradition Act 1989 defines “extradition crimes” as such conduct which if it occurred in the United Kingdom would constitute an offense punishable for a term of 12 months or any greater punishment and which is so punishable under the laws of the country in which the conduct was committed (cf Extradition Act 1989, Section 30(2)). This in the context of Bermuda means any such offense that is punishable in Bermuda for a term of 12 months or any greater punishment and therefore extends to the principal offenses under the PCA and the Terrorism Order provided the minimum punishment requirement was met. Extradition for these offenses would be permissible under the Extradition Act 1989 to such countries that have extradition arrangements with the U.K. Government.</p> <p>41. <i>Bermuda has a legal framework for extradition as outlined in the response to criterion 40. There have been no extradition proceedings.</i></p> <p>42. <i>The Attorney General deals with the requests for mutual assistance. There have been very few of those requests. They were all successful.</i></p> |
| <p><b>Analysis of Effectiveness</b></p> <p>34. The provisions under Sections 5(1) and 6(1) of the CJICBA provide for the obtaining of evidence for use in Bermuda and overseas, although they do not provide for powers of search and seizure. The provisions of the CJICBA would seem to apply for the purposes of ML and FT.</p> <p>36. Bermuda has the benefit of international conventions or treaties extended to it by the U.K. Government but is unable to enter into these international conventions or treaties. However, the CJICBA provides for direct request for mutual legal assistance between Bermuda and another country or territory.</p> <p>37. There have not been many instances of mutual legal assistance to date although the avenues, by way of the CJICBA, are broadly in place should there be a need to make or to respond to a request.</p> <p>38. The agency-to-agency cooperation between law enforcement agencies appears to be in place for cooperation in investigation.</p> <p>40. Extradition of the principal offenses under the PCA and the Terrorism Order would be permissible under the Extradition Act 1989 to such countries that have extradition arrangements with the U.K. Government, although they have not expressly recognized as extraditable offenses.</p>   |
| <p><b>Recommendations and Comments</b></p> <p>34. The authorities should incorporate more specific provisions for mutual legal assistance in enforcement</p>   |

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| matters, such as powers of search and seizure.   |
| 40. The authorities should consider introducing provisions for extradition of persons charged ML or FT offenses.   |
| <b>Implications for compliance with FATF Recommendations 3, 32, 33, 34, 37, 38, 40, SR I, SR V</b>   |
| 34. Bermuda is compliant in Recommendations 3, 32, 34, and 40. It is materially non-compliant with Recommendation 37 on the basis that there is no provision for search and seizure under the CJICBA; Recommendation 38 on the basis that there is no provision to take expeditious action for mutual legal assistance and there is no provision for seizure under the CJICBA; Special Recommendation I on the basis that the UN International Convention for the Suppression of Terrorism (1999) has not been extended to Bermuda although the Terrorism Order has been extended to Bermuda and the extent to which these conventions and treaties of these order are extended to Bermuda is dependent on the approach of the U.K. Government; and Special Recommendation V on the basis that terrorism per se is not a criminal offense in Bermuda.<br>34.1 Bermuda is compliant with Recommendation 34. It is materially non-compliant with Recommendation 37 on the basis that there is no provision for search and seizure under the CJICBA, with Recommendation 38 on the basis that there is no provision to take expeditious action for mutual legal assistance and there is no provision for seizure under the CJICBA; and with Special Recommendation V on the basis that terrorism per se is not a criminal offense in Bermuda.<br><br>34.2 Bermuda is compliant with Recommendation 33.<br><br>36. Bermuda is compliant in Recommendations 3 and 34.<br><br>37. Bermuda is compliant with Recommendation 34. It is materially non-compliant with Special Recommendation V on the basis that terrorism per se is not a criminal offense in Bermuda.<br><br>38. Bermuda is compliant with Recommendations 3 and 36.<br><br>40. Bermuda is compliant with Recommendations 3 and 40. It is materially non-compliant with Special Recommendation V on the basis that terrorism per se is not a criminal offense in Bermuda. |

### **Assessing preventive measures for financial institutions**

33. In order to assess compliance with the following criteria assessors must verify that: (a) the legal and institutional framework are in place and (b) there are effective supervisory/regulatory measures in force that ensure that those criteria are being properly and effectively implemented by all financial institutions. Both aspects are of equal importance.

Table 5. Detailed Assessment of the Legal and Institutional Framework for Financial Institutions and its Effective Implementation

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| <p>I—General Framework<br/>(compliance with criteria 43 and 44)</p>  |
| <p>Description</p>   |
| <p>43. There is no general secrecy law. Confidentiality of customer information is provided under the common law where FIs are deemed to have an implied contractual duty not to disclose affairs of their customers. The common law duty is nonetheless qualified, inter alia, to the extent that information may be disclosed pursuant to public interest, such as for the purpose of preventing fraud or criminal conduct. See also discussion under Criterion 27.</p> <p>44. The NAMLC is tasked with developing Bermuda’s AML policy and the various member authorities in the NAMLC, such as the BMA and the Police, play essential roles in the enforcement of the AML regime (which include implementation of the FATF 40 Recommendations to the extent they have been incorporated into the AML regime). There is currently no equivalent body for the CFT regime although the relevant authorities would perform their respective roles in the enforcement of the CFT regime (which include implementation of the FATF Special Recommendations to the extent they have been incorporated into the CFT regime).</p> <p>An important aspect of Bermuda’s AML/CFT regime is the role played by the BMA in conducting, on behalf of MOF, due diligence on beneficial owners of companies seeking to incorporate in Bermuda or to obtain a permit to conduct business there. This is undertaken for all companies but a more rigorous examination is undertaken in respect of companies/entities seeking to become regulated financial institutions. For these entities due diligence is extended to all the directors and senior executives and routinely includes police checks.</p> <p>At the policy level principal responsibility for AML/CFT rests with the Enforcement Coordinator. AML/CFT surveillance activity is undertaken by staff responsible for the regulation of various financial sectors. On -site surveillance (which started two years ago in respect of AML/CFT) has been undertaken in respect of banks and investment firms. While reports are prepared by external auditors in respect of insurance companies, to date none of these has focused on AML/CFT issues.</p> <p>Prior to on-site examinations institutions complete and submit to the BMA Form POC (Proceeds of Crime). This document facilitates review of compliance with the POC legislation. Each institution has to attach a copy of its anti-money laundering procedures for review by the BMA</p> <p>During on-site visits the BMA reviews the policies and practices adopted by licensees. This involves a review of procedures manual and an examination of records to assess compliance with the relevant legislation and regulation.</p> |
| <p>Analysis of Effectiveness</p>   |
| <p>43. There is no general secrecy law and the common law on customer confidentiality does not limit the disclosure of information where relevant, such as pursuant to public interest (such as for the purpose of preventing fraud or criminal conduct).</p> <p>44. Whilst Bermuda has an extensive AML/CFT regime, there remains room for ensuring that the requirements under the FATF 40+8 Recommendations are fully incorporated into the AML/CFT legislation. In addition, it is important for the scope of regulated institutions covered under the PCMLR and the NAMLC Guidance Notes to be extended. For instance, consideration could be given to extending the scope to professionals such as lawyers and accountants.</p> <p>The reference in Regulation 2(2)(a)(iv) of the PCMLR to such insurers that are part of regulated institutions as “a company or society registered under the IA to the extent that it is carrying out long term insurance (but not reinsurance) under the IA, other than life insurance and disability insurance” is unclear as to the category of insurers that is treated as regulated institutions and therefore subject to the PCMLR (and the Guidance Notes).</p> <p>The PCMLR does not cover persons captured by the Investment Business (Exemption) Order. While this is</p>  |



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| <p>acceptable in respect of persons who do not act as intermediaries or deal directly with client assets it is not clear that all exempt persons fall into this category.</p>  |
| <p><b>Recommendations and Comments</b></p>   |
| <p>44. The limitation to the scope of the PCMLR and the NAMLC Guidance Notes has been recognized in the Consultation Paper; the authorities may wish to consider extending the scope of the PCMLR and the NAMLC Guidance Notes beyond the range of financial institutions that are currently regulated to cover company service providers and professionals, such as accountants and lawyers.</p> <p>The authorities should in put place suitable monitoring arrangements to ensure adequate monitoring of AML/CFT systems employed by these entities</p> <p>The authorities may also wish to revise the reference to insurers under Regulations 2(2)(a)(iv) of the PCMLR to clarify the category of insurers that is treated as regulated institutions and therefore subject to the PCMLR (and the Guidance Notes). The PCMLR should be reviewed to ensure that all persons conducting investment business who act as intermediaries or deal in client assets are captured by the legislation. Such persons should also be covered by the BMA’s supervision in respect of AML/CFT.</p> <p>The BMA should provide specific directions to auditors of insurance entities indicating AML/CFT issues to be examined during on-site examinations.</p>  |
| <p><b>Implications for compliance with FATF Recommendation 2</b></p>   |
| <p>Bermuda is compliant with Recommendation 2</p>  |
| <p><b>II—Customer identification</b><br/>(compliance with criteria 45-48 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 68-83 for the banking sector, criteria 101-104 for the insurance sector and criterion 111 for the securities sector).</p>   |
| <p><b>Description</b></p>  |
| <p>45. Regulated institutions are required to establish and maintain identification procedures which require any applicant wishing to (i) form a business relationship; (ii) conduct a one-off transaction where payment of a minimum of \$10,000 is to be made by or to the applicant; and (iii) conduct two or more one-off transactions where the transactions appeared to be linked and that the total amount payable by or to the applicant is for a minimum of \$10,000, to produce satisfactory evidence of his identity (PCMLR, Regulation 4(1)). The BMA also plays an important role in the scrutiny of beneficial owners of entities that are to be registered in Bermuda; and in the case of licensed institutions, the scrutiny extends to directors and senior executives.</p> <p>Paragraph 27 on the Guidance Notes on the Prevention of Money Laundering (The Notes) indicates that regulated institutions should undertake verification to ensure that every verification subject relevant to an application actually exists. It also provides that the identity of all subjects to a joint application should normally be verified making an exception for verification of a limited group of persons (e.g., senior family members, principal shareholders, etc.) in instances in which there are a large number of subjects.</p> <p>The Notes stress that as far as possible, verification procedures for non-Bermuda residents should similar to those undertaken for residents.</p> <p>The Notes indicate that for prospective non-residents who may wish to open accounts by post, verification of identity should be sought from a reputable institution from the applicant’s country. (see below discussion re introduced business). The Notes require that verification details should be requested on the applicant’s name address and signature.</p> <p>46. The customer identification requirements save for that described under criterion 45 above are not provided under the PCA or the PCMLR for the purpose of criterion 46, but are provided under the 1998 Guidance Notes.</p> <p>Paragraph 53 indicates that the best form of identity is one that is difficult to replicate or obtain unlawfully. Paragraph 59 indicates that the best documents for establishing identity are passports and drivers licenses that bear a</p> |

photograph. Paragraph 60 indicates that documents that are easily obtained such as birth certificates and identity cards issued by an employer should not be used. Paragraph 54 indicates that file copies of documents should be maintained whenever possible.

Paragraph 68 indicates that the following documents should be obtained in respect of applications from corporate entities: a certificate in incorporation, a memorandum and articles of association, copies of powers of attorney, and other authorities given by directors in relation to the company and a certificate of incumbency and valid account opening authority including the full names of all directors and their specimen signature.

Paragraph 40 indicates that verification is not required for small one-off transactions which are not linked with other transactions. Regulation 4 (2) (b) of the PCML defines a small on-off transaction as one in which the payment made by or to an applicant is less than \$10,000.

At the time of the mission no specific guidance was provided in relation to reverification.<sup>17</sup>

Paragraph 7 (b) of Appendix E of the Notes indicates that there may be legitimate reasons for a customer to use a numbered account. There is however no provision for exemption from the verification of identity.

The wording in paragraphs 58 and 68 of the Notes “The relevance and usefulness of the following ... information should be considered” does not clearly indicate the standard expected of licensees.<sup>18</sup>

47. Regulated Institutions are required to establish and maintain identification procedures that require reasonable measures to be taken for establishing the identity of the person on whose behalf an applicant for business is acting, in circumstances where the applicant appears to be acting otherwise than a principal (PCMLR, Regulation 4(4)).

Paragraph 28 of the Notes provides that where there are underlying principals, the true nature of the relationship between the principals and the account signatories must be established and appropriate enquiries performed on the former, especially if the signatories are accustomed to act on their instruction.

Paragraph 37 provides that where a regulated institution suspects that there may be an undisclosed principal (whether individual or corporate), it should monitor the activities of the customer to ascertain whether the customer is in fact merely an intermediary. If a principal is found to exist, further enquiry should be made and that principal should be treated as a verification subject.

Paragraph 33 indicates the beneficial owner includes any person on whose instructions the signatories of an account or any intermediaries instructing such signatories are accustomed to act.

Appendix E (9) of the Notes indicate that an example of a suspicious transaction in the insurance sector is the transfer of the benefit of a product to an apparently unrelated third party. The BMA indicated that this suspicion would normally give rise to the verification of the identity of the third party.

In the case of companies that are not quoted on a recognized stock exchange, regulated institutions are required by the Guidance Notes (paragraphs 32-33) to take steps to identify the underlying beneficial owners of everyone with an interest of 5 percent or more.

The Notes define principals to include the settlors and beneficiaries of trusts. Such persons are therefore subject to

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<sup>17</sup> Draft revised guidance notes which were devised subsequent to the mission address this issue. The notes have been issued for consultation but are not yet effective.

<sup>18</sup> See footnote 17.

identity verification by financial institutions. It is also required that trustee be subject to verification unless it is a regulated institution or its identity was previously verified.

Under the existing framework for introduced business regulated intuitions are allowed to rely on the assurance of a trustee/manager of a trust that he is aware of the identity of underlying principal(s) (paragraph 28 Notes). The BMA indicates that in practice banks normally receive copies of verification documents but that there are instances where documents are retained by introducers. The retention of verification documents by introducers represents a potential weakness in customer due diligence framework.

At the time of the mission the eligible introducer certificate appearing at Appendix B to the Notes offered an option (B1) in which the introducer does not have to assert that identity verification documents are held and will be available on demand. Subsequent to the mission the sample certificate was amended to correct this problem.

48. There is presently no legislation in place with respect to recording originator information with regard to wire transfers by financial institutions.

Paragraph 98 of the Notes indicates that in the case of electronic transfers regulated institutions should retain records of payments made with sufficient detail to enable them to establish the identity of the remitting customer and as far as possible the ultimate recipient. While this relates to record retention it pre-supposes that the identity information was obtained in the first place. There is however no requirement that the identity information remain with the transfer through the payment chain. The BMA has indicated that it is awaiting international developments related to the resolution of technical difficulties in this regard.

Although there has been no across-the-board documented requirement from the BMA, banks, have been encouraged by the BMA, to put in place a risk-based program for completing due diligence for accounts that pre-dated the PCA. Each bank has established a schedule to complete this work with the latest deadline being June 2004. There have been instances in which relationships with customers were terminated where verification was not completed to a bank's satisfaction.

At the time of the mission the BMA did not provided specific guidance on dealing with Politically Exposed Persons and correspondent banking accounts. The consultation paper "Amendments to Proceeds of Crime Legislation and Guidance (December 2001) indicates that the issues of introduced business, non face-to-face customers, PEPS and pooled accounts will be reviewed. Draft revised guidance notes which were devised subsequent to the mission address this issue. The notes have been issued for consultation but are not yet effective.

Institutions visited generally had acceptable procedures in place for customer identification. Some institutions primarily banks, are well advanced in the process of retroactive identification. Non-bank institutions were addressing this matter less aggressively. Some institutions utilize the existing framework for introduced business which creates some degree of vulnerability in respect of verification of identity.

#### Analysis of Effectiveness

45. Whilst Regulation 4(1) of the PCMLR provides a requirement for regulated institutions to obtain customer identification by way of establishing and maintaining identification procedures, there is no explicit legal requirement that such procedures be followed.

46, 46.1, and 46.2. The legal requirements under the PCA and the PCMLR do not provide for customer identification requirements and for renewing identification with existing customers although the Consultation Paper is considering the possible introduction of such requirements. Draft revised guidance notes which were devised subsequent to the mission address this issue. The notes have been issued for consultation but are not yet effective. Customer identification requirements are currently listed in the 1998 Guidance Notes.

47. Regulation 4(4) of the PCMLR provides for reasonable measures to be taken for establishing the identity of underlying principals.

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| <p>48. There is presently no legislation in place with respect to recording originator information by financial institutions.</p>   |
| <p>Recommendations and Comments</p>   |
| <p>46. The PCMLR should be amended to explicitly require that customer identification procedures be followed by the regulated institutions. Moreover the authorities should require financial institutions to (i) identify their customers on the basis of official or other identifying document; (ii) record their customers' identity when establishing business relations; (iii) identify and record the identity of their occasional customers when performing transactions over a specified threshold; and (iv) renew identification when doubts appear as to their identity in the course of the business relationship.</p> <p>Wording in paragraphs 58 and 68 of the Notes "The relevance and usefulness of the following ... information should be considered" should be amended to more clearly indicate the practices that licensees are expected to follow.</p> <p>Consideration should be given to amending the framework for introduced business to require that documentation pertaining to customer identity be submitted without delay by the introducer to the FI.</p> <p>The Notes should be amended to provide guidance in relation to reverification, PEPS, and correspondent banking relationships.</p> <p>48. The BMA should impose a requirement for (i) originator information to remain with transfers or related messages through the payment chain within the deadline established by the FATF. and (ii) introduce a requirement to give enhanced scrutiny to wire transfers that do not contain complete originator information within the deadline established by the FATF.</p> |
| <p>Implications for compliance with FATF Recommendations 10, 11, SR VII</p>   |
| <p>Full compliance would be assured when institutions are required to have taken adequate steps to satisfy themselves that necessary documentation will be made available without delay.</p>  |
| <p>III—Ongoing monitoring of accounts and transactions<br/>(compliance with Criteria 49-51 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 84-87 for the banking sector, and criterion 104 for the insurance sector)</p>  |
| <p>Description</p>  |
| <p>49. The requirements are not provided under the PCA or the PCMLR. They are listed in the 1998 Guidance Notes.</p> <p>Paragraph 74 of the Guidance Notes emphasizes that an important pre-condition of recognition of a suspicious transaction is for the regulated institution to know enough about the customer's business to recognize that a transaction, or a series of transactions, is unusual.</p> <p>Paragraph 75 indicates that regulated institutions should be alert to the implications of financial flows and transaction patterns particularly where there is a significant unexpected and unexplained change in the behavior of the account.</p> <p>Paragraph 76 notes that against patterns of legitimate business, suspicious transactions should be recognizable as falling into a number of categories including :</p> <ul style="list-style-type: none"> <li>• any unusual activity of a customer in the context of his usual activities;</li> <li>• unusual transactions or series of linked transactions;</li> <li>• unusual employment of an intermediary, or method of settlement; and</li> <li>• unusual or disadvantageous early redemption of an investment product.</li> </ul>   |

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| <p>Appendix E gives examples of unusual transactions in the banking, investments and insurance sectors that may point to money laundering activity.</p> <p>Paragraph 91 notes that the procedures should require the maintenance of a register of all reports made to the FIU. Paragraph 84 indicates that if in good faith the Reporting Officer decides that the information does not substantiate a suspicion, the Reporting Officer is not obliged to make a report. Nevertheless the Reporting Officer would be well advised to record fully the reasons for the decision not to report to the FIU.</p> <p>50. The requirements are not provided under the PCA or the PCMLR. They are listed in the 1998 Guidance Notes. NAMLC issues advisories relating to the FATF's NCCTs. The advisories refer specifically to the wording of FATF recommendation 21. These advisories are issued pursuant to Section 49 (1) (b) of the POC which indicates that NAMLC can issue from time to time guidance as to compliance with the Act and regulations under the Act.</p> <p>Appendix A permits acceptance of "reliable introductions" from regulated institutions in certain jurisdictions. The list is comprised essentially of FATF member countries but excludes FATF members which Bermuda considers to have an AML/CFT framework that is less robust than its own.</p> <p>51. There is presently no additional requirement with respect to originator information in funds transfer, as discussed under Criterion 48.<sup>19</sup></p> <p>Bermuda has not yet introduced specific guidance regarding wire transfers that do not contain complete originator information. It is still reviewing the steps being taken internationally by banks and wire services to effect full implementation of this Special Recommendation.</p> <p>Most institutions appear to employ mechanism to monitor account activity. These are generally manual systems but two banks have indicated that plans are in place to migrate to automated systems.</p> |
| <p><b>Analysis of Effectiveness</b></p> <p>51. The existing arrangements in respect of guidance re. the monitoring of originator information on wire transfers will need to be enhanced when the FATF requirements for wire transfers becomes effective.</p>   |
| <p><b>Recommendations and Comments</b></p> <p>49. The authorities should require financial institutions to (i) pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose; (ii) examine as far as possible the background and purpose of such transactions; (iii) set forth their findings in writing; (iv) and to keep such findings available for competent authorities.</p> <p>51. See recommendation for criterion 48.</p>   |
| <p><b>Implications for compliance with FATF Recommendations 14, 21, 28, SR VII</b></p> <p>Compliant with FATF 14 ,21 28.</p>   |
| <p><b>IV—Record keeping</b><br/>(compliance with Criteria 52-54 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criterion 88 for the banking sector, criteria 106 and 107 for the insurance sector, and criterion 112 for the securities sector)</p>  |
| <p><b>Description</b></p>  |

<sup>19</sup> Draft revised guidance notes which were devised subsequent to the mission address this issue. The notes have been issued for consultation but are not yet effective.

52. Regulated Institutions are required to keep evidence of client identification by way of a copy of that evidence or a record indicating the nature of that evidence and providing such information as would enable a copy of it to be obtained, for a minimum retention period (PCMLR, Regulation 5(1)). The minimum retention period is 5 years from the closing of an account or from the date on which the transaction recorded took place, or where a Regulated Institution is informed by the Police that particular records may be relevant to an investigation which is being carried out, for such records to be retained pending the outcome of the investigation (PCMLR, Regulation 5(4)). The PCMLR does not require account files and business correspondences to be maintained in this manner, save for such records or copies of records containing such details of its business as may be necessary to assist an investigation into suspected ML activities, which regulated institutions are required to maintain for a minimum retention period (PCMLR, Regulation 5(2)). The BMA may require financial institutions to furnish it such information as may be reasonable in its regulatory and supervisory capacity (BMAA, Section 22(1)).

Paragraph 5 of the Regulations requires customer identity documents to be retained for at least 5 years from termination of an account or business relationship.

Paragraph 94 of the Notes indicates that entry records including verification documents should be maintained for a period of at least five years.

53. The requirements are provided for under the PCMLR and the 1998 Guidance Notes.

Paragraph 94 indicates that ledger records and all supporting records such as debit and credit slips should be maintained for at least five years following the date on which the relevant transaction was completed.

Paragraph 4(c) of the Regulations provides that in any case where a police officer has notified a regulated institution in writing that particular records are or may be relevant to an investigation which is being carried out, records shall be retained pending the outcome of the investigation.

53.1 Paragraph 97 of the Guidance Notes gives specific guidance as to what transaction records will generally comprise, including the names and addresses, of the customer, the beneficial owner of the account or product, any counterparty; details of securities and investments transacted including the nature of such securities/investments, valuation(s) and price(s), memoranda of purchase and sale, source(s) and volume of funds and bearer securities, destination(s) of funds and bearer securities, memoranda of instruction(s) and authority(ies), book entries, custody of title documentation, the nature of the transaction, the date of the transaction, the form (e.g., cash, cheque) in which funds are offered and paid out.

In relation to insurance business paragraph 145 indicates that insurers should have access to the client financial assessment, the needs analysis, details of payment method, illustration of benefits, post-sale records, and details of maturity processing and /or claim settlement.

The Guidance Notes contain no detailed guidance in relation to transaction records (other than those necessary to identify the customer ) that should be maintained by deposit taking institutions.<sup>20</sup>

54. Regulated institutions are required to keep all customer identification records and such records or copies of records containing such details of its business as may be necessary to assist an investigation into suspected ML activities, in such a way to allow for their retrieval in legible form within a reasonable period of time (PCMLR, Regulation 5(3)). Law enforcement authorities may have access to such records by way of production orders or monitoring orders under the PCA (PCA, Sections 37 and 41).

Regulated institutions are required to maintain the relevant records. The FIU has the powers to obtain production

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<sup>20</sup> See footnote 19.

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| orders from the Supreme Court under Section 37 of the PCA to obtain customer and transaction records from all financial institutions and from other persons.   |
| <b>Analysis of Effectiveness</b>   |
| 52. Regulation 5 of the PCMLR provides for record-keeping and Section 22 of the BMAA provides for the general power of the BMA to require financial institutions to furnish information.   |
| 53. The Guidance Notes contain no detailed guidance in relation to transaction records (other than those necessary to identify the customer ) that should be maintained by deposit taking institutions.  |
| 54. Regulation 5 of the PCMLR provides for record-keeping and Sections 37 and 41 of the PCA allows law enforcement authorities to have access to records by way of production or monitoring orders.  |
| <b>Recommendations and Comments</b>  |
| 53. The authorities should consider revisions to Regulation 5 (2) of the PCMLR to ensure that “business records” as specified in the Regulation is understood to mean all necessary records on transactions for the purpose of FATF Recommendation 12  |
| 53.1 The Guidance Notes should be amended to provide guidance in respect of transaction records (other than those necessary to identify the customer) that should be maintained by deposit taking institutions.  |
| <b>Implications for compliance with FATF Recommendation 12</b>   |
| <b>Bermuda is compliant with FATF 12</b>   |
| <b>V—Suspicious transactions reporting<br/>(compliance with Criteria 55-57 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 101-104 for the insurance sector)</b>   |
| <b>Description</b>   |
| 55. The PCA provides that a person is guilty of an offense if he knows or suspects that another person is engaged in money laundering which relates to any proceeds of drug trafficking, the information or other matter on which that knowledge or suspicion is based came to his attention during the course of his trade, profession, business or employment, and he did not disclose the information or other matter to a police officer as soon as it is reasonably practicable (PCA, Section 46(2)).   |
| Section 48(2) of the Proceeds of Crime Act makes it an offense to fail to report to a police officer a suspicion in relation to any form of criminal activity. The legal provisions do not as yet extend specifically to cover terrorist-related financing. Institutions are asked to report to the FIU on the basis of a standard form prescribed in the Guidance Notes.  |
| 55.1 The PCMLR provides for the internal reporting procedures to be established for regulated institutions, which include (i) identifying a MLRO to whom a report is to be made of any information or other matter which comes to the attention of an employee and which in the opinion of the employee gives rise to a knowledge or suspicion that another person is engaged in money laundering; (ii) requiring any such report to be considered by the MLRO in the light of all relevant information for the purpose of determining whether or not the relevant information does give rise to a knowledge or suspicion; (iii) allowing the MLRO to have access to any information which may be of assistance to him in considering the report; and (iv) requiring the MLRO to file a STR where he knows or suspects that a person is engaged in ML (PCMLR, Regulation 6). |
| Paragraph 6 of the Proceeds of Crime Regulations requires all regulated persons to have clear procedures for reporting communicated to all relevant personnel.   |
| Paragraphs 81–84 indicates that relevant employees should be required to report suspicions. On receipt of a report the reporting officer should determine whether a report should be made to the FIU. Where he so decides he must make the report promptly.  |

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| <p>Paragraph 80 of the Notes indicates that institutions should ensure that relevant employees know to whom their suspicious report should be made and that there is a clear procedure for making reports without delay.</p> <p>Appendix F contains a suggested format for reports.</p> <p>55.2 NAMLC issued the 1998 Guidance Notes and the 2001 Guidance Notes to provide guidance with respect to suspicious transactions generally and suspicious transaction reporting in the context of fiscal offenses.</p> <p>The Notes contain guidance as to the requirements and as to compliance with them, including providing examples of ML techniques and methods. FT is not covered.</p> <p>Paragraphs 7–25 of the Notes describe money laundering and explain the “duty of vigilance” and consequences of failure to be vigilant in the context of the relevant AML legislation.</p> <p>56. The PCA provides that any disclosure to a police officer by a person made in good faith with respect to his suspicion or belief that another person is engaged in ML or any information or matter on which that suspicion or belief is based, shall not be treated as a breach of any restriction upon the disclosure of information and shall not give rise to any civil liability (PCA, Section 46(1)).</p> <p>57. The PCA provides that a person is guilty of an offense if he knows or suspects that a police officer is acting or is proposing to act in connection with an investigation which is being or is about to be conducted on ML, and he discloses to any person information or other matter which is likely to prejudice that investigation or proposed investigation (PCA, Section 47).</p> <p>Discussions with FIs and the FIU suggest that directors, and staff of FIs generally have a close working relationship with the FIU and follow any instructions issued.</p> <p>All institutions visited had procedures in place for the reporting of suspicious transactions. The FIU appears to maintain close contact with institutions periodically speaking at training sessions organized by individual FIs. There is generally a high level of reporting among banks. However, one institution visited had never filed an SAR.</p> |
| <p><b>Analysis of Effectiveness</b></p> <p>55. Section 46(2) of the PCA refers to money laundering in the context of drug trafficking and not the other predicate offenses, which also excludes FT. It also does not designate the FIU and/or another competent authority to which the SARs should be sent. Similarly, the PCMLR and the NAMLC Guidance Notes do not refer to FT.</p> <p>55.1 and 55.2 The PCA and PCMLR only refer to reporting to a police officer and not the FIU, although the NAMLC Guidance Notes are more specific in prescribing filing of SARs to the FIU.</p> <p>56. The protection under Section 46(1) of the PCA applies only to ML and not FT, and does not specifically require for the disclosure to be made to the FIU.</p>   |
| <p><b>Recommendations and Comments</b></p> <p>55, 55.1, and 55.2 The authorities should incorporate provisions pertaining to FT at appropriate aspects of the PCA, the PCMLR, related laws and regulations and the NAMLC Guidance Notes. The Authorities should indicate that the FIU is the appropriate body for receiving SARs and dealing with financial information and intelligence in relation to ML and FT (as discussed under Criterion 17).</p> <p>56. The authorities should extend the scope of Section 46(1) of the PCA to include FT and specifying the disclosure to be made to the FIU.</p> <p>57. The authorities should consider extending the scope of Section 47 of the PCA to include FT.</p>   |
| <p><b>Implications for compliance with FATF Recommendations 15, 16, 17, 28</b></p> <p>Compliant with FATF 15,16,17 and 28</p>   |



VI—Internal controls, Compliance and Audit

(compliance with Criteria 58-61 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 89-92 for the banking sector, criteria 109 and 110 for the insurance sector, and criterion 113 for the securities sector)

58. The PCMLR imposes requirements for customer identification, record keeping, internal reporting, suspicious transaction reporting and employee training for AML purposes (PCMLR, Regulations 4, 5, 6, and 7). There is however no requirement for regulated institutions to audit their compliance processes.

