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Bermuda: Assessment of Financial Sector Supervision and Regulation

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BERMUDA

ASSESSMENT OF FINANCIAL SECTOR SUPERVISION AND REGULATION

Prepared by the Monetary and Capital Markets Department

Approved by Jan Brockmeijer

September 8, 2008

This report is based mainly on information obtained during missions from June 12 to 22, and May 7 to 23, 2007 (for the AML/CFT evaluation), stress testing based on end-2006 company data, and consultations with the authorities between September 2007 and May 2008. The assessment team members comprised Ms. Mary G. Zephirin (Mission Chief), Messrs. Jorge Chan-Lau (Senior Economist) (both IMF), and Marcel Maes (consultant, banking supervision); and for the review of the insurance sector, Ms. Su Hoong Chang (consultant), Mr. Henning Göbel (consultant, German Federal Financial Supervisory Authority, BaFin), and Mr. Ray Spudeck (consultant, Florida Department of Insurance Supervision). The AML/CFT team comprised Messrs. Manuel Vasquez (Mission Chief), Antonio Hyman Bouchereau (both IMF), Ross Delston (consultant) and John Abbott (consultant).

Bermuda is a globally important reinsurance center and the second largest captive insurance domicile after the U.S. Appropriate oversight of its financial system therefore has significant cross-border benefits. The assessment found that, with the exception of the AML/CFT regime, recommendations of the earlier assessment had been implemented.

- Insurance supervision for the commercial insurers and reinsurers has a high level of observance of the IAIS Core Principles. Implementation of a risk-based regulatory framework is in place for the most systematically-important market segment. Full rollout to the industry is required for achievement of comprehensive market oversight.

- The Banking Supervision Department of the Bermuda Monetary Authority (BMA) has been restructured to support the introduction of a formal risk-based supervisory system. The regulatory framework has been substantially improved.

- Securities regulation has been updated with, in particular, 2006 legislation governing collective investment schemes and a dedicated inspection team. The BMA has also been given statutory oversight of clearing and settlements.

- The AML/CFT regime requires significant updating to keep pace with the FATF recommendations, and to implement the recommendations of the 2003 assessment.

This report was written by Mary G. Zephirin and Jorge Chan-Lau with contributions from other members of the assessment team.

The AFSSR is a summary report on implementation of the indicated financial sector regulatory standards. It has been developed to help jurisdictions identify and remedy weaknesses in financial sector supervision and regulation. The reviews do not directly assess risks such as those associated with asset quality, markets, or fraud that could affect the soundness of financial systems or individual institutions.

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GLOSSARY

AGC	attorney-general's chambers
AML	anti-money laundering
ATFA	The Anti-Terrorism (Financial and Other Measures) Act 2004
ART	alternative risk transfer
Authority	Bermuda Monetary Authority
BDCA	Banks & Deposit Companies Act 1999
BMA	Bermuda Monetary Authority
BMAA	Bermuda Monetary Authority Act 1969
BSX	Bermuda Stock Exchange
CDD	customer due diligence
CIS	collective investment scheme(s)
CFT	combating the financing of terrorism
CP	core principle(s)
CSP	companies and trusts service providers
DAR	detailed assessment report
DPP	Director of Public Prosecutions
FATF	Financial Action Task Force
FIA	Financial Intelligence Agency
FIU	financial intelligence unit
FT	financing of terrorism
GWP	gross written premium
IA	Insurance Act 1978
IAC	Insurance Advisory Committee
IAIS	International Association of Insurance Supervisors
ICP	Insurance Core Principles
ID	Insurance Department
IBA	Investment Business Act 1998
IBA/03	Investment Business Act 2003
IFA	Investment Funds Act
IOSCO	International Organization of Securities Commissions
ML	money laundering
MLRO	money laundering reporting officer
MOF	Minister of Finance
MOU	memorandum of understanding
NAMLC	National Anti-Money Laundering Committee
POCA	Proceeds of Crime Act 1997
PCMLR	Proceeds of Crime (Money Laundering) Regulations 1998
NCCT	non-cooperative countries and territories
ROSC	Report on Observance of Standards and Codes
SAR	suspicious activity report
SFT	Suppression of the Financing of Terrorism
SRO	self-regulatory organization
SR	special recommendation
TSB	trust service business

EXECUTIVE SUMMARY

Bermuda is the third largest reinsurance center after London and New York, and the second largest captive insurance domicile after the U.S. Appropriate oversight of its financial system therefore has significant cross-border benefits. Bermuda's financial sector supervision was first assessed by the IMF in 2003 (see http://www.imf.org/external/np/ofca/ofca.asp). Since that assessment, the Bermudian authorities have made impressive progress in developing and implementing a risk-focused approach to supervision across the range of their sectoral supervisory responsibilities. At the time of the assessment missions, recommendations of the 2003 assessment had been taken into account or implemented in all areas but anti-money laundering and combating the financing of terrorism (AML/CFT). Supervision of the insurance industry, especially of the large commercial companies, has been significantly strengthened.

Insurance supervision for the commercial insurers and reinsurers has a high level of observance of the IAIS Core Principles. The decision to restructure the supervisory system on the basis of a risk-based framework enhanced the system beyond the 2003 recommendations that aimed at improving the previous largely self-supervised system. The current Bermudian insurance regulatory system is, in contrast, based on hands-on risk-sensitive supervision. Insurers are ranked by risk likelihood and impact, with riskier categorizations attracting increased supervisory attention. The risk-based framework is largely established, its implementation is in train and in place for Class 4 companies, the most systemically important market segment. See section III.C for the description of insurance company classes.

Full rollout of the risk-based regulatory system to all market segments is, however, required for achievement of comprehensive oversight of the market. Effective, comprehensive implementation of the risk-based regulatory system requires continuous review of regulatory resources, preservation of regulatory independence, high levels of disclosure, and the granular risk-rating and supervision of the companies in the Class 3 group.

Banking supervision has progressed both organizationally and in supervisory practices. To support the introduction of a formal risk-based supervisory system, the banking department has been restructured. Supervisory programs are tailored to entities with the highest risk scores identified through standardized analysis. The regulatory framework has also been substantially improved.

Both insurance and banking supervisors are monitoring firms affected by sub prime exposures. Unsurprisingly, some insurance companies have been adversely impacted. However, the authorities have taken a proactive stance in assessing both the risks and the companies' risk management. Such exposure is not anticipated to be a systemic threat.

Securities regulation has been updated in line with the 2003 recommendations. In particular, a new Investment Funds Act (IFA), that provides additional rules for collective investment schemes, was passed in 2006 and a dedicated inspection team was formed. The BMA has been given statutory oversight of clearing and settlement systems.

The AML/CFT regime requires significant updating to keep pace with the Financial Action Task Force (FATF) recommendations, implement the recommendations of the 2003 assessment, and to implement a risk-sensitive approach to preventative measures for financial institutions.

To maintain the momentum of execution, the BMA must continue to build staff resources, and to promote and enhance their experience and expertise. This and other key recommendations are indicated in Table 1.

The authorities are implementing most of these recommendations. Staff resources continue to increase in both quantity and depth, with larger supervisory teams for all sectors, a separate risk and policy unit, an actuarial unit, and a dedicated insurance run-off team, as well as a program of specialist training for staff. In response to the insurance assessment recommendation that it keep its relationship with industry under review, the BMA is publishing a statement of policy on its approach to consultation with industry.

The rollout of the risk-based supervisory program has continued with Class 4 companies filing results of the risk based capital model and enhanced disclosures at end-2007. In July 2008, legislation subdividing the Class 3 group was passed, facilitating their coverage by the risk-based framework and capital model. The BMA's 2008–09 Business Plan also signals its plan to introduce insurance group supervision by 2011. Transparency has been enhanced by legislation requiring that Class 4 publish their GAAP accounts, and other measures are under review. Updated AML/CFT legislation was enacted in 2007 and additional primary and secondary legislation is in process.

Table 1. Key Recommendations

Bermuda Monetary Authority
• The BMA has already made a considerable effort and progress in increasing skilled staff. However, to meet the standard it has set itself of becoming a leading regulator, the BMA must continue to work to attract and retain a range of skilled staff.
Insurance
• The BMA should periodically review its relationship with industry to preserve regulatory independence.
• Supervisors should proceed as planned to implement the full rollout of the new supervisory framework.
• Given the global systemic nature of the companies headquartered in Bermuda, the Insurance Department (ID) should formulate a pragmatic approach, and start closer cooperation with other authorities in order to implement group supervision.
• The BMA should enhance transparency of companies, including through implementation of the IAIS standard on disclosure.
• As part of the staffing mentioned above, the BMA will need specialized resources to validate the risk-management models of, and communicate effectively with, the companies.
Banking
• Legislation should be enacted to provide the BMA with more direct intervention tools in the case of a troubled bank.
AML/CFT
• Update legislation and regulations, and amend procedure and implementation as detailed in the AML/CFT Report on Observance of Standards and Codes (ROSC).

I. INTRODUCTION

1. **An update of the 2003 offshore financial center (OFC) Module 2 assessment of financial regulation and supervision in Bermuda was carried out in the periods May 7–23 and June 12–22, 2007** within the framework of the OFC Assessment Program approved by the Executive Board of the Fund in November, 2003. Consultations with the authorities continued between September 2007 and May 2008.