58.1 The PCMLR provides that regulated institutions should from time to time (i) take appropriate measures for making all relevant employees aware of the PCA and related legislation for AML purposes, and of the procedures maintained by the regulated institutions in compliance with their obligations under the PCA and related legislation; and (ii) provide all relevant employees appropriate training in the recognition and handling of transactions of persons who are or appear to be engaged in ML (PCMLR, Regulations 7(1) and (2)).

Paragraph 2 of the Notes indicates that they represent good practice and suggests that those subject to the Proceeds of Crime Act 1997 and Proceeds of Crime (Money Laundering) Regulations 1998 should adopt internal procedures that are of equivalent standard.

Paragraph 12 indicates that banks should have procedures in place to determine true identity of customers, recognize and report suspicious transactions, keep records for prescribed time, train employees, liaise closely with FIU, ensure that the internal auditing and compliance department regularly monitors the implementation and operation of vigilance procedures.

There is no present requirement for an audit function to test the system. It is intended that revised Guidance Notes will address the need to have audit functions in place.

Paragraph 7 of the Regulations provides that a regulated institution shall take appropriate measures from time to time for the purpose of making all relevant employees aware of the Proceeds of Crime Act 1997, these Regulations and any other statutory provision relating to money laundering; and of the procedures maintained by the institution in compliance with the duties imposed under these Regulations. A regulated institution shall provide all relevant employees from time to time with appropriate training in the recognition and handling of transactions carried out by or on behalf of any person who is, or appears to be engaged in money laundering. Training under this regulation shall in addition be given to all new relevant employees as soon as practicable after their appointment.

Paragraph 105 sets out training that should be provided to various categories of employees including new employees, cashier, account opening staff, supervisors, managers, and reporting officers. It also indicates that there should be regular updates of training.

Paragraphs 7–25 of the Notes describes money laundering and explain the “duty of vigilance” and consequences of failure to be vigilant in the context of the relevant AML legislation.

59. The PCMLR provides for the designation of a MLRO (PCMLR, Regulations 6(1)).

Regulated persons are required under paragraph 6 of the Regulations to designate a reporting officer. Paragraph 16 of the Guidance Notes states that the reporting officer should be of sufficient authority to ensure compliance by the regulated institution with the Regulations.

60. There is currently no requirement for adequate screening procedures. although the BMA vets the persons who are to be appointed as directors or managers of Bermudian entities.

There is currently no formal legal requirement in relation to the screening of new employees. The BMA undertakes full checks on the fitness and propriety of senior personnel within licensed institutions. The BMA requires licensees to submit completed personal information questionnaires in respect of new senior staff. The authority undertakes full due diligence on such persons. The BMA uses databases such as Lexis Nexis, World Check, etc., and also makes

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| <p>enquiries with other regulatory authorities and other official sources.</p> <p>Paragraph 4 of the Guidance Notes indicates that where a regulated institution has a branch subsidiary or representative office in another country, it should ensure that the office observes the Guidance Notes or adheres to local standards provided that those standards are at least equivalent.</p> <p>61. The requirements are not provided under the PCA or the PCMLR, but under the 1998 Guidance Notes.</p> <p>Paragraph 5 of the Guidance Notes states that where a regulated institution operates branches or controls subsidiaries or has representative offices in another jurisdiction, it should ensure that such entities observe the Guidance Notes or adhere to local standards if those are at least equivalent; keep all such entities informed as to current group policy; and ensure that each such entity informs itself as to its own local reporting point equivalent to the FIU in Bermuda, and that it is conversant with procedures for disclosure to the FIU equivalent to Appendix G of the Guidance Notes.</p> <p>Where the BMA acts as consolidated supervisor, it expects standards at least equivalent to the minimum Bermuda requirements to be applied uniformly throughout a consolidated group.</p> <p>There is no documented requirement for licensees to inform the BMA of instances in which it is not possible to implement standards equivalent to those required in Bermuda.</p> <p>Institutions visited generally had internal systems in place that meet the requirements of the legal and regulatory framework. Training is generally provided on entry to the institutions with follow-up provided periodically thereafter. In general, more intense training is provided for front line and compliance staff. In the case of one institution, however, there was no requirement for periodic refresher training.</p> <p>Institutions indicated that they required branches and subsidiaries to apply at a minimum, Bermuda legal and regulatory requirements.</p> |
| <b>Analysis of Effectiveness</b>  |
| <p>58. The requirements under the PCMLR should be applicable for both AML and CFT purposes and that regulated institutions should be required to audit their compliance processes.</p> <p>59. Regulation 6(1) of the PCMLR provides for the designation of a MLRO.</p> <p>60. The legal requirements under the PCA and the PCMLR do not provide for financial institutions to put in place screening procedures.</p> <p>61. The legal requirements under the PCA and the PCMLR do not provide for financial institutions to require their foreign branches and subsidiaries to observe AML standards that are consistent with their home jurisdiction requirements. The requirement is set out in the Guidance Notes.</p>   |
| <b>Recommendations and Comments</b>   |
| <p>58. The authorities may wish to consider incorporating provisions for FT at appropriate instances and for requiring regulated institutions to audit their compliance processes.</p> <p>60. The authorities may wish to consider incorporating provisions for the screening of employees under the PCA or the PCMLR.</p> <p>61. The revised Guidance Notes should provide more detailed guidance on the function of the MLRO.</p>   |
| <b>Implications for compliance with the FATF Recommendations 19, 20</b>   |
| <p>Compliant with FATF 19 and 20.</p>   |
| <b>VII—Integrity standards</b><br>(compliance with Criteria 62 and 63 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criterion 14 for the securities sector)  |

| Description   |
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| <p>62. The requirements are not provided under the PCA or the PCMLR.</p> <p>The BMA, on behalf of MOF, undertakes due diligence on the beneficial owners of all companies seeking to incorporate in Bermuda or to obtain a permit to conduct business there. The Registrar will register a new company only when he has received approval from the BMA /MOF. Internet data-base searches are conducted for all applicants. For regulated entities the process is much more intense and includes due diligence on all the directors and senior executives and routinely includes police checks. A record of criminal activities or adverse regulatory judgments provides grounds to reject an application. Such vetting is also undertaken in all instances where there is a change in beneficial ownership.</p> <p>The directors, controllers and senior personnel of licensed financial institutions are required to be fit and proper persons. The requirement includes a review of all the matters listed. These institutions are also subject to provisions involving regulatory consent to all changes of controller.</p> <p>Paragraph 2 of the second schedule of the Bank and Deposit Companies Act indicates that in determining whether a person is a fit and proper person to hold any particular position, regard shall be had to his probity, to his competence and soundness of judgment for fulfilling the responsibilities of that position and to the diligence with which he is fulfilling or likely to fulfill those responsibilities.</p> <p>Paragraph 3 of the schedule indicates that regard may be had to any evidence that he has committed an offense involving fraud or other dishonesty or violence; contravened any provision made by or under any enactment appearing to the BMA to be designed for protecting members of the public against financial loss due to dishonesty, incompetence, or malpractice by persons concerned in the provision of banking, insurance, investment, or other financial services or the management of companies or against financial loss due to the conduct of discharged or undischarged bankrupts; engaged in any business practices appearing to the BMA to be deceitful or oppressive or otherwise improper (whether lawful or not) or which otherwise reflect discredit on his method of conducting business.</p> <p>Paragraph 1.1 (9) of the Guidance Notes issued under Section 28 (3) of the IBA indicate that fit and proper includes a conviction or finding of guilt in respect of any criminal offense other than a minor road traffic offense by any court of competent jurisdiction.</p> <p>63. The beneficial ownership of Bermudian entities is subject to vetting by the BMA. The Charities Commissioners conduct due diligence on application for charities and review the annual accounts of charities (which are also subject to public inspection).</p> <p>The Charities Commissioners conduct due diligence on applications for registration of charities and review the accounts that must be filed annually by every registered charity.</p> <p>No specific guidance was seen in relation to charities and shell corporations and not-for profit organizations.<sup>21</sup></p> |
| Analysis of Effectiveness   |
| <p>62. The legal requirements under the PCA and the PCMLR do not prohibit criminals holding or controlling a significant investment, or holding a senior position, in a financial institution.</p> <p>The absence of guidance in the current guidance notes in respect of charities, shell corporations and not-for profit organizations is a weakness.</p>   |

<sup>21</sup> Draft revised guidance notes which were devised subsequent to the mission address this issue. The notes have been issued for consultation but are not yet effective.

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| 63. Beneficial owners of entities and charities are vetted by the BMA and the Charities Commissioners respectively.   |
| <b>Recommendations and Comments</b>   |
| 62. The authorities should consider incorporating provisions for prohibiting criminals from holding or controlling a significant investment, or holding a senior position, in a financial institution under the PCA or the PCMLR.   |
| The revised Notes should provide guidance in relation to charities and shell corporations, charities and not-for profit organizations.  |
| The authorities should consider incorporating the concept of fit and proper in the IA to reinforce the vetting procedure that is currently in place and for consistency with the BDCA and the IBA.  |
| <b>Implications for compliance with FATF Recommendation 29</b>  |
| 62. Bermuda is compliant with Recommendation 29.  |
| <b>VIII—Enforcement powers and sanctions</b><br>(compliance with Criteria 64 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 93-96 for the banking sector and criteria 115-117 for the securities sector)   |
| <b>Description</b>  |
| As regulator for deposit-taking institutions, insurers, investment service providers and trust service providers, the BMA has power under the respective legislation to revoke or cancel the license or registration (where relevant) of the respective financial institutions (BDCA, Section 18; IA, Section 41; IBA, Section 13; and TRTBA, Section 16). Where an offense has been committed by one of the above financial institutions that is also a body corporate and where the offense has been committed with the consent of or connivance of, or is attributable to neglect on the part of, any officer of the financial institution, such officer as well as the financial institution shall be guilty of the offense (BDCA, Section 56; IA Section 55; IBA Section 27; and TRTBA, Section 53). |
| <b>Analysis of Effectiveness</b>  |
| 64. The powers under the BDCA, the IA, the IBA and the TRTBA do not apply to all financial institutions, such as company service providers, which are not regulated by the BMA. Whilst the BMA has the power of ultimately terminating the licenses or registration of deposit-taking institutions, insurers, investment service providers and trust service providers, it does not mean that the BMA has the necessary power of enforcement and sanction under the PCA, the Terrorism Order and related legislation.   |
| <b>Recommendations and Comments</b>   |
| 64. Whilst the approach seems to be for the respective authorities under the NAMLC (BMA, FIU) to have responsibility for their respective areas in the AML/CFT regime, for instance the BMA is principally concerned with customer due diligence and record-keeping and the FIU principally concerned with SARs and investigation and dissemination of financial information and intelligence, the authorities may wish to consider empowering the BMA and the FIU with the appropriate powers for enforcement and sanction.  |
| Apart from the withdrawal of a license the BMA has powers to restrict bank activity or a license. It may restrict a license by imposing such conditions as it thinks desirable for the protection of the institution’s depositors, and for safeguarding its assets....” It may  |
| <ul style="list-style-type: none"> <li>• require the institution to take certain steps or to refrain from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way;</li> <li>• impose limitations on the acceptance of deposits, the granting of credit, or the making of investments;</li> <li>• prohibit the institution from entering into any other transactions or class of transactions;</li> <li>• require the removal of any director, controller, or senior executive; and</li> <li>• specify requirements to be fulfilled otherwise than by action taken by the institution.</li> </ul>  |

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| <p>The BMA's powers of intervention in respect of insurance entities include the authority to order a company to take or refrain from taking certain actions if there is a significant risk of the insurer becoming insolvent or if a provision of the Insurance Act is violated, or if the conditions attached to the license have been breached. The BMA may also intervene where an insurer has failed to meet any liquidity ratios in addition to solvency margins as may be required by law or regulation, when matters threatening the solvency of an insurer are brought to its attention through a statutory financial return, audit, auditor or principle representative or where an insurer fails to retain a principle representative, loss reserve specialist or actuary as may be required by law (Section 32(4)).</p> <p>The powers include ordering the insurer to provide written particulars relating to its financial circumstances, to cease writing certain contracts of insurance or to cease writing all contracts for insurance, to refrain from making investments of a specified class and other powers of similar nature (Section 32). The BMA may direct an insurer threatened with insolvency to transfer specified assets for deposit in a banking institution determined by the BMA (Section 32 (3)). If a report has been required under Section 31-A or if an inspector has been appointed under Section 18-A (5), both of which apply only to Class 3 and Class 4 companies, the BMA must wait for the reports before taking action on the assets.</p> <p>Under the IBA, the BMA has the right to withdraw or suspend a license and under the <i>CIS Regulations</i> it has the authority to classify a collective investment scheme or withdraw the classification. In its short history of regulating investment businesses and collective investment schemes, it has relied on this power or the threat of it to enforce compliance with the law. The BMA also has an ability to levy fines under the IBA. The BMA could also refer violation of the law to the public prosecutor for prosecution through the courts. It also has the power to direct investment firms to take specific actions and appoint a custodian manager to oversee the operations of an investment firm if necessary.</p> |
| <p>IX—Cooperation between supervisors and other competent authorities<br/>(compliance with Criteria 65-67 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 97-100 for the banking sector and criteria 118-120 for the securities sector)</p>   |
| <p>Description</p>  |
| <p>65. The BMA is a full member of, and active participant in, the NAMLAC. As such, the BMA is fully involved in all aspects of the development and effective implementation of Bermuda's AML/CFT requirements, both as to policy and practice. A number of the BMA's policy and regulatory staff are well-versed in AML matters.</p> <p>Staff are trained domestically and internationally in areas related to AML/CFT. They participate in initiatives organized by the Compliance Officers Association and have attended training programs put on by CFATF and the Caribbean Anti-Money Laundering Program. The BMA's surveillance activity looks at AML/CFT risk along with other areas of risk.</p> <p>At the policy level principal responsibility for AML/CFT rests with the Enforcement Coordinator. AML/CFT surveillance activity is undertaken by staff responsible for the regulation of various financial sectors. On-site surveillance has been undertaken in respect of banks and investment firms. While reports are prepared by external auditors in respect of insurance companies, to date none of these has focused on AML/CFT issues.</p> <p>Over the last two years, the BMA's on-site visits to banking and investment firms have included reviews of AML/CFT policies and practices. Recent visits to investment firms have deliberately focused on AML/CFT issues. The only on-site surveillance undertaken in respect of insurance companies is carried out by auditors. The BMA gives no direction to such auditors in respect of issues related to AML/CFT which should be covered during on-site visits. As a result this is the only sector regulated by the BMA where on-site visits do not cover AML/CFT issues.</p>   |

66. The BMA liaises closely with other domestic agencies, and notably with the FIU, in dealing with anti-money laundering matters. The BMA is able to provide such assistance as may be required in connection with investigations/prosecutions.<sup>22</sup>

67. The BMA has the necessary powers and “gateways” enabling it to exchange information with supervisors internationally—see specifically the BMAA, Section 30A, and the individual regulatory statutes.<sup>23</sup> It can exchange any necessary information for regulatory purposes. However, in practice, most exchanges of information in relation to individual money laundering suspicions or issues take place between police or judicial authorities, and not through regulatory gateways. The BMA is able to share information with equivalent overseas regulators both to assist it in fulfilling its regulatory responsibilities and in order to assist another regulator. The overseas regulator needs to be subject to equivalent safeguards on disclosure of protected information.

The BMA does not require a memorandum of understanding (MOU) to be in place in order to cooperate with an overseas regulator although it has a small number currently in place or under negotiation. MOUs exist with Jersey and the Isle of Man.

The IBA provides the necessary powers for the BMA to obtain information. However, in one respect the present Act remains deficient as regards information-sharing. This is because the Act fails to override a general restriction in the Bermuda Monetary Authority Act 1969 on the provision of customer-specific information.<sup>24</sup>

Section 54 (2) of the BDCA indicates that restrictions placed on the sharing of information held by the Authority Section 52 do not preclude the disclosure of information for the purpose of enabling or assisting an authority in a country or territory outside Bermuda to exercise functions corresponding to the functions of the Authority under this Act.

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<sup>22</sup> The BMA does not in general have power to disclose any information regarding a customer of a financial institution which it has received in its regulatory and supervisory capacity. The exception is where the Minister of Finance may authorize by warrant any police officer of a minimum rank of inspector to inspect and take copies of such information, where the Minister takes the view that it is desirable to do so in the interest of internal security or for the detection of crime (BMAA, Sections 31(1C) and (2)). Moreover, sector-specific legislation, namely the BDCA, the IA and the TRTBA, allows the BMA to disclose information relating to banks, deposit companies, insurers and trust service providers to the Minister or another domestic authority where the disclosure is for the purpose of enabling the BMA to discharge its regulatory functions (BDCA, Sections 54(1); IA, Sections 52B(1); TRTBA, Sections 50(1)). A similar provision for investment service providers is included in the bill that has been proposed to replace the IBA. (The new legislation was enacted subsequent to the mission).

<sup>23</sup> The BMA has discretion as to whether it would assist a foreign regulatory authority that has requested assistance for the purpose of its regulatory functions. The basis for the BMA’s consideration includes whether corresponding assistance would be given to the BMA and the nature of the inquiry and the information to which the inquiry is sought (BMAA, Section 30A). In the exercise of its discretion, the BMA may require the financial institution to furnish it with such information or provide such assistance as it requires for the purpose of the inquiry (BMAA, Section 30B). In addition, the sector-specific legislation, namely the BDCA, the IA and the TRTBA, provides for the exchange of information between the BMA and foreign regulatory authorities with respect to the regulatory functions of the BMA with respect to banks, deposit companies, insurers and trust service providers (BDCA, Sections 54(2) and 55(1); IA, Sections 52B(2) and 52C(1); TRTBA, Sections 50(2) and 51(1)). Similarly, an equivalent provision for investment service providers is provided in the proposed bill for replacing the IBA. (The new legislation was enacted subsequent to the mission.)

<sup>24</sup> This deficiency is addressed by the IBA that was enacted subsequent to the mission.

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| <p>Section 55 of the draft IBA indicates the restrictions on the disclosure of information held by the BMA imposed by Section 53 of draft Act) do not preclude the disclosure of information for the purpose of enabling or assisting an authority in a country or territory outside of Bermuda that exercises functions corresponding to the functions of the BMA under the Act.</p>  |
| <p><b>Analysis of Effectiveness</b></p> <p>Bermuda has a generally effective framework for cooperation between supervisors and competent authorities.</p> <p>The absence of specific guidance on AML/CFT issues to auditors that undertake on-site visits to insurance entities on behalf on the BMA is a weakness.</p>  |
| <p><b>Recommendations and Comments</b></p> <p>65. The current initiative by the BMA to review its resources should ensure that resources are adequate to provide for sustained on-site surveillance in respect of AML/CFT as well as all other areas of risk.</p> <p>The BMA should provide specific directions to auditors of insurance entities indicating AML/CFT issues to be examined during on-site examinations.</p> <p>67. The current initiative to amend the IBA to provide for the exchange of information between the BMA and foreign regulatory authorities for the purposes of discharging the BMA’s regulatory function should be expedited.<sup>25</sup></p> |
| <p><b>Implications for compliance with FATF Recommendation 26</b></p> <p>Bermuda is compliant with recommendation 26.</p>  |

### Description of the controls and monitoring of cash and cross-border transactions

Table 6. Description of the Controls and Monitoring of Cash and Cross Border Transactions

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| <p><b>FATF Recommendation 22:</b></p>   |
| <p><b>Description</b></p> <p>Bermuda Customs has the ability to find and seize cash and negotiable instruments it regards as suspicious under the powers conferred by Section 50 of the Proceeds of Crime Act and by Section 96 of the Revenue Act 1898. Bermuda Customs liaises closely with the Bermuda Police Service and with U.S. and U.K. Customs regarding intelligence on individuals suspected of carrying large amounts of cash, etc. A number of seizures have been made in accordance with the provisions cited above. Bermuda Customs sees the intended addition of a currency declaration to the Immigration /Customs form as reinforcing their present arrangements and simplifying the seizure process.</p> <p>Section 92 of the Revenue Act requires an accounting of bullion or coins imported into Bermuda to be delivered to Customs within ten days of their arrival in Bermuda. Failure to deliver a full and true account subjects the importer, etc., to a financial penalty.</p> |
| <p><b>FATF Recommendation 23:</b></p>   |
| <p><b>Description</b></p>   |

<sup>25</sup> The new IBA came into effect in January 2004.

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| Bermuda has considered options for routine reporting of all financial transactions above a threshold. However, this is not seen as adding value, given the incidence of entirely legitimate high value commercial transactions. Instead, in common with many other countries, it has been judged much more effective to apply a system whereby suspicions-based reporting to the authorities occurs. Information on all underlying transactions is, of course, available to the FIU within the banks for investigatory purposes as and when the need arises. |
| <b>Interpretative Note to FATF Recommendation 22:</b>  |
| <b>Description</b>   |
| The NAMLC Consultative Paper (paragraph 4(e)) proposes an amendment to the Proceeds of Crime Act 1997 introducing an obligation to report /declare cross-border movements of cash and negotiable instruments. This is intended to involve the addition of a specific question to the Immigration / Customs form completed by persons arriving in Bermuda. It is likely that the obligation would be to notify amounts of \$10,000 (or foreign currency equivalent) or greater.   |

### III. RATINGS OF COMPLIANCE WITH FATF RECOMMENDATIONS, SUMMARY OF EFFECTIVENESS OF AML/CFT EFFORTS, RECOMMENDED ACTION PLAN, AND AUTHORITIES' RESPONSE TO THE ASSESSMENT

Table 7. Ratings of Compliance with FATF Recommendations Requiring Specific Action

| FATF Recommendation  | Based on Criteria Rating | Rating            |
|--|--------------------------|-------------------|
| 1 – Ratification and implementation of the Vienna Convention   | 1                        | Compliant         |
| 2 – Secrecy laws consistent with the 40 Recommendations  | 43                       | Compliant         |
| 3 – Multilateral cooperation and mutual legal assistance in combating ML   | 34, 36, 38, 40           | Compliant         |
| 4 – ML a criminal offense (Vienna Convention) based on drug ML and other serious offenses.   | 2                        | Compliant         |
| 5 – Knowing ML activity a criminal offense (Vienna Convention)   | 4                        | Largely Compliant |
| 7 – Legal and administrative conditions for provisional measures, such as freezing, seizing, and confiscation (Vienna Convention)                      | 7, 7.3, 8, 9, 10, 11     | Largely Compliant |
| 8 – FATF Recommendations 10 to 29 applied to non-bank financial institutions; (e.g., foreign exchange houses)  |                          | Largely Compliant |
| 10 – Prohibition of anonymous accounts and implementation of customer identification policies  | 45, 46, 46.1             | Largely Compliant |
| 11 – Obligation to take reasonable measures to obtain information about customer identity  | 46.1, 47                 | Largely Compliant |
| 12 – Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer identification documents                      | 52, 53, 54               | Compliant         |
| 14 – Detection and analysis of unusual large or otherwise suspicious transactions  | 17.2, 49                 | Compliant         |
| 15 –If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the FIU | 55                       | Compliant         |
| 16 – Legal protection for financial institutions, their  | 56                       | Compliant         |



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| directors and staff if they report their suspicions in good faith to the FIU  |  |                          |
| 17 – Directors, officers and employees, should not warn customers when information relating to them is reported to the FIU  | 57   | Compliant                |
| 18 – Compliance with instructions for suspicious transactions reporting   | 57   | Compliant                |
| 19 – Internal policies, procedures, controls, audit, and training programs  | 58, 58.1, 59, 60   | Compliant                |
| 20 – AML rules and procedures applied to branches and subsidiaries located abroad   | 61   | Compliant                |
| 21 – Special attention given to transactions with higher risk countries   | 50, 50.1   | Compliant                |
| 26 – Adequate AML programs in supervised banks, financial institutions or intermediaries; authority to cooperate with judicial and law enforcement  | 66   | Compliant                |
| 28 – Guidelines for suspicious transactions’ detection  | 17.2, 50.1, 55.2   | Compliant                |
| 29 – Preventing control of, or significant participation in financial institutions by criminals   | 62   | Compliant                |
| 32 – International exchange of information relating to suspicious transactions, and to persons or corporations involved   | 22, 22.1, 34   | Largely Compliant        |
| 33 – Bilateral or multilateral agreement on information exchange when legal standards are different should not affect willingness to provide mutual assistance  | 34.2, 35.1   | Compliant                |
| 34 – Bilateral and multilateral agreements and arrangements for widest possible range of mutual assistance  | 34, 34.1, 36, 37   | Compliant                |
| 37 – Existence of procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution | 27, 34, 34.1, 35.2   | Materially Non-Compliant |
| 38 – Authority to take expeditious actions in response to foreign countries’ requests to identify, freeze, seize and confiscate proceeds or other property  | 11, 15, 16, 34, 34.1, 35.2, 39   | Materially Non-Compliant |
| 40 – ML an extraditable offense   | 34, 40   | Compliant                |
| SR I – Take steps to ratify and implement relevant United Nations instruments   | 1, 34  | Materially Non-Compliant |
| SR II – Criminalize the FT and terrorist organizations  | 2.3, 3, 3.1  | Materially Non-Compliant |
| SR III – Freeze and confiscate terrorist assets   | 7, 7.3, 8, 13  | Materially Non-Compliant |
| SR IV – Report suspicious transactions linked to terrorism  | 55   | Materially Non-compliant |
| SR V – provide assistance to other countries’ FT investigations   | 34, 34.1, 37, 40, 41   | Materially Non-compliant |
| SR VI – impose AML requirements on alternative remittance systems   | 45, 46, 46.1, 47, 49, 50, 50.1, 52, 53, 54, 55, 56, 57, 58, 58.1, 59, 60, 61, 62 | Not Rated                |
| SR VII – Strengthen customer identification measures for wire transfers   | 48, 51   | Not Rated                |

Table 8. Summary of Effectiveness of AML/CFT efforts for each heading

| Heading  | Assessment of Effectiveness  |
|--|--|
| <b>Criminal Justice Measures and International Cooperation</b> |  |
| I—Criminalization of ML and FT                                 | <p>1. The PCA, the CJIBA and the Terrorism Order are the principal legislation for the purpose of the Vienna Convention and the UN Resolution 1373. The UN International Convention for the Suppression of Terrorism (1999) and the UN Convention Against Transnational Organized Crime (2002) have not been extended to Bermuda.</p> <p>2. The PCA provides for (i) the criminalization of ML; and (ii) the scope of predicate offenses to be extended to relevant indictable offenses as well as drug trafficking offenses; and (iii) the ML offenses to be applicable to persons who have committed the ML offense and persons who have committed both the ML and the predicate offenses.</p> <p>3. The Terrorism Order provides for the prosecution of the collection, receipt and provision of funds for terrorism. It does not however criminalize terrorists acts nor provide for terrorist organizations (although financing of terrorism could be committed by bodies corporate for the purpose of the Terrorism Order), although it provides for prosecution when the terrorist acts take place outside Bermuda. Terrorist acts are therefore not predicate offenses for the purpose of the AML legislation.</p> <p>4. For the ML offenses under PCA, it seems that the mens rea requirement ranges from “intention”, “knowledge”, “suspicion” and “reasonable grounds to suspect”, with “knowledge” being the common requirement. The tests for “intention”, “knowledge” and “suspicion” are subjective to the extent that it would be necessary to determine what was in the mind of a person in order to ascertain whether or not the person should be guilty of one of the ML offenses. The test for “reasonable grounds to suspect” as expressly set out in the case of the Section 43(2) offense (and as suggested by the authorities to also extend to the Section 44(1) offense) has both subjective and objective elements in the sense that it would be necessary for the prosecution to show that the person should have been suspicious in the particular instance and that a reasonable person would have found grounds for suspicion in that instance. Nonetheless, given that there has been no prosecution of the ML offenses to date, it remains to be seen how the courts would approach the mens rea requirement of</p> |

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|   | <p>these offenses.</p> <p>5. It would seem that the criminal sanctions under the PCA are dissuasive although the terms of imprisonment under the PCA may be rather rigorous given that punishment for some of the predicate offenses may be lower than the ML offenses. The maximum fine for summary conviction under the Terrorism Order is rather low.</p>  |
| <p>II—Confiscation of proceeds of crime or property used to finance terrorism</p>   | <p>7 and 8. There is currently no provision for civil forfeiture for the purpose of ML offenses. The scope for the application of Section 39(1) of the PCA should extend to investigation of relevant offenses as defined under the PCA and not merely with regard to drug trafficking offenses, a person has benefited from criminal conduct and the whereabouts of any proceeds of criminal conduct. It is also unclear what is meant by the need to show as one of the limbs of the criteria to be satisfied before the production order is granted, that “it is in the public interest having regard to the benefit likely to accrue to the investigation if the material is so obtained, as well as (ii) the circumstances under which the person in possession of the material holds it”, (i.e., whether the requirement would unduly impede the application for production orders in practice).</p> <p>9. Sections 16(1) and (2) of the PCA provides for the protection of third parties in this regard.</p> <p>10. There is currently no provision for rendering contracts void or unenforceable on the basis that parties to the contracts knew or should have known that authorities would, as a result of the contracts, be prejudiced in their ability to recover financial claims under the AML/CFT regime.</p> <p>13. The Terrorism Order does not have provisions that deal with seizure and confiscation of property that is the proceeds of or are to be used for terrorism, terrorist acts or by terrorist organizations,</p> <p>13.1 / 14 Article 5(1) of the Terrorism Order provides for the restraint of funds and property in this regard.</p> <p>15. Section 55A of the PCA provides for the establishment of such an asset forfeiture fund (the CAF).</p> <p>16. The asset forfeiture fund (the CAF) established under Section 55A of the PCA provides for such asset-sharing mechanism.</p> |
| <p>III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence</p> | <p>17. Whilst the 1998 Guidance Notes have provided for the FIU to deal with the SARs and the PCMLR provides</p>  |

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| <p>at the domestic and international levels</p> | <p>for SARs to be made to police officers, the law does not expressly set out the role of the FIU in receiving, analyzing and disseminating information and intelligence relating to ML and FT activities (for instance, police officers are to include officers from the Customs Department for the purpose of the PCA (PCA, Section 57(1)). Given that the FIU is deemed to be the competent authority for the purpose of carrying out the function of a financial intelligence unit and has been established as such, the authorities may wish to consider stating this more clearly in the legislation. This is of particular concern since civilians may eventually be recruited to bring additional expertise to the FIU and civilians are not subject to the same obligations as police officers (such as that relating to disclosure of information, which is integral to the work of the FIU), and to mitigate challenges against the FIU on its authority to carry out its functions as a financial intelligence unit.</p> <p>18. It is important for the FIU to be able to obtain the production orders and the monitoring orders efficiently in order for its work to be effective in practice, especially given the question that is currently being considered in court of whether orders which involve the non-criminal aspects of the PCA should be properly brought by the Attorney-General's Chambers (which deals with the non-criminal aspects of the AML/CFT regime) or the Office of the Director of Prosecutions.</p> <p>19. See analysis for Criterion 18.</p> <p>20. The FIU and the BMA do not have express powers to impose sanctions or penalties under the AML/CFT regime.</p> <p>21. Whilst the FIU has been empowered to disseminate financial information and intelligence to domestic authorities for investigation or action, the authority is not expressly provided under the PCA or the PCMLR and it is preferable for the authority to be provided under the AML/CFT legislation.</p> <p>22. The FIU has the power to share financial information and intelligence with its foreign counterparts provided that it does not to disclose any financial information or intelligence save for the purpose of carrying out its functions.</p> |
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| <p>IV—Law enforcement and prosecution authorities, powers and duties</p>       | <p>26. The general powers of the Police provide for the use of relevant investigative techniques.</p> <p>27. The relevant powers under the PCA allow law enforcement authorities to obtain information by way of the relevant orders.</p>  |
| <p>V—International cooperation</p>   | <p>34. The provisions under Sections 5(1) and 6(1) of the CJICBA provide for the obtaining of evidence for use in Bermuda and overseas, although they do not provide for powers of search and seizure. The provisions of the CJICBA would seem to apply for the purposes of ML and FT.</p> <p>36. Bermuda has the benefit of international conventions or treaties extended to it by the U.K. Government but is unable to enter into these international conventions or treaties. However, the CJICBA provides for direct request for mutual legal assistance between Bermuda and another country or territory.</p> <p>37. There have not been many instances of mutual legal assistance to date although the avenues, by way of the CJICBA, are broadly in place should there be a need to make or to respond to a request.</p> <p>38. The agency-to-agency cooperation between law enforcement agencies appears to be in place for cooperation in investigation.</p> <p>40. Extradition for the principal offenses under the PCA and the Terrorism Order would be permissible under the Extradition Act 1989 to such countries that have extradition arrangements with the U.K. Government, although they have not been expressly recognized as extraditable offenses.</p> |
| <p><b>Legal and Institutional Framework for All Financial Institutions</b></p> |  |
| <p>I—General framework</p>   | <p>43. There is no general secrecy law and the common law on customer confidentiality does not limit the disclosure of information where relevant, such as pursuant to public interest (such as for the purpose of preventing fraud or criminal conduct).</p> <p>44. Whilst Bermuda has an extensive AML/CFT regime, there remains room for ensuring that the requirements under the FATF 40+8 Recommendations are fully incorporated into the AML/CFT legislation. In addition, it is important for the scope of regulated institutions covered under the PCMLR and the NAMLC Guidance Notes to be extended. For instance, consideration could be given to extending the scope to professionals such as</p>   |

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|  | <p>lawyers and accountants.</p> <p>The reference in Regulation 2(2)(a)(iv) of the PCMLR to such insurers that are part of regulated institutions as “a company or society registered under the IA to the extent that it is carrying out long term insurance (but not reinsurance) under the IA, other than life insurance and disability insurance” is unclear as to the category of insurers that is treated as regulated institutions and therefore subject to the PCMLR (and the Guidance Notes.</p> <p>The PCMLR does not cover persons captured by the Investment Business (Exemption) Order. While this is acceptable in respect of persons who do not act as intermediaries or deal directly with client assets it is not clear that that all exempt persons fall into this category.</p>   |
| <p>II—Customer identification</p>                          | <p>45. Whilst Regulation 4(1) of the PCMLR provides a requirement for regulated institutions to obtain customer identification by way of establishing and maintaining identification procedures, there is no explicit legal requirement that such procedures be followed.</p> <p>46, 46.1, and 46.2. The legal requirements under the PCA and the PCMLR do not provide for customer identification requirements and for renewing identification with existing customers although the Consultation Paper is considering the possible introduction of such requirements. Draft revised guidance notes which were devised subsequent to the mission address this issue. The notes have been issued for consultation but are not yet effective. Customer identification requirements are currently listed in the 1998 Guidance Notes.</p> <p>47. Regulation 4(4) of the PCMLR provides for reasonable measures to be taken for establishing the identity of underlying principals.</p> <p>48. There is presently no legislation in place with respect to recording originator information by financial institutions.</p> |
| <p>III—Ongoing monitoring of accounts and transactions</p> | <p>51 The existing arrangements in respect of guidance re. the monitoring of originator information on wire transfers will need to be enhanced when the FATF requirements for wire transfers becomes effective.</p>  |
| <p>IV—Record keeping</p>                                   | <p>52. Regulation 5 of the PCMLR provides for record-keeping and Section 22 of the BMAA provides for the general power of the BMA to require financial institutions to furnish information.</p> <p>53. The Guidance Notes contain no detailed guidance in</p>  |

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|   | <p>relation to transaction records (other than those necessary to identify the customer ) that should be maintained by deposit taking institutions.</p> <p>54. Regulation 5 of the PCMLR provides for record-keeping and Sections 37 and 41 of the PCA allows law enforcement authorities to have access to records by way of production or monitoring orders.</p>  |
| <p>V—Suspicious transactions reporting</p>        | <p>55. Section 46(2) of the PCA refers to money laundering in the context of drug trafficking and not the other predicate offenses, which also excludes FT. It also does not designate the FIU and/or another competent authority to which the SARs should be sent. Similarly, the PCMLR and the NAMLC Guidance Notes do not refer to FT.</p> <p>55.1 and 55.2 The PCA and PCMLR only refer to reporting to a police officer and not the FIU. The NAMLC Guidance Notes are more specific in prescribing filing of SARs to the FIU.</p> <p>56. The protection under Section 46(1) of the PCA applies only to ML and not FT, and does not specifically require for the disclosure to be made to the FIU.</p>                |
| <p>VI—Internal controls, compliance and audit</p> | <p>58. The requirements under the PCMLR should be applicable for both AML and CFT purposes and that regulated institutions should be required to audit their compliance processes.</p> <p>59. Regulation 6(1) of the PCMLR provides for the designation of a MLRO.</p> <p>60. The legal requirements under the PCA and the PCMLR do not provide for financial institutions to put in place screening procedures.</p> <p>61. The legal requirements under the PCA and the PCMLR do not provide for financial institutions to require their foreign branches and subsidiaries to observe AML standards that are consistent with their home jurisdiction requirements. The requirement is set out in the Guidance Notes.</p> |
| <p>VII—Integrity standards</p>                    | <p>62. The legal requirements under the PCA and the PCMLR do not prohibit criminals holding or controlling a significant investment, or holding a senior position, in a financial institution.</p> <p>The absence of guidance in respect of charities, shell corporations, and not-for profit organizations is a weakness.</p>  |

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|   | 63. Beneficial owners of entities and charities are vetted by the BMA and the Charities Commissioners, respectively.  |
| VIII—Enforcement powers and sanctions                               | 64. The powers under the BDCA, the IA, the IBA and the TRTBA do not apply to all institutions, such as company service providers, which are not regulated by the BMA. Whilst the BMA has the power of ultimately terminating the licenses or registration of deposit-taking institutions, insurers, investment service providers and trust service providers, it does not mean that the BMA has the necessary power of enforcement and sanction under the PCA, the Terrorism Order and related legislation. |
| IX—Co-operation between supervisors and other competent authorities | Bermuda has a generally effective framework for cooperation between supervisors and competent authorities.<br><br>The absence of specific guidance on AML/CFT issues to auditors that undertake on-site visits to insurance entities on behalf on the BMA is a weakness.  |

Table 9. Recommended Action Plan to Improve the Legal and Institutional Framework and to Strengthen the Implementation of AML/CFT Measures in Banking, Insurance, and Securities Sectors

| <b>Criminal Justice Measures and International Cooperation</b>             | <b>Recommended Action</b>   |
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| I—Criminalization of ML and FT   | <p>3. Authorities should expedite current initiatives to introduce provisions for terrorist offenses per se and related matters.</p> <p>4. The authorities may wish to consider whether to incorporate an objective test to the mens rea requirement for the money laundering offenses under Section 43(1) and 45(1) (and Section 44(1) offense).</p> <p>5. The authorities may wish to consider whether civil sanctions for ML and FT are suitable for the jurisdiction.</p> <p>6. <i>There is the need to assign adequate resources to the intelligence / investigative units and there must be clearly defined roles; that is, a team for specific data entry and basic information gathering and a team of investigators for the sole purpose of investigating matters and enabling prosecutions.</i></p> |
| II—Confiscation of proceeds of crime or property used to finance terrorism | 7 and 8. The authorities may wish to consider whether to introduce provisions for civil forfeiture. The scope for the application of Section 39(1) of the PCA should extend to investigation of relevant  |



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|  | <p>offenses as defined under the PCA and not merely with regard to drug trafficking offenses, whether a person has benefited from criminal conduct and the whereabouts of any proceeds of criminal conduct.</p> <p>10. The authorities may wish to consider incorporating relevant provisions for rendering contracts void or unenforceable on the basis that parties to the contracts knew or should have known that authorities would, as a result of the contracts, be prejudiced in their ability to recover financial claims under the AML/CFT regime.</p> <p><i>11. There is a need to limit access to the data base to FIU personnel only.</i></p> <p><i>12. There is the need for refresher training for the staff of the FIU. Consideration should also be given to awareness raising programs for prosecutors and the judiciary. There is the need for investigators to have relevant accreditation. Specific training plans ought to be included in the overall training program and accordingly budgeted for.</i></p> |
| <p>III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels</p> | <p>17. The authorities may wish to consider amending the PCA or related legislation to establish the FIU formally (i.e., there should be a legal requirement for the FIU to receive SARs directly from FIs).</p> <p>20, 21, and 22. The authorities may wish to consider stating more explicitly the powers of the FIU.</p> <p><i>24. It is recommended that the FIU be allocated separate offices properly secured and in an accessible location to the commercial centre. Authorities indicated that efforts are on-going to find appropriate accommodation.</i></p> <p><i>While careful dissemination of information is vital, the FIU should endeavor to publish information relating to trends and typologies.</i></p>   |
| <p>IV—Law enforcement and prosecution authorities, powers and duties</p>   | <p>26.1 <i>The FIU needs to enhance its intelligence cell and continued to work with other units. It also needs to build and utilize informants more.</i> The increase in staffing levels should assist in this regard.</p> <p><i>29. Separate provisions must be made in the budget for training.</i></p> <p><i>31. There is the need to intensify the Police’s awareness of the FIU in order to facilitate further exchange of information.</i></p>   |

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|   | <p>33. <i>There is need for clarification in respect of the role the offices of the DPP and the Attorney General in relation to confiscation, restraining and monitoring orders.</i></p>   |
| V—International cooperation   | <p>34. The authorities should incorporate more specific provisions for mutual legal assistance in enforcement matters, such as powers of search and seizure.</p> <p>40. The authorities should consider introducing express provisions for ML and FT offenses as extraditable offenses.</p>  |
| <b>Legal and Institutional Framework for Financial Institutions</b> |  |
| I—General framework   | <p>44. The limitation to the scope of the PCMLR and the NAMLC Guidance Notes has been recognized in the Consultation Paper; the authorities may wish to consider extending the scope of the PCMLR and the NAMLC Guidance Notes beyond the range of financial institutions that are currently regulated to cover company service providers and professionals, such as accountants and lawyers.</p> <p>The authorities should put in place suitable monitoring arrangements to ensure adequate monitoring of AML/CFT systems employed by these entities</p> <p>The authorities may also wish to revise the reference to insurers under Regulations 2(2)(a)(iv) of the PCMLR to clarify the category of insurers that is treated as regulated institutions and therefore subject to the PCMLR (and the Guidance Notes). The PCMLR should be reviewed to ensure that all persons conducting investment business who act as intermediaries or deal in client assets are captured by the legislation. Such persons should also be covered by the BMA’s supervision in respect of AML/CFT.</p> <p>.The BMA should provide specific directions to auditors of insurance entities indicating AML/CFT issues to be examined during on-site examinations.</p> |
| II—Customer identification  | <p>45. The PCMLR should be amended to explicitly require that customer identification procedures be followed by the regulated institutions. Moreover the authorities should require financial institutions to (i) identify their customers on the basis of official or other identifying document; (ii) record their customers’ identity when establishing business relations; (iii) identify and record the identity of their occasional customers when performing transactions over a specified threshold; and (iv) renew identification when doubts appear as to their identity in the course of the business relationship.</p>   |

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|  | <p>Wording in paragraphs 58 and 68 of the Notes “The relevance and usefulness of the following ... information should be considered” should be amended to more clearly indicate the practices that licensees are expected to follow.</p> <p>Consideration should be given to amending the framework for introduced business to require that documentation pertaining to customer identity by submitted without delay by the introducer to the FI.</p> <p>The Notes should be amended to provide guidance in relation to reverification, PEPS, non face-to-face customers and correspondent banking relationships.</p> <p>The BMA should impose a requirement for (i) originator information to remain with transfers or related messages through the payment chain within the deadline established by the FATF; and (ii) introduce a requirement to give enhanced scrutiny to wire transfers that do not contain complete originator information within the deadline established by the FATF.</p> |
| <p>III—Ongoing monitoring of accounts and transactions</p> | <p>49. The authorities should require financial institutions to (i) pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose; (ii) examine as far as possible the background and purpose of such transactions; (iii) set forth their findings in writing; and (iv) to keep such findings available for competent authorities.</p> <p>51. See recommendation for criterion 48.</p>   |
| <p>IV—Record keeping</p>                                   | <p>53. The authorities could consider revisions to Regulation 5 (2) of the PCMLR to ensure that “business records” as specified in the Regulation is understood to mean all necessary records on transactions for the purpose of FATF Recommendation 12.</p> <p>53.1 The Guidance Notes should be amended to provide guidance in respect of transaction records (other than those necessary to identify the customer) that should be maintained by deposit taking institutions.</p>   |
| <p>V—Suspicious transactions reporting</p>                 | <p>55, 55.1, and 55.2 The authorities should incorporate provisions pertaining to FT at appropriate aspects of the PCA, the PCMLR related laws and regulations and the NAMLC Guidance Notes. The Authorities</p>  |

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|  | <p>should indicate that the FIU is the appropriate body for receiving SARs and dealing with financial information and intelligence in relation to ML and FT (as discussed under Criterion 17).</p> <p>56. The authorities should extend the scope of Section 46(1) of the PCA to include FT and specifying the disclosure to be made to the FIU.</p> <p>57. The authorities should extend the scope of Section 47 of the PCA to include FT.</p>   |
| <p>VI—Internal controls, compliance and audit</p>                          | <p>58. The authorities may wish to consider incorporating provisions for FT at appropriate instances and for requiring Regulated Institutions to audit their compliance processes.</p> <p>60. The authorities may wish to consider incorporating provisions for the screening of employees under the PCA or the PCMLR.</p> <p>61. The revised Guidance Notes should provide more detailed guidance on the function of the MLRO.</p>   |
| <p>VII—Integrity standards</p>   | <p>62. The authorities should consider incorporating provisions for prohibiting criminals from holding or controlling a significant investment, or holding a senior position, in a financial institution under the PCA or the PCMLR.</p> <p>The revised Notes should provide guidance in relation to charities, shell corporations, and not-for profit organizations.</p> <p>The authorities should consider incorporating the concept of fit and proper in the IA to reinforce the vetting procedure that is currently in place and for consistency with the BDCA and the IBA.</p> |
| <p>VIII—Enforcement powers and sanctions</p>                               | <p>64. Whilst the approach seems to be for the respective authorities under the NAMLC (BMA, FIU) to have responsibility for their respective areas in the AML/CFT regime, for instance, the BMA is principally concerned with customer due diligence and record-keeping and the FIU principally concerned with SARs and investigation and dissemination of financial information and intelligence, the authorities may wish to consider empowering the BMA and the FIU with the appropriate powers for enforcement and sanction.</p>  |
| <p>IX—Co-operation between supervisors and other competent authorities</p> | <p>65. The current initiative by the BMA to review its resources should ensure that resources are adequate to provide for sustained on-site surveillance in respect of AML/CFT as well as all other areas of risk.</p>  |

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|   | <p>The BMA should provide specific directions to auditors of insurance entities indicating AML/CFT issues to be examined during on-site examinations.</p> <p>67. The current initiative to amend the IBA to provide for the exchange of information between the BMA and foreign regulatory authorities for the purposes of discharging the BMA's regulatory function should be expedited.<sup>26</sup></p> |
| <b>Banking Sector based on Sector-Specific Criteria</b>             | 53.1 The Guidance Notes should be amended to provide guidance in respect of transaction records (other than those necessary to identify the customer) that should be maintained by deposit taking institutions.  |
| <b>Insurance Sector based on Sector-Specific Criteria</b>           |  |
| II—Customer identification  |  |
| VII Integrity standards   | The authorities should consider incorporating the concept of fit and proper in the IA to reinforce the vetting procedure that is currently in place and for consistency with the BDCA and the IBA.   |
| VI—Internal controls, compliance and audit                          | The BMA should provide specific directions to auditors indicating AML/CFT issues to be examined during on-site examinations of insurance companies.  |
| <b>Securities Sector based on Sector-Specific Criteria</b>          |  |
| IX—Co-operation between supervisors and other competent authorities | There should be a provision in the IBA to allow the Authority to share information with other regulatory authorities. <sup>27</sup>  |

### Authorities' response

Bermuda welcomes the fact that the assessment has confirmed the robustness of the measures in place to protect our institutions and markets from money laundering and terrorist financing abuses. As the assessment also notes, Bermuda is already engaged in taking steps to introduce further enhancements to its present arrangements, reflecting in particular the revised standards put in place by the FATF in its recent Revised Recommendations, together with the additional Special Recommendations on anti-terrorist financing measures. The necessary changes are being carried forward as a priority, illustrating Government's firm commitment to continuing to meet international standards in its international business and its determination to protect Bermuda's reputation as a high quality financial services centre.

<sup>26</sup> The new legislation was enacted subsequent to the mission.

<sup>27</sup> This deficiency is addressed by the IBA that was enacted subsequent to the mission.

#### **IV. DETAILED ASSESSMENT REPORT ON OBSERVANCE OF THE INSURANCE CORE PRINCIPLES OF INSURANCE REGULATION**

##### **A. General**

34. The assessment of the Insurance Sector was performed as part of an OFC assessment for Bermuda. The main objectives of the assessment are to determine the levels of observance with the International Association of Insurance Supervisors (IAIS) Principles, and to suggest areas where further development may be appropriate.

35. The assessment is based on Bermudian regulation: Bermuda Monetary Authority Act 1969, amended in 1993, 1997, 1998, 1999, 2000, and 2001; the Bermuda Monetary Authority (Financial Institutions) (Control) Regulations of 1994; the Insurance Act of 1978, amended in 1995, 1998, 2001 and 2002, and the 2002 Statement of Principles; the Insurance Accounts Regulations 1980, as amended; the Insurance Returns and Solvency Regulations 1980, as amended, the Government Fees Amendment (n<sup>o</sup>2) Regulations 2002, the Life Insurance Act 1978, as amended, the Companies Act, as amended, and the Exchange Control Act of 1972.

36. The mission met with senior officials and staff of the Ministry of Finance, the Bermuda Monetary Authority and, especially, with the insurance supervision division, all involved in the supervision and regulation of the insurance system. The mission also met with representatives of insurance companies (XL, IPC Re, Renaissance Re, Allied World Assurance Company), captive managers (Aon, Liberty International, International Advisory Services), actuaries (Swiss Re, AIG, and Partner Re) and auditors (PriceWaterhouseCoopers, KPMG, and Ernst & Young).

##### **B. Information and Methodology Used for Assessment**

37. The review of the IAIS Core Principles (October 2000) involved the review of the self-assessment prepared by the Bermuda Monetary Authority, comparison with the Core Principles and the Core Principles Methodology, the Standards and Principles already adopted, and a review of the necessary parts of the insurance laws.

38. Bermudian regulation does not distinguish between insurance and reinsurance companies primarily because Bermuda has always been known to be a predominantly a captive and reinsurance market. Market data reflects the system of licensing that has four classes of general business insurers, and the data that makes a distinction between direct and assumed business covers less than 60 percent of net premiums (in 2001). The direct business done in Bermuda is, in its overwhelming majority, with “household name” companies (Fortune 1000 U.S. companies or companies of comparable size from other domiciles), be it through captives or commercial companies. The characteristics of this type of direct business that deals with corporate accounts more closely parallel reinsurance than direct insurance. The objective of supervision of this type of business is not, first and foremost, the protection

of policyholders as is the case in direct insurance involving an unsophisticated party. The IAIS Core Principles explicitly do not apply to reinsurance companies but these principles are in the process of being revised and will cover both reinsurance and direct insurance. As these revised principles have not yet been adopted, and to ensure consistency with other assessments made to date, the draft revised principles will not be used.<sup>28</sup>

39. However, Bermuda is predominantly an international insurance market that operates as a business-to-business market between sophisticated buyers and sellers of insurance and reinsurance, and regulation is geared toward such business. Thus, an assessment of the Core Principles limited to the domestic companies writing direct retail lines (25 companies out of 1,600, to cover a population of 60,000 people, representing 0.3 percent of the gross premiums in 2001) would be nugatory (the Bermudian focus is not on the policyholder). In addition, it is not possible to differentiate direct insurers from reinsurers (corporate accounts can be insured either directly or through reinsurance, and data separating these two types of premiums is limited). The self-assessment done by the Bermuda Monetary Authority did not distinguish between the two.

40. An additional particularity of the Bermudian market is the size of its captive industry, which has no specific treatment in the IAIS Principles. It is not the place to take a stance on whether captives should or should not have specific regulation. But bearing in mind these characteristics, the IAIS Core Principles will be aimed toward assessing the supervision of all of the Bermudian insurance (including reinsurance) industry.

### **C. Institutional and Macro Prudential Setting—Overview**

41. On January 1, 2002, the Bermuda Monetary Authority (BMA) assumed responsibility as the regulator and supervisor for all financial services, including insurance supervision which was transferred from the Ministry of Finance. At the same time, the BMA undertook a major restructuring, with the Board expanded to 11 persons, three of whom are executive directors—the Chairman and Chief Executive Officer, the Supervisor of Insurance and the Superintendent of Banking, Trust and Investment.<sup>29</sup>

42. Bermuda insurance industry includes 1,600 insurance (and reinsurance) companies, with actively writing companies having \$172 billion in assets, and writing over \$48 billion in annual gross premiums in 2001. The industry has two main components—captives and reinsurance. Bermuda is the largest captive domicile in the world<sup>30</sup> with approximately 940

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<sup>28</sup> The revised IAIS Core Principles were adopted in October 2003.

<sup>29</sup> The National Pension Scheme (Occupational pensions) Act 1998 has set up a Pension Commission that monitors occupational pension plans; it is composed of 7 to 9 members all appointed by the MOF, as well as the Financial Secretary, and forms part of the Ministry of Finance. As pension funds are managed by entities that are not insurance companies, they are excluded from the BMA's authority.

<sup>30</sup> In 2000, A.M. Best estimated that Bermuda had 32 percent of the world market in terms of number of captives, and 48 percent in terms of net premiums (<http://www3.ambest.com/captive/default.asp>).

active captives (but 1,200 registered), with total gross<sup>31</sup> premiums of \$32.5 billion, at end-2002. Gross premiums for professional insurers and reinsurers totaled \$10.2 billion in 2001. The insurance market is very developed, with U.S. subsidiaries playing a major role.

43. The four classes of business created by the 1995 amendment to the Insurance Act (see below) do not distinguish between direct insurance and assumed reinsurance. Statistics making the distinction are only available for 29 percent of companies by number and 58 percent by net premiums (in 2001). The term insurance will include reinsurance hereafter. Companies licensed exclusively in long-term business represent 9 percent of the number of companies and 8 percent of the gross premiums in 2001. Bermudian regulation makes the distinction between general business and long-term business (non-life and life, approximately). However, a company operating in general business (respectively long-term business) can also operate in long-term business (respectively general business) if that activity is of a limited extent, and it has an authorization by the BMA under Section 56.<sup>32</sup> Composite companies are those who do significant business in both. Available aggregate market statistics do not make the distinction between long-term business and general business, except where the companies are specifically licensed to do one or the other (the breakdown of companies' premiums between long-term business and general business is not available for composite companies nor for those companies that do the other line of business on a limited basis).

44. The Insurance Act was amended in 1995, to create a licensing and solvency system for general business insurers based on four different classes. Class 1 comprises single parent captive insurance companies owned by one or more affiliates of a group that underwrite only the risks of their owners and affiliates of their owners. Class 2 comprises single parent captives writing up to 20 percent of their net premiums to insure unrelated parties, and multi-owner captives that underwrite only the risks of their owners and affiliates. Class 3 consists of those companies not included in classes 1, 2, and 4. This class requires that insurers maintain minimum capital and surplus of \$1million. The Class 3 category basically includes small commercial insurers that do not write excess liability insurance or property catastrophe reinsurance, single-parent captives where more than 20 percent of net premiums written is from risks unrelated to the business of their owners, multi-owner captives writing third-party business and protected cell captives (rent-a-captive). Class 4 insurers are the large commercial insurers and reinsurers and must maintain a minimum capital and surplus of at least \$100 million. This group includes insurers that underwrite excess liability insurance or property catastrophe reinsurance business.

45. Bermudian companies ceded 16 percent of gross premiums on average in 2001. But the premiums ceded vary considerably according to the class and, to the extent that it can be determined, by type of business. The BMA's "Analysis of 2001 statutory financial returns for all insurers" suggests that long-term business companies do not cede any premiums.

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<sup>31</sup> Gross premiums are gross of the reinsurance premium.

<sup>32</sup> Unless otherwise specified, all references relate to the 1978 Insurance Act.



However, these companies report on a net basis, and the information on their gross premiums is not available. Since no statistics are available on the reinsurance ceded on long-term business, all companies writing long-term business (including composite companies) are excluded in the following. For the first three classes of business, the lower the class number, the more the general business companies cede (21 percent of gross premiums are ceded by Class 3 companies, 25 percent by Class 2, and 28 percent by Class 1). This is logical given that the higher the Class number, the more professional the reinsurer, and the more capable of retaining risk. However, surprisingly, the large professional Class 4 reinsurers writing exclusively general business cede nearly 40 percent of their premiums.<sup>33</sup>

46. Exclusively long-term business companies are less capitalized than composite companies which in turn are less capitalized than exclusive general business companies (the net premiums to 'capital and surplus' ratio were 170 percent, 89 percent, and 32 percent, respectively, in 2001 – the lower the ratio, the greater the capital as compared to the net premiums underwritten). Excluding the pure long-term business companies, Class 3 companies are not as well capitalized as Classes 2 and 4 companies, which in turn have a lower capitalization than Class 1 companies. Although Class 3 companies account for most (59 percent) of the net premiums underwritten by the four classes of companies, they are the least capitalized (ratio of 73 percent). Class 2 and Class 4 companies are equally capitalized (50 and 48 percent, respectively), while Class 1 companies are the best capitalized (ratio of net premiums to capital and surplus of 31 percent).

47. The Bermuda Monetary Authority and the Insurance Advisory Committee (and its sub-committees) are established by statute. Industry associations and the actuarial association are not established by statute. These include: PC RE ELI<sup>34</sup> (association of most Class 4 reinsurers whose principal focus is advocacy), Insurance Casualty Actuaries of Bermuda (association of actuaries), Bermuda Association of Insurance and Financial Advisors (ex-Bermuda Life Underwriters Association) for intermediaries selling domestic life insurance, and Bermuda Insurance Management Association (BIMA) which is the professional association of the insurance managers. Also involved in insurance but not specific to that sector are the Bermuda Institute of Internal Auditors and the Institute of Chartered Accountants of Bermuda.

48. The relationship between the supervisor and the industry is harmonious and there are currently no major problems. The industry itself has been to date very concerned with maintaining an excellent image of Bermuda, and avoiding the entry of lower quality, or poorly reputed insurers. The supervisor outsources supervision to the professional bodies. In particular, the supervisor relies on key players, of whom he must have explicitly approved on the basis of their fitness and propriety and of their knowledge of insurance, to alert him to any potential solvency problem: the principal representative, the independent auditor, the loss

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<sup>33</sup> Calculations based on the data in the BMA's "Analysis of 2001 statutory financial returns for all classes."

<sup>34</sup> Subsequent to the mission PC RE ELI was renamed as the Association of Bermuda Insurers and Reinsurers.

reserve specialist (for general business; annually for Classes 3 and 4, triennially for Class 2) and the actuary (for long-term business). Reporting requirements are met by the filing of statutory returns generally audited by the Big 4 accounting firms. However, serious potential for conflicts of interest exists.

49. Nevertheless, given that problems tend to develop more slowly in insurance companies (mainly because of the inverted production cycle as the premium price is paid many years before production cost, a claim, is incurred), and given the weight of the reserves in the liabilities, and that they result from an estimation, verification of the company's data is essential.