2. **This report briefly describes the developments in the financial system and regulatory and supervisory arrangements in Bermuda since 2003; provides an update on how the relevant recommendations from the 2003 assessment have been implemented; and summarizes the results of the detailed assessments.** Detailed assessments were carried out of the supervision of commercial insurers—on the basis of the International Association of Insurance Supervisors (IAIS) Insurance Core Principles, and of the AML/CFT regime—on the basis of the AML/CFT methodology of 2004, as updated in June 2006, for assessing compliance with the Financial Action's Task Force 40+9 Recommendations. ROSCs based on the detailed assessments of insurance supervision and the AML/CFT regime are annexed. The 2003 assessment of banking supervision was factually updated, taking account of the revised Basel Core Principles (BCP).

3. The 2003 assessment had found that supervision was well-developed in banking, key areas of securities regulation, and for AML/CFT (based on the then-current standard), but noted some deficiencies in insurance supervision.

4. **Bermuda is both the third largest reinsurance center after London and New York, and the second largest captive insurance domicile after the U.S.[1]** The assessment update gave most attention to the insurance sector, focusing in particular on the systemically-important features of the Bermuda market. Commercial insurers are globally active and supervisory standards to cover them have been agreed by supervisors internationally. The detailed IAIS assessment covered the commercial sector, with stress testing of a sample of such companies to complement the assessment. However, exposure to captives is dominated by related parties, and there is as yet no agreement on the extent of oversight required in the captive insurance sector.[2] To reflect this situation, a review of captive supervision was carried out. The extensive changes in the AML/CFT standard since 2003 dictated a detailed assessment of that regime.

[1] Captive insurance is defined by the IAIS as "an insurance or reinsurance entity created and owned, directly or indirectly, by one or more industrial, commercial or financial entities, the purpose of which is to provide insurance or reinsurance cover for risks of the entity or entities to which it belongs, or for entities connected to those entities and only a small part if any of its risk exposure is related to providing insurance or reinsurance to other parties".

[2] See IAIS, *Issues Paper on the Regulation and Supervision of Captive Insurance Companies,* October 2006.

II. Political and Economic Background

5. **Bermuda is a self-governing British Overseas Territory.** The governor, appointed by and representing the British monarch, has responsibility for external affairs, defense, internal security, and the police. The legislature has two chambers—the upper house of 11 appointed members and a 36-member house of assembly elected for a 5-year term. The last elections were held in 2003. Bermuda's legal system is based on English common law, the doctrines of equity, and Bermuda statute law dating from 1612. The judicial branch is headed by the Chief Justice and the courts comprise magistrates' courts, the supreme court, and a court of appeal. In 2006, a commercial court was established as part of the supreme court and supreme court rules were updated.

6. **Bermuda is one of the wealthiest jurisdictions in the world with per capita GDP of over US$ 75,000 in nominal terms in 2005, largely as a result of its international financial center**.[3] The center contributed over half of real GDP, and almost 30 percent of employment in 2006. In 2008, the population is projected to be 64,200. Bermuda issues its own currency at par with the U.S. dollar and has a consumption-based taxation system with a payroll tax of up to 12.5 percent (on employment income), inheritance tax, and various stamp duties, but no taxes on unearned income or capital gains.

7. **Economic growth also reflects Bermuda's status as a global reinsurance and direct insurance center.** In 2006, real growth accelerated to 5.4 percent from an average of 3.9 percent in the previous three years, with growth of 19, 4, and 19 percent respectively in the financial intermediation, business activities, and international business activities industries. This growth reflected the inflow of catastrophe reinsurance capital following the 2005 hurricane season. Output from hotels and restaurants grew by 10 percent.[4] Inflation as measured by the consumer price index was 3.8 percent in 2007.

III. Financial System Overview

8. **Bermuda is a major international financial center, mainly due to its importance as an operating base for the international insurance and reinsurance industry,** and to a lesser extent for collective investment schemes. The banking sector is small and focuses on serving the international business sector. There is one stock exchange that lists domestic companies and mutual funds as well as cross-lists international companies. Trading volume in the exchange is very thin.

A. Banking

9. **There are four licensed banks in Bermuda, two of which are locally-controlled—Bank of N.T. Butterfield and Son, Ltd., and Capital G. Bank Ltd.**; the third, Bank of Bermuda, was purchased by HSBC—the U.K.-based banking group—in 2004, and the

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[3] See CIA World Factbook at http://www.cia.gov and http://www.gov.bm, Statistics.

[4] See http://www.gov.bm, Statistics

fourth, Bermuda Commercial Bank is controlled by a Curaçao bank. Consolidated total assets of banks and the single deposit company[5] amounted on average to $22 billion during 2003–2006, or four times the country's GDP.[6]

10. **Most banks have focused their operations on serving the growing international business sector** by offering investment, trustee, and financial management services, since the growth potential for retail banking is limited by the small size of the population. An indirect indication of the reliance of banks on commercial operations targeted to the international business, particularly the insurance sector, and business overseas, is the share of their foreign assets in their combined consolidated balance sheet. At the end of 2007, the BMA reported that foreign assets accounted for 80 percent ($19.4 billion) of the total combined balance sheet of Bermuda banks and deposit companies (Table 2).

Table 2. Bermuda Financial Sector

Sector	2003	2004	2005	2006	2007
	(In million Bermudian dollars, unless otherwise specified)				
Banks and Deposit Companies					
Total Assets	22,404	20,487	22,371	23,100	24,168
Of which: Foreign Currency	19,504	17,221	18,570	18,831	19,412
Deposit Liabilities	20,116	18,276	19,586	19,906	20,807
Loans and Advances	4,845	5,497	5,890	6,806	7,351
Loan/Deposit ratio (percent)	24.09	30.08	30.07	34.19	35
Other assets (deposits and investments)	16,784	13,955	14,877	15,082	15,575
Investment Funds					
Mutual funds (number)	1,321	1,637	1,609	1,715	1,679
Unit trusts (number)	221	374	434	475	483
Total Funds Net Asset Value	116	158	188	212	249
	($ billion, except where otherwise noted)				
Bermuda Stock Exchange					
Market capitalization	114	100	325	350	350
Number of securities listed	383	385	363	430	543
Insurance Companies 1/					
Gross premiums	94.7	95.3	100.7	115.8	
Net premiums	84.1	82.9	86.3	100.4	
Total assets	236.0	290.2	329.8	440.4	
Capital and surplus	87	107	110	158	
Number of companies	1,267	1,300	1,312	1,305	

Source: Bermuda Monetary Authority (BMA), and BMA,Annual Reports, 2003 to 2006.
1/ Includes companies holding both general and composite business licenses. Since the insurance companies have different financial years, comparable aggregate data is not yet available for 2007.

[5] Firms with a deposit company licence can accept only term deposits and make only mortgage-secured loans.
[6] All figures in Bermudian dollars, unless otherwise specified. The Bermudian dollar is at par with the U.S.

11. **Certain indicators suggest low risk in the banking sector.** Capital adequacy in the consolidated banking sector appears adequate. The capital to risk-weighted assets ratio was 17.1 percent at end-2007 (16.8 percent at March 2008), well above the 10 percent minimum ratio required by the BMA, and up from around 15 percent at end-2005. Liquidity, as measured by the loan-deposit ratio, deteriorated to 35 percent at end-2007 from 24 percent at end-2004.[7] The liquidity position of the banks, however, is still considered comfortable by rating agencies.

B. Securities Markets

Collective Investment Schemes

12. **Bermuda has a large and active investment fund and investment funds services sector**. The jurisdiction hosts a number of multinational financial services organizations, and is home to a large number of hedge funds, investment managers, and portfolio managers as well as internationally-active fund administrators.

13. **The number of collective investment schemes (CIS) in Bermuda increased substantially during 2002–2006**, favored in part by the absence of income or capital gains taxes for CIS, and reflecting the growth of the hedge fund industry.[8] There were 1,303 schemes with a net asset value of $249 billion in 2007, up from 912 schemes with a net asset value of $68 billion in 2002. The schemes manage a total of 2,162 portfolios for 1,679 funds (mutual funds, umbrella funds, sub-funds, segregated accounts, and segregated account companies) and 483 trusts (unit trusts, umbrella trusts, and sub-trusts).

Stock Exchange

14. **Bermuda has a stock exchange with a limited number of full-service brokerage firms.** The Bermuda Stock Exchange (BSX) is a fully electronic offshore securities market that serves as a domestic market for local companies and domestic CIS, and as a venue for recording trades in internationally-listed companies. As of end-2007, there were 543 securities listed in the BSX, including 361 CIS and 37 international companies cross-listed on onshore exchanges. The total market capitalization of the BSX was $350 billion at end–2007, and $391.3 billion at March 2008, up from $150 billion in 2002.

15. **The vast bulk of trading volume on the exchange takes place in international issues—the domestic market was less than one percent of market capitalization in 2007**. The annual trading volume in domestic equity securities was relatively thin in 2006 at $121 million but up by two-thirds compared with 2005, and in 2007 it rose by one-third to $165 million. The number of trading members in the BSX declined to 11 in 2007 from 16 in

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[7] In the absence of deposit insurance and a lender of last resort, banks traditionally maintain high liquidity.

[8] The legal term for CIS in Bermuda is investment fund.

2002. All trading members must be Bermuda-domiciled companies. The BSX also operates a clearing and settlement system and a depository. All systems are fully automated.

C. Insurance

16. **With more than 1,400 registered (re)insurers, Bermuda is a significant player in the global insurance market.** The Bermudian market is diversified and sophisticated. In 2006, Bermuda accounted for 12 of the top 40 global reinsurers rated by Standard and Poor's, and 15 of the top 35 reinsurers rated by AM Best in 2004. The total number of registered insurers was 1,480 at end-2007. About 92 percent or 1,312 of the 1,421 registered insurers in 2005 were actively conducting business. They included 1,135 general insurers, 100 composite insurers, 77 long-term insurers, and 19 insurers that write domestic business. Composite insurers write a combination of general and long-term business provided that their long-term insurance business is incidental and limited[9]. Box 1 provides a brief history of the development of the industry.