#### **D. General Preconditions for Effective Insurance Supervision**

50. The legal regime in Bermuda is based upon the Bermuda Constitution Order 1968 which sets out the respective powers of the Governor appointed by the Crown, and Parliament, a bicameral body with an elected lower house and an appointed upper house. An independent judiciary exists with appeal rights to the Privy Council. The principle legal framework for the regulation of insurance is found in the Bermuda Monetary Authority Act as amended, the Insurance Act, as amended and the Companies Act. The Bermuda insurance industry is supported by a well developed infrastructure that includes management talent, the presence on a large scale of the Big 4 auditing firms, actuaries, accountants, captive insurance company management firms and legal professionals. Various professional organizations and advocacy groups exist to support the industry professionals.

51. There is no lack of talent available to recruit, or draw on from within the various components of the insurance infrastructure. A Bermuda Insurance College exists as do various scholarships and foundation programs to support Bermudians with an interest in entering the industry. The Bermudians who wish to work in the insurance sector have the opportunity to do so. To meet total market infrastructure needs in the accounting, actuarial and management sectors, many must be recruited abroad on work permits. It has been estimated that there is a significant amount of rotation within the various professional categories employed in the industry on a work permit basis in their first five years. However, those who chose to remain are reported to often do so long term. Representatives of several of the Big 4 auditing firms stated that turnover challenges have been successfully met by aggressive training programs. There are also four banks to round out the insurance industry infrastructure.

52. Bermuda is a country with a population of 60,000, whose main source of revenue is international business, followed by tourism. There are 1,600 insurance companies, with actively writing companies having gross insurance premiums amounting to 12 times the GDP in 2001. In March 2003, the insurance supervisory staff consisted of 17 persons, 3 of whom are administrative. Given these basic figures, it is understandable that Bermuda has pursued a system based on co-supervision and outsourcing. Staff was increased subsequent to the mission. In May 2004, it stood at 25, 4 of whom are administrative.

53. Outsourcing the inspections can be an important means of obtaining necessary skills in supervision. However, outsourcing must be done in such a way that it ensures the supervisor will have adequate and independent information. This objective could be reached, for example, by giving explicit instructions to an independent reviewer, in addition to the existing legal and professional standards and expectations. As an output, the reviewer would be required to produce a report detailing each of the points he was commissioned to assess. The BMA would need to have a minimum in-house actuarial capacity to verify this report. Outsourcing an independent examination capability to verify data submitted to the authority would substantially enhance the robustness of the regulatory regime. Another alternative would be to develop this capability in-house.

54. In 2004, the authorities informed of the following post-mission developments which have not been evaluated by the assessment team. They are listed by relevant principle:

- Principle 4, Corporate Governance: prepared draft guidance note addressed to the Board of Directors and Senior management on corporate governance; introduction in 2005 of more extensive program of regular on-site visits;
- Principle 5, Internal Controls: prepared a draft guidance note on risk management and internal controls;
- Principle 7, Liabilities: in 2004 prepared a draft guidance note for the loss reserve specialist;
- Principle 8, Capital adequacy and solvency: drafted a series of guidance notes on investments, insurance underwriting, role and qualifications of the loss reserve specialist and actuary, internal controls and risk management;
- Principle 9, Derivatives and “Off-balance sheet” items: drafted guidance notes on investments, and risk management and internal controls;
- Principle 11, Market conduct: drafted guidance note on market conduct for domestic insurers and intermediaries;
- Principle 12, Financial Reporting: Insurance Amendment Act, 2004, requires insurers to file their financial statements simultaneously with their annual Statutory Financial Return;
- Principle 13, On-site inspections: developing a more comprehensive risk-based approach to be introduced in 2005;
- Principle 16, Coordination and Cooperation: Memorandum of Understanding (MOU) with the Financial Services Authority of the United Kingdom.

### E. Principle-by-Principle Assessment

Table 10. Detailed Assessment of Observance of the IAIS Insurance Core Principles

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| <p><b>Principle 1.</b></p> | <p><b>Organization of an Insurance Supervisor</b></p> <p>The insurance supervisor of a jurisdiction must be organized so that it is able to accomplish its primary task, i.e., to maintain efficient, fair, safe, and stable insurance markets for the benefit and protection of policyholders. It should, at any time, be able to carry out this task efficiently in accordance with the Insurance Core Principles. In particular, the insurance supervisor should:</p> <ul style="list-style-type: none"> <li>– be operationally independent and accountable in the exercise of its functions and powers;</li> <li>– have adequate powers, legal protection, and financial resources to perform its functions and exercise its powers;</li> <li>– adopt a clear, transparent, and consistent regulatory and supervisory process;</li> <li>– clearly define the responsibility for decision-making; and</li> <li>– hire, train, and maintain sufficient staff with high professional standards who follow the appropriate standards of confidentiality.</li> </ul>  |
| <p>Description</p>         | <p>(a) Independence</p> <p>Bermuda started to regulate insurance in 1981, by adopting the Insurance Act (1978). Supervision was located with the Registrar of Companies, in the Ministry of Finance, until 2001. Since the Insurance Amendment (n<sup>o</sup>2) Act of 2001, the supervision of insurance has become a responsibility of the Bermuda Monetary Authority (BMA). The 2001 amendment (Bermuda Monetary Authority Amendment (n<sup>o</sup>2) Act 2001), provides that BMA’s Board shall consist of 11 persons, 3 of whom are executive directors (the Chairman, the Supervisor of Insurance and the Superintendent of Banking, Trust and Investment) and 8 who are non-executive; these last persons are appointed by the MOF from amongst the Insurance Advisory Committee<sup>35</sup> (4 persons) and persons with experience of the financial services industry (4 persons). The Supervisor of Insurance is appointed by the BMA, with the approval of the Minister. The BMA has two main regulatory divisions headed by the Superintendent of Banking, Trust and Investment and the Supervisor of Insurance. In addition, there are two support Divisions: the Legal Counsel Unit (Legal counsel and Authorization &amp; Compliance) and the Administration Unit (IT, Currency operations, Human resources and Finance).</p> <p>The BMA Act 1969 (“BMA Act”) details in Section 3 the objectives of the Authority, among which are “to supervise, regulate and inspect any financial institution which operates in or from within Bermuda; to promote the financial stability and soundness of financial institutions.” The Preamble to the Insurance Act describes in broad terms the objectives of insurance supervision: “Whereas it is expedient to regulate the carrying on of insurance business in or from Bermuda; to provide for the registration of insurers and other persons engaged in that business; and to provide for matters connected with, or incidental to, the matters aforesaid.”</p> <p>Pursuant to Section 21(2) of the BMA Act “the Minister may give to the Authority in writing such general directions as appear to the Minister to be necessary in the public interest.”</p> <p>(b) Powers</p> <p>The Insurance Act confers extensive powers on the Authority through Section 4 on licensing, Sections 29A and 29B relating to the power to obtain information and documents, respectively, and perform on-site inspections (both recently enacted in 2002 ); Section 30 relating to the power</p> |

<sup>35</sup> See principle 2 on the Insurance Advisory Committee.

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|  | <p>to appoint an inspector to investigate the affairs of an insurer; 32 relating to powers of intervention, and Section 35 providing the power to petition for winding up of a company.</p> <p>In addition, Section 56 allows the Authority to modify, on a case by case basis, the existing regulations on crucial issues, such as minimum capital and surplus or statutory financial statements, without limitations. The measures may be retroactive.</p> <p>The BMA is not however able to impose intermediate recovery measures such as require the submission of a written recovery plan within a relatively short time or take temporary control over the management to rectify an insurer's hazardous condition without initiating court proceedings.</p> <p>(c) Employment system</p> <p>In addition to the support provided from these Units, a staff of 16 persons (3 assistant directors, 8 senior analysts, 2 junior analysts and 3 administrative staff) assists the Supervisor of Insurance. In October 2002, the Insurance Division reorganized into 3 groups: a Daily team (head + 7 analysts), a Regulatory Authorization team dealing with routine regulatory requests, a Compliance team (head + 3 senior analysts), dealing with non-compliant institutions and on-site visits, and a new Policy &amp; Administrative team (head + 3 administrative staff), which deals with international and regulatory issues, staff training and managing the administrative staff. By May 2004, staffing had increased to 25 directly involved in the supervision of the sector with the recruitment of various skilled professionals including a consulting actuary and a regulatory consultant.</p> <p>The BMA submits its budget to the MOF for approval (Section 26 of the BMA Act). The budget is funded by supervisory fees and seignorage resulting from the issuance of Bermuda currency.</p> <p>The insurance supervisory staff has adequate legal protection from suit and other proceedings when acting bona fide in pursuance of its functions (Section 4B, as amended in 2001, of the BMA Act).</p> <p>In 2002, the Authority conducted a training needs assessment of all posts within the Authority. In 2002 an updated system of performance-based appraisal was introduced as well as training on how to conduct the appraisal interviews. Performance-related pay was simultaneously introduced, enhancing salaries.</p> <p>Two members of senior staff have an auditing background. In the last two years, four staff members have temporarily joined auditing firms as trainees for periods of 3 to 6 months.</p> <p>A status report concerning the IT system was followed by a strategy report that is currently under revision by the BMA board. A strategic plan will be adopted before May 2003.</p> <p>The insurance database contains all the data that is filed in the statutory returns, since 1996 (data previous to 1996 is available in a historical database).</p> <p>Outsourcing of the inspection process is permitted (Sections 18A (5), 29A, and 30).</p> <p>The staff is required to maintain the confidentiality of the supervised institutions' information. This is ensured by the provisions of Section 31 of the Bermuda Monetary Act as amended in 1999 and Section 52 of the Insurance Act, which provide parallel criminal penalties for the unauthorized disclosure of information.</p> <p>The Authority has a very complete and detailed policy regarding not only personal dealing rules (transaction and ownership of shares in financial institutions is severely restricted) but also</p> |
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|            | <p>acceptance of gifts and hospitality (all gifts must be declared, only those of value less than \$100 may be kept and substantial hospitality—theatre, golf, trips—must be approved by the Authority).</p> <p>The BMA reports quarterly and annually on its activities. These reports are available on the BMA’s website.</p>  |
| Assessment | Largely observed   |
| Comments   | <p>The Minister may give the BMA general policy directions as to the performance of its functions and the BMA shall give effect to such directions (Section 21 (2) of the BMA Act). The existence of this power may create the impression that its independence is not fully established, even if it has not been used. It is therefore recommended that the legislation be amended to remove this power.</p> <p>The Insurance Act confers extensive powers on the BMA although effective applications of those sanctioning or limiting a company’s scope seem few (no statistics were available).</p> <p>The Statement of Principles introduced by the Insurance Amendment Act 2002, indicates that “use of the powers under Section 29A ... will be infrequent and exceptional if the Authority is able to rely on the information voluntarily provided by the institution.”</p> <p>Actions under Section 29B, “Power to require production of documents”, can be taken if the BMA “reasonably” requires it for the performance of its functions. Similarly, Section 30 allows appointment of an inspector where it is “required in the interest of policyholders.”</p> <p>Section 56 could be understood to allow for tightening as well as easing regulatory constraints. In practice, it is only used to ease them (usually to exempt from the filing date deadline for new companies, to allow certain assets to be included in the “relevant” assets for the liquidity ratio, to exempt a company from filing a loss reserve specialist opinion in exceptional cases, but also to relieve companies from the need to keep two sets of accounts: for example, to allow insurance contracts with no significant transfer of risk to be considered as non-insurance contracts).</p> <p>Furthermore, the BMA should be able to impose recovery measures (require a recovery plan, change the management without the delay of a court proceeding).</p> <p>The current IT system is not totally adequate (the BMA was unable to give the number of approved intermediaries). However, the insurance supervision division is aware of these deficiencies and will take action as soon as the strategic directions are set out.</p> <p>Retaining trained staff is a challenge in an environment where international companies are permanently ready to recruit local staff at higher salaries. The Authority considers enhancing its IT system a priority and plans to increase its staff to 30 people. The supervisory challenges are formidable when a staff of 17 has to ensure an on-going supervision of 1,600 companies and does not benefit from a well-developed IT system.</p> |

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| <p><b>Principle 2.</b></p> | <p><b>Licensing</b><br/>         Companies wishing to underwrite insurance in the domestic insurance market should be licensed. Where the insurance supervisor has authority to grant a license, the insurance supervisor:</p> <ul style="list-style-type: none"> <li>– in granting a license, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include proforma financial statements, a capital plan, and projected solvency margins; and</li> <li>– in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent.</li> </ul>  |
| <p>Description</p>         | <p>The licensing procedure consists of two operations: incorporation and registration (actual licensing) which are, in practice handled simultaneously. It can be extremely rapid: the <a href="http://www.bermuda-insurance.org">www.bermuda-insurance.org</a> website claims that it takes under two weeks for a captive company.</p> <p>Bermudian regulation does not make the distinction between direct insurance and reinsurance, so all the rules apply to both types of companies.</p> <p>Although the incorporation process is technically the responsibility of the Registrar of Companies (part of the Ministry of Finance), the Bermuda Monetary Authority screens the beneficial owners and the management of the corporate body. Insurance companies can be licensed under four different types: i) the domestic companies (local ownership and locally incorporated, 10 companies currently), ii) exempted companies (incorporated in Bermuda but exempted from the 60 percent Bermudian ownership rule), the permit companies (incorporated in another jurisdiction but with a Ministerial permit to operate in Bermuda), and iv) a subgroup of these permit companies, the Non Resident Insurance Undertakings (NRIU) which are allowed to operate on the domestic market (22 companies of which 8 are no longer active).</p> <p>Insurance business is defined in the 1978 Insurance Act as “the business of effecting and carrying out contracts (a) protecting persons against loss or liability to loss in respect of risks to which such persons may be exposed; or (b) to pay a sum of money or render money’s worth upon the happening of an event, and includes re-insurance business” (Section 1).</p> <p>The companies can apply for nine different types of licenses, according to the business they are planning to write, general business and/or long-term business. A company can ask to be licensed in general business only (in one of the four classes introduced in 1995), in long-term business only, or may write businesses as a composite company doing both long-term business and general business (there are four types of licenses depending of their class for the general business). Statistics usually consider only 5 classes of license by joining the four types of composite companies with the four types of purely general business companies (Classes 1 to 4), and the companies licensed to do long-term business only.</p> <p>There were 1,602 companies incorporated at the end of 2001, this number is up 109 from the previous year. There seem to be 1,536 companies registered (licensed) at the same date (the discrepancy is at least partly explained by the fact that the date used for long-term business companies is the date of registration, while it is the date of licensing for the others, and the entry data is not completely accurate). Of these companies, 835 are captives (Class 1 and 2), 31 are Class 4 (big companies that write excess liability business or property catastrophe reinsurance business), 148 are exclusively long-term business (life), and the rest are the 522 Class 3 companies (either captives with more than 20 percent of unrelated business, rent-a-captive or small commercial insurance companies).</p> <p>Long-term business are contracts on human life, contracts against accidents covering at least a 5 year period, and contracts where “... in return for one or more premiums paid to the insurer a sum</p> |

or series of sums is to become payable to the persons insured in the future ....” A distinction is made between long-term business and general business (life and non-life, respectively) with workers compensation classified as general business unless the contract length is over 5 years; individual disability coverage falls into a gray area between general and long-term business. Of the 1,602 companies existing at the end of 2001, 84 percent do exclusively general business (approximately 1,350 companies), 9 percent are licensed to do long-term business only (148 companies) and the remaining 6 percent are composite (104 companies).

The application for licensing requires the company to give information as to the legal form of the company, describe the type of business (long-term or general business, lines of business, nature of the links with the policyholders), give a projected income statement (in practice, it covers most often five years), the general lines of the reinsurance / retrocession program, and the names of its principal representative, insurance manager (for captives), approved auditor and, where required, loss reserve specialist and approved actuary. In deciding on the application, the Authority considers in addition the fitness and properness of the shareholders and managers (including the principal representative), their knowledge and expertise and the adequacy of the premises (Section 5).

The Authority can take the advice of the Insurance Advisory Committee (IAC). The IAC is composed of at least 5 persons appointed by The MOF; they are currently 19 (members come from the auditing, legal and actuarial professions and from the insurance industry). The IAC advises the Authority and the Minister on any matters relating to the insurance industry at their or the BMA’s initiative (Section 2 of the Insurance Act). The IAC has set up various subcommittees and appointed their members (not all members of a subcommittee belong to the IAC), among which is the Insurance Admissions Committee (referred to as the IAC Admissions Committee).

The IAC Admissions Committee has 12 members, including 3 practicing actuaries, professional accountants, insurance executives and a lawyer specializing in insurance practice. The present quorum requirement is that two members attend out of the 12 appointees, but it appears that the usual number of members present ranges from four to seven. The IAC Admissions Committee meets every Friday to consider insurers’ applications (if some have been made). The Authority must receive submissions by 17:00 on the Monday immediately preceding the Friday meeting and transmits them to the IAC Admissions Committee members for consideration at that Friday’s meeting. The fitness and properness checks are conducted both on the part of the industry and the BMA. The application can be conditionally recommended for approval if the check has not been completed. The IAC Admissions Committee also examines whether an applicant possesses the requisite level of industry knowledge and expertise, the business plan and the reinsurance program. It can be recommended that an application can be approved, deferred, approved with conditions, rejected, or be withdrawn. A representative from the insurance division normally attends IAC admissions committee meetings. The IAC admissions committee forwards its recommendations to the insurance supervisor who then issues an approval in most circumstances. The insurance supervisor also has the benefit of a review by the legal authorization and compliance division.

Insurance managers, brokers, agents and salesmen are also required to register with the BMA (Sections 9 to 12). The BMA checks both their fit and proper character and their knowledge of the business. These applications are also submitted to the IAC Admissions subcommittee. The IAC Admissions has met 44 times in 2002, to study the 141 applications made (32 for intermediaries and 109 for insurance companies). The majority of the applications are recommended for approval. Out of the 141 applications, all but 13 applications have been approved, 3 concerning intermediaries and 10 concerning insurers (declined in 5 cases, considered insufficient for review in 5 cases and withdrawn or outstanding in 3 cases).



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|                     | <p>Insurance companies can do business not related to insurance, with segregated accounts. Though the possibility is offered, the BMA indicates that there are few companies use it.</p> <p>The companies that do both long-term and general business have to “keep its account in respect of its long-term business separate from any accounts kept in respect of any other business.” The receipts from long-term business must be kept in a special fund, so that the long-term business fund’s assets and liabilities “can be readily identified at any time” (Section 24).</p>   |
| Assessment          | Observed  |
| Comments            | <p>The definition of long-term business is broad and vague. It should be more precise to give a clear idea of what can be done under that type of business. The Insurance Advisory Committee’s Regulatory subcommittee is to address that issue.</p> <p>The business plan that the company has to present in order to obtain a license is not precisely characterized in the regulations. The business plans reviewed are very different in quality and quantity of details. The regulations should be more detailed (income statement per defined lines of business, for example) on that subject and explicitly require a five-year financial plan, including balance sheets.</p> <p>The terms of “fit” and “proper” are not defined in the insurance regulations. The IAC Regulatory subcommittee has been tasked to define the criteria characterizing fitness and properness. In practice, the fitness and properness of the applicants are extensively checked, including criminal record and resume, and a personal declaration form has to be signed by all applicants.</p> <p>The role of the IAC Admissions Committee is, in practice, important in the licensing procedure, and its advice generally followed, subject to the imposition by the Supervisor of additional conditions in some instances. Given the reliance on the application process to help prevent the need to later resort to formal remedial action, it is recommended that consideration be given to increasing the quorum requirements and precisely defining the characteristics of the business plan.</p> <p>The license of a captive manager has never been canceled (revoked).</p> |
| <b>Principle 3.</b> | <p><b>Changes in Control</b></p> <p>The insurance supervisor should review changes in the control of companies that are licensed in the jurisdiction. The insurance supervisor should establish clear requirements to be met when a change in control occurs. These may be the same as, or similar to, the requirements which apply in granting a license. In particular, the insurance supervisor should:</p> <ul style="list-style-type: none"> <li>– require the purchaser or the licensed insurance company to provide notification of the change in control and/or seek approval of the proposed change; and</li> <li>– establish criteria to assess the appropriateness of the change, which could include the assessment of the suitability of the new owners as well as any new directors and senior managers, and the soundness of any new business plan.</li> </ul>   |
| Description         | <p>All changes, even if they are not material, that affect private companies have to be notified to the BMA (Authorization &amp; Compliance unit) and approval obtained, according to the Exchange Control Regulations 1973 (Sections 12 and 13).</p> <p>The Authority assesses first and foremost the suitability of the owners and of the management and, if the company’s initial business plan will change, the new business plan.</p> <p>Public companies have to ask for an exemption from a prior notification, and approval, of changes in control, which is granted if they are traded on a recognized exchange. Understandably, all public companies have asked and obtained this exemption. The consequence is that, for public companies, no notification is required when holders of participations exceeding a certain</p>  |

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|                     | threshold change.  |
| Assessment          | Observed   |
| Comments            | <p>The Authority receives approximately 7 applications a week; a proposed change has sometimes been deferred until the company was in a sound financial condition.</p> <p>Although the BMA is often aware of these changes through the frequent exchange with industry, significant changes in ownership in public companies may be formally notified to the BMA.</p>  |
| <b>Principle 4.</b> | <p><b>Corporate Governance</b></p> <p>It is desirable that standards be established in the jurisdictions which deal with corporate governance. Where the insurance supervisor has responsibility for setting requirements for corporate governance, the insurance supervisor should set requirements with respect to:</p> <ul style="list-style-type: none"> <li>– the roles and responsibilities of the board of directors;</li> <li>– reliance on other supervisors for companies licensed in another jurisdiction; and</li> <li>– the distinction between the standards to be met by companies incorporated in his jurisdiction and branch operations of companies incorporated in another jurisdiction.</li> </ul>   |
| Description         | <p>The Authority does not have the responsibility for setting requirements for corporate governance, but has the authority to do so. The Companies Act and common law regulate corporate governance. These dispositions are not replicated in the Insurance Act. The existing dispositions set duties for directors and companies. They do not however encompass general guidelines to the Board that clearly set out their responsibilities toward specific corporate governance principles, stating strategic objectives and monitoring their progress toward them or rules as regards appointment procedures and separation of responsibilities.</p> <p>A large number of insurance companies supervised by the Authority are subsidiaries of large U.S. corporations that usually follow the corporate governance policies of their parent. Some are listed on a U.S. stock exchange, and therefore subject to the Sarbanes-Oxley Act, which imposes extensive corporate governance rules.</p> <p>The Authority also maintains that the auditor would qualify or, at least, to introduce an “emphasis of matter” paragraph in his opinion if he was concerned about this aspect. The auditor can also express his views in a management letter, which the BMA can ask to see.</p> <p>Based on a 2002 amendment, an on-site visit program was planned. The BMA has started to visit the Class 4 companies (and will eventually extend it to some Class 3 companies). In preparation for this visit, the supervisor systematically requires the management letter and during the visit, the supervisor may gather information on the company’s corporate governance policies.</p> <p>The insurance supervisor does not require the board of directors to have in place clear complaints procedures and communicate them properly to their customers.</p> |
| Assessment          | Not Applicable   |
| Comments            | <p>This principle is not applicable because it is not the BMA’s responsibility to set requirements as to corporate governance procedures in insurance companies, nor is the BMA responsible for verifying their application. However, in a regime largely dependent upon controls put in place by the companies themselves, the regulator must be able to depend on companies having detailed internal procedures ensuring that objectives are set, as well as procedures for monitoring and evaluating the progress made, that the respective accountabilities of the board and the management are clearly defined and that the balance between executive and non-executive members of the board is kept. The market’s general security would be improved by the BMA taking on, directly or indirectly, the responsibility of verifying that insurance companies have set clear corporate governance guidelines.</p> <p>The BMA should also require of companies that sell insurance products on the domestic market</p>  |

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|                     | to have clear complaints procedures in place for individual policyholders.  |
| <b>Principle 5.</b> | <p><b>Internal Controls</b></p> <p>The insurance supervisor should be able to:</p> <ul style="list-style-type: none"> <li>– review the internal controls that the board of directors and management approve and apply, and request strengthening of the controls where necessary; and</li> <li>– require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investment and liquidity management.</li> </ul>   |
| Description         | <p>The BMA has the authority to review an insurer’s internal controls through the approved auditor’s annual statutory audit. The external auditor applies Generally Accepted Audit Principles which include a review of an insurer’s internal controls. In the instructions relating to the auditor’s report (Section 7 of the insurance returns and solvency regulations 1980), the BMA requires the auditor to qualify his report if there were “deficiencies” found during the audit, which could be seen as including internal controls. All annual statutory financial statements have to be audited and the auditor’s report has to be filed with the Authority for all companies, regardless of Class. The BMA relies on the external auditor to review and mention internal controls in his report (or management letter) if they are found to be inadequate.</p> <p>The BMA also relies on the duties imposed on the principal representative by the insurance regulations. Each company has a principal representative in Bermuda, approved by the Authority (Section 8). The principal representative must, within 30 days of becoming aware of it, write to the BMA to report namely the likelihood of the insurer of becoming insolvent and failure by the insurer to comply with a regulatory imposition (Section 8A). Although it is not explicit in the legislation, it is reasonable to consider that regulatory impositions include internal controls that are not adequate for the nature and the scale of the company’s business.</p> <p>The BMA does not require that internal controls address issues of an organizational structure nor accounting procedures, reconciliation of accounts, control lists and information for management.</p> <p>Within the framework of the annual on-site visits the BMA can raise the issue of the existing controls for underwriting risks, valuation of technical provisions, investment and liquidity management and reinsurance.</p> <p>The BMA has access to internal audit reports if it can “reasonably” require it (Sections 29A and 29B).</p> <p>If there is a “significant risk” of the insurer becoming insolvent or if the insurer has breached a provision of the regulations, the BMA can inter alia require the insurer not to make any investments of a specified class or to keep in the custody of a specified bank the assets (Section 32).</p> <p>Finally, the insurance supervisor can cancel the registration (revoke the license) if “in the opinion of the Authority, the insurer has not been carrying on business in accordance with sound insurance principles” (Section 41 (1) (vii)).</p> |
| Assessment          | Materially non-observed   |
| Comments            | <p>It is recommended that internal controls be mentioned explicitly as a regulatory imposition.</p> <p>The BMA has the authority to verify that adequate and efficient internal controls are implemented in insurance companies. The BMA has several sources of information if deficiencies were to be revealed in a company’s internal controls (principal representative and independent auditors). In an environment where regulation is not detailed, internal controls are a key element.</p>  |

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|                            | <p>The supervisor's reliance on the auditor's annual review of internal controls, based on the generally accepted audit principles, should be supplemented by explicit wording, for example, in the instructions given for the auditor's report. More generally, the flow of information from the auditor to the BMA should be more explicit and more frequent. The auditor should systematically communicate in writing to the BMA the details of the review carried out on the instructions of the BMA and its results.</p> <p>The BMA can ask for internal audit reports if the request can be considered reasonable relative to the performance of its functions.<br/>If internal controls are insufficient, the option of canceling the license is not a practical one as it imposes a penalty that is too high to be effective and deters the supervisor from applying it.</p>   |
| <p><b>Principle 6.</b></p> | <p><b>Assets</b></p> <p>Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction. Where insurance supervisors have the authority to establish the standards, these should apply at least to an amount of assets equal to the total of the technical provisions, and should address:</p> <ul style="list-style-type: none"> <li>- diversification by type;</li> <li>- any limits, or restrictions, on the amount that may be held in financial instruments, property, and receivables;</li> <li>- the basis for valuing assets which are included in the financial reports;</li> <li>- the safekeeping of assets;</li> <li>- appropriate matching of assets and liabilities; and</li> <li>- liquidity.</li> </ul>  |
| <p>Description</p>         | <p>The Insurance Accounts Regulations 1980 and the Insurance Returns and Solvency Regulations 1980 are concise. In the numerous cases where the Bermuda accounting standards are silent, the BMA allows companies to choose the accounting standard so as not to burden companies with two sets of accounts. Most companies choose U.S. or Canadian General Accepted Accounting Principles (very few choose U.K. GAAP). The method used must be described in the notes to the statutory financial statements (Insurance Accounts Regulations 1980). Open year (accounting on the former three-year Lloyd's model) is also an option but, in practice, it is not used.</p> <p>Assets may be valued at either quoted value (for quoted investments), fair value determined in good faith (unquoted investments) or amortized cost. Equities cannot be valued for an amount exceeding their fair value. Investments in affiliates are valued either by the cost or equity method. The equity method must be chosen if it is the lower of the two (however, if the fair value determined in good faith is even lower than these two, it must be used). Uncollectibles must be deducted.</p> <p>The assets are grouped by main categories (cash and time deposits, quoted investments, unquoted investments, investments in and advances to affiliates, investment in mortgage loans on real estate, collateral loans, investment income due and accrued, accounts and premiums receivable, reinsurance balances receivable, funds held by ceding reinsurers, sundry assets, letters of credit and guarantees).</p> <p>The Authority relies on the auditor's due diligence to review the process of safeguarding assets. Long-term business insurers must segregate their long-term business from any other business (Section 24). Insurers can also have an activity not related to insurance; if it is the case, the insurer must keep separate accounts in respect of its insurance business (Section 19).</p> <p>Asset allocation, their limits by geographical area, markets, counterparties or currencies, and appropriate matching of assets and liabilities are the responsibility of each company.</p> |

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|                     | <p>However, general business insurers must respect a liquidity ratio (Section 11 of Insurance Returns and solvency regulations 1980). The value of relevant assets must be no less than 75 percent of the amount of relevant liabilities. Relevant assets are cash and time deposits, quoted investments, unquoted bonds and debentures, investments in mortgage loans on real estate with first liens, investment income due and accrued, accounts and premiums receivables, reinsurance balances receivable and funds held by ceding reinsurer. Unquoted equities, investment in and advances to affiliates, real estate and collateral loans are not included for this purpose.</p> <p>The Authority can use its powers under Section 56 to allow assets that are not admitted under the current regulations to classify as relevant assets, such as hedge funds, deferred acquisition costs in a long-term business company or receivables from a parent company. These authorizations are usually given on a case-by-case basis for one year.</p> <p>The relevant liabilities are: the sum of total general business insurance reserves and total other liabilities, less deferred income tax, sundry liabilities (those not specifically defined) and letters of credit and guarantees.</p> <p>During the on-site visit, the Authority insurers are asked to explain their policy on derivatives and off-balance sheet items.</p> |
| Assessment          | Materially non-observed   |
| Comments            | <p>The insurance company, with the careful review of the independent auditor, is ultimately responsible for its asset management. Though the number is not monitored, companies that are SEC registrants are subject to numerous controls. The BMA does not establish provisions defining the diversification by type of asset, nor limiting the amounts that can be held by type of asset, nor requiring appropriate matching of assets and liabilities. because, through its close contacts with the industry, it is sufficiently aware of the changes in trends, and can then give a direction ad hoc as warranted.</p> <p>The liquidity ratio includes unquoted bonds, valued at market value, in relevant assets. Given the value's volatility and the uncertain liquidity of such assets, they should be excluded from the liquidity ratio. Whether or not a receivable is collectible is judged first and foremost by the directors of the company and checked by the auditor.</p> <p>The supervisor could enhance the supervision of assets by giving the auditor, or any other qualified professional to whom this role would be delegated, detailed terms of reference and requiring a detailed report on the findings.</p>   |
| <b>Principle 7.</b> | <p><b>Liabilities</b></p> <p>Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. In developing the standards, the insurance supervisor should consider:</p> <ul style="list-style-type: none"> <li>- what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary;</li> <li>- the standards for establishing policy liabilities or technical provisions; and</li> <li>- the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectibility.</li> </ul>   |
| Description         | <p>The Insurance Accounts Regulations 1980 defines three types of insurance reserves in general business: provisions for unearned premiums, loss and loss expenses provisions and "other" (to include open year business). There are seven types of reserves in long-term business: reserves for reported claims, reserves for unreported claims, policy reserves in life, policy reserves in accident</p>  |

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|            | <p>and health, policyholders' funds on deposit, liability for future policyholders' dividends, and other reserves. The reserves are indicated net of all recoverables (including reinsurance) except if the amount is considered uncollectible. There is no requirement to disclose the respective gross and net figures.</p> <p>General business reserves can be discounted if the amount of loss provisions and the payment date of the losses are fixed or the insurer's approved auditor considers that those dates can be "reasonably" ascertained (it is used for workers compensation, for example). Discounting is also authorized for those companies that have discounted before December 31, 1988.</p> <p>The Insurance Act does not set standards for the calculation of reserves but stipulates that the methods used must be described in the notes to the balance sheet. The supervisor does not have the authority to prescribe standards for establishing technical provisions but the MOF may, acting on the advice of the Authority, make these regulations,. As the accounting is done according to GAAP (United States and Canada mostly), the reserves are calculated on the basis of a best estimate.</p> <p>The auditor is required to qualify his report if he "disagreed with any valuation made in the statutory financial statements" (instructions relating to Auditor's report in the Insurance returns and solvency regulations 1980).</p> <p>The Authority has detailed annual information from Class 4 companies on reinsurance recoverables through schedule C (introduced by the Insurance Amendment Act 1995, Section 5 (1) (d) of the Insurance Returns and solvency regulations 1980). This schedule forms part of the insurance returns; it requires Class 4 companies to give the name of its different reinsurers, their rating, their jurisdiction, the amount of ceded premium during the year, the amount of reinsurance recoverable from it, the amount of reinsurance balances payable to it and the amount of net reinsurance recoverable from it broken down in whether it has been due for more or less than 180 days. The BMA could be considered as having the possibility to set a limit for the valuation of the amounts recoverable of a particular reinsurer under Section 56, but has never used it in this sense. Concerning recoverables in general, the regulations only state the general rule that "if any amount is in the opinion of directors uncollectible, that amount shall be deducted."</p> <p>The annual returns of a general business insurer must include an opinion of a loss reserve specialist, employed by the company or independent, on the loss and loss expenses provisions. These specialists are predominantly actuaries. Opinions are included annually for Classes 3 and 4 companies, and for any company writing professional liability constituting more than 30 percent of its gross premiums, every third year for Class 2 companies, and if a company has not met its general business solvency margin on an undiscounted basis. (Section 18B and Insurance Accounts Regulations 1980 Schedule III, Part II).</p> <p>The annual returns must include the opinion of an actuary on the amount of the liabilities outstanding on account of the insurer's long-term business (Section 27).</p> <p>The Life Act does not state provisions on the calculation of life reserves, and does not, in particular, set rules for the choice of the interest rates or the mortality tables.</p> <p>The information on reserves in the financial returns (that is, excluding the income statement and balance sheet) consists in the amount of loss and loss expenses provisions net of all recoverables.</p> |
| Assessment | Materially non-observed  |
| Comments   | The information on reserves should be expanded: gross and net information per line of business as well as specific information on recoveries, loss expenses reserves and liquidation of prior years  |

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|                            | <p>reserves.</p> <p>The information on the method of calculating reserves, which has to be disclosed in the notes to the balance sheet often consist, in practice, of a very general sentence.</p> <p>There is no specific mention of the loss reserves in the guidelines given by the Authority to the auditor.</p> <p>The Authority looks to the independent auditor’s report, the opinion of the loss reserve specialist and/or that of the actuary to check the sufficiency of these reserves. The auditor assesses the quality of the data and the actuary or loss reserve specialist assesses, on the basis of the data given to him by the company, the adequacy of the technical provisions. In order to supervise the adequacy of the reserves, the BMA could issue precise guidelines on the checks to be carried out to the auditor, the actuary and the loss reserve specialist, and require a detailed report addressing those concerns.<sup>36</sup></p> <p>The regulations do not require the calculation of a premium insufficiency reserve. Though they could be included in “other reserves,” it would give a clearer indication to explicitly allow for them.</p> <p>Deducting reinsurance recoverables is the rule and deducting an uncollectible amount is the exception. The BMA may consider setting a general rule limiting reinsurance recoverables (excluding unrated or below-investment-grade reinsurers, for example).</p> <p>Although domestic life insurance represents only \$54 million in 2001, setting up rules for the calculation of life reserves would be recommended.</p> |
| <p><b>Principle 8.</b></p> | <p><b>Capital Adequacy and Solvency</b></p> <p>The requirements regarding the capital to be maintained by companies which are licensed, or seeking a license, in the jurisdiction should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity, and business risks of the company in the jurisdiction.</p>   |
| <p>Description</p>         | <p>The minimum paid-up share capital requirements are detailed in the Insurance Act Section 7(1). The minimum capital and surplus requirements are in Section 6 of the Insurance Act and in regulations 10 (for general business) and 12 (for long-term business), as well as schedule 1 of the Insurance Returns and Solvency regulations. They are risk-based in that they are geared to the differing levels of risk each Class sustains.</p> <p>The minimum share capital is \$120,000 for Class 1, 2, and 3 companies; \$1 million for Class 4; \$250,000 for long-term business insurer; and composite companies have to add the long-term business and the general business requirements (their general business requirement depends on the class).</p> <p>The minimum solvency margin for long-term business companies is that their long-term business assets exceed the value of share capital liabilities by \$250,000.</p>  |

<sup>36</sup> Subsequent to the mission the BMA prepared draft guidance notes that seek to provide additional clarity in relation to the role played by persons who perform important functions in the insurance regulatory framework, including loss reserve specialists and auditors.

|                            | <p>For the 4 classes of companies doing general business, the general business assets of the insurer must exceed the general business liabilities by the greatest of figures A, B, and C below:</p> <table border="1"> <thead> <tr> <th>Type of license:</th> <th>class 1</th> <th>Class 2</th> <th>Class 3</th> <th>Class 4</th> </tr> </thead> <tbody> <tr> <td>A: min capital and surplus</td> <td>\$120,000</td> <td>\$250,000</td> <td>\$1 million</td> <td>\$100 million</td> </tr> <tr> <td>B: Premium test</td> <td>20% of 1<sup>st</sup> 6 M\$ NPW + 10% of Excess of \$6M NPW</td> <td>20% of 1<sup>st</sup> 6 M\$ NPW + 10% of excess of \$6M NPW</td> <td>20% of 1<sup>st</sup> 6 M\$ NPW + 15% of excess of \$6M NPW</td> <td>50% of NPW (limit deduction to 25% of GPW)</td> </tr> <tr> <td>C: Loss reserve Test</td> <td>10% of net reserves</td> <td>10% of net reserves</td> <td>15% of net reserves</td> <td>15% of net reserves</td> </tr> </tbody> </table> <p>NPW = Net Premiums Written      GPW = Gross Premiums Written</p> <p>For Class 4 insurers, the deduction of premiums ceded for reinsurance cannot exceed 25 percent of the gross premiums written in respect of general business of the Class 4 reinsurer.</p> <p>The solvency ratio must be maintained at all times, throughout the year.</p>  | Type of license:   | class 1  | Class 2                                    | Class 3 | Class 4 | A: min capital and surplus | \$120,000 | \$250,000 | \$1 million | \$100 million | B: Premium test | 20% of 1 <sup>st</sup> 6 M\$ NPW + 10% of Excess of \$6M NPW | 20% of 1 <sup>st</sup> 6 M\$ NPW + 10% of excess of \$6M NPW | 20% of 1 <sup>st</sup> 6 M\$ NPW + 15% of excess of \$6M NPW | 50% of NPW (limit deduction to 25% of GPW) | C: Loss reserve Test | 10% of net reserves | 10% of net reserves | 15% of net reserves | 15% of net reserves |
|----------------------------|---|--|--|--|---------|---------|----------------------------|-----------|-----------|-------------|---------------|-----------------|--|--|--|--|----------------------|---------------------|---------------------|---------------------|---------------------|
| Type of license:           | class 1   | Class 2  | Class 3  | Class 4                                    |         |         |                            |           |           |             |               |                 |  |  |  |  |                      |                     |                     |                     |                     |
| A: min capital and surplus | \$120,000   | \$250,000  | \$1 million  | \$100 million                              |         |         |                            |           |           |             |               |                 |  |  |  |  |                      |                     |                     |                     |                     |
| B: Premium test            | 20% of 1 <sup>st</sup> 6 M\$ NPW + 10% of Excess of \$6M NPW  | 20% of 1 <sup>st</sup> 6 M\$ NPW + 10% of excess of \$6M NPW | 20% of 1 <sup>st</sup> 6 M\$ NPW + 15% of excess of \$6M NPW | 50% of NPW (limit deduction to 25% of GPW) |         |         |                            |           |           |             |               |                 |  |  |  |  |                      |                     |                     |                     |                     |
| C: Loss reserve Test       | 10% of net reserves   | 10% of net reserves  | 15% of net reserves  | 15% of net reserves                        |         |         |                            |           |           |             |               |                 |  |  |  |  |                      |                     |                     |                     |                     |
| Assessment                 | Largely observed  |  |  |  |         |         |                            |           |           |             |               |                 |  |  |  |  |                      |                     |                     |                     |                     |
| Comments                   | <p>The solvency margin defined in Bermudian regulation is quite stringent, especially in regard to reinsurers and is not just an end-of-year requirement. However, this positive assessment of the capital adequacy regime must be balanced by keeping in mind that capital is the remainder once assets and liabilities have been measured satisfactorily, which is not the case (see core principles 7 and 8). The stringency of the solvency regime is thus much reduced compared to what it appears to be on the surface.</p> <p>The actual capital and surplus of Class 4 companies is in fact much higher than the minimum capital and surplus required of \$100 million. The new companies that have been set up after September 11, 2001 have more than \$500 million of capital and surplus. Some companies have over \$1 billion.</p> <p>Defining a solvency margin on a net basis implies that, apart from the sums considered as clearly uncollectible, all the reinsurance recoverables taken into account will in effect be recovered. While the solvency of Classes 1 and 2 captives is closely linked to that of its owners, Class 3 companies, which accounted for more than half the premiums in 2001, are a hybrid sort on which the supervisor may benefit from gathering additional information. If these companies cede 80 percent of their business to reinsurers considered hitherto as solid, they will benefit from a low solvency margin requirement and, if the reinsurers fail, they may become rapidly insolvent.</p> <p>Legal provisions do not address the adequate cover of technical provisions by assets, by ensuring that reasonably secure assets (excluding, for example, unquoted equities or premium receivables owed for a long period) are currently included to cover the appropriate amount of liabilities.</p> |  |  |  |         |         |                            |           |           |             |               |                 |  |  |  |  |                      |                     |                     |                     |                     |
| <b>Principle 9.</b>        | <p><b>Derivatives and ‘Off-Balance Sheet’ Items</b></p> <p>The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form a part of the financial report of a company licensed in the jurisdiction. In setting these requirements, the insurance supervisor should address:</p> <ul style="list-style-type: none"> <li>– restrictions in the use of derivatives and other off-balance sheet items;</li> <li>– disclosure requirements for derivatives and other off-balance sheet items; and</li> <li>– the establishment of adequate internal controls and monitoring of derivative positions.</li> </ul>  |  |  |  |         |         |                            |           |           |             |               |                 |  |  |  |  |                      |                     |                     |                     |                     |
| Description                | There are no requirements as to restrictions in the use of derivatives and other off-balance sheet  |  |  |  |         |         |                            |           |           |             |               |                 |  |  |  |  |                      |                     |                     |                     |                     |



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|                      | <p>items. There is no requirement to disclose off-balance sheet items nor derivatives. However, the Insurance Accounts Regulations 1980, Schedule II, Part I, note n°13 requires that “any other information which in the opinion of directors is required to be disclosed if the statutory financial statements are not to be misleading.” On this basis, in practice, the auditor usually encourages the company to disclose its off-balance sheet elements in general, and particularly, the use of derivatives.</p> <p>The BMA does not require insurers to have in place an appropriate policy nor an investment risk management system capable of measuring the risk from derivatives.</p> <p>During the on-site visits (started in 2003 for Class 4 companies and there are plans to extend the visits to some Class 3 companies), the BMA inquires about the insurer’s policy as regards derivatives. The supervisor relies on the limited scope of the company, for captives (Classes 1, 2, and partly 3), or, at the other opposite, on the fact that Class 4 companies are professional insurers, for derivatives to be used wisely and in accordance to the objectives of the company. As for Class 4 insurers, half are listed on a foreign stock exchange and have to provide this information (SEC requirements for U.S.-listed companies and similar requirements exist for companies listed elsewhere).</p> |
| Assessment           | Materially non-observed  |
| Comments             | <p>The Insurance Accounts Regulations 1980, Schedule II, Part I, note n°13 requires that “any other information which in the opinion of directors is required to be disclosed if the statutory financial statements are not to be misleading.” On this basis, in practice, the auditor usually encourages the company to disclose its off-balance sheet elements in general, and particularly, the use of derivatives. The supervisor could require the disclosure of off-balance sheet items, and especially, of derivatives, for all insurance companies.</p> <p>The supervisor could also ask the auditor to specifically verify that insurers put into place strict internal controls to ensure that no operation contrary to the company’s policy on off-balance sheet items could escape its notice.</p>   |
| <b>Principle 10.</b> | <p><b>Reinsurance</b></p> <p>Insurance companies use reinsurance as a means of risk containment. The insurance supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them.</p> <p>The insurance supervisor should set requirements with respect to reinsurance contracts or reinsurance companies addressing:</p> <ul style="list-style-type: none"> <li>– the amount of the credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collectibility of the reinsurance recoverable and may take into account the supervisory control over the reinsurer; and</li> <li>– the amount of reliance placed on the insurance supervisor of the reinsurance business of a company which is incorporated in another jurisdiction.</li> </ul>   |
| Description          | <p>As no distinction is made between primary insurers and reinsurers, a reinsurer who also underwrites direct business is subject to the same supervision as a primary insurer.</p> <p>The assessment of the ultimate collectibility of the reinsurance recoverables are the responsibility of the management of the company. The regulations stipulate a general rule that “if any amount is in the opinion of directors uncollectible, that amount shall be deducted.” These amounts would be reviewed by the auditors in the course of their annual audit.</p> <p>The BMA is able to review the general lines of the reinsurance program when an applicant company applies for a license. For Classes 1 and 2 captive companies, the business plan is generally straightforward and gives adequate detail on the risks underwritten and the reinsurance</p>   |

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|                      | <p>cover. For Classes 3 and 4 companies, the business plan can be vague.</p> <p>On an on-going basis, the supervisor relies on the independent auditor’s due diligence to review the security of the reinsurers.</p> <p>For Class 4 insurers, the annual statutory financial returns include an informative statement of ceded reinsurance, which provides details such as the name of the reinsurers, their ratings and the amounts involved. Captives that do unrelated business (insuring risks that are not those of its shareholders or of any affiliates) are usually required by their ceding companies to post collateral.</p> <p>As part of the on-site visit program undertaken in 2003 and thereafter annually, the supervisor may also review the reinsurance arrangements.</p>  |
| Assessment           | Materially non-observed  |
| Comments             | <p>The supervisor reviews the initial reinsurance program to assess the degree of reliance that can be placed on these arrangements and if reinsurance is ceded in accordance to the characteristics of the business of the company, if the application contained a sufficient degree of detail in the description of both the risks it is planning to underwrite and the reinsurance it is planning to cede.</p> <p>The on-site visit allows for a wide-ranging discussion on the insurer’s current situation, but is not conceived to include very concrete data checking.</p> <p>On an on-going basis, the auditor’s due diligence include a review of the reinsurance program. It is not clear whether the auditor’s focus encompasses the adequacy of the reinsurance program to the risks underwritten by the company. Requiring the auditor to specifically review not only the security of the reinsurers but also the adequacy of the reinsurance program for the level of capital of the insurer and for the profile of risks (defined in a more precise manner than the Class level) it underwrites would increase the level of comfort of the whole insurance industry.</p> <p>The annual statutory filings contain very limited information as to the nature of the risks underwritten. Also, for the Class 4 companies, the schedule on reinsurance ceded, although extensive, gives no information as to the risks covered.</p> |
| <b>Principle 11.</b> | <p><b>Market Conduct</b></p> <p>Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills, and integrity in dealing with their customers.</p> <p>Insurers and intermediaries should:</p> <ul style="list-style-type: none"> <li>– at all times act honestly and in a straightforward manner;</li> <li>– act with due skill, care, and diligence in conducting their business activities;</li> <li>– conduct their business and organize their affairs with prudence;</li> <li>– pay due regard to the information needs of their customers and treat them fairly;</li> <li>– seek from their customers information which might reasonably be expected before giving advice or concluding a contract;</li> <li>– avoid conflicts of interest;</li> <li>– deal with their regulators in an open and cooperative way;</li> <li>– support a system of complaints handling, where applicable; and</li> <li>– organize and control their affairs effectively.</li> </ul>   |
| Description          | <p>The Authority must approve insurance managers, brokers, agents, and salesmen. Very strict fit and proper checks are required for approval (Sections 9 to 11). The BMA states that if an entity were found doing unauthorized business, it would be stopped. There are approximately 300 intermediaries (insurance managers, brokers, agents and salesmen) according to the BMA.</p> <p>The Bermuda Association of Insurance and Financial Advisors (ex-Bermuda Life Underwriters</p>  |

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|                      | <p>Association) has a code of ethics, which applies to its members.</p> <p>The BMA has not focused on market conduct customer-related issues because the Bermuda market is primarily a wholesale market (0.3 percent is domestic direct) where transactions are conducted between sophisticated buyers and sellers, instead giving priority to areas of greater risk. However, a Consumer Affairs Bureau that has existed for some time, has in 2001 seen its mission extended to include insurance business. This Bureau is part of the Ministry of Community Affairs and Sport. There have been as yet very few complaints (less than 3). The supervisory staff has sometimes received complaints directly.</p> <p>There are no provisions imposed on the insurer to disclose information regarding life insurance policies or other conventional consumer protection in the Life Insurance Act.</p>  |
| Assessment           | Non-observed for domestic companies, Not applicable for international reinsurance   |
| Comments             | <p>The approach in Bermuda, aimed at the large-scale international market, does not provide a differentiated treatment of domestic insurance. Even if the domestic market represents a small part of the insurance premiums collected in Bermuda, the needs of the individual and small corporate Bermudian policyholders should be addressed (to receive meaningful and understandable information in a timely manner and to have access to an equitable treatment of their complaints).</p> <p>The existence of the Consumer Affairs Bureau could be mentioned in the new insurance policies to increase individual policyholders' awareness that such possibilities are open.</p>  |
| <b>Principle 12.</b> | <p><b>Financial Reporting</b></p> <p>It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis, supported by information obtained through special information requests, on-site inspections, and communication with actuaries and external auditors.</p> <p>A process should be established for:</p> <ul style="list-style-type: none"> <li>– setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports, actuarial reports, and other information;</li> <li>– setting the accounting requirements for the preparation of financial reports in the jurisdiction;</li> <li>– ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and</li> <li>– setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction.</li> </ul> <p>In so doing, a distinction may be made:</p> <ul style="list-style-type: none"> <li>– between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared for the insurance supervisor; and</li> <li>– between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in another jurisdiction.</li> </ul> |
| Description          | <p>All insurers are required to file an annual audited Statutory Financial Return (SFR). The information included with the SFR is dependent upon the class. The SFR for classes 2, 3, and 4, and long-term insurers, includes audited statutory financial statements. Class 1 insurers do not have to file the auditor's opinion with the SFR (Section 18). Although the statutory financial statements for Class 1 are not required to be filed, they must be maintained for a period of five years at the insurers' principal office (Section 17).</p> <p>The notes on the financial statements and the statutory financial returns have to be filed with the</p>   |

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|            | <p>Authority. The statutory financial return consists of a cover sheet (information on the nature of business—general business, long-term or composite—and the gross premiums written by class—there is no official classification of lines of business), the auditor’s report, a declaration of statutory ratios (signed by the principal representative and two directors), and, depending on the business, a general business solvency certificate (signed by the principal representative and two directors), an opinion of a loss reserve specialist (on the loss and loss expense provisions: annually for a Class 3 or 4 and triennially for a Class 2, or when the general business solvency margin on an undiscounted basis is not met although it is met on a discounted basis; on the professional liability reserves when the premiums from this business is over 30 percent of the total premiums), and a long-term business solvency certificate (signed by the principal representative and two directors), an actuary’s certificate (on long-term business liabilities) and, in the case of Class 4 insurers, a detailed schedule of ceded reinsurance (The insurance returns and solvency regulations 1980).</p> <p>There are three statutory ratios (Insurance Returns and Solvency Regulations 1980, schedule II):</p> <ul style="list-style-type: none"> <li>• the premiums to statutory capital and surplus ratio (net premiums written divided by the following amount: statutory capital and surplus less, given the case, minimum solvency margin for long-term business);</li> <li>• the five-year operating ratio (sum of the net loss ratio and the expense ratio less the investment income ratio over a five-year period); and</li> <li>• and the change in statutory capital and surplus ratio (variation in the statutory capital and surplus over the year).</li> </ul> <p>The Deputy Director heads the Compliance team, which consists of 3 senior analysts. This team deals with the non-compliant companies and on-site visits. The non-compliant companies are those that have a qualified auditor’s report, a principal representative’s report, no filings, or have breached a statutory requirement or on which the Authority has received negative information from another jurisdiction. Following the assessment mission, the Compliance team was expanded—in July 2004, it comprised an Assistant Director (head), two Principals of Compliance, and 4 senior analysts, and the consultant actuary is assigned a pivotal role.</p> <p>For testing the validity of the detailed data, the supervisor relies exclusively on the auditor. The actuary does checks on the figures given to him by the management but it is the auditor that tests the accuracy, consistency and completeness of the information.</p> |
| Assessment | Materially non-observed  |
| Comments   | <p>The Authority enforces very strict observance of the filing delays.</p> <p>Financial reporting gathers both the essential numbers describing the company’s activity and the signatures of the principal representative, the directors, the independent auditor and, where applicable, the actuary and the loss reserve specialist. This is characteristic of co-supervisory regimes that imply a high degree of accountability of the company and of its independent reviewers. However, the supervisor should have the means to check the information, directly or indirectly, but, in the latter case, by explicit appointment of the party to which it outsources this mission.</p> <p>Financial reporting should be more detailed, and distinguish direct and assumed insurance, lines of business, and for reinsurance, type of contracts (for example, proportional treaties, non-proportional treaties, and facultatives).</p> <p>Information on losses is limited. In particular, there is no information on the liquidation of</p>   |

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|                             | <p>reserves. Several options are available to the BMA to check this information, directly or indirectly: if it is done indirectly, the BMA should explicitly commission the approved actuary and/or loss reserve specialist to do this check and include in his report a comment on the liquidation of the provisions in addition to their sufficiency; if doing it directly, the BMA could hire an actuary who would analyze the data gathered. An intermediate solution would be for the BMA to outsource the analysis to an independent actuary. However, the two latter options imply that the data be collected through the financial returns (which would be need to be modified to include this data).<sup>37</sup></p> <p>A requirement for quarterly accounts could also be imposed, at least on Classes 3 and 4 companies, given that not only the type of assets, but also the characteristics of the business can change quickly in reinsurance (reinsurers have few contracts with high average premiums, compared to primary insurers).</p> <p>Class 1 companies should also file their financial statements with the Authority. This would allow the supervisor to be proactive if the shareholder and insured of the captive has financial troubles.</p>  |
| <p><b>Principle 13.</b></p> | <p><b>On-Site Inspection</b><br/>The insurance supervisor should be able to:</p> <ul style="list-style-type: none"> <li>– carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates; and</li> <li>– request and receive any information from companies licensed in its jurisdiction, whether this information be specific to a company or be requested of all companies.</li> </ul>   |
| <p>Description</p>          | <p>The supervisor can do on-site inspections by invoking either Sections 29A and 29B or Section 30. The BMA considers that, while inspections carried out pursuant to Section 29A are prudential visits, Section 30 inspections are a sanction and, as such, should not be evaluated under Principle 13 on “On-site inspections. The legal text does not warrant this distinction. In addition, it is not clear how an inspection can constitute itself a remedial action unless the recommendations issued during the inspection must be followed. However, Section 30 makes no mention of recommendations resulting from the inspection.</p> <p>The Insurance amendment act 2002 insert Sections 29A to 29F in the Insurance Act. Sections 29A and 29B introduce the powers of the BMA to obtain information and reports, and to require the production of documents. Section 29F refers to a statement of principles to be published giving the conditions in which the Authority will use Sections 29A and 29B. The statement of principles was subsequently adopted and severely restrains the use of Sections 29A and 29B. It states that “use of the powers under Section 29A ... will be infrequent and exceptional if the Authority is able to rely on the information voluntarily provided by the institution.” The BMA can undertake actions under Section 29B, if it “reasonably” requires it for the performance of its functions., that is, the BMA can ask for any information “as the Authority may reasonably require with respect to matters that are likely to be material to the performance, in relation to the registered person, of its functions under the Act” (BMAA).</p> |

<sup>37</sup> Subsequent to the mission the BMA prepared draft Guidance Notes that seek to provide additional clarity in relation to the role played by persons who perform important functions in the insurance regulatory framework, including auditors, principal representatives and loss reserve specialists.

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|            | <p>The insurance supervision division initiated in January 2003 an on-site visit to the Class 4 companies, and some selected Class 3 companies. This annual program involves three BMA staff members making a half-day visit to the management of a selected company. Prior to the visit, the Authority sends a letter asking for the organizational chart, the biographies of key employees, copy of the information given to other regulators and information given by the rating agencies on that company, and, given the case, the auditor’s management letter. During the visit, the BMA asks about the business underwritten, its future evolution and the capital adequacy.</p> <p>Section 30 allows the Authority to appoint an inspector only if it is “required in the interest of policyholders.” Policyholders are deemed by the BMA to extend to all contracts for insurance, reinsurance and retrocession (individuals, companies whatever the size and the business, including insurance). Every year, one company is inspected on average.</p> <p>The supervisor appoints as inspector a firm of auditors, of actuaries or of lawyers, according to what is needed, to review the insurance company. To prevent conflicts of interest, the inspectors are from a different firm than that of either the independent auditor and/or independent actuary of that company. The international firms themselves also do international conflict checks (if the firm’s U.K. company has audited the account of a parent company of the Bermudian insurer, the assignment can’t be accepted), going back over a three-year period. There are six major firms of auditors in Bermuda, which by order of decreasing size are the following (the number of staff is approximate)—(A) 200 staff of which 130 are full time auditors; (B) 170 staff of which 100 auditors; (C) 160 staff of which 90 auditors; (D) 140 of which 70 auditors; (E) 40 of which 25 auditors; and (F) 20 of which 10 auditors. Another 18 small firms (some with only one auditor) are also approved and audit the accounts of at least one insurance company (usually a captive).</p> |
| Assessment | Materially non-observed   |
| Comments   | <p>Outsourcing the inspections can make a valuable contribution to a supervisory system. However, the supervisor must find a way of acquiring first-hand knowledge of what is going on. The supervisor needs to perform independent checks, directly or indirectly, on the information given by the company. This objective could be reached by giving explicit instructions to an independent reviewer, on the model implemented by the banking sector in Bermuda, in the frame of Section 30. The inspectors would have to give detailed reports detailing each of the points they were commissioned to assess.</p> <p>These inspections could be supplemented by requiring the auditors to systematically write a management letter as part of the annual process, again on the model of what is done in the banking sector.<sup>38</sup></p> <p>The on-site visit is more in the form of an informal discussion than an inspection. It is a useful additional tool contributing to the establishment of a complete supervisory system.</p> <p>Inspections (Section 30), generally conducted by one of the “Big Four” audit firms, are too infrequent. The inspectors should be required to allow the BMA to have access to the working papers done in response its explicit demand, which also implies that the BMA has the necessary expertise to study them. In total, including liquidations, the BMA gives approximately 15 assignments annually to the independent reviewers.</p>  |

<sup>38</sup> Subsequent to the mission the BMA prepared draft Guidance Notes that seek to provide additional clarity in relation to the role played by persons who perform important functions in the insurance regulatory framework, including inspectors.