[9] Composite insurers are included in the data reported under Classes 1 to 4 insurers.

Box 1. Development of the Bermuda Market, in Brief

Bermuda's insurance market began in 1947 when the founder of the American Insurance Group (AIG) based the international business of his insurance company in Bermuda. In the 1960s, Bermuda was a pioneering domicile for captive insurance companies. Bermuda remains the second largest domicile, after the U.S., for captive companies.

In the mid 1980s, when there was a shortage of coverage and high prices for excess liability insurance (additional coverage when limits on underlying policy are exceeded), the reinsurance companies Ace Ltd and XL Capital Ltd (earlier Exel) were formed for the sole purpose of providing excess liability. These later offered directors' and officers' liability, as did one insurer established for this purpose, and eventually diversified their lines of business. In 1988 Centre Re was formed to provide the innovative structured reinsurance ("arrangements that transfer limited risk relative to aggregate premiums that could be charged under the contract", IAIS). These companies, formed to serve the U.S. market, chose to incorporate in Bermuda because of the timeliness with which incorporation was possible and the absence of income tax. Proximity to the New York markets and association with the U.K. would also have enhanced Bermuda as a location.

Following the loss of capacity in the U.S. market after the 1992 Hurricane Andrew, eight property catastrophe reinsurers entered the market. In the late 1990s, Arrow Re (Goldman Sachs) and Lehman Re (Lehman Brothers) were formed to facilitate reinsurance access to capital markets. These were followed by financial guarantee companies that provide guarantees for debt securities.

In addition to the initial important sources of attraction described above, the concentration of professional insurance skills in Bermuda now appear to be of dominant importance in attracting both firms and their customers. The concentration of insurance skills creates economies of scale for risk managers and others seeking corporate insurance. Major new influxes of capital followed September 11, 2001—whose insured losses resulted in lower capacity—and the 2005 hurricanes Katrina, Rita, and Wilma. The latter wave also included the innovation of sidecars. Sidecar structures allow a reinsurer to manage the underwriting risk of a book of business in an entity that is financed through the issuance of debt and equity to the market. Sidecars permit additional capital without the need to establish a new company. Several were closed in 2007 as the need for additional capacity has declined.

Source: http://www.bermuda-insurance.org

17. **Bermuda legislation categorizes general insurers in four classes** (see Table 3):

- Class 1: single-parent captives insuring only the risks of its owners or affiliates of the owners, or pure captives;

- Class 2: multi-owner pure captives and captive insurers deriving up to 20 percent of their net premiums from unrelated parties[10];

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[10] "Unrelated parties" are policyholders of a captive who are not associated by ownership with the owner of the captive.

- Class 3: insurers not included in Classes 1, 2, or 4, including “captives” with more than 20 percent of their net premiums from unrelated parties; and

- Class 4: insurers with minimum capital and surplus of $100 million underwriting direct excess liability and/or property catastrophe reinsurance risk.

18. **Measured in terms of gross written premium (GWP), the Bermudian insurance market has more than doubled from 2001 to 2006, and it continues to attract a diverse range of start-ups and innovative insurance arrangements.** The attractiveness of Bermuda for the insurance sector is evidenced by the record number of 82 new insurers that were established in Bermuda in 2006, a three-year high. In particular, the bulk of new capital attracted into the global reinsurance industry by the higher premiums resulting from the 2005 hurricane season flowed into Bermuda (see Box 1).

19. **Ownership in the Bermuda insurance sector is geographically diverse but dominated by U.S. companies**, which owned 60 percent of the 589 active commercial insurers at end-2005. Bermudian-owned and European-owned insurers represented 18 percent and 14 percent of the market, respectively. Around one in three commercial insurers were publicly-listed companies, of which two-thirds were listed in U.S. exchanges. The insurance sector accounted for 7.6 percent of the total employment of 38,947 in Bermuda. Insurance density (premiums per head) in the domestic market was $6,072.

20. **Table 4 indicates the high degree of concentration in the insurance industry**. GWPs in 2006 totaled $115.8 billion, of which almost 90 percent was written by commercial insurers.[11] The top ten of the commercial insurers in each of the Classes 3, 4, and long-term together, had a share of two-thirds of total market GWP, and the top 10 of the Class 4 and long-term companies had 70 percent and 98 percent of GWP in their classes, respectively.

[11] Commercial insurers are Classes 3, 4, and long-term insurers and reinsurers.

Table 3. Bermuda: Insurance Sector

	2003	2004	2005	2006
	($ billion, except where otherwise noted)			
Insurance Industry by Regulatory Class 1/				
Classes 1 and 2				
Gross premiums	8.9	9.9	13.4	13.8
Net premiums	7.2	7.6	10.9	11.7
Total assets	38.0	48.7	51.5	55.1
Capital and surplus	17.8	20.8	21.4	23.9
Number of companies	718	731	723	696
Class 3				
Gross premiums	32.9	35.8	33.8	42.3
Net premiums	26.0	28.1	25.0	32.6
Total assets	103.9	122.5	117.2	194.5
Capital and surplus	34.8	42.0	38.3	66.8
Number of companies	452	469	474	490
Class 4				
Gross premiums	24.6	28.6	30.8	32.2
Net premiums	22.5	26.2	27.6	28.6
Total assets	72.7	89.9	116.8	135.2
Capital and surplus	30.0	35.6	40.9	57
Number of companies	30	29	38	38
Long-term insurers				
Gross premiums	28.4	21.1	22.8	27.5
Net premiums	28.4	21.1	22.8	27.5
Total assets	21.3	29.0	44.3	55.6
Capital and surplus	4.6	8.2	9.4	10.0
Number of companies	67	71	77	81

Source: Bermuda Monetary Authority (BMA), and BMA, Annual Reports, 2003 to 2006.

1/ Includes companies holding both general and composite business licenses.

Table 4: Analysis of Gross Written Premiums in 2006

Class	Companies by Class Number	Companies by Class Share	GWP by Class GWP	GWP by Class Share	GWP of Top 10 GWP	Top 10 Shares All Cos	Top 10 Shares Class
	Number	(percent)	($ million)	(percent)	($ million)	(percent)	
1	344	26	4,768	4	2,585.0	2	54
2	353	27	9,029	8	4,967.0	4	55
3	490	38	42,302	37	26,860.0	23	63
4	38	3	32,217	28	22,682.0	20	70
Long-term	81	6	27,468	24	26,902.0	23	98
Total	1,306	100	115,784	100	83,996	73	

Source: Bermuda Monetary Authority

21. **GWP is diversified by the insurance line of business, and risk retention is generally high.** Based on a survey covering two-thirds of the industry, in 2005 long-term insurers wrote 34 percent of GWP, "mixed" insurers[12] 26 percent, and reinsurers 16 percent. Retention rates[13] are high, almost 95 percent for long-term insurers and nearly 90 percent for mixed insurers. Direct insurers and reinsurers retained about 88 and 80 percent of their GWP respectively. While GWP (and hence exposure) sourced from North America declined from 62 percent in 2003/4 to 57 percent in 2005, GWP from Europe rose from 6.7 percent (2003) to 19.4 percent. Global business represented 20.4 percent of industry GWP in 2005. [14]

22. **Overall, the Bermuda insurance market strengthened its capital base in 2006**.[15] While profitability of Bermudian reinsurers was hit by their combined 30 percent share of the insured losses from hurricanes Katrina, Rita, and Wilma (KRW), there has been a net-capital inflow**.** Hedge funds have been among the recent investors in the reinsurance industry, taking advantage of an innovative short-term risk transfer mechanism (sidecar) to help fill the depleted capacity caused by the hurricane losses in 2005 (see Box 1). The dominant players are the Class 4 insurers which accounted for 36 percent of the total capital and surplus at end-2006. They supply 40 percent of the property catastrophe reinsurance capacity to the U.S.

[12] "Mixed" insurers are direct insurers writing more than 10 percent of reinsurance within a portfolio, or vice versa.

[13] That is, the companies retain a large proportion of the insured risk on their own books, rather than reinsuring or ceding it.

[14] Global business is that where premiums cover bundled cross-regional risks.

[15] Bermuda Insurance Update–*Howling Winds of Change* (2007 Vol. 1)

market. Collectively, they settled $17 billion of claims arising from the 2005 hurricane season.

23. **The investment profile of the industry is relatively liquid.** Fifty two percent of the total assets as at end-2005 were in quoted bonds and equities, and 9.3 percent in cash and deposits. Investment and advances to affiliates represented 53 percent and 14 percent of the assets of direct insurers and composite insurers, respectively.[16] In contrast, reinsurers and long-term insurers held 5 percent and 2.6 percent respectively, in intra-group balances. In 2006, quoted investments of commercial insurers were 50 percent of assets, investment in affiliates 23 percent, and cash and time deposits 8 percent. [17]

24. **Going forward, the main strategic concern of commercial insurers is the tradeoff between gaining/retaining market share by lowering rates, and reduced profitability.** As property/casualty insurance rates have fallen in the absence of major claims since 2005, competitive pressures have increased. Greater portfolio diversification has been driven by credit rating considerations[18] and potential over-capacity, the latter due partly to added pressure from state-funded capacity for catastrophe risks in the U.S. Some sidecars that have provided additional capacity to reinsurers, such as those funded by highly leveraged investors, have disappeared. Standard and Poor's noted that the depth and breadth of senior management of the class of 2006 start-ups are noticeably weaker than previous cohorts, as technical expertise may be spread thin by the high number of start-ups since 2001. Furthermore, their strong focus on property and other catastrophe-exposed lines of business could pose a challenge if volatility risk continues to increase as experienced during recent years.