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| <p><b>Principle 14.</b></p> | <p><b>Sanctions</b></p> <p>Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The insurance supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered. The legislation should set out the powers available to the insurance supervisor and may include:</p> <ul style="list-style-type: none"> <li>– the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions;</li> <li>– the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice; and</li> <li>– the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the license of a company or imposing remedial measures where a company violates the insurance laws of the jurisdiction.</li> </ul>  |
| <p>Description</p>          | <p>The BMA may refuse to register an insurer under Section 4 or a manager, agent, broker, or salesman under Section 10 of the Insurance Act if it deems it not in the public interest to do so (Section 12). The BMA may also impose fines for the failure to file required statements or returns (Section 18A).</p> <p>The BMA has the power to take remedial action where the BMA has reasonable grounds to believe that a material violation of the Insurance Act has occurred (Section 29). These powers include, upon notice in writing to the insurer, the power to obtain information and reports (29A), upon notice in writing to the insurer, the power to require the production of documents (29B), and upon notice in writing to the insurer, the power to appoint an inspector to investigate the affairs of a company (Sections 18A-(5) and 30).</p> <p>A Class 3 or Class 4 company is prohibited from declaring dividends if it fails in meeting its general business solvency margins and must notify the BMA within 30 days after becoming aware of such failure (Section 31-A). A class 4 insurer whose statutory capital and surplus falls below \$75,000,000 has 45 days to respond to the BMA with further information concerning specified matters including an unaudited interim statutory financial statement, an opinion of a loss reserve specialist and a general solvency certificate regarding the matters reported on.</p> <p>The BMA has powers of intervention to order a company to take or refrain from taking certain actions if there is a significant risk of the insurer becoming insolvent or if a provision of the Insurance Act is violated, or if the conditions attached to the license have been breached. The BMA may also intervene where an insurer has failed to meet any liquidity ratios in addition to solvency margins as may be required by law or regulation, when matters threatening the solvency of an insurer are brought to its attention through a statutory financial return, audit, auditor or principle representative or where an insurer fails to retain a principle representative, loss reserve specialist or actuary as may be required by law (Section 32(4)).</p> <p>The powers include ordering the insurer to provide written particulars relating to its financial circumstances, to cease writing certain contracts of insurance or to cease writing all contracts for insurance, to refrain from making investments of a specified class and other powers of similar nature (Section 32). The BMA may direct an insurer threatened with insolvency to transfer specified assets for deposit in a banking institution determined by the BMA (Section 32 (3)). If a report has been required under Section 31-A or if an inspector has been appointed under Section 18-A (5), both of which apply only to Class 3 and Class 4 companies, the BMA must wait for the reports before taking action on the assets.</p> <p>The BMA may cancel the registration (revoke the license) of an insurer if, according to Section 41:</p> <p>(a) False, misleading, or inaccurate information has been supplied by or on behalf of the</p> |

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|            | <p>insurer in contravention of the Insurance Act or any regulation promulgated pursuant thereto.</p> <p>(b) The insurer has failed to commence business or ceased to do business.</p> <p>(c) The insurer has refused to pay fees.</p> <p>(d) The insurer has not complied with a condition attached to its registration or other requirement imposed by law.</p> <p>(e) The BMA finds that the insurer has not been carrying on business in accordance with sound insurance principles.</p> <p>Likewise, the BMA may cancel the registration of managers, brokers, agents, or salesmen on grounds similar to those for an insurer as well as upon conviction of an offense against the Insurance Act or the regulations or upon conviction of a crime involving fraud or dishonesty (Section 42).</p> <p>The BMA can petition the Court for winding up where the insurer is unable to pay its debts within the meaning of Sections 161 and 162 of the Companies Act 1981; that the company has failed to satisfy an obligation under the Insurance Act; and specifically where it has failed to satisfy its obligation to prepare accounts or produce statutory financial statements and as a result, the BMA is unable to ascertain an insurer’s financial position (Section 35).</p> <p>Section 29B-5 provides criminal penalties consisting of a fine of \$10,000 or imprisonment for up to 6 months or both for failure to comply, without reasonable excuse, with the BMA’s power to require information or documents.</p> <p>Section 55 provides that any person committing an offense under the Insurance Act for which no specific criminal penalties otherwise attach may be proceeded against summarily or by indictment. Upon a summary conviction punishment may consist of imprisonment for 12 months or fine of \$5,000 or both. Upon conviction by indictment punishment may consist of imprisonment for 3 years or fine of \$15,000 or both. Where an offense committed under the Insurance Act is attributable to any director, manager, secretary or similar officer, or anyone purporting to act in such capacity, then that person is liable along with the company and can be proceeded against and punished separately.</p> <p>Financial penalties for late filings range from up to \$500 per week to up to up to \$5,000 per week depending on the class of insurer involved. Where a class 4 insurer is over three months late in meeting its filing requirements an inspector would be appointed (Section 18A).</p> <p>Under Section 56 of the Insurance Act the BMA may issue directions (commonly referred to as “Section 56 Directions”) that exempt insurers from certain provisions of the Insurance Act principally involving matters relating to the contents of statutory filing materials, solvency margins and distinctions between long-term business and general business. Section 55 penalties attach for failure to comply with the terms of such directions.</p> <p>Section 51D (1) imposes a penalty for the failure to cooperate with requirements of Section 51B relating to assisting foreign authorities. That offense punishable by a fine of \$5,000 or imprisonment for six months or both. A person who gives false or misleading information to the BMA under Section 51B is subject to a fine of \$25,000 or to imprisonment for two years or both.</p> |
| Assessment | Observed  |
| Comments   | On the whole, an appropriate substantive statutory scheme exists to enable the BMA to take  |



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|                             | <p>remedial actions when necessary. The Insurance Act also imposes a duty on the Principal Representative or certain other persons to report activities that may endanger the financial health of an insurer. The supervisory provisions in the Act place a high degree of reliance on filings, whose accuracy depend on the efficacy of private sector procedures and practices to verify and check data. These processes are intended to prevent situations from developing that would require the BMA to initiate formal sanctions.</p> <p>The BMA can take action against an insurer, manager, broker, agent or salesman but has no legal authority to require changes in the composition of the board or senior management. Instead it proceeds against the company itself as a legal person. The BMA may appoint an inspector, petition for winding up or proceed criminally against an officer, director, manager, or similar officer.</p> <p>Although the BMA can appoint an inspector, short of petitioning the Court for winding up, the inspector has no authority under Section 30 of the Insurance Act to assert immediate control and exercise management functions on a temporary basis for the purpose of stabilizing or rehabilitating the insurer or preserving information and records. Such action would require a petition to the court.</p> <p>The powers under Sections 29A and 29B as enunciated in the Statement of Principles adopted by the BMA pursuant to the Insurance Act 1978 Section 29F, appear to be principally intended as investigatory tools that may precede further regulatory action where the Supervisor has reason to believe that the insurer may not be compliant with the legal requirements of the Insurance Act. The Principles make clear that the use of the powers under 29A and 29B will be infrequent and exceptional if the BMA is able to rely on information voluntarily provided by the insurer.</p> <p>It is noted that Sections 29B-5 and 55 involving failure to disclose information to the BMA provide far less stringent criminal penalties than breaches of confidentiality for agents of the BMA. While failure to disclose may attract a fine of \$10,000 or imprisonment for up to 6 months or both under Section 29B (5), and Section 55 has a catch-all penalty provision provides that upon summary conviction punishment may consist of a fine of \$5,000 or imprisonment for 12 months or both or, upon conviction by indictment, punishment may consist of a fine of \$15,000 or imprisonment for 3 years or both (Section 55). On the other hand, penalties for breaches of confidentiality are far more stringent (a person summarily convicted of the improper disclosure of information is subject to a fine of \$50,000 or imprisonment for two years or both. A person convicted by indictment of the improper disclosure of information is subject to a fine of \$100,000 or imprisonment for five years. Section 52 of the Insurance Act and Section 31 of the Bermuda Monetary Act, as amended in 1999).</p> |
| <p><b>Principle 15.</b></p> | <p><b>Cross-Border Business Operations</b></p> <p>Insurance companies are becoming increasingly international in scope, establishing branches and subsidiaries outside their home jurisdiction, and sometimes conducting cross-border business on a services basis only. The insurance supervisor should ensure that:</p> <ul style="list-style-type: none"> <li>– no foreign insurance establishment escapes supervision;</li> <li>– all insurance establishments of international insurance groups and international insurers are subject to effective supervision;</li> <li>– the creation of a cross-border insurance establishment is subject to consultation between host and home supervisors; and</li> <li>– foreign insurers providing insurance cover on a cross-border services basis are subject to effective supervision.</li> </ul>   |
| <p>Description</p>          | <p>Part II Section 3 of the Insurance Act requires that no person shall carry on insurance business in or from within Bermuda unless registered by the BMA. Maintenance of a principal office in Bermuda and a Principal Representative is also required (Section 8). The Insurance Act also</p>  |

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|            | <p>requires the registration of insurance managers, brokers, salesmen and agents (Section 9). The Insurance Act does not distinguish insurers from re-insurers (Insurance Act generally). Section 20 requires that non-resident insurance undertakings maintain approved assets of a value fixed and ordered by the Minister.</p> <p>The powers to assist foreign authorities are set forth in the Insurance Act (Sections 51A, 51B, and 51C).</p> <p>Section 51A permits the BMA to assist foreign governments where certain preconditions have been met such as that the requesting authority exercise functions corresponding to those of the home regulator (51A (2)), that the requesting authority bear appropriate costs related to the request (51A (6)), and that any statement made in the exercise of the cooperation not be used in evidence against the maker of the statement in the requesting foreign jurisdiction 51A (7).</p> <p>Section 51B gives discretion to the BMA if it is satisfied that the request for assistance is appropriate under Section 51A to compel information from any person registered under the Insurance Act after first serving notice in writing of the information sought. The assistance provided may be in the form of a requirement to produce documents, to appear before the BMA to answer questions or provide further information and to provide such further assistance as the person may reasonably be able to give. The provisions of Section 51B do not require that the person whose cooperation is sought to waive any legal privilege (51B (1) (d), and 51B (3)) or to have any such statement made entered into evidence against him (51B (4)).</p> <p>Section 51C authorizes the BMA to delegate those powers in 51B to a competent person to exercise on behalf of the BMA.</p> <p>The Insurance Act provides a penalty for the failure to cooperate with requirements of 51B relating to assisting foreign authorities. That offense is punishable by a fine of \$5,000 or imprisonment for six months or both (Section 51D (1)). A person who gives false or misleading information to the BMA under 51B is subject to a fine of \$25,000 or to imprisonment for two years or both (Section 51D (2)).</p> <p>Section 52C extends the confidentiality protections and exclusions of Section 52 to information received from relevant overseas supervisory authorities provided further that the BMA may use information received for purposes related to the discharge of its duties under the Insurance Act or the institution of criminal proceedings under the Insurance Act or Bermuda law generally. The strict confidentiality provisions contained in Sections 52B and 52C interplay with provisions of Sections 51A, 51B, and 51C.</p> |
| Assessment | Observed   |
| Comments   | <p>The BMA has the essentials of the regime for effective supervision of cross border operations in place. Under the Bermuda Insurance Act, authority exists to regulate insurance activities that take place within Bermuda irrespective of form and to cooperate with foreign authorities to encourage prudential supervision. The powers granted the BMA to assist foreign authorities are broad in scope but can be seen as potentially limited in their application by virtue of the conditions which attach to their use and the amount of discretion granted the BMA regarding whether to exercise them. This matter is somewhat complicated by their interplay with the confidentiality requirements and the stringent penalties that attach to their violation which could be seen to have as a potential disincentive to effective information sharing with foreign authorities regarding relevant matters. Information sharing has not, in practice, been reported as being hindered by the statutory provisions.</p> <p>The BMA states that a foreign incorporated entity would only be allowed an insurance license in Bermuda if it were satisfied that the home jurisdiction exercises effective continuing supervision over the company as a whole including its branch operations in foreign jurisdictions. However,</p>  |

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|  | <p>no explicit provision exists in Part II of the Insurance Act permitting the BMA to formally consider this factor. If a foreign insurer intends to promote insurance contracts in Bermuda it would have to be registered to do so under Part II of the Insurance Act.</p> <p>Bermuda's licensing scheme provides for licensure and revocation and substitution of statutory filings under circumstances where the home filing requirements are deemed to be equivalent or more stringent than statutory filings. (Part II Insurance Act as amended).</p> <p>The BMA states that it has the power to refuse to grant a license or place conditions on a license where it has material concern about the continuing effective supervision in its home jurisdiction. Under the provisions contained in Part II of the Insurance Act, The BMA may refuse to license a company or place conditions on a license. Section 12 confers broad powers to deny a license if its issue is determined not to be in the public interest. However, the BMA lacks the specific authority to base a decision on this factor and there are no written criteria making it part of the review procedure. The BMA also lacks the authority to prevent a Bermuda insurer from writing other business in foreign jurisdictions but if the business is not being conducted prudently the BMA can cancel an insurer's license under Section 41 (b) (vii).</p> <p>The BMA states that reporting arrangements between foreign branches/subsidiaries and Bermuda will form a part of the BMA's internal control procedures undertaken during on-site compliance visits. A schedule of such visits for Class 4 companies is presently being initiated. It is planned that on site visits for some Class 3 insurers will begin next year.</p> <p>Insurance supervisors are able to exchange information under certain statutory provisions for cooperating with foreign authorities and exceptions to confidentiality requirements under the Insurance Act. However, the statutes as presently written appear to make this process more difficult and complex than it should need to be.</p> <p>The BMA has certain powers to obtain data under Sections 29A–29B of the Insurance Act. However, the powers under Section 29A and 29B as enunciated in the Statement of Principles adopted by the BMA pursuant to the Insurance Act 1978 Section 29F, appear to be principally intended as investigatory tools that may precede further regulatory action where the insurance supervisor has reason to believe that the insurer may not be compliant with the legal requirements of the Insurance Act. The Principles make clear that the use of the powers under 29A and 29B will be infrequent and exceptional if the BMA is able to rely on information voluntarily provided by the insurer.</p> <p>The BMA states that it would not object to an on-site visitation of branches of foreign insurers doing business in Bermuda observing protocols that would involve prior notice to the BMA of the commencement of an examination, upon its conclusion and involving communication on the initiative of either party. The information gathered by the home supervisor would be treated as confidential and used solely for supervisory principles.</p> |
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| <p><b>Principle 16.</b></p> | <p><b>Coordination and Cooperation</b></p> <p>Increasingly, insurance supervisors liaise with each other to ensure that each is aware of the other's concerns with respect to an insurance company that operates in more than one jurisdiction, either directly or through a separate corporate entity.</p> <p>In order to share relevant information with other insurance supervisors, adequate and effective communication should be developed and maintained.</p> <p>In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor:</p> <ul style="list-style-type: none"> <li>– is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (i.e., insurance, banking, or securities) to share information or otherwise work together;</li> <li>– is permitted to share information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors who have agreed, and are legally able, to treat the information as confidential;</li> <li>– should be informed of findings of investigations where power to investigate fraud, money laundering, and other such activities rests with a body other than the insurance supervisor; and</li> <li>– is permitted to set out the types of information and the basis on which information obtained by the insurance supervisor may be shared.</li> </ul>  |
| <p>Description</p>          | <p>The Insurance Act provides mechanisms for information sharing under the provisions of Sections 51, 51A, 51B, and 51C relating to requests for assistance by foreign regulatory authorities. Those sections interplay with the provisions of Sections 52B and 52C relating to confidentiality. No explicit section in the Insurance Act enables the BMA to enter into specific information sharing protocols. Provisions that exist in the Bermuda Monetary Authority Act, correspond with the provisions of Sections 51, 51A, 51B, and provide no independent basis for information sharing (Bermuda Monetary Authority Act, as amended in 2001 Section 30A).</p> <p>The Authority regularly coordinates and cooperates with foreign authorities on an ad hoc basis through its membership in the International Association of Insurance Supervisors (IAIS) and in its attendance at the National Association of Insurance Commissioners (NAIC) conferences as well as other international forums and conferences. It has no formal information sharing agreements presently in effect.</p> <p>Section 51A (3) precludes the BMA from sharing information with other regulators unless it is first satisfied that the assistance requested by the foreign regulatory authority is for the purposes of discharging its regulatory duties. Thereafter, the BMA may exercise its discretion to share information based on the following considerations in particular (Section 51A(5)):</p> <ol style="list-style-type: none"> <li>1) whether corresponding assistance would be given in that country or territory to the BMA;</li> <li>2) whether the request relates to a breach of the law or other requirement that has no close parallel in Bermuda or involves the assertion of a jurisdictional basis not recognized by Bermuda;</li> <li>3) the nature and seriousness of the matter to which the inquiries relate, the importance to the inquiries of the information sought in Bermuda and whether the assistance could be obtained by other means; and</li> <li>4) whether it is otherwise appropriate and in the public interest to give the assistance sought.</li> </ol> <p>Other conditions relate to the payment of costs for producing the information and the rights of the parties from whom the information is sought. (Sections 51A (6), 51A (7), and 51B (3)).</p> |

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|            | <p>The sharing of information with other authorities contained in Sections 51A, 51B and 51 C, is subject to an interplay of strict confidentiality provisions contained in Sections 52B and 52C and parallel provisions in the Bermuda Monetary Act. Those provisions can be seen as a constraint on effective decision sharing and should be revised for the purposes of style and clarity.</p> <p>Although no formal agreements for information sharing yet exist, the BMA indicates that it would be willing to enter into such agreements. The BMA also indicated that it has a close working relationship with the FIU and other police authorities and would be informed of relevant concerns.</p> <p>The BMA indicates that it would carefully consider the need to alert a host supervisor to any emerging concerns.</p> <p>The BMA also states that where information is received from a supervisor, the Authority will undertake to consult where possible with the supervisor if they propose to take action based upon the information supplied.</p> <p>The BMA states that it has not had occasion to inform host supervisors of material changes in supervision of the parent by the Authority which may have a significant bearing on the operation of such insurers. At present the Authority relies on certificates of compliance.</p> <p>Where an insurance supervisor has doubts about the standard of host supervision in a particular jurisdiction, and as consequence, is anticipating action that will affect the foreign establishments in the jurisdiction concerned, they will consult with the host supervisor in advance. The Authority states that it does not observe this practice because it does not allow such developments to happen.</p> <p>The BMA states that should it take action against a permit company it would notify the company's parent of the impending action and inform the home supervisor if it was deemed appropriate to do so.</p> <p>The BMA is able to obtain information on behalf of an insurance supervisor in another jurisdiction pursuant to the provisions of Sections 51A, 51B, and 51 C, provisions contained in Sections 52B and 52C and parallel provisions in the Bermuda Monetary Act.</p> |
| Assessment | Observed   |
| Comments   | <p>The BMA is able to keep abreast of developments and emerging trends in insurance supervision through its participation in IAIS and attendance at the NAIC and other insurance conferences.</p> <p>Statutory provisions exist to allow for cooperation and coordination between supervisory authorities in different jurisdictions. However, the existing statutory scheme for information sharing can be seen to place an undue burden on the Authority both to weigh and consider numerous legal factors and also exercise subjective judgment before making a determination to cooperate and coordinate with officials in other jurisdictions. It must also consider carefully the complex requirements contained in provisions of the Insurance Act and Bermuda Monetary Authority Act relating to confidentiality. These factors can be seen to weigh against a robust regime of relevant information sharing among supervisors even though in practice, it may not.</p>  |

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| <p><b>Principle 17.</b></p> | <p><b>Confidentiality</b><br/> All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections.</p> <p>The insurance supervisor is required to hold confidential any information received from other insurance supervisors, except where constrained by law or in situations where the insurance supervisor who provided the information provides authorization for its release.</p> <p>Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and jurisdictions where information received from another insurance supervisor cannot be kept confidential, are urged to review their requirements.</p>   |
| <p>Description</p>          | <p>The Insurance Act (Section 52) and the Bermuda Monetary Act (Section 31 of as amended in 1999), provide parallel criminal penalties for the unauthorized disclosure of information. Under both Acts, a person summarily convicted of the improper disclosure of information is subject to a fine of \$50,000 or imprisonment for two years or both. A person convicted by indictment of the improper disclosure of information is subject to a fine of \$100,000 or imprisonment for five years or both. Neither section applies to information already in the public domain or if it is in collated form (so that information concerning a particular person cannot be ascertained) or if prior consent is obtained to release the information from the person to whom it relates and (if different) the person from whom it was received.</p> <p>Section 52A allows for the disclosure of otherwise protected information where such disclosure will enable or assist the BMA to discharge its duties under the Insurance Act. It also specifically provides for disclosure to the auditor of a registered person where such disclosure will enable or assist the BMA to discharge its duties under the Insurance Act or protect policyholders.</p> <p>Section 52B provides certain exemptions to Section 52 where disclosure is made to the Finance Minister or other authority where the purpose is to assist the Minister or authority to discharge their regulatory functions or to foreign authorities under specified circumstances to enable such authorities to discharge their regulatory functions. Section 52B also allows for the disclosure of relevant information to an inspector appointed under Section 30 of the Insurance Act or to certain high ranking police officials or to the public prosecutor. It further provides that the use of information disclosed under that provision shall be limited to purposes permitted in the section.</p> <p>Section 52C extends the confidentiality protections and exclusions of Section 52 to information received from relevant overseas supervisory authorities provided further that the BMA may use information received for purposes related to the discharge of its duties under the insurance Act or the institution of criminal proceedings under the Insurance Act or under Bermuda law generally. The confidentiality provisions contained in Section 52B and 52C interplays with provisions of Sections 51A, 51B, and 51 C, which set forth powers to assist foreign authorities.</p> |
| <p>Assessment</p>           | <p>Observed</p>  |

|          |  |
|----------|--|
| Comments | Appropriate confidentiality provisions exist together with reasonable exclusions for legitimate public purposes. However, Sections 52B and 52C of the Insurance Act are complex and procedurally cumbersome to comprehend and comply with in their present form. Confidentiality provisions can be seen as a constraint on effective information sharing under what would otherwise be appropriate circumstances, as 8 different sections or subsections of the Insurance Act must be consulted to determine whether a appropriate “gateway” exists for sharing information. The statute should be modified for the purposes of style and clarity. |
|----------|--|

Table 11. Summary Observance of IAIS Insurance Core Principles

| Assessment Grade        | Principles Grouped by Assessment Grade |                           |
|-------------------------|--|---------------------------|
|                         | Count                                  | List                      |
| Observed                | 6                                      | CP 2, 3, 14, 15, 16, 17   |
| Largely observed        | 2                                      | CP 1, 8                   |
| Materially non-observed | 7                                      | CP 5, 6, 7, 9, 10, 12, 13 |
| Non-observed            | 1                                      | CP 11 (domestic)          |
| Not applicable          | 1 - 2                                  | CP 4, 11 (international)  |

## F. Recommended Action Plan and Authorities’ Response to the Assessment

### Recommended action plan

Table 12. Recommended Action Plan to Improve Observance of IAIS Insurance Core Principles

| Reference Principle   | Recommended Action   |
|---|--|
| <b>Organization of an Insurance Supervisor</b>  |  |
| CP 1  |  |
| The insurance supervisor of a jurisdiction must be organized so that it is able to accomplish its primary task, i.e., to maintain efficient, fair, safe, and stable insurance markets for the benefit and protection of policyholders. It should, at any time, be able to carry out this task efficiently in accordance with the Insurance Core Principles. | The Minister should not have the possibility to give directions to the BMA. The conditions in which the BMA can exercise its powers should be more clearly defined so as not to be able to be readily challenged.<br><br>The BMA should continue to improve to improve its IT system and to recruit staff, both of which are priorities. Knowledge of actuarial techniques should be developed in the staff. |
| <b>Licensing and Changes in Control</b>   |  |
| CPs 2–3   |  |

| Reference Principle  | Recommended Action  |
|--|---|
| <p>Companies wishing to underwrite insurance in the domestic insurance market should be licensed.</p> <p>The insurance supervisor should review changes in the control of companies that are licensed in the jurisdiction. The insurance supervisor should establish clear requirements to be met when a change in control occurs.</p>   | <p>Given the reliance on the licensing procedure as a tool to help prevent the need to later resort to formal remedial action, it is recommended that consideration be given to increasing the quorum requirements of the IAC Admissions Committee, completing the project to develop fit and proper licensing criteria and defining in detail the requirements of the business plan.</p> <p>The definition of long-term business should be more precise so as to give a clear idea of what can be done under that type of business.</p> <p>Significant changes in ownership of public companies should be formally notified to the BMA.</p>  |
| <p><b>Corporate Governance and Internal Controls</b></p>   |   |
| <p>CPs 4–5</p>   |   |
| <p>It is desirable that standards be established in the jurisdictions which deal with corporate governance.</p> <p>The insurance supervisor should be able to review the internal controls that the board of directors and management approve and apply, and request strengthening of the controls where necessary; and require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investment and liquidity management.</p>  | <p>In a regime largely dependent upon self-policing controls, the regulator must be able to depend on companies having detailed internal procedures ensuring that objectives are set, as well as procedures for monitoring and evaluating the progress made, that the respective accountabilities of the board and the management are clearly defined and that the balance between executive and non-executive members of the board is kept.</p> <p>Internal controls should be mentioned explicitly as a regulatory imposition.</p> <p>The flow of information between the BMA and the auditor should be more frequent and especially, more detailed. The supervisor should explicitly require the auditor to do specific checks (including the review of internal controls) and the auditor should systematically write his comments on those checks.</p> |
| <p><b>Prudential Rules</b></p>   |   |
| <p>CPs 6–10</p>  |   |
| <p>Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction.</p> <p>Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction.</p> <p>The requirements regarding the capital to be maintained by companies which are licensed, or seeking a license, in the jurisdiction should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity,</p> | <p>The BMA should consider limiting investment in certain assets and a stricter definition of relevant assets.</p> <p>Regulation should require that admissible assets cover 100 percent of the insurance liabilities. These admissible assets of secure value should be defined in a prudent manner, for example, excluding assets such as unquoted bonds and hedge funds.</p> <p>The information in the annual statutory filings should be more detailed concerning the lines of business and reserves (gross and net reserves per line of business as well as specific information on recoveries, loss expenses reserves and liquidation of reserves).</p>   |



| Reference Principle  | Recommended Action  |
|--|---|
| <p>and business risks of the company in the jurisdiction.</p> <p>The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form a part of the financial report of a company licensed in the jurisdiction.</p> <p>Insurance companies use reinsurance as a means of risk containment. The insurance supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them.</p> | <p>The accounting standard used by the company should be explicitly stated in the statutory filings.</p> <p>A general rule limiting reinsurance recoverables should be set (excluding not rated or below investment grade reinsurers, for example).</p> <p>Regulation should explicitly allow for a premium insufficiency reserve.</p> <p>The BMA should clarify the auditor’s responsibilities as to the reliability of the data, and require a final auditor report indicating precisely the checks made on the general data, and more specifically, on actuarial data.</p> <p>The actuary’s report should include detailed indications on the method used for reserving and the verifications conducted.</p> <p>The compulsory disclosure of off-balance sheet items would increase the accuracy of the financial statements.</p> <p>The appropriateness of the reinsurance program to cover the profile of the risks underwritten should be checked, either by the insurance supervisor or by outsourcing to the auditor.</p> <p>Auditors should systematically write management letters.</p> |
| <p><b>Market Conduct</b></p>   |   |
| <p>CP 11</p>   |   |
| <p>Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills, and integrity in dealing with their customers.</p>   | <p>It is recommended that market conduct customer-related issues be addressed for the individual or small corporate Bermudian policyholders (to receive meaningful and understandable information in a timely manner and to have access to an equitable treatment of their complaints).</p> <p>The existence of the Consumer Affairs Bureau could be mentioned in the new insurance policies to increase individual policyholders’ awareness that such possibilities are open, for example.</p>   |
| <p><b>Monitoring, Inspection and Sanctions</b></p>   |   |
| <p>CPs 12–14</p>   |   |

| Reference Principle  | Recommended Action   |
|--|--|
| <p>It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis, supported by information obtained through special information requests, on-site inspections, and communication with actuaries and external auditors.</p> <p>The insurance supervisor should be able to carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates; and request and receive any information from companies licensed in its jurisdiction, whether this information be specific to a company or be requested of all companies.</p> <p>Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The insurance supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered.</p> | <p>In order to have a better understanding of the market, the financial reporting should be more detailed, and distinguish direct and assumed insurance, lines of business, and for reinsurance, type of contracts (for example, proportional treaties, non-proportional treaties, and facultatives). The information on losses should be considerably expanded, to include, amongst other, data on the liquidation of the provisions.</p> <p>The BMA should require the actuary and/or the loss reserve specialist to give explicit written comments on reserving adequacy.</p> <p>The financial returns should be regularly updated.</p> <p>Consolidated information, where applicable, and quarterly accounts, at least for Classes 3 and 4 companies, could be required. Class 1 companies should file their financial statements with the Supervisor.</p> <p>The independent reviewers mandated to a specific effect by the BMA should give access to the BMA to their working papers. The BMA must have the capability, either directly or indirectly, of checking the reviewers' working papers.</p> <p>The number of appointment of inspectors (Section 30) should be increased, to conduct on-site inspections.</p> <p>It is essential that the supervisor be capable of verifying the information given by the company, directly or indirectly.</p> <p>To strengthen the authority to impose sanctions, it is recommended that:</p> <ol style="list-style-type: none"> <li>1) Explicit powers be given the BMA to intervene to require changes in the composition of the board and or senior management if the insurer is found to be in a hazardous condition. In the alternative, it is recommended that the Authority be able to vest temporary control and management powers in the inspector or other person with authority to act to rectify an insurer's hazardous condition.</li> <li>2) Legislation be considered to allow the Authority the express legal authority to require the submission of a written recovery plan within a relatively short time.</li> <li>3) An expanded range of civil penalties may be considered in instances where legal requirements are not met but do not rise to the level of criminal conduct.</li> </ol> |

| Reference Principle   | Recommended Action   |
|---|--|
| <p><b>Cross-Border Operations, Supervisory Coordination and Cooperation, and Confidentiality</b></p>  |  |
| <p>CPs 15–17</p>  |  |
| <p>Insurance companies are becoming increasingly international in scope, establishing branches and subsidiaries outside their home jurisdiction, and sometimes conducting cross-border business on a services basis only.</p> <p>Increasingly, insurance supervisors liaise with each other to ensure that each is aware of the other’s concerns with respect to an insurance company that operates in more than one jurisdiction, either directly or through a separate corporate entity.</p> <p>In order to share relevant information with other insurance supervisors, adequate and effective communication should be developed and maintained.</p> <p>All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections.</p> <p>The insurance supervisor is required to hold confidential any information received from other insurance supervisors, except where constrained by law or in situations where the insurance supervisor who provided the information provides authorization for its release.</p> <p>All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections.</p> <p>The insurance supervisor is required to hold confidential any information received from other insurance supervisors, except where constrained by law or in situations where the insurance supervisor who provided the information provides authorization for its release.</p> | <p>It is recommended that BMA’s ability to regulate cross-border business operations be strengthened by amending relevant statutory provisions relating to disclosure of information. “Fast track provisions” may be considered for inclusion to further facilitate the timely exchange of information between cooperating authorities. Such a provision can be conditioned on a pre-existing memorandum of understanding regarding information sharing executed between Bermuda and cooperating outside or foreign jurisdictions.</p> <p>Given the importance of protecting the confidentiality of certain information, the gravity of penalties that attach to the unlawful disclosure of information and the complexity of the statute in its present form, consideration should be given to a technical revision of sections of the Insurance Act along with the relevant parallel BMA Act, for purposes of clarity and organization (Bermuda Monetary Authority Act, as amended in 2001 Section 30A).</p> |

### **Authorities' response**

We are pleased that the IMF Assessment has rightly recognized the strength and quality of the business to business market between sophisticated buyers and sellers of insurance and reinsurance that comprises the overwhelming portion of Bermuda's regulated insurance business. The Report also recognized the effectiveness of the unique regulatory framework put in place in Bermuda under which reinsurance business has been long subject to effective regulation in the jurisdiction, while still being largely or wholly unregulated in many other major jurisdictions.

At the same time, the Report acknowledges the complexity of an attempt to apply the IAIS Principles in place at the time of the visit to an industry "organized around captives, insurance of corporate accounts and reinsurance" (paragraph 80), as was felt to be required by the terms of reference and the fact that Bermuda has developed a framework under which it regulates the full spectrum of insurance business conducted in the jurisdiction. It is, of course, also the case that a significant proportion of Bermuda's insurance industry is made up of captives whose primary, and in many cases, sole activity involves the self-insuring of group risks, rather than any wider involvement in third party risk. We sympathize with difficulties clearly faced by the assessors in striving to apply Principles aimed essentially towards direct insurance business to a market for which the standards were evidently less than wholly appropriate.

Since the time of the IMF on-site visit, the IAIS Principles have been subject to extensive overhaul and enhancement, including through the development by a special Reinsurance Sub-Committee of standards geared directly towards reinsurers. Bermuda has been a full and active participant in this detailed review and in the development of new insurance (and particularly, reinsurance) standards in the various international fora and specialized working parties.

At the same time, in anticipation of the new international standards, which have now been adopted, Bermuda has moved swiftly to develop and enhance a number of aspects of its regulatory regime, consistently with the requirements of these new standards. This process is already well advanced, with numerous changes already introduced and others expected to be implemented during the first part of 2005. Certain amendments to the Insurance Act 1978 have been enacted, in particular underpinning the ability of the BMA to clarify aspects of the regulatory requirements and standards through guidance to the industry. Moreover, the BMA has taken a number of steps to further enhance the effectiveness of its insurance regime including: significant increases in qualified technical staff; development of a more sophisticated risk-based supervisory model and further enhancement of the on-site elements of the regulatory regime for insurers.

Arising out of the IMF Assessment, the Authority's Board has reviewed all the specific recommendations made, to determine what additional action might still be required in order to deal with any issues highlighted. This, again, reflects Bermuda's strong ongoing commitment to maintaining compliance with relevant international regulatory standards.

Appropriate amendments, both to the Insurance Act and to aspects of the regulatory framework, have been identified, and the necessary action put in train. Some of these actions that have already been taken include increases in staff complement, the issuance of detailed guidance notes on critical matters related to supervision and an enhancement of our risk based supervisory model. Through these and other initiatives currently in preparation, the BMA is confident that it will continue to achieve a high degree of compliance with the relevant international standards.

## **V. IMPLEMENTATION OF THE IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION AND TRANSPARENCY OF SECURITIES REGULATION**

### **A. General**

55. An assessment of the *IOSCO Objectives and Principles of Securities Regulation* (2002) was undertaken in Bermuda as part of the Offshore Financial Centre assessment mission in March 2003. The assessment was conducted by Jennifer Elliott.

### **B. Information and Methodology Used for Assessment**

56. The assessment was based on a review of Bermuda legislation, additional guidance and interpretation issued by the BMA, Bermuda Stock Exchange (BSX) rules and regulations, and interviews with BMA staff, interviews with Ministry of Finance staff, a review of documentation at the BMA, interviews with market participants and with the BSX. The mission is grateful for the generous assistance of the authorities and the private sector.

57. The assessment used as its methodology the Bank/Fund Staff Guidance Note for the Assessment of the IOSCO Principles, September 2002.

### **C. Institutional and Macprudential Setting, Market Structure**

58. Bermuda is a small jurisdiction with a stock exchange, a number of full service brokerage firms and a large and active investment fund and investment funds services sector. The jurisdiction serves as a hub or offshore conduit for a number of multinational financial services organizations. As well as serving a relatively affluent resident population, the securities sector serves institutional clients from a variety of onshore and offshore jurisdictions. Bermuda is home to a large number of hedge funds, investment managers and portfolio managers as well as internationally active fund administrators.

59. There are 54 firms licensed to carry on business under the IBA. The majority of firms act as investment advisers and portfolio managers although there is also a small full-service industry. As of end December, 2002 there were 1426 classified collective investments schemes in Bermuda with \$68 billion assets under management. Firms relying on exemptions under the IBA are required to file an exemption notice with the BMA. There are a large number of exempt investment businesses located in the jurisdiction including portfolio managers and investment advisers. Exemptions are available to investment advisors or portfolio managers dealing only with institutions and sophisticated investors. A number of investment funds in the jurisdiction are also exempt from regulation. Bermuda is also home to a number of service providers for funds—many of whom are not currently subject to direct regulation. The BMA has proposed direct regulation of mutual fund administrators under the new CIS Act.

60. There are both listed and unlisted registered public companies in Bermuda. The BSX serves as a domestic market for local companies and as a venue for recording trades in internationally listed companies. There are 393 listings on the BSX with a total market

capitalization, as of December 31, 2002, of \$150 billion. Of these, 359 are domestic listed companies (including 263 listed investment funds) with a total market capitalization of \$1.3 billion. The remaining 34 international companies listed on the BSX are cross-listed on onshore exchanges. The bulk of trading volume on the exchange takes place in the after hours crossing market which allows execution of orders at or between the closing bid/offer spread. This feature allows institutional or fund investors to execute basket trades or value weighted average price trades once the onshore exchange has closed.

61. Trading volume in domestic securities is thin and the exchange has suffered from the cross-listing of its major stock, the Bank of Bermuda, on Nasdaq in 2001. Investment funds and insurance companies dominate the domestic market. The BSX produces a BSX Index and the Bermuda Insurance Index. Like many small exchanges, the BSX is facing a challenging future as liquidity moves to more established large exchanges in Europe and North America. The BSX also hosts trading in a pre-public offering mezzanine market—currently there are 13 companies traded on this market.

62. There are 16 trading members on the BSX—some of these are remote access, non-Bermudian residents and are not licensed by the BMA. The BSX also operates a clearing and settlement system and a depository (BSD). All systems are fully automated.

#### **D. Description of Regulatory Structure and Practices**

63. The *Bermuda Monetary Authority Act* (BMA Act) establishes the BMA and charges it with responsibility for the regulation of financial institutions including investment firms, collective investment schemes and the BSX. Under the IBA, the BMA is given authority and responsibility for licensing and supervision of market intermediaries and under the *Bermuda Monetary Authority (Collective Investment Scheme Classification) Regulations* (CIS Regulations) the BMA is given authority and responsibility for classification and supervision of collective investment schemes. The BMA also plays a role in the registration of companies by vetting registration filings for all companies in the jurisdiction. Companies are registered by the Registrar of Companies, located in the Ministry of Finance. The BSX is responsible under the *Bermuda Stock Exchange Act* for regulation of its listed companies, trading members and for surveillance of trading on the exchange.

64. Securities regulation is a relatively new development in Bermuda. The *CIS Regulations* were adopted in February 1998—collective investment schemes were given a transition period of one year following which they were expected to be in compliance with the *CIS Regulations*. The IBA first came into effect January 2000—investment businesses were given six months to make an application or file an exemption with the BMA. A new IBA took effect in January 2004 and a new draft a CIS Act and revised CIS Regulations are being prepared. The new legislation will grant the BMA, among other things, greater licensing and inspection authority. As a reflection of the unique industry structure in Bermuda, the BMA is seeking authority to license and inspect mutual fund administrators (which may not now fall within licensing requirements unless the activity is located in a licensed bank or investment business).

## E. General Preconditions for Effective Securities Regulation

65. IOSCO has identified a number of preconditions for effective securities regulation including no unreasonable barriers to entry and exit from markets and products; adequate development of regulatory policy and the impact of the regulatory requirements; appropriateness of legal, tax and accounting framework within which the securities markets operate, and the effectiveness of procedures for the efficient resolution of problems in the securities market; and soundness of macroeconomic policies (those aspects that could affect the operations of the securities market). These preconditions appear to be in place in Bermuda. Although Bermuda restricts corporate activity through its economic planning and registration process, there does not appear to be an unreasonable barrier to entry and exit and there is competition in the sector. The BMA and the Ministry of Finance have a comprehensive program of policy development and there is significant attention paid to the economic impact of regulation. The legal and accounting system are adequate and supported by a depth of supporting professional skills.

## F. Principle-by-Principle Assessment

66. A Principle will be considered *implemented* whenever all assessment criteria are generally met without any material deficiencies. The Principles acknowledge that there are often several ways for countries to implement the Principles. A Principle will be considered to be *broadly implemented* whenever only minor shortcomings are found, which do not raise major concerns and when corrective actions to achieve full implementation with the Principle are scheduled and realistically achievable within a short period of time. A Principle will be considered *partly implemented* whenever significant shortcomings are found, and the authorities have not implemented one or more assessment criteria. The difference between *implemented* and *partly implemented* may in part depend upon the improvements needed and on doubts as to the authorities' ability to implement within a reasonable time-frame. A Principle will be considered *non-implemented* whenever major and material shortcomings are found in adhering with the assessment criteria. A Principle will be considered *not applicable* whenever it does not apply given the structural and institutional conditions.

### Regulator

67. The BMA operates independently and is publicly accountable for its undertakings. Authority over all issuers, trading systems and clearing and settlement systems should be more clearly established in law.<sup>39</sup> Independence would be enhanced with changes to the

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<sup>39</sup> Part IV of IBA/03 establishes a framework for the regulation of recognized investment exchanges and clearing houses by the BMA.



Minister's ability to give direction to the BMA and greater budgetary autonomy.<sup>40</sup> There are a number of weaknesses in legal authority over investment firms and collective investment schemes such as the right to inspect without notice. These are generally recognized and the development of a new CIS Act and revisions to the *CIS Regulations*, along with implementation of the new IBA, will remedy any problems. The BMA is currently able to attract high quality staff—however there is some concern that in-depth technical skills required in this sophisticated market are not sufficient because of the authority's difficulty in retaining staff who are drawn to industry by better salaries. This is, of course, an on going problem for many regulators but particularly challenging in Bermuda because this small Authority is responsible for oversight of a highly sophisticated sector.

### **Cooperation and information sharing**

68. The BMA relies on authority under the BMA Act to obtain and share information from investment firms.<sup>41</sup> In practice the BMA shares information with a number of foreign counterparts including Canada, the United Kingdom, and the United States. In addition, it has formal agreements in place with its counterparts in Jersey and the Isle of Man.

### **Issues**

69. Regulation of companies offering shares to the public is split between listed companies, regulated by the BSX and subject to prospectus and continuous disclosure obligations, and unlisted companies, subject to prospectus and some continuous disclosure requirements but not to regulatory oversight. The BMA should be given authority to regulate all public companies—including greater oversight of the BSX listing function. New rules instituting insider reporting requirements and public disclosure of these reports, and takeover bid, change of control, and related party transaction requirements would improve protection of shareholders. The BSX and BMA should coordinate efforts in this regard.

### **Collective investment schemes**

70. The BMA has a comprehensive classification (licensing) system in place covering collective investment schemes in the form of mutual funds and unit trusts, although it requires additional inspection authority. The classification process could be supplemented with further guidance to industry in the form of guidance notes and interpretation—this would provide greater transparency to requirements currently imposed in the classification process and develop additional rules regarding handling of conflicts of interest, calculation

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<sup>40</sup> Section 11 of IBA/03 provides that the Minister may give the BMA policy directions that are not inconsistent with the provisions of the Act.

<sup>41</sup> Sections 78–81 of IBA/03 sets out a framework for the sharing of information.

and publication of net asset value, segregation of client assets and securities lending. The BMA should also have the authority to override a suspension of redemptions.

### **Market intermediaries**

71. Licensing requirements and the licensing process are also comprehensive in the case of market intermediaries. The use of guidance notes and codes of conduct developed by the BMA are helpful in providing the industry greater guidance. The BMA has a full inspection program in place but would benefit from enhanced depth of technical skill amongst inspection staff. The BMA also requires additional legal authority to inspect market intermediaries and approve changes in ownership.<sup>42</sup> Market intermediaries are subject to capital requirements; these are monitored by the intermediaries or their auditors along with quarterly and annual reporting to the BMA.<sup>43</sup> There is no independent on-site monitoring by the BMA—the authority could consider enhancing this monitoring with its own staff inspections of investment firms financial conditions. The BMA should develop a contingency plan for potential failure of an intermediary.

### **Secondary markets**

72. The BMA is responsible for oversight of the BSX, both in its role as a trading system and clearing and settlement system. Proposed amendments to the IBA will create a full licensing regime for trading systems and clearing and settlement systems and give the BMA broader powers over the BSX. At present, the BSX is not subject to a licensing regime and is not subject to inspections; although, it is subject to prudential requirements.<sup>44</sup> While the exchange appears to be operating well and has sound regulatory practices in place, supervision of the BSX could be strengthened and the BMA should give some attention to develop staff skills in this specialized area. Insider trading and market manipulation rules should be developed for general application—currently the government is considering bringing in related criminal code provisions.<sup>45</sup>

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<sup>42</sup> Section 47 of IBA/03 gives the Authority the power to enter an institution to obtain information and documents.

<sup>43</sup> Section 28 of the IBA/03 gives the Authority some power to control the acquisition of shareholding or control of an investment provider.

<sup>44</sup> Part IV of IBA/03 establishes a framework for the regulation of recognized investment exchanges and clearing houses by the BMA.

<sup>45</sup> The authorities have reported that subsequent to the mission amendments to the criminal code have addressed these deficiencies in the legislation.

**Comments**

73. The securities regulatory system in Bermuda is largely sound. The BMA has, in a short period of a few years, brought into place a credible licensing and supervision system for market intermediaries and collective investment schemes. There are a number of legislative issues that should be addressed to provide the BMA with additional required authority—these have been acknowledged; some have been addressed in the new IBA and others should be addressed in upcoming CIS legislation. Given the nature of the market, which is dominated by investment advisers and collective investment schemes, the regulation of issuers and trading systems has been somewhat neglected. As the BMA completes its reforms in intermediary and collective investment scheme regulation it should turn its attention to some regulation of issuers and closer supervision of the BSX.

74. The BMA staff are qualified, professional and committed. The BMA is able to provide competitive salaries but still has some difficulty in retaining staff. The consequent lack of depth of technical skill is a challenge that should be addressed, particularly in the area of trading system oversight and inspections.

Table 13. Detailed Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation

| <b>Principles Relating to the Regulator</b> |  |
|---|--|
| <b>Principle 1.</b>                         | The responsibilities of the regulator should be clear and objectively stated.  |
| Description                                 | <p>There are three major statutes which set out the BMA’s responsibilities and authority. The <i>Bermuda Monetary Act</i> (BMA Act) establishes the BMA and grants it general authority to supervise financial institutions—including the Bermuda Stock Exchange which is specifically defined in a schedule to the Act as a financial institution.</p> <p>The IBA grants the BMA authority to license and supervise all defined investment businesses. The definition encompasses a broad range of securities related activities including brokerage activity, portfolio management and investment advice. The <i>Bermuda Monetary Authority (Collective Investment Scheme Classification) Regulations</i> (CIS Regulations) grants the BMA classification and supervision authority over collective investment schemes. There are a number of exemptions available under each Act.</p> <p>The BMA is not granted authority to regulate trading systems or public issuers per se. The BSX is constituted by a private act and includes, within a single legal entity, the secondary market, clearing and settlement system and central depository. As part of its activities the BSX supervises listed issuers—a function described in the BSX Act. While the BMA has general supervisory power over the BSX, there is no direct connection giving the BMA authority over listed companies. The Ministry of Finance is given authority to review prospectus offerings as part of its registration of companies function under the <i>Companies Act</i>.</p> |

|                     |  |
|---------------------|--|
| Assessment          | Broadly implemented  |
| Comments            | <p>The IOSCO Principles require that all areas of regulation be covered by at least one statutory regulator—this condition is not fully met in Bermuda. There is no clear regulation of unlisted issuers other than registration—this is both a gap in legislation and a gap in practice. Responsibility for all issuers should be clearly set out in legislation. The Ministry of Finance registers prospectuses but has no on going role in the oversight of public issuers. It would be preferable for regulatory authority over all public issuers to reside in the BMA.</p> <p>Regulatory authority over trading systems should also be set out clearly by statute.<sup>46</sup> The statutory treatment of new trading systems is currently unclear although in practice it is likely that a new private act would be created for a new exchange. A proposed new law would define a regulatory regime for trading systems generally—addressing this issue.</p>   |
| <b>Principle 2.</b> | The regulator should be operationally independent and accountable in the exercise of its functions and powers.   |
| Description         | <p>The BMA is constituted as an independent authority under the <i>BMA Act</i>, directly accountable to the MOF. The authority is funded by way of user fees and seignorage—there appears to be sufficient on-going funding to support the authority’s functioning. The annual expenditure budget must be approved by the MOF. The authority operates on a profit basis and remits part of its annual profit to the government. The BMA is obligated by statute to make an annual report, including audited financial statements, to the Minister. The annual report is published and is available to the general public. Section 21(2) of the BMA grants the MOF the right to give direction to the BMA if the Minister deems it to be in the public interest.</p> <p>The BMA is governed by a board of 11 directors, composed of executive staff of the BMA, and representatives of the financial sector not affiliated with a regulated entity. Members of government are not eligible to serve on the board. The Chairman also serves as the Chief Executive Officer. Under the BMA Act, the Board is appointed by the MOF for a minimum three year term. Board members may be dismissed for negligent or unlawful conduct. Members of the Board and staff are protected from liability for acts undertaken in good faith by the BMA Act. Board members and staff are subject to confidentiality rules under the BMAA and staff are subject to a code of conduct covering conflicts of interest. A code of conduct is applicable to board members.</p> <p>All final decisions of the BMA are subject to judicial review under Bermudian law. Licensed investment firms whose licenses are varied, suspended, or cancelled may appeal the decision to a Review Committee—an appeal committee created under the IBA. Collective investment schemes can appeal decisions to the MOF. Neither appeal process has been used thus far.</p> <p>In the development of policy and rules, the BMA consults with industry and works with the Ministry of Finance. However, day to day operations are carried out independently.</p> |

<sup>46</sup> Part IV of IBA/03 establishes a framework for the regulation of recognized investment exchanges and clearing houses by the BMA.

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| Assessment          | Broadly implemented  |
| Comments            | <p>The right of the Minister to give direction to the BMA is a limitation on the BMA's independence, albeit one that has not been a concern or practice.<sup>47</sup> The BMA's budget process, whereby it must be approved by the Minister and excess revenue is shared with the government, may also cause concern with respect to the BMA's ability to operate independently. While in practice this may not be an issue, the right should be removed from legislation to remove any perception of interference in the BMA's regulatory role. The proposed IBA would have additional language limiting the Minister's ability to issue a direction to policy issues and require that direction be consistent with the IBA.</p> <p>There are two separate appeal processes for collective investment schemes and investment businesses—the BMA should consider a consistent approach and establish an appeal process for collective schemes that mirrors that for investment businesses.</p>   |
| <b>Principle 3.</b> | The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.   |
| Description         | <p>The BMA has clear licensing and supervision authority over investment businesses under the IBA; it has clear supervisory authority over the BSX under the BMA Act and clear classification and supervisory authority over collective investment schemes under the <i>CIS Regulations</i>. It does not, however, have adequate inspection authority with respect to investment businesses, collective investment schemes or the BSX which may impede its ability to carry out inspections and investigations. There is no clear and direct authority over issuers or over trading systems.</p> <p>The BMA has the ability to adopt guidance notes in specific areas under the IBA and <i>CIS Regulations</i> but otherwise does not have rule-making power. In practice this does not appear to have caused undue delay in its ability to respond to changes in the market.</p> <p>The BMA has sufficient resources to carry out its current tasks. There are currently eight staff dedicated to securities related regulation plus two executive officers responsible in this area. Increased responsibility for issuers may require additional resources. The BMA has successfully attracted qualified staff. However a number of market participants expressed concern that high turnover at the authority meant that sufficient in-depth knowledge of the industry was not always available at the authority. The BMA acknowledges this problem. Experienced staff have been hired away by industry where salaries are higher.</p> |
| Assessment          | Broadly implemented  |
| Comments            | <p>The BMA requires additional authority to inspect, on demand, investment businesses, collective investment schemes and the BSX.<sup>48</sup> Such authority over investment firms is contained in the new IBA. Provisions granting authority over exchanges will come into force September 2004. Although full ability to adopt new rules under overriding legislation is not required by the Principle, such authority would allow the BMA to respond more flexibly to changing needs.</p>  |
| <b>Principle 4.</b> | The regulator should adopt clear and consistent regulatory processes.  |

<sup>47</sup> Section 11 of IBA/03 provides that the Minister may give the BMA policy directions that are not inconsistent with the provisions of the Act.

<sup>48</sup> Part IV of IBA/03 establishes a framework for the regulation of recognized investment exchanges and clearing houses by the BMA.

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| Description                          | <p>The BMA operates transparently and is subject to the general provision of administrative law in Bermuda. It has posted all applicable legislation on its website and has developed informational documents designed to clarify the licensing process. The BMA has produced guidance notes and codes that set out expectations of compliance with existing legislation. Internally the authority has developed procedure manuals and an inspection manual that help to ensure consistent processes. The BMA is obliged to publish new rules, new licenses and decisions to withdraw licenses in the local press.</p> <p>The BMA consults with industry in developing new rules and policies. It has a close relationship with the BSX in this regard. The BMA is obliged to provide written reasons for the withdrawal or suspension of license or the imposition of other sanctions. Under the IBA, affected parties also have the right to make representations prior to a final decision. The BMA is not required to provide written reasons for refusal of a licensing application but does so in practice.</p> |
| Assessment                           | Implemented   |
| Comments                             | The BMA might consider posting proposed rules or amendments for public comment using the website or other public medium to ensure equal access to information. Proposed rules of the BSX could also be published for public comment during the review process. CIS operators should be given the right to make representations prior to a final decision.   |
| <b>Principle 5.</b>                  | The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.  |
| Description                          | The BMA Act establishes an obligation to maintain confidentiality of information. Staff of the BMA are subject to the <i>Personal Dealing Rules and Procedures</i> —internal rules which set out detail regarding handling of conflicts of interest. Staff are required to seek prior approval before purchasing or selling shares in a regulated entity or an entity for which the BMA may have sensitive information as well as for any material change to their personal financial dealings. This reporting under the code is made directly to the Chairman. Staff are subject to confidentiality rules.   |
| Assessment                           | Implemented   |
| Comments                             | The BMA should consider establishing a separate internal function responsible for reporting under the code.   |
| <b>Principles of Self-Regulation</b> |   |
| <b>Principle 6.</b>                  | The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.   |
| Description                          | The BSX acts as a self-regulatory organization. The exchange is responsible for regulation of its trading members including their financial condition, general compliance with securities law and regulation of their trading. The exchange is also responsible for its listed issuers including the setting and enforcement of original and on-going listing requirements, and the setting and enforcement of continuous disclosure obligations.   |
| Assessment                           | Implemented   |
| Comments                             | IOSCO has indicated that there are no criteria for implementation of this Principle since the use of SROs is always optional.   |
| <b>Principle 7.</b>                  | SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.  |

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| Description  | <p>The BSX operates pursuant to the <i>Bermuda Stock Exchange Act</i>, a private act of parliament. The BMA has supervisory authority over the BSX by virtue of the BMA Act which includes the BSX in the definition of a regulated financial institution and the BSX Act. The BSX is not currently subject to a licensing regime, per se—the exchange existed prior to the establishment of securities regulation in Bermuda. The BMA does not currently have the authority to impose conditions on the BSX’s license.</p> <p>The BSX is required to file all rules and rule amendments with the BMA for approval. These include trading rules, member regulation rules and listing rules. The BSX provides a daily report of trading activity to the BMA for review. The BMA has access to real time trading information and has the authority to halt trading in any security. The BMA also holds quarterly prudential meetings with BSX management to discuss regulatory issues. In practice the two organizations have a close working relationship. There have been no instances of a failure to provide the BMA with necessary information.</p> <p>The BSX carries out inspections of members annually, maintains a market surveillance system, investigates trading infractions and monitors listed companies for compliance with listing requirements. The BSX also takes disciplinary measures against its members or their employees if required. It may also publish a non-compliance notice or delist a company that is not in compliance with exchange rules.</p> |
| Assessment   | Partly implemented  |
| Comments   | The BSX should be subject to a full licensing regime setting out requirements for its operation and conduct of regulation. <sup>49</sup> The exchange is relied on heavily, particularly in regulation of issuers, and it is therefore important that the BMA have full authority over it. Inspections rights should also be established in law. These issues will be addressed in IBA provisions which come into force September 2004.   |
| <b>Principles for the Enforcement of Securities Regulation</b> |   |
| <b>Principle 8.</b>  | The regulator should have comprehensive inspection, investigation and surveillance powers.  |
| Description  | <p>Section 20 of the IBA grants the BMA authority to request information from licensed investment firms and their employees, past and present. Section 19 gives the BMA authority to conduct an investigation of the licensed entity. However, the drafting of Section 19 is weak and might successfully be challenged—it is unclear that the BMA would have unfettered access to the premises and documents of an investment firm. Section 19(3) gives the BMA authority to compel testimony of licensed investment firms or their officers and directors.</p> <p>The <i>CIS Regulations</i> grant the BMA limited inspection and investigations rights over investment funds. Section 10 allows the BMA to request information from the investment fund and s.11 gives the BMA authority to inspect premises if this information is not provided. This authority does not clearly provide the BMA with unfettered access without notice.</p> <p>The BMA has no authority to inspect or investigate the BSX. The BMA can halt trading in securities on the BSX. It has no authority to inspect or investigate public companies.</p>  |
| Assessment   | Broadly implemented.  |
| Comments   | The BMA requires additional inspection and investigation powers over the BSX and collective investment schemes. The provisions of the IBA, which come into force September 2004, and the proposed new <i>CIS Regulations and new CIS Act</i> should address these issues. <sup>50</sup>   |
| <b>Principle 9.</b>  | The regulator should have comprehensive enforcement powers.   |

<sup>49</sup> See first footnote in paragraph 78.

<sup>50</sup> IBA/03 came into force in January 2004.

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| Description   | <p>Under the IBA, the BMA has the right to withdraw or suspend a license and under the <i>CIS Regulations</i> it has the authority to classify a collective investment scheme or withdraw the classification. In its short history of regulating investment businesses and collective investment schemes, it has relied on this power or the threat of it to enforce compliance with the law. The BMA has an ability to levy fines under the IBA. The BMA could also refer violation of the law to the public prosecutor for prosecution through the courts. This has never happened. The BMA also has the power to direct investment firms to take specific actions and appoint a custodian manager to oversee the operations of an investment firm if necessary.</p> <p>The BMA does not have enforcement authority over the BSX (although this will be in place September 2004) or over public issuers. The BSX has the ability to delist an issuer in the event of a breach of securities law and the Ministry of Finance would have the authority to withdraw the registration of the issuer. It would require an act of Parliament to withdraw the BSX's permission to operate in the jurisdiction.</p>   |
| Assessment  | Broadly implemented.  |
| Comments  | The BMA requires enforcement authority over the BSX and issuers. <sup>51</sup>  |
| <b>Principle 10.</b> The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program. |   |
| Description   | <p>The BMA has established an inspection program for all licensed investment businesses—the program began 2001. The authority has developed internal policies and procedures and an inspection manual. The inspections consider the full range of activities. The BMA relies on external auditors to conduct on-site prudential examinations, but may raise prudential issues in the course of inspections. The BMA intends to inspect each licensed firm at least once over a period of three years. Recently inspections have focused very heavily on client account documentation and anti money laundering concerns. Investigations into breaches of rules have resulted in suspension of licenses.</p> <p>The BMA has recently developed a separate investigations enforcement function in the legal authorization and compliance department. Such investigations and enforcement have, until this, been carried out by inspections and licensing staff.</p> <p>Market surveillance is carried out by the BSX, which has a fully automated surveillance program in place. There are no full time surveillance personnel but the market is very thinly traded and this is not deemed necessary. A summary of surveillance alerts and their resolution is provided to the BMA in the daily report.</p> |
| Assessment  | Implemented   |
| Comments  | In a short period of time, the BMA has established a credible inspection program, despite difficulties in retaining experienced staff and some weaknesses in authority. Over time, this inspection program will be valuable in improving quality of compliance in the sector. The BMA does not routinely include financial audits in its inspections (relying on auditors, annual meetings and quarterly filings)—it might consider establishing a financial review program for those investment firms that handle customer cash and securities as a means of providing a check on quality of compliance.   |
| <b>Principles for Cooperation in Regulation</b>   |   |
| <b>Principle 11.</b> The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.  |   |
| Description   | The BMA, as a unified financial services regulator, is not challenged by domestic information sharing requirements. The BMA is able to share information with the Ministry of Finance and does so on a routine basis.   |

<sup>51</sup> See first footnote in paragraph 78.