D. Regulatory Framework, Oversight, and Market Integrity Arrangements

25. **Bermuda's single regulator, the BMA, supervises the insurance, banks, trust and investment businesses, collective investment schemes, the BSX, and the credit union.** It also issues the Bermudian dollar.

26. The regulatory framework is based on the following legislation:

- Bermuda Monetary Authority Act, 1969, last amended in 2006;
- Banks and Deposit Companies Act, 1999;

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[16] The high intra-group balance for direct insurers was distorted by one insurer who accounted investment outsourced to a subsidiary as a loan due from the subsidiary. Given the high proportion reported as intra-group balance, approval had to be obtained from the BMA to meet the minimum relevant asset requirement. All insurers have to maintain at least 75% of their relevant liabilities in the form of eligible relevant assets.

[17] The information for 2005 comes from a survey which distinguished between direct insurers and reinsurers. The data for 2006 represents 63 percent of the commercial market.

[18] Greater diversification is seen as increasing resilience.

- Insurance Act, 1978, last amended 2006;
- Investment Business Act, 2003;
- Trusts (Regulation of Trust Business) Act, 2001; and
- Investment Funds Act, 2006.

27. **The BMA board is responsible for the policy and strategy of the BMA and the general administration of its affairs and business.** The Board has 12 members, 3 of whom are executives appointed by the BMA subject to approval by the Minister of Finance (MOF). The minister appoints non-executive members. To enhance independence, board members are appointed for terms ranging from three to five years, and can only be removed from office for legislated reasons. The BMA's non-executive chairman chairs the Non-Executive Directors' (NED) Committee to provide an independent check on the performance of the executive members of the board. In 2006, the board instituted a number of reforms to its processes, restructuring the audit committee to an audit and risk management committee, and instituting a board code of conduct and conflict of interest policy, inter alia.

28. At the time of the assessment mission, the supervision of **insurance** was carried out by the Insurance Department (ID) of the BMA, headed by the Supervisor of Insurance. All supervisory units now report to the Deputy CEO, a post created in 2007–08. Under recent legislative change, the BMA appoints executive members of the board, though these appointments do not have effect until approved by the minister. The staff of the ID stood at 50 persons at the time of the assessment, up from about 17 in 2003, and professional staff reached 45 by end-2007. An Insurance Advisory Committee (IAC), established under the Insurance Act 1978 (the IA) advises the minister on insurance matters**.** A number of professional bodies and self-regulatory industry associations complement the regulatory regime.

29. **Banking supervision and securities regulation** is the responsibility of the Banking, Trust and Investment Department (BTI) that is under a director who reports to the Deputy CEO of the BMA. The department was restructured in 2006. The Investment Funds Act of 2006 (IFA) came into effect in March 2007. The act seeks to align the regulation of CIS with the level of sophistication of their investors, and defines three types of funds: Standard, Institutional, and Administered Funds. Most of the CIS target sophisticated and/or institutional investors, and accordingly, regulations for these schemes focus mainly on the proper disclosure of information to investors. Private funds, open to a maximum of 20 investors, are excluded from the act.

30. **The main pieces of legislation governing money laundering and the financing of terrorism are the Proceeds of Crime Act 1997 (POCA), and the Proceeds of Crime (Money Laundering) Regulations 1998, and The Anti-Terrorism (Financial and Other Measures) Act 2004 (The ATFA) respectively**. Important amendments to the POCA, the Criminal Justice International Cooperation (Bermuda Act), and the Financial Intelligence

Agency Act (FIA Act) were enacted in July 2007. The FIA Act (which was still to be put into effect in January 2008) establishes a new administrative agency (the FIA) that is being organized to take on the responsibilities of the current financial intelligence unit (FIU), part of the Bermuda police. The National Anti-Money Laundering Committee (NAMLC) brings together key ministries and departments and fills, in practice, the AML/CFT policy formulation function. NAMLC's main legal mandate is, however, to advise the MOF and to issue industry guidance on AML issues.

E. Findings of Earlier Assessments

31. **The 2003 assessment found that the regulatory and supervisory framework was well-developed in banking, key areas of securities regulation, and for AML/CFT (based on the then-standard and methodology).** Some deficiencies were noted in insurance supervision—the ample powers of the BMA had not been fully realized. Annex III describes the actions taken in response to the 2003 assessments of banking and insurance supervision, and securities regulation.

32. **As described below, the BMA has made extensive reforms to all areas of supervision, with the exception of the AML/CFT regime** since 2003, with particularly radical improvement in insurance supervision.

IV. Strengths and Vulnerabilities in the Financial System

A. Progress in the implementation of financial standards and follow-up on 2007/08 market disturbances

Banking

33. **The BMA has addressed most of the recommended actions in the 2003 report**. In 2006, a major restructuring of the BTI was undertaken to support the introduction of a more formal risk-based supervisory framework and the required expertise was hired. Higher-risk institutions are identified through a standardized analysis and greater attention paid to these. An appropriate system has also been introduced to define a capital charge where there is material market risk.[19] This is the first step toward putting in place the new Basel II capital adequacy framework that the BMA intends to implement in 2009. Credit evaluation and policy has also been strengthened through a policy paper that sets out the BMA's enhanced responses in cases of large exposure, connected lending, and other risks. Policy papers also address operational and other risks. On- and off-site supervision have also been strengthened.

34. **In addition to addressing the 2003 recommendations, the BMA has upgraded its policy framework to comply with the 2006 revised BCPs**. The increased standard of

[19] Material risk of loss on on- and off-balance sheet positions due to market price changes.

supervision will require continuous attention to resources. In addition, the mission recommends:

- reviewing the scope and frequency of on-site examinations;
- enhanced country exposure reporting; and
- more direct intervention tools in the event of impending bank failure.

35. **The two Bermudian banks holding some sub-prime related assets in their investment portfolios have suffered mark-to-market declines in value, resulting in stepped-up scrutiny from the BMA.** The assets are higher rated tranches of asset-backed credits, representing 10 to 15 percent of their investment portfolios, and are held-to-maturity investments. As a result, the banks and their auditors are of the view that there has not been permanent value impairment. The BMA is reviewing portfolio details on a monthly basis, and holding meetings with management to monitor portfolio management.

Insurance

36. **In insurance, the BMA has instituted a strongly risk-focused supervisory approach in line with the diversified range of insurers in Bermuda**. Supervisory scope and intensity is determined by an assessment of the likely scale of impact of a risk, as well as of its likelihood.

37. **There is a high level of observance of the IAIS core principles**. The ID's goal of becoming a leading international regulator has resulted in a well-designed process of staff, systems, and framework upgrading that is proceeding expeditiously. Taking account of the 2003 assessment recommendations, the IA has been amended several times and initial guidance was introduced. The 2006 Amendment Act revised the framework to introduce more detailed licensing criteria, and required the BMA to publish a Statement of Principles and introduce a code of conduct. It also introduced a detailed regime for oversight of insurance controllers. Annex I provides the Report on the Observance of Standards and Codes (ROSC) for the IAIS insurance core principles assessment of the supervision on commercial insurers.

38. **Implementation of a risk-focused framework, that assigns risk factors to the companies, has been started.** Insurers are ranked by risk likelihood and impact. A riskier categorization results in increased supervisory focus including on-site inspection. The framework will also include a risk-based solvency regime. The licensing function has also been revamped with strengthened criteria, and enhanced regulatory reporting will be introduced.

39. **Oversight of Classes 1 and 2, predominantly captives, is supported through the insurance manager infrastructure.** [20]These managers are licensed and integrated into the supervisory process. Management services give the supervisor a means of monitoring and inspecting numerous small companies by providing a focal control point representative of the management of the captives.

40. **Effective and comprehensive implementation of the risk-based regulatory system will depend on**:

- continuous review of regulatory resources;
- preservation of regulatory independence;
- high transparency and disclosure to enhance recognition and support supervision; and
- risk rating Class 3 companies to allow for the granular tailoring of supervisory stance currently available for Class 4.

41. **The sub-prime-related exposures are affecting or could affect Bermudian companies mainly through four principal channels**: investment in structured products, financial guarantee portfolios, liquidity positions, and potential claims on professional and executive liability insurance. The conservative investments of many Bermuda-based insurers have limited their direct exposure.[21] Nevertheless, asset valuation uncertainty is affecting insurers (for example, AIG was downgraded and life reinsurer Scottish Re bought out). Fitch notes that, while Bermudian insurers place a higher proportion of invested assets in MBS and ABS than do U.S. insurers, the credit quality of their MBS and ABS remained high despite recent pressure. [22] It would appear that exposure has been greatest for shareholders in financial guarantors who insured structured products, with the financial guarantee industry under considerable stress; for example, XL has been downgraded in part because of its exposure to a bond insurer. Exposures to loss from executive and professional liability are not yet known but these are reported to be reserved. [23]

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[20] An insurance manager is "a person who, not being an employee of any insurer, holds himself out as manager in relation to one of more insurers, whether or not the functions performed by him as such go beyond the keeping of insurance business accounts and records." (IA)

[21] See Guy Carpenter and Company, LLC *Managing Prosperity: 2008 Bermuda Update Report, May 2008.* The companies referred to in their reports are 25 insurance holding Bermuda-domiciled companies that they analyze on a regular basis. .

[22] See Fitch Ratings, *Bermuda Market Overview*, March 3, 2008

[23] See *Benfield Bermuda Quarterly,* March 2008. These exposures, usually referred to as director and officers' liability and errors and omissions, could arise, for example, from claims on the companies that created structured products.

42. **The BMA has taken a proactive approach to the sub-prime crisis.** It conducted two surveys in August and November 2007 to assess investment and underwriting exposure to sub-prime risk, and evaluate insurers' risk management programs. The studies analyzed the four main areas of potential exposure and conducted stress tests, concluding that there is no systemic stress to the Bermuda market. A few companies were identified for enhanced supervision and monitoring. This work has been shared with related home or host supervisors in other jurisdictions and discussed at IAIS meetings. A guidance note on reserving practices for financial guarantee insurers has been issued for consultation.

Securities

43. **The BMA has improved its ability to oversee CIS.** New legislation provides full powers of information-gathering and inspection, as well as fund and prospectus rules. A dedicated investment funds team with additional experienced staff has been established and Fund administrator licensing has begun.

44. **Other upgrades in securities regulation cover market intermediation and clearing and settlement.** The BMA staff's technical skills have been upgraded through recruitment and training, and clearer rules and guidance for inspection of investment providers have been put in place. Through the Investment Business Act, 2003, the BMA now has the authority to license clearance and settlement systems (currently only provided by the BSX). In addition, the offences of market manipulation and insider dealing were introduced by 2004 legislation.

Anti-money Laundering and Combating the Financing of Terrorism

45. **The AML/CFT regime has not been much changed since the AML legislation of 1998 and the 2003 IMF assessment.** Apart from the 2004 ATFA Act and some changes to the POCA, revisions to the guidance notes resulting from recommendations of the 2003 assessment are still in draft. Therefore, Bermuda has not kept pace with the FATF Recommendations and has not been able to introduce the risk-sensitive approaches to financial institution oversight permitted under the FATF 40+9.[24] The regulatory framework does not address CFT issues, and customer due-diligence requirements are narrowly focused on customer identification. Enhanced capacity and resources are required to strengthen AML/CFT supervision in key industries. The new laws, POCA, the Bermuda Act, and the FIA Act address a number of the weaknesses in the AML/CFT legal framework identified by the mission. Annex II provides the ROSC for the assessment of the implementation of the FATF Recommendations for AML/CFT.

[24] New legislation (in draft at the time of the AML/CFT assessment mission) was passed in June 2007.

B. Stress Test Results for Class 4 and Long-Term Issuers

46. **Ten of the 41 Class 4 and long-term insurers used their internal models to calculate the impact of various shocks, but these did not affect their ability to meet regulatory requirements**. Results were reported in terms of the reporting requirements of the BMA, viz. change in capital and surplus, minimum regulatory premium ratio, and minimum regulatory loss reserves ratio. All of the companies employed a combination of proprietary and in-house models to analyze their risk exposures. The scenarios included three natural catastrophe events, two pandemic events, and worst-case scenarios that each firm in the sample was asked to specify for itself. The catastrophic events were found to have a high negative effect on companies' capital, with the most severe impact resulting from the worst-case scenarios, only two of which included economic (in addition to natural catastrophe) events. No companies in the sample fell below the regulatory requirements, demonstrating the strong balance sheets of the companies.

47. **Due to time constraints faced by the BMA and tested companies, the stress tests only covered a subset of the risk factors considered necessary to obtain an overall risk profile.** However, more comprehensive assessment of risks would be obtained by use of a wider variety of stress tests (including financial market effects, and stresses on assets for example), and employment of economic valuation rather than accounting data. The single company that combined economic recession and catastrophic events in its worst-case scenario had a worse outturn than the others, suggesting that future stress testing could usefully focus on examining the effects of combining extreme events to obtain more insight into possible vulnerabilities. The BMA should also devote resources to understanding the companies' models to learn the strengths and weaknesses of their risk analyses.

C. Cross-border Cooperation and Information Exchange

48. **The BMA does not require a formal agreement or memorandum of understanding (MOU) to provide assistance to other supervisors.** However, it has been willing to enter into bilateral MOUs where other authorities prefer to document mutual commitments by this means. The BMA has the ability to share confidential information with foreign supervisory authorities under "gateway" provisions in its regulatory laws. It also has specific powers to compel the production of information from licensed persons where the information is not required for its supervisory purposes, but only in order to assist a third country supervisor.

49. **In relation to compulsory power, the BMAA, 1969, (Sections 30A to 30C) provides powers for assisting foreign regulatory authorities.** The BMA is, however, required to take account of certain matters prior to providing the requested information. These include the likelihood of reciprocity, whether the requesting foreign regulatory authority has legislation and requirements similar to those of Bermuda law protecting the confidentiality of information provided to it, public interest, the nature and seriousness of the issue, and whether the requesting authorities will meet costs if required to do so.

50. **There are also sectoral provisions for cooperation and information exchange**. Section 52B(2) of the IA provides for assistance to be given to requesting authorities exercising similar regulatory functions without requiring strict reciprocity. In addition, there are two MOUs specifically covering insurance, and the BMA has applied to be a signatory of the IAIS's multilateral MOU. The 2003 IOSCO assessment had found that the BMA had fully implemented the IOSCO standard on cooperation. In addition, in 2007 the BMA signed IOSCO's Multilateral MOU. The guidance on consolidated supervision in the banking sector has been revised in line with the 2006 BCP.

51. **As a regulator in an important home jurisdiction for insurance, while existing provisions are adequate, enhanced cooperation would be valuable**. The mission recommends that the BMA implement routine arrangements to alert host supervisors of material developments, formalize exchanges with state insurance supervisors in the U.S. and the U.K. FSA, and consider joint inspections.

52. **Bermuda has a comprehensive legal and institutional framework for international cooperation that is largely consistent with international standards for AML/CFT purposes**, but there is a need to strengthen cooperation mechanisms among governmental institutions for AML/CFT.

ANNEX I. Report on the Observance of Standards and Codes (ROSC) for the IAIS Insurance Core Principles

Introduction

Regulatory initiatives, expanded supervision, and increased staffing have strengthened Bermuda's insurance supervisory regime since 2003. Taking account of the recommendations of the 2003 OFC assessment, the authorities introduced a phased program to update legislation and supervisory practices. The BMA has significantly enhanced its risk-based approach that is aligned with the diversified range of insurance entities domiciled in Bermuda. The updated framework has a high level of observance of the IAIS core principles, but implementation of the reforms is in transition. The BMA's vision is to become a regulatory leader before 2010. Strong commitment to sound regulation by the industry contributes to this vision, but has to be constantly balanced with preserving regulatory independence and effectiveness.

Executive Summary

This assessment benchmarks Bermuda's regulatory regime against the IAIS core principles based on the 2003 IAIS methodology. The assessment was conducted from June 11–22, 2007[25].

This ROSC covers commercial direct insurers and reinsurers classified as Classes 3, 4, and long-term under the Bermudian regime (commercial insurers). Comments on Class 3 insurers apply to long-term insurers unless stated otherwise. Captive insurers holding Class 1 and 2 licenses are covered in a separate factual update.

Information and methodology used for assessment

The assessments are based solely on the laws, regulations, and other supervisory requirements and practices that are in place at the time of assessment. In particular, the BMA is finalizing a risk-based solvency regime that will be complemented by enhanced regulatory reporting. These ongoing regulatory initiatives are noted by way of additional comments. The assessment was facilitated by meetings with industry bodies and insurers that were coordinated by the BMA, as well as by technical discussions with, and briefings by the authority.

Institutional and market structure—overview

The BMA has had authority for regulating, supervising, and inspecting virtually all of Bermuda's regulated financial sector, including insurance, since 2002 under the BMA Act, 1969. An Insurance Advisory Committee (IAC) established under the IA advises the MOF on insurance matters. The non-executive chairman chairs the Non-Executive Directors

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[25] The assessment was conducted by Henning Göbel and Su Hoong Chang.

Committee which provides an independent check on the performance of the board and the BMA.

Bermuda is a significant player in the global insurance market with over 1,400 registered (re)insurance companies, 92 percent (1,312) of which were active at end-2005. They comprise 1,135 general, 100 composite, 77 long-term insurers, and 19 domestic insurers. Composite insurers are permitted to write both general and long-term insurance provided the long-term is incidental and limited. The general insurers are licensed in four classes:

- Class 1—pure captives;
- Class 2—multi-owner pure captives and those deriving up to 20 percent of net premiums from unrelated parties;
- Class 3—insurers not included in Classes 1, 2, or 4;
- Class 4—insurers with minimum capital of B$100 million underwriting direct excess liability insurance and/or property catastrophe.

Gross written premiums in 2005 totaled B$100.7 billion of which 87 percent were written by commercial insurers. Average net risk retention rates were 94 and 87 percent of GWP for long-term and " mixed" insurers respectively. [26] Direct insurers and reinsurers retained about 88 and 90 percent of GWP respectively. The Bermuda insurance market strengthened its capital base in 2006, with a net capital inflow following hurricanes Katrina, Rita, and Wilma. Their investment is relatively liquid with 52 percent of total assets in quoted bonds and equities at end-2005, and 9.3 percent in cash and deposits.

Main findings

The insurance regulatory and supervisory regime demonstrates a high level of observance of the IAIS standards, as described below:

(i) C***onditions for effective insurance supervision (ICP1)***—the Bermuda financial sector policy is supported by an efficient financial market structure, including specialized skills, and facilitated by easy access to U.S. financial markets.

(ii) ***The supervisory system (ICPs 2–5)***—The BMA is a fully empowered insurance regulator with extensive operational and financial autonomy. It continues recruitment to effectively execute its enhanced supervisory framework. The relationship with industry should be constantly reviewed to preserve regulatory independence. The BMA has started implementation of its risk-focused supervisory framework with Class 4 insurers. The framework bases supervisory attention on assigned company ratings that take account of the impact and probability of risky events. Enhanced regulatory reporting will complement this

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[26] "Mixed" insurers write more than 10 percent of reinsurance within an insurance portfolio or vice-versa.

risk-focused approach. While the licensing categories are broadly risk-based, Class 3s are a mix of entities, and the classification could be reviewed. Cooperation and information sharing are satisfactory and the BMA is encouraged to make routine and formalize some arrangements.

(iii) ***The supervised entities (ICPs 6–10)***—the licensing process is systematic and efficient and the BMA has recently made arrangements to ensure home-host consultation on the licensing of cross-border establishments. The BMA has clear criteria and guidance for vetting owners and key management and for approving changes in control, but should acquire the power to approve the transfer of insurance portfolios. The corporate framework in place is supported by a formalized on-site inspection program.

(iv) ***Ongoing supervision (ICPs 11–17)***—The BMA has made significant progress in strengthening regulatory reporting and off-site monitoring. Early formulation and implementation of a regime for group supervision of Bermuda-based insurance groups would help reduce regulatory risks. A formal on-site inspections program was introduced in 2006. Its active market analysis will be strengthened by enhanced regulatory reporting and the ongoing increase in resources. Intervention powers and sanctions are well-defined. Winding up and exits have been administered without disruption but the BMA should consider clarifying the priority of policyholders' claims in composite insurers and those insurers with non-insurer business in the same legal entity. The BMA should clarity the conditions under which insurers are allowed to encumber assets held for the benefit of policyholders.

(v) ***Prudential requirements (ICPs 18–22)***—The current solvency regime sets a minimum capital and surplus based on class of licence, subject to two other criteria based on net written premiums or net reserves with floors. Class 4 insurers must hold a minimum of B$100 million. At the time of the assessment the regime did not address double or multiple gearing of capital, but the BMA is consulting Class 4 insurers on a risk-based solvency regime. The BMA has provided guidance to insurers on its expectations for their risk management systems whose practical assessment is facilitated by ongoing inspections. Disclosure requirements should be established for derivatives and similar commitments, and the BMA is advised to issue guidance on the basis and adequacy of technical provisions.

(vi) **Markets and consumers (ICPs 24–27)**—The regulatory requirements for intermediaries are appropriate for the small domestic market. Insurance fraud is not an issue and is effectively covered under the criminal code and proceeds of crime regulation. The BMA should plan to implement the IAIS supervisory standard on public disclosures to facilitate market discipline.

(vii) AML/CFT (ICP28)—not assessed.

Table 5 outlines these findings on a principle-by principle basis.

Table 5. Summary of Observance of the Insurance Core Principles

Insurance Core Principle	Comments
ICP1—conditions for effective insurance supervision	Bermuda has a progressive financial sector policy supported by efficient financial market infrastructure. The Bermudian insurance industry continues to attract skilled professionals, locally and abroad. Easy access to the mature financial markets in the U.S. facilitates effective asset-liability management by insurers.
ICP2—Supervisory objectives	The principal objectives of the authority and ID are clear. The BMA's multiple mandates, including fostering close relations with financial institutions, have to be constantly balanced to ensure its independence and effectiveness.
ICP3—Supervisory authority	The authority has extensive operational and financial autonomy. It is fully empowered to administer and enforce the IA. It has drawn up a comprehensive plan to recruit regulatory staff to implement the enhanced supervisory framework. At the time of assessment, the BMA was actively recruiting to complete its recruitment plan. Strong commitment from industry players contributes positively to the BMA vision to be a regulatory leader. Nonetheless, the authority's relationship with the industry should be constantly reviewed with the view to preserving regulatory independence and credibility.
ICP4—Supervisory process	The BMA has implemented significant enhancements to its risk-focused supervisory framework. Implementation has started with class 4 insurers and will be progressively rolled out to Class 3 and long-term insurers based on their composite risk ratings. The BMA is designing enhanced regulatory reporting to complement the enhanced supervisory framework and the proposed risk-based solvency regime. While the current licensing categories are broadly risk-based, Class 3 insurers are a mix of entities with varying risk profiles. Going forward and after the BMA has gained experience with the risk-based supervisory framework, there are merits in reviewing the relevance of the Class 3 category as their composite risk ratings provide more granularity.
ICP5—Supervisory cooperation and information sharing	The IA provides clear grounds and power to the authority to cooperate and exchange information domestically and with foreign regulators. The authority is encouraged to execute routine arrangements to alert host supervisors of material supervisory developments in Bermuda and to formalize the informal exchanges with state insurance regulators in the U.S.
ICP6—Licensing	The licensing process is systematic and efficient, enabling the authority to reach decisions in a timely manner. The BMA has established robust criteria for vetting the applications. In view of the international nature of insurers domiciled in Bermuda, the authority has recently introduced arrangements to liaise with relevant overseas authorities where licensing applications relate to branches or subsidiaries of foreign regulated insurers.
ICP7—Suitability of persons	The BMA has established clear criteria and guidance for vetting the suitability of significant owners, senior management, and key functionaries.

Insurance Core Principle	Comments
ICP8—Changes in control and portfolio transfers	While the BMA has strengthened the criteria and requirements for approving changes in control, it does not require that insurers obtain its approval for portfolio transfers. To safeguard the interests of the policyholders of both the transferee and transferor, the authority should at least be notified of portfolio transfers and be given veto power on such transfers.
ICP9—Corporate governance	The corporate governance framework is in place, supported by a formalized on-site inspections program, including assessment of the adequacy and actual implementation of insurers' corporate governance. The on-site program will be progressively implemented in Class 3 and long-term insurers. The BMA is advised to provide formal guidance to insurers on its expectations with regard to the remuneration policy for directors and senior management.
ICP10—Internal controls	The BMA's guidance on risk management and internal controls sets out its expectations of insurers in these areas clearly. The on-site inspections program has started in Class 4 in 2006 and will be progressively implemented in Class 3 and long-term insurers. This will help the BMA have a better understanding of insurers' internal controls. In line with international best practices, the BMA is advised to require loss reserve specialists and the approved actuary to have a direct reporting relationship to the board of directors.
ICP 11—Market analysis	Given the international operations of Bermudian insurers, the BMA is actively monitoring and analyzing available information to identify current and emerging trends in the global insurance markets. Its market analysis will be strengthened by enhanced regulatory reporting and the planned increase in resources.
ICP12—Reporting to supervisors and off-site monitoring	The BMA has made significant progress in strengthening its regulatory reporting and off-site monitoring. It should continue to push forward its proposal to enhance the comprehensiveness of reporting by insurers. The BMA should give due consideration to a) improving the timeliness of reporting by introducing quarterly reporting that would focus on key indicators and appropriate management reports; b) requiring insurers to submit information about their financial condition and performance on both a solo and a group-wide basis; and c) clarifying that all insurers must maintain proper books of accounts in Bermuda.
ICP13—On-site inspection	The BMA conducts on-site inspections as part of its risk-based supervisory regime introduced in 2006. This program will be progressively extended to Class 3 and long-term insurers.
ICP 14—Preventive and corrective measures	The IA empowers the BMA to take a range of proportionate intervention powers with clearly defined triggers and conditions. The BMA takes a measured approach to assessing the severity of the concerns and works with the insurers to take appropriate remedial measures.
ICP15—Enforcement or	The BMA has wide ranging powers to enforce the IA and impose sanctions for breaches of the IA, or to address serious regulatory

Insurance Core Principle	Comments
sanctions	concerns.
ICP16—Winding-up or exit from the market	Winding-up and exits have been administered without disruptions to the market. Nonetheless, the BMA should give due consideration to clarifying the priority of policyholders' claims for grandfathered composite insurers and insurers allowed to undertake non-insurance related business within the same legal entity. The BMA should also formulate a clear policy stance on insurers' credit facilities and the conditions under which they are allowed to encumber/pledge assets held for the benefit of policyholders.
ICP17—Group-wide supervision	Recognizing the significant number of large Bermuda-based insurance groups, early formulation and implementation of a pragmatic and effective regime for group supervision helps to reduce regulatory risks to the BMA.
ICP18—Risk assessment and management	The BMA has provided guidance to insurers on its expectations on their risk assessment and management. On-going inspections of Class 4 insurers facilitate practical assessment of their risk management frameworks, and this will be extended to Class 3 and long-term insurers. The BMA is advised to consider formulating a regulatory stance on functions outsourced by an insurer, including powers to inspect third party service providers.
ICP19—Insurance activity	While the BMA requires insurers to evaluate and manage their underwriting risks, there is scope for clearer guidance on adequacy of reinsurance arrangements as well as treatment of reinsurance recoverables.
ICP20—Liabilities	The BMA relies on the LRS or approved actuary to opine on insurers' technical provisions. In this regard, the authority is advised to work closely with the relevant professional associations to issue guidance on the basis and adequacy of technical provisions. Valuation of the amounts recoverable under reinsurance arrangements should be clarified.
ICP21—Investments	The BMA has outlined the standard expected of insurers' investment management and risk management. It should consider establishing clear guidance on asset-liability management, concentration risks and asset valuation as part of its risk-based capital framework.
ICP22—Derivatives and similar commitments	The regulatory requirements for insurers to adopt sound and prudent policies and processes for derivative activities are in place. To allow monitoring of insurers' exposures, the BMA should establish disclosure requirements for derivatives and similar commitments.
ICP23—Capital adequacy and solvency	The current solvency regime is factor-based with an enhanced threshold of B$100 million for Class 4 insurers. It does not address inflation of capital (through double or multiple gearing or intra-group transactions) and suitable forms of capital resources. The BMA is currently consulting Class 4 insurers on a risk-based solvency regime.
ICP24—Intermediaries	The BMA's requirements are appropriate for Bermuda's small domestic market and close proximity, which effectively reduces the role of intermediaries at the retail level.
ICP25—Consumer protection	The current regime for consumer protection is adequate for the retail segment accounts for a negligible 0.1 percent of total NWP of the

Insurance Core Principle	Comments
	industry.
ICP26—Information, disclosure and transparency towards markets	To facilitate market discipline, the BMA should formulate plans to implement the IAIS supervisory standards on public disclosures.
ICP27—Fraud	Insurance fraud is effectively covered under the Criminal Code and the Proceeds of Crime Regulations. The BMA's review of insurers' risk management and internal controls helps to identify and manage fraud risks.
ICP28—Anti-money-laundering, combating the financing of terrorism	Not assessed.

Recommended action plan

Table 2. Recommended Action Plan to Improve Observance of the Insurance Core Principles

Principle	Recommended Action
ICP 3—Supervisory Authority.	Consider: a) public disclosure of information about problem or failed insurers, including supervisory actions taken without compromising confidentiality considerations; and b) strengthening measures to ensure that, where supervisory functions are outsourced, potential conflict of interests is minimized.
ICP4—Supervisory process.	Review the relevance of Class 3 category after the BMA has gained experience with the risk-based supervisory framework, that provides greater granularity.
ICP 5—Supervisory cooperation and information sharing.	Implement routine arrangements to alert host supervisors of material supervisory developments in Bermuda, formalize the informal exchanges with state insurance regulators in the U.S. and consider joint inspections with foreign regulators.
ICP 8—Changes in control and portfolio transfers.	Require insurers to notify portfolio transfers subject to the BMA's veto power on such transfers.
ICP 9— Corporate governance.	Provide formal guidance to insurers on its expectations with regard to the remuneration policy for directors and senior management.
ICP 10—Internal controls.	Require loss reserve specialists to have a direct reporting relationship to the board of directors.
ICP 12—Reporting to supervisors and off-site monitoring.	Consider: a) improving the timeliness of reporting by introducing quarterly reporting focusing on key indicators, on unaudited basis; b) requiring insurers to submit information about their financial condition and performance on both a solo and a group-wide basis; and c) clarifying that all insurers must maintain proper books of accounts in Bermuda.
ICP16—Winding-up or exit from the market.	Clarify the priority of policyholders' claims for grandfathered composite insurers and insurers allowed to undertake non-insurance related business within the same legal entity. Formulate a clear policy stance on insurers' credit facilities and encumbrances of assets held for the benefit of policyholders.
ICP17—Group-wide supervision.	Formulation and implementation of a pragmatic and effective regime for group supervision.
ICP18—Risk assessment and management.	The BMA is advised to consider formulating its regulatory stance on functions outsourced by an insurer, including powers to inspect third party service providers.
ICP19—Insurance activity.	Clearer guidance on adequacy of reinsurance arrangements as well as treatment of reinsurance recoverables.
ICP20—Liabilities.	Work closely with the relevant professional associations to issue guidance on the basis and adequacy of technical provisions and clarify valuation of the amounts recoverable under reinsurance arrangements.
ICP21—Investments.	Establish clear guidance on asset-liability management, concentration risks and asset valuation as part of its risk-based capital framework.
ICP22—Derivatives and similar commitments.	Establish disclosure requirements for derivatives and similar commitments.
ICP26—Information, disclosure and transparency towards markets.	To facilitate market discipline, the BMA should formulate plans to implement the IAIS supervisory standards on public disclosures.

Authorities' Response to the Assessment

The Authority is pleased that the IMF Assessment has recognized the effectiveness of the regulatory framework put in place in Bermuda, and the significant work that has been undertaken since the last IMF Review in 2003.

At the same time, in anticipation of the new international standards as a result of initiatives such as Solvency II, Bermuda has moved swiftly to even further develop and enhance a number of aspects of its regulatory regime, consistent 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 2009. Certain amendments to the Insurance Act 1978 have been enacted, in particular underpinning the ability of the Authority to clarify aspects of the regulatory requirements and standards through codes of conduct to the industry. Moreover, the Authority has taken a number of steps to further enhance the effectiveness of its insurance regime including: significant increases in qualified technical staff; extending the risk-based model and further enhancement of the on-site elements of the regulatory regime to all classes, including the captives. Through these and other initiatives currently in train, the Authority is confident that it will continue to maintain a high degree of compliance with the relevant international standards.

More specifically, the Authority has been in a period of significant growth in staffing resources and has targeted further increases in supervisory and other resources for the remainder of 2008. These efforts have meant we have increased the size of our insurance and banking, trust and investment supervisory teams; have developed an independent risk and policy unit; have set up a dedicated insurance run-off team and have created an in-house actuarial unit. The Authority is making a significant investment in learning & development in its staff with a multi-tier program of core, intermediate, and specialist training, and sponsored study and accreditation.

The Authority values maintaining a strong working relationship with its external stakeholders in the various segments of the insurance industry. We will shortly publish a statement of policy on our approach to consultation with industry to set out a transparent framework for engaging with stakeholders on legislative and regulatory change. In our supervisory operations, our increased resources and enhanced on-site risk assessment and solvency frameworks allow the Authority to engage in a challenging dialogue with individual firms.

Since the IMF assessment mission, the Authority has made further progress in the roll-out of its supervisory program for insurance, including further on-site assessment, enhanced solvency standards, and specialist risk reviews. Our 2008–09 Business Plan sets out the Authority's road-map to implement the remaining elements of the framework.

The Authority's existing risk-based framework allows it to assess group governance, controls and risk management arrangements as part of its solo supervisory monitoring. The Authority's 2008–2009 Business Plan sets out our intention to publish a discussion paper on insurance group supervision in the first quarter of 2009 and to move to implement a group supervision framework by 2011. In the meantime, the Authority is hosting a number of supervisory colleges to facilitate supervisory co-operation on our largest insurance companies.

Following the IMF assessment mission, the Authority has introduced a requirement for Class 4 insurance companies to publish their GAAP accounts. The Authority will consult on extending this requirement to the largest Class 3 companies and on further types of disclosure. The Authority is also in the process of reviewing and considering the appropriateness of other risk disclosures to enhance transparency.

In addition to building specialist risk capabilities, the Authority required Class 4 insurers to file the new risk-based capital model (Bermuda Capital Solvency Requirement) for the 2007 year-end. The model was accompanied by substantial risk and forward looking disclosures. Class 4 insurers were also required to file prescribed stress and scenario tests. Further, the Authority has designed an in-house system independent of the Bermuda Capital Solvency Requirement to evaluate the robustness of both the capital model and insurers' ability to sustain catastrophic losses at varying levels. More comprehensive legislation with respect to the risk-based solvency regime was passed in July 2008. The legislation makes provision for the internal models of Class 4 insurers to be approved for the calculation of regulatory capital requirements upon satisfying certain criteria.

The legislation also subdivides the existing heterogeneous Class 3 sector into three separate classes (captives, small commercial and large commercial) to enhance the risk-based approach applied to the Authority's insurance register.

ANNEX II: ROSC for the FATF's Recommendations for AML/CFT

Bermuda: Report on Observance of Standards and Codes—FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)

Introduction

53. This report on the Observance of Standards and Codes (ROSC) for the FATF 40 Recommendations for Anti-Money Laundering (AML) and 9 Special Recommendations Combating the Financing of Terrorism (CFT) was prepared by the International Monetary Fund (IMF). The report provides a summary of the AML/CFT measures in place in Bermuda, the level of compliance with the FATF 40+9 Recommendations, and contains recommendations on how the AML/CFT system could be strengthened. The assessment is based on the information available at the time of the mission from May 7–23, 2007 and was conducted using the 2004 Assessment Methodology. The Detailed Assessment Report (DAR) on which this ROSC is based was adopted by the Caribbean Financial Action Task Force (CFATF) on November 23, 2007. The views expressed in this document, as well as in the detailed assessment report (DAR), are those of the IMF mission team[27] and do not necessarily reflect the views of the Government of Bermuda or the Executive Board of the IMF.

Key Findings

54. **There has not been much change in Bermuda's AML/CFT regime since the AML legislation and guidance notes (GNs) came into force in 1998, and the last IMF assessment in 2003.** Apart from a few changes to the POCA and the GNs, the only significant new legislation enacted was the Anti-Terrorism (Financial and Other Measures) Act 2004 (ATFA). New draft GNs, prepared soon after the last IMF assessment, are still to be finalized and implemented. Therefore, the current AML/CFT regime has not kept pace with changes in the FATF Recommendations, and the authorities have been slow in implementing a number of key recommendations from the last IMF assessment, particularly with respect to the financial and non-financial sectors. At the time of the mission, several pieces of new legislation were under consideration by parliament to address a number of weaknesses in the regime as described below.

55. **The lack of sufficient reforms to the AML/CFT regime has also limited Bermuda's ability to apply risk-sensitive approaches to preventive measures for financial institutions (FIs), as permitted under the FATF Recommendations.** In Bermuda's case, the application of risk-based approaches seems particularly relevant, not only with respect to insurance—which is the most significant sector—but also in other types of financial and non-financial activities. The AML Regulations and GNs contain exemptions or simplified customer due diligence (CDD) provisions, but lower risk has not been proven in all cases. Furthermore, some of the exemptions are clearly inappropriate. Implementation of

[27] The mission team comprised Manuel Vazquez, Antonio Hyman Bouchereau (both IMF), Ross Delston, and John Abboth (both consultants).

the recently passed legislation (post-mission), proposed regulations, and GNs will address some of the identified weaknesses in the preventive regime and, as contemplated, can provide for a more risk-based approach to compliance and supervision.

Legal Systems and Related Institutional Measures

56. **The criminalization of money laundering (ML) and the financing of terrorism (FT) are generally comprehensive, with offenses applying to both natural and legal persons, and to the requisite predicate offenses.** However, it is difficult to assess effectiveness of the legal framework given that there has been only one prosecution for ML in the last five years, as well as limited ML investigations. With respect to FT, no criminal investigations relating to terrorist activities, their financing, or the provision of support to them have been referred to the courts in Bermuda and there have been no FT-related suspicious activity reports (SAR) filed.

57. **Under current law, protections from civil liability, but not explicitly from criminal liability, apply only to those who file ML-related SARs**. In addition, regulated institutions who file FT-related SARs are not explicitly protected from either civil or criminal liability. The tipping-off offense is narrowly focused on investigations, rather than explicitly prohibiting disclosures relating to a SAR being filed or the contents of the SAR.

58. **The legal framework for investigation and prosecution of ML is well-developed, and law enforcement and prosecutorial staff are highly motivated and professional.** However, the staffing constraints in the office of the Director of Public Prosecutions (DPP) and the Financial Intelligence Unit (FIU) may have contributed to a low number of ML investigations, limiting their ability to carry out their AML/CFT tasks effectively. In practice, only a small number of SARs that are analyzed are fully investigated.

59. **Following Parliament's recent enactment of the Financial Intelligence Agency Act 2007 (the FIA Act which is still to be put into effect), a new administrative agency (the FIA) is in the process of being organized to take on the responsibilities of the current FIU that is part of the Bermuda police**. To prevent an interruption in transfer of responsibilities, the BMA should provide for a suitable period of transition where the FIU remains tasked with financial intelligence functions until the FIA is fully operational. All police officers within the FIU have training in basic financial investigations, and most have been trained in areas such as confiscations, money laundering, and advanced financial investigative techniques. However, the current volume of work impacts the effectiveness of the FIU in undertaking timely analysis and investigations. In this regard, the FIU should be sufficiently staffed and provided with additional technical resources—including expertise in forensic accounting—during the transitional period to avoid operational gaps and to efficiently manage the transfer of the intelligence-related tasks to the FIA.

60. **At the time of the mission, three important draft laws were under consideration that were enacted in June 2007.** These are amendments to the POCA, the Criminal Justice

International Cooperation (Bermuda Act), and the FIA Act. Once implemented, these new laws will address a number of the weaknesses in the AML/CFT legal framework identified by the mission.

Preventive Measures—Financial Institutions

61. **The scope of the AML regulatory framework does not address CFT issues, and does not cover key areas of the financial sector, including life insurance business and certain elements of the investment/mutual funds sector.** The lack of coverage in these areas constitutes an important deficiency in Bermuda's AML/CFT regime, particularly in light of its role in the international financial system, even though life insurance does not account for the largest share of this sector. The POCA Regulations and GNs remain practically unchanged since the last IMF assessment mission in 2003, despite the weaknesses previously identified, a major upgrade of the international AML/CFT standards in 2003, and continued growth in the financial services industry. At the time of the mission, the BMA had prepared draft new regulations and was contemplating amending the GNs, pending passage of proposed new legislation that was to be passed subsequent to the mission.

62. **The regulatory framework for FIs lacks basic CDD requirements, and risk-based approaches to compliance and supervision are underdeveloped.** CDD requirements are narrowly focused on customer identification, and there are no provisions for complying with key CFT recommendations such as those for wire transfers. These and other deficiencies do not facilitate effective implementation, supervision, and enforcement. In addition, the GNs (which are non-enforceable) do not provide sufficient guidance for purposes of implementing broad-based CDD, and contain a number of customer identification provisions that could be detrimental to compliance. A key challenge also lies in the ability of FIs headquartered in Bermuda to implement and monitor their global operations. Increased attention should be given to the management of cross-border ML and FT risks, especially those associated with business relationships and transactions introduced through local and foreign intermediaries. In addition, compliance with recordkeeping requirements can be strengthened, including for beneficiary clients and business relationships established before the AML/CFT legislation was introduced.

63. **A key strength of Bermuda's supervisory regime is the integrated nature of financial sector supervision by the BMA and the professionalism of its staff.** The BMA has a relatively strict licensing regime, which has contributed to the stability of its financial sector. Nonetheless, AML/CFT supervision is still developing particularly with respect to on-site inspections. While the BMA continues to improve its supervisory systems and processes, enhanced capacity, skills, and resources are required to strengthen AML/CFT supervision, particularly on-site inspections in key industries, namely the insurance and investments services sectors. The BMA also faces practical constraints in its ability to effectively conduct ongoing consolidated AML/CFT supervision, especially in the insurance sector and on a cross-border basis. This will require careful resource management and increased collaboration with other key players such as external auditors and overseas regulators. The conduct of sector-specific ML and FT risk assessments should be considered to better

manage the supervisory process, identify supervisory priorities, and more efficiently allocate resources.

64. **There is good cooperation between the BMA and the financial sectors, but the absence of specific sanctions for AML/CFT breaches limits the effectiveness of the BMA's compliance oversight regime.** To this end, more focused risk-based AML/CFT inspections should be conducted and, where necessary, enforcement action taken. The BMA has started to develop more broad-based on-site supervisory programs, which should be expedited across all sectors. Following a risk-based approach, the BMA should enhance the focus of its on-site procedures to reviewing compliance with CDD requirements for beneficial customers, including more rigorous enforcement of such requirements for accounts in existence when the AML regime was introduced in 1998.

65. **The BMA has a wide array of formal sanctioning powers available to it but has never imposed them against a FI for a deficiency or violation of AML/CFT requirements.** The practice has been for the BMA to apply moral suasion and less formal approaches to enforcement of compliance with these and other requirements, generally through the issue of warning letters, and these have been used only in a few cases.

D. Preventive Measures—Designated Non-Financial Businesses and Professions (DNFBP)

66. **A comprehensive AML/CFT framework for DNFBPs was only beginning to be put in place at the time of the mission.** Only trust service providers were subject to AML/CFT preventive measures including for monitoring compliance with these requirements. Other relevant DNFBPs are subject to the general requirement to report suspicious activities that applies to all citizens in the course of their business or profession. However, in the absence of an effective system of preventive measures and compliance oversight, these requirements are not being effectively implemented. It is rare that DNFBPs, other than trust services businesses, file SARs even though, as mentioned above, there is a general obligation on all persons to report.

67. **The ML and FT vulnerabilities related to activities of lawyers, accountants, trust service providers, and company service providers have not been closely analyzed, although they are key gateways to the highly sophisticated and internationally active financial sector of Bermuda.** Although there is little analysis to back this up, the risks of ML and FT through these sectors are generally perceived by the professions to be low. Regulation and supervision of the trust service business (TSB) mitigate against these risks in trust operations. In addition, relatively strict requirements and procedures for the incorporation of Bermudian companies also reduce the potential for ML and FT in this sector.

68. **Local drug traffickers utilize the proceeds of drug trafficking to facilitate further drug shipments, as well as to acquire assets.** Investigations related to possible confiscation orders frequently find that drug traffickers have used their proceeds to invest in local property, generally at the lower to middle end of the market, and frequently through the use of nominees. Car purchases are also a common use of the proceeds of drug trafficking.

Access by nonresidents to the Bermuda property market is tightly restricted which may limit the attractiveness of this sector for international money launderers.

69. **Plans are well-advanced to bring lawyers and accountants in public practice, as well as corporate service providers, within the AML/CFT preventive regime, but supervisory arrangements are not yet agreed.** These plans include amendments to the POCA that were enacted by the legislature subsequent to the mission, and draft amendments to the POC Regulations which should include lawyers and accountants under the preventive regime. The provisions being adopted fall short of FATF standards in several respects, particularly in regard to the scope of activities of lawyers and accountants that would be subject to AML/CFT requirements. The scope of activities of lawyers and accountants that are subject to AML/CFT preventive measures is narrower than called for under the FATF Recommendations.

Legal Persons and Arrangements & Non-Profit Organizations (NPOs)

70. **Bermuda is not a significant jurisdiction for the incorporation of companies, and there are a range of controls to mitigate the risk that legal entities and trust arrangements will be misused for illicit purposes.** Incorporation of Bermuda companies requires that ultimate beneficial ownership be established twice before registration is accepted; once by the party submitting the application (who would normally be a lawyer), and again independently by the authorities. Companies are required to maintain a register of shareholders that is accessible to the public. With respect to trusts, any person offering trust services as a business is required to be licensed and supervised by the BMA as an FI. TSBs are required to establish the identity of parties to a trust relationship including settlors and ultimate beneficiaries. Law enforcement can gain full access to such CDD information and can share it with foreign authorities.

71. **Ongoing oversight of charities is light but compliance with legal requirements appears to be good.** In the NPO sector, charities are required to register if they are to raise money from the public. Most funds raised in Bermuda are applied in Bermuda and the vulnerability of the sector to ML and FT appears to be low. However, no risk assessment has been undertaken and AML/CFT is not a focus in the oversight of the charities sector.

National and International Co-operation

72. **Bermuda has a comprehensive legal and institutional framework for international cooperation that is largely consistent with international standards, but there is a lack of conventional national cooperation mechanisms among governmental institutions on AML/CFT.** The National Anti-Money Laundering Committee (NAMLC) brings together key ministries and departments, and fills in practice, the AML/CFT policy formulation role in Bermuda. NAMLC’s main legal mandate is, however, to advise the MOF and to issue industry guidance on AML issues, not to coordinate the formulation and implementation of AML/CFT policy. This situation may have contributed to the slow pace of legal and institutional reforms since the last IMF assessment in 2003.

E. Other Issues

73. **The Suppression of the Financing of Terrorism (SFT