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|  | <p>There are no specific information sharing provisions under the IBA or the <i>CIS Regulation</i> and the BMA therefore relies on general provisions under the BMA Act. Section 31 of the BMA Act requires the BMA to keep information confidential but allows it to share information that is public in nature or which is shared for regulatory purposes. The BMA is able to share information on licensing status, market conditions, the BSX and other public information. The BMA is also able to routinely share for regulatory purposes confidential information that it has in its possession.</p> <p>Section 31(1)(c) of the BMA Act restricts the sharing of information related to client identity. In order to clarify the BMA’s authority to obtain information in order to assist foreign counter parts, the Act was amended by adding s.30A—this section, sets out the framework for obtaining and providing information, including that related to individual clients, to foreign counterparts. The framework requires the BMA to satisfy itself as to the merit of the request and the use to which the information will be put. Section 30A restricts the sharing of information to information requested for regulatory purposes. Section 30B allows the BMA to obtain and share a broad range of information with the foreign counterpart. In practice the BMA has used s.30B to share client information with requesting foreign counterparts.</p> <p>Recent changes to the IBA have clarified authority to share information. These changes are modeled on existing powers in the <i>Banking Act</i>.</p> |
| Assessment   | Implemented  |
| Comments   |  |
| <b>Principle 12.</b> Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts. |  |
| Description  | The BMA Act establishes the general framework for information sharing. Requests for information are vetted by staff. Information already in the possession of the BMA can be routinely provided to counterparts. Requests for information that must be obtained specifically for a foreign authority are considered by staff, with a recommendation made to the board of directors for review and approval. The BMA gets such requests, particularly from the U.S. SEC and Canadian authorities. The BMA has entered into information sharing agreements with Jersey and the Isle of Man. A formal agreement is not required for any form of regulatory information sharing.   |
| Assessment   | Implemented  |
| Comments   | The BMA has established an effective mechanism for sharing of information and is able to honor requests for information in a timely and cooperative manner.  |
| <b>Principle 13.</b> The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.       |  |
| Description  | The BMA utilizes s.30B of the BMA Act to obtain information for foreign regulators. recent changes to the IBA will strengthen the BMA’s authority to obtain information In practice the BMA has been able to honor all requests for information that it regards as within the appropriate purposes of s.30A.   |
| Assessment   | Implemented  |
| Comments   | The draft amendments clarifying the BMA’s inspections rights and its authority to share client information will address the legal authority issues under this Principle. <sup>52</sup>   |
| <b>Principles for Issuers</b>  |  |
| <b>Principle 14.</b>   | There should be full, accurate and timely disclosure of financial results and other information that is material to investors’ decisions.  |

<sup>52</sup> Sections 78–81 of IBA/03 sets out a framework for the sharing of information.

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| Description   | <p>All public issuers in Bermuda are required to register with the Registrar of Companies, part of the Ministry of Finance. The <i>Companies Act</i> requires the issuance of a prospectus when the company offers shares to the public. Prospectuses must include: the names, descriptions and addresses of the promoters, officers or proposed officers; the business or proposed business of the company; the minimum subscription which, in the opinion of the promoters, directors; any rights or restrictions on the shares that are being offered; all commissions payable on the sale of the shares referred to in the prospectus and the net amount receivable by the company in respect of the sale; the name and address of any person who owns five percent or more of the shares of the company; financial statements of the company; a report or statement by the auditor of the company; the date and time of the opening and closing of subscription lists; the use to which the capital raised will be put. Directors must sign and are liable for the contents of the prospectus. Prospectuses are filed with the Registrar.</p> <p>There are three tiers of companies on the BSX system: domestic listed companies, international listed companies and companies traded in the mezzanine (unlisted) market. Domestic listings constitute the bulk of the listing work at the BSX. International listed companies are cross-listed on onshore markets and the BSX is not the primary regulator of these companies (although there are applicable listing and disclosure standards for these companies). The mezzanine market has no listing rules. A company listing on the BSX will be subject to a prospectus review by the exchange. The BSX has a full set of listing requirements for all listed companies and is responsible for monitoring compliance with disclosure rules. The Companies Act also requires companies continuously offering shares to file annual reports with shareholders.</p> <p>The Companies Act requires all material events be disclosed to shareholders immediately. The BSX requires listed companies to notify the exchange of all material events and the exchange subsequently issues a press release. BSX listed companies and trading members are also subject to insider trading and market manipulation rules.</p> |
| Assessment  | Partly implemented   |
| Comments  | <p>Regulation of listed companies is largely in place—the BSX listing rules are thorough and meet the standards of this Principle. There is however little regulation of unlisted issuers—although requirements may exist under the Companies Act, they are not effectively monitored. Further, the BMA requires clearer authority over and greater supervision of the BSX’s listing function—while the Principles contemplate delegation to a SRO of regulatory functions, they also require a concomitant level of supervision of the SRO.</p>   |
| <b>Principle 15.</b> Holders of securities in a company should be treated in a fair and equitable manner. |  |
| Description   | <p>Under the <i>Companies Act</i>, issuers are required to treat shareholders equally. There are various shareholder notice and voting requirements under the Act. All shares of the same class must have the same voting rights. The offering prospectus must disclose the nature of voting rights attaching to a share and must disclose major shareholdings.</p> <p>The <i>Companies Act</i> defines insiders as officers, directors and shareholders with 5 percent or more ownership. Acquisition of 5 percent is a material event requiring disclosure to shareholders. The BSX sets more detailed requirements—listed companies must have a minimum of 25 percent freely traded shares.</p> <p>There are no rules with respect to take over bids, mergers, changes of control or related party transactions in Bermuda. There is no requirement to report insider transactions nor is there an insider reporting mechanism that would allow shareholders or the public to see insider activity. There is no prohibition on insider trading for unlisted companies—the BSX prohibits insider trading and proposed changes to the criminal code will criminalize insider trading for all issuers.</p>   |
| Assessment  | Partly implemented   |

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| Comments  | Minority shareholder protection requires significant enhancement—this is largely due to lack of involvement of the securities regulator in issuer regulation. The <i>Companies Act</i> contains only basic requirements. The BSX does not have a full range of regulations covering take over bids, mergers, changes of control and related party transactions. The further development of issuer regulation in Bermuda should include rules in these areas. An insider reporting regime should also be strongly considered—this would be a tool for transparency to shareholders as well as a means of monitoring of compliance with insider trading rules.  |
| <b>Principle 16.</b> Accounting and auditing standards should be of a high and internationally acceptable quality.  |   |
| Description   | <p>The Bermudian system defines its accounting standards as those of Canada (Canadian GAAP). Companies may also use U.S. GAAP or IAS standards. The Canadian Institute of Chartered Accountants is an industry organization that sets the accounting and auditing standards. Accountants and auditors in Bermuda are required to be qualified in Canada, the United Kingdom or the United States and subject to certification by industry bodies in those jurisdiction. The quality and independence of the audit profession is felt to be very high—Bermuda is able to attract qualified accountants from other jurisdictions when it has a local shortfall and there are few conflicts for auditors who do not have consulting or tax practices.</p> <p>The BMA does not set any additional accounting or audit requirements. The BSX Listing Regulations recognize Canadian GAAP, U.S. GAAP, IAS or equivalent standards.</p>  |
| Assessment  | Implemented   |
| Comments  |   |
| <b>Principles for Collective Investment Schemes</b>   |   |
| <b>Principle 17.</b> The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme. |   |
| Description   | <p>The <i>CIS Regulations</i> set out a classification regime for three categories of investment fund—standard schemes which are primarily retail funds, recognized schemes which are schemes eligible for sale in the United Kingdom as well as Bermuda and institutional schemes. The BMA may also grant exemptions from the regulations.</p> <p>There are currently no recognized schemes although there have been in the past.</p> <p>The BMA has developed a thorough classification process. Applications must set out all service provider relationships (custodian, administrator, auditor etc.) and these are approved as part of the approval. The <i>CIS Regulations</i> define tasks and responsibilities of custodians, administrators etc. but there are no defined standards governing these service providers. Standards are developed internally and applied by staff in practice. Custodians are normally banks and for standard funds either the administrator or the custodian must be located in Bermuda. Custodians and administrators per se are not directly licensed in Bermuda—although many of them are licensed as banks or investment businesses. The proposed CIS Act would create a licensing regime for fund administrators of these entities, giving the BMA additional authority over collective investment scheme operations. The new IBA defines custody of assets as an investment services thereby bringing custodians under the Act. The staff can approve a connected custodian and administrator provided adequate measures are in place for independence; although, there are no specific conflicts of interest rules. There are no rules governing related party transactions or other conflicts of interests.</p> <p>Funds are allowed to delegate and sub delegate investment management and the terms of such delegation must also be set out in the application and disclosed to investors. The application must include a statement of investment policy, rules of the fund with respect to fee structure, calculation of net asset value, subscriptions and redemptions. Operators of the fund are subject to fit and proper assessments and are required to demonstrate capacity and ability to operate a fund. Because many of these requirements are not contained directly in the Regulations, the BMA staff make a practice of including detailed terms in the terms of the classification. The scheme must notify the BMA of any</p> |

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|  | <p>material changes to the terms of the prospectus or to service providers arrangements and these are subject to approval.</p> <p>Classifications are granted by the BMA. Under the <i>CIS Regulations</i>, decisions to withdraw, amend or vary classifications may be appealed to the MOF.</p> <p>Collective investment schemes must file annual audited financial statements in accordance with the requirements set out in the <i>CIS Regulations</i>. The scheme must file an annual statement of compliance with the authority. Schemes must also submit a monthly report to the BMA including net asset valuation calculations, net redemptions and subscriptions, errors and omissions etc. Collective investment schemes are not subject to routine inspections by BMA staff. Staff have conducted inspections of banks carrying on investment fund businesses in coordination with banking supervision staff and have undertaken inspections in other jurisdictions including the Channel Islands, Singapore and Hong Kong focusing on the fund administration carried out by the banks.</p> <p>The BMA's inspection power under the <i>CIS Regulations</i> is somewhat limited—s.11 gives the authority the right to inspect upon receiving a complaint but does not give it broad power to inspect without notice. Under proposed legislative amendments, the BMA will have full licensing and inspection authority over fund administrators.</p> |
| Assessment   | Broadly implemented   |
| Comments   | There are a large number of requirements not found in the <i>CIS Regulations</i> but effectively applied through the classification process. The BMA should use its the authority under s.5 of the <i>CIS Regulations</i> to create guidance notes and codes of conduct under the <i>CIS Regulations</i> and use this authority to set out specific requirements for eligibility for classification, use of service providers, internal controls, handling of potential conflicts of interest etc. as the BMA has done in the case of requirements for investment firms.  |
| <b>Principle 18.</b> The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.   |   |
| Description  | <p>Collective investment schemes in Bermuda can take the form of unit trusts or mutual funds. Mutual funds are legally defined in the <i>Companies Act</i> and unit trusts are legally defined in the <i>Stamp Duties Act</i>. Both are defined as collective investment schemes in the BMA Act. Under both definitions, assets of the fund are separate from those of operator and client assets are protected from general bankruptcy proceedings against the operator. Closed-end funds are not regulated.</p> <p>There is no specific requirement under the <i>CIS Regulations</i> that client assets be segregated, although this is required in practice. Investment funds are required to appoint custodians and custodians are subject to specific responsibility for safeguarding client assets under the <i>CIS Regulations</i>. There are no rules regarding the lending of securities (other than in the case of recognized funds).</p>   |
| Assessment   | Broadly implemented   |
| Comments   | The BMA should develop rules governing securities lending and should establish a legal obligation to segregate client assets.   |
| <b>Principle 19.</b> Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme. |   |

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| Description                                 | Investment funds licensed as standard (retail) and institutional funds in Bermuda are subject to general prospectus and disclosure requirements under the <i>Companies Act</i> and the specific prospectus requirements under the <i>CIS Regulations</i> . Funds are required to disclose, among other things, investment policies and objectives, subscription and redemption rights, audited financial statements, fees and commissions, rules for valuation of assets, remuneration policies, description of potential conflicts and applicable policies and details of service provider relationships including custodian, sub custodians, investment managers, administrator and auditor. Material changes to the terms of the prospectus require republication and reapproval of the prospectus.   |
| Assessment                                  | Implemented  |
| Comments                                    |  |
| <b>Principle 20.</b>                        | Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.   |
| Description                                 | <p>The BMA has not established specific rules governing the calculation of net asset valuation. Collective investment schemes must disclose their method of asset valuation in the licensing application and must disclose it to investors through the prospectus. In practice, staff review the net-asset value policy for reasonableness during the licensing process. Schemes must be audited by a qualified audit firm using an acceptable accounting standards—Canadian or U.S. GAAP or IAS. The accounting rules used in calculation of net asset valuation and the annual audited financial statements must be disclosed to investors.</p> <p>There is no requirement that funds publish NAV calculations nor is there a requirement as to the frequency of calculation. However, the <i>CIS Regulations</i> require that price be available to investors upon request at any time. Collective investment schemes are required to submit monthly reports to the BMA which include a calculation of net asset valuations, subscriptions and redemptions.</p> <p>There are no rules prescribing subscription and redemption policies. These must be approved at the point of classification and disclosed to investors in the prospectus. Any changes are subject to approval and disclosure requirements, as well. The BMA does not have the authority to act should a fund suspend redemptions.</p> |
| Assessment                                  | Broadly implemented  |
| Comments                                    | The BMA could provide additional detailed guidance on calculation of NAV, particularly for illiquid assets, rather than relying on the fund’s auditors. There should be requirements regarding timing and publication of the calculation. The BMA could also provide guidance on redemptions. The BMA should be granted authority to issue directions to schemes in the event of an unreasonable suspension of redemptions. This issue would be addressed in the proposed CIS Act.   |
| <b>Principles for Market Intermediaries</b> |  |
| <b>Principle 21.</b>                        | Regulation should provide for minimum entry standards for market intermediaries.   |

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| Description          | <p>Section 7 of the IBA grants the BMA the authority to license firms engaging in investment business in Bermuda. Investment business is defined broadly in the Act. Section 7(3) sets out licensing criteria. Investment firms are required to submit detailed licensing applications, including a business plan, details of internal control and bookkeeping processes, capital and insurance, service providers including auditors and details with respect to management of the firm. The BMA has issued guidance notes giving applicants and potential applicants detailed guidance on licensing requirements.</p> <p>Directors and managers are subject to fit and proper assessments and must also demonstrate skill and ability to carry on the business. There is no requirement that owners of investment firms be vetted in the licensing process (although they would be subject to fit and proper assessments under the registration of companies requirements) nor is there a requirement that change in ownership be approved by the BMA. The BMA has asked for this authority in the new IBA.</p> <p>Investment firms can be corporations, partnerships or sole proprietorships. There are currently 54 licensed firms in Bermuda. The majority of firms are investment advisors or portfolio managers. For the purposes of capital and reporting requirements, firms are categorized as those that may act as principal, those that act only as agent and those that are purely advisory in nature.</p> <p>The IBA contains a number of exemptions from licensing requirements including for firms dealing only with institutions or sophisticated clients. A company relying on an exemption under the Act is required to file a notice of exemption with the BMA, indicating the exemption it relies on. There are a large number of such filings.</p> <p>The BMA can impose terms and conditions on licenses and does so in practice—for example, it has detailed terms that are not licensing conditions under the Act (such as ownership) so that changes to these terms are subject to approval. It has the power to vary, suspend or cancel a license. Every licensed firm must advertise its licensing status and the BMA website makes available a list of all licensed firms along with a contact person and address.</p> <p>On-going supervision of market intermediaries involves an inspection program (described under Principle 10) annual financial statements and annual prudential meetings (described under Principle 22).</p> |
| Assessment           | Broadly implemented  |
| Comments             | The licensing of market intermediaries is generally comprehensive and the licensing process sound. In the short time that the BMA has undertaken direct regulation of investment business it has built a credible system of on-going oversight. The proposed new IBA gives the BMA additional inspection powers, and formal authority to approve changes of ownership. <sup>53</sup>   |
| <b>Principle 22.</b> | There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.  |

<sup>53</sup> Section 47 of IBA/03 gives the Authority the power to enter an institution to obtain information and documents. Section 28 of the IBA/03 gives the Authority some power to control the acquisition of shareholding or control of an investment provider.

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| Description   | <p>Regulations to the IBA set out capital requirements for licensed investment firms. There are three categories of investment firms for capital purposes: firms that may act as principal (that is have an inventory of securities) are required to have a minimum capital of \$250,000. Firms that act only as agent are required to hold \$100,000 in capital. These firms must submit annual audited financial statements if they in fact handle client monies (unaudited if they do not)and file quarterly unaudited statements. Investment advisors, which do not handle customer cash or securities, are required to hold \$12,000 in capital and must submit an annual unaudited financial report to the BMA. Auditors must be approved by the BMA.</p> <p>Eligible capital is defined in the BMA’s notice on <i>Measurement of Capital</i> developed under the <i>Banking Act</i>. The measurement of capital is based on the Basel Accord concepts of core and supplementary capital. The BMA also has the authority to require additional capital if it deems it necessary given the investment firm’s activities. The basic capital requirement is supplemented by a liquidity requirement also—brokerage firms are required to have 3 months expenses in liquid assets and other firms 1 month’s expenses.</p> <p>In addition to annual and quarterly filings, the BMA also holds annual prudential meetings with senior management of the firm. Management of the firm and its auditors are obliged to report to the BMA if the firm’s capital falls below the minimum.</p>  |
| Assessment  | Implemented  |
| Comments  | The BMA should consider supplementing its supervision program with some inspections focusing on the financial condition of investment firms. This need not be an annual requirement but use of staff audits could enhance compliance and would provide staff with additional insight into the investment firms activities and associated risks.  |
| <b>Principle 23.</b> Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters. |  |
| Description   | <p>The Regulations to the IBA sets out general books and records, audit trail and client account documentation requirements which are supplemented in the BMA Guidance Note. The requirements include detailed client account documentation rules including a semi-annual account statement and a confirmation of trade requirement. There are full know-your-client requirements and firms are responsible for acting in the best interest of clients. The BMA has issued “General Business Conduct and Practice: Code of Conduct” detailing requirements for conduct with customers. The Code includes requirements regarding disclose potential conflicts of interest to the client; confidentiality of client information; sufficient disclosure of risks and information to clients to enable informed decisions; and prohibitions on front running.</p> <p>Investment firms are required to establish policies and procedures to ensure compliance with all applicable legal and regulatory requirements; establish policies and procedures which ensure integrity, security, availability, reliability and thoroughness of all information relevant to the firms’ business operations; firms must have systems for the identification and segregation of client assets and must maintain proper accounting and records sufficient to ensure compliance with all applicable regulation. The firm must establish an appropriate system of supervision and segregation of duties.</p> <p>The BMA inspection program includes a review of compliance with these requirements.</p> <p>There is no requirement for a separate compliance function to be established, although in practice the BMA staff would require this in the licensing process for firms handling customer assets and carrying out brokerage activities. Senior management of the firm is required to file a statement of compliance annually.</p> |
| Assessment  | Implemented  |
| Comments  | The BMA should formalize a requirement for a separate compliance function.   |

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| <b>Principle 24.</b> There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.   |   |
| Description  | The BMA monitors the financial condition of investment firms through its annual reporting requirement and the quarterly financial filings required of all firms. The BSX also monitors financial conditions with similar reporting requirements. The BMA also holds annual prudential meetings.<br><br>In the event of an impending insolvency, the BMA could use its general authority to direct a failing firm to take particular action. It also has the authority to appoint a custodian manager to manager customer assets. It does not, however, have a contingency plan in place to deal with an insolvency.       |
| Assessment   | Partly implemented  |
| Comments   | The BMA does not have a contingency plan in place. While the BMA has general powers to give a firm direction or appoint a custodian manager, greater clarity on how and when these powers should be used would be helpful both to staff and to the industry in planning for a failure.  |
| <b>Principles for the Secondary Market</b>   |   |
| <b>Principle 25.</b> The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.  |   |
| Description  | The BSX is authorized to operate an exchange pursuant to the <i>Bermuda Stock Exchange Act</i> , a private act of parliament. As described under Principle 7, the BMA has supervisory authority over the exchange with some shortcomings. There is no provision in law for new trading systems or exchanges. The Section IV of the new IBA incorporates a licensing regime for exchanges and the definition would extend to alternative trading systems. The new provisions would sets standards for licensing and giving the BMA full supervisory and licensing authority. This section comes into force September 2004. |
| Assessment   | Broadly implemented.  |
| Comments   | See Principle 7.  |
| <b>Principle 26.</b> There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants. |   |
| Description  | See Principle 7.  |
| Assessment   | Broadly implemented.  |
| Comments   | The BMA actively supervises the BSX through daily reporting requirements, rule review and approval and periodic meetings. There is, however, no in-depth supervision of the listing function—the BSX is relied on entirely for regulation of issuers but has little guidance or interference from the BMA. There is also a lack of expertise on issuers and trading systems at the staff level.   |
| <b>Principle 27.</b> Regulation should promote transparency of trading.  |   |
| Description  | Trading on the BSX provides market participants with real-time price and volume transparency of bids and offers. It also provides real time transparency on price and volume of executed transactions. This information is disseminated electronically to all market participants at the same time.<br><br>There are no transparency requirements for the trading of unlisted securities.   |
| Assessment   | Implemented   |
| Comments   |   |
| <b>Principle 28.</b> Regulation should be designed to detect and deter manipulation and other unfair trading practices.  |   |



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| Description   | BSX rules contain prohibitions against insider trading and market manipulation and the exchange uses its market surveillance system and investigation powers to actively enforce these requirements. There is no insider reporting system. Issuers are required to disclose to the exchange and investors when one shareholder has acquired a 5 percent interest. Insider trading and market manipulation are not prohibited for trading outside of the exchange. The exchange has the ability to discipline its members or to delist an issuer for abuse of these rules but does not have the authority to enforce compliance against investors or others outside of its jurisdiction. The BMA has no role in market abuse regulation other than its role as the supervisor of the BSX.   |
| Assessment  | Partly implemented   |
| Comments  | Insider trading and market manipulation should be laws of general application rather than rules of the exchange and should apply to all trading of securities in Bermuda. Additions to the criminal law will bring both insider trading and market manipulation into criminal law. <sup>54</sup> Unless authority to regulate issuers is given to the BMA, the BMA's role in monitoring market abuse is unclear since it has no direct authority over issues and is not responsible for pursuit of breach of criminal law.   |
| <b>Principle 29.</b> Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.  |  |
| Description   | There is no definition of 'large exposure' on the BSX system and no monitoring of large positions per se. Default risk is managed through the requirement that participants maintain a cash settlement account and do not exceed that amount (described under Principle 30). This collateral requirement makes the concept of large exposure irrelevant with respect to trading in the exchange. It is unclear that in the event of a participant's financial failure, the BSX has the right to call on collateral in the cash account to settle a trade without interference from general bankruptcy law. In the event of a market disruption the BSX and the BMA have the right to halt trading and take prompt corrective action. All information on trading and member positions is available real time to the BMA and BSX. The domestic market has very low volumes and trading can be very thin. Market disruption and default are not major risk factors. |
| Assessment  | Partly implemented   |
| Comments  | The BMA should take a more active role in monitoring clearing and settlement. Risks to the system caused by the legal status of the collateral and guarantees in the cash account should be addressed. See comments under Principle 30.  |
| <b>Principle 30.</b> Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk. |  |

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<sup>54</sup> The authorities have reported that subsequent to the mission amendments to the criminal code have addressed these deficiencies.

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| Description | <p>The BSX operates the Bermuda Securities Depository (BSD), a clearing and settlement system and share depository. The system operates on a T+3 basis. Securities not held by BSD must be delivered to the BSD at T+1. Cash must be delivered T+3. Trades do not settle on a delivery-versus-payment basis—while delivery of securities from the BSD to the clearing and settlement system is connected to the system, the cash settlement system is not connected to the BSX system. Instead, firms are required to pay in at T+3 and payment is guaranteed by the requirement to maintain payment accounts. The payment account is reconciled on a rolling basis and the automatic trading system will refuse a trade that would exceed the amount in the firm’s account. Accounts include pledged collateral as well as bank guarantees. The legal status of the guarantees and collateral in the cash account in the event of a participant’s insolvency is unclear. The BSX is seeking to address this concern through insurance.</p> <p>Short selling and lending of securities within the BSX system are not permitted.</p> <p>Securities can be held in the BSD system in nominee accounts or in client name. Trading in international listings is settled in on-shore clearing and settlement systems including DTCC in the United States.</p> <p>The BSD is currently in the process of dematerializing securities in Bermuda—a challenging task because law allows securities to remain in paper form and many Bermudian companies are held very long term by Bermudian residents who do not trade the securities frequently and thus are not encouraged to turn over certificates. Foreign ownership restrictions mean that shares are not freely transferable—trades must be marked as coming from foreign or Bermudian accounts and reconciled against the records of the company to ensure the foreign ownership restriction is not breached. The BSX system achieves this automatically and will not let a trade proceed without a positive reconciliation.</p> <p>The BMA’s supervisory responsibility for the BSX (under the BMA Act) includes the clearing and settlement and depository functions. The BMA does not have direct authority to license and supervise clearing and settlement systems and has limited ability to inspect the BSD or BSX and does not have the ability to direct the BSX to take a particular action. On-going supervision of the BSD is combined with that of the BSX (see Principle 7).</p> <p>The BSX has authority to regulate its trading members using the clearing and settlement system and has brought into place clearing and settlement rules. These rules are reviewed and approved by the BMA.</p> <p>The BMA’s oversight of the BSX’s settlement system and the BSD is carried out primarily through quarterly meetings. There is no required reporting of settlement failures and there is no inspection program for the clearing and settlement system. There are no specific requirements or performance standards for the system.</p> |
| Assessment  | Partly implemented   |
| Comments    | <p>The supervision of clearing and settlement systems should be strengthened. The BMA should be granted licensing authority over clearing and settlement systems and develop standards for clearing and settlement, particularly with respect to risk management.<sup>55</sup> The BMA should also consider an inspection program and reporting requirements that would assist in closer monitoring of the system. The risk created by the uncertainty of the legal status of the cash account should be resolved.</p>   |

<sup>55</sup> See first footnote in paragraph 78.

Table 14. Summary Implementation of the IOSCO Objectives and Principles of Securities Regulation

| Assessment Grade    | Principles Grouped by Assessment Grade |                                    |
|---------------------|--|------------------------------------|
|                     | Count                                  | List                               |
| Implemented         | 12                                     | P 4,5,6,10,11,12,13,16,19,22,23,27 |
| Broadly Implemented | 11                                     | P 1,2,3,8,9,17,18,20,21,25,26      |
| Partly Implemented  | 7                                      | P ,7,14,15,24,28,29,30             |
| Not Implemented     |  |                                    |
| Not applicable      |  |                                    |

### G. Recommended Actions and Authorities' Response to the Assessment

#### Recommended Actions

Table 15. Recommended Plan of Actions to Improve Implementation of the IOSCO Objectives and Principles of Securities Regulation

| Reference Principle  | Recommended Action   |
|--|--|
| Principles Relating to the Regulator (P 1–5)                     | <ul style="list-style-type: none"> <li>• remove BMAA authority given to the MOF to direct BMA;</li> <li>• grant BMA budgetary autonomy; and</li> <li>• create a separate internal process for reporting under the employee code of conduct.</li> </ul>   |
| Principles for the Enforcement of Securities Regulation (P 8–10) | <ul style="list-style-type: none"> <li>• improve authority to inspect collective investment schemes; and</li> <li>• create authority to sanction issuers and trading systems.<sup>56</sup></li> </ul>  |
| Principles for Issuers (P 14–16)                                 | <ul style="list-style-type: none"> <li>• grant BMA authority and responsibility for regulating all public issuers including review of prospectuses and on-going monitoring of continuous disclosure;</li> <li>• develop insider trade reporting requirements and system of transparency for insider activity; and</li> <li>• develop rules related to take-over bids, mergers, changes of control and related</li> </ul> |

<sup>56</sup> See first footnote in paragraph 78.

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|  | party transactions.   |
| Principles for Collective Investment Schemes (P 17–20) | <ul style="list-style-type: none"> <li>• further develop staff technical skills for inspections; and</li> <li>• develop additional guidance for collective investment schemes with respect to licensing and conduct requirements, securities lending, segregation of assets, calculation and publication of net asset value, and redemptions.</li> </ul>  |
| Principles for Market Intermediaries (P 21–24)         | <ul style="list-style-type: none"> <li>• grant BMA clearer inspection rights;<sup>57</sup></li> <li>• develop staff technical skills for inspections;</li> <li>• develop a contingency plan for failure of an intermediary; and</li> <li>• consider carrying out on-site prudential inspections of financial condition for firms handling client assets.</li> </ul>   |
| Principles for the Secondary Market (P 25–30)          | <ul style="list-style-type: none"> <li>• increase oversight of clearing and settlement system;</li> <li>• develop staff skills with respect to clearing and settlement and trading systems;</li> <li>• fully dematerialize securities;</li> <li>• develop standards for performance and risk management of clearing and settlement systems;</li> <li>• criminalize insider trading and market manipulation;<sup>58</sup> and</li> <li>• resolve cash account risk.</li> </ul> |

### Authorities' response

The BMA has devoted considerable efforts to introducing appropriate regulation for the investment services sector, and to ensuring that the requirements are effectively implemented and policed. It notes the assessors' acknowledgment of the progress made in only a relatively short space of time in implementing the necessary provisions. Moreover, since the completion of the IMF's on-site review, as acknowledged by the assessors, Bermuda has also introduced very significant enhancements to its provisions, notably through the enactment of

<sup>57</sup> Section 47 of IBA/03 gives the Authority the power to enter an institution to obtain information and documents.

<sup>58</sup> The authorities have reported that subsequent to the mission amendments to the criminal code have addressed these deficiencies.

the new Investment Business Act 2003 which has replaced the 1998 legislation and which should ensure a very high level of compliance with the IOSCO Principles for investment businesses. At the same time, Government is expected to introduce into Parliament shortly a new Collective Investment Schemes Act which should similarly deal with the outstanding weaknesses identified with respect to the regulation of mutual fund vehicles. This new Act is also intended to introduce a specific licensing regime for those conducting fund administration business in Bermuda. Together, these provisions should go a very long way towards dealing with matters identified by the assessors as warranting further attention. In addition, the BMA will be considering with the Ministry of Finance the specific recommendations made in the Report with regard to the additional regulation of issuers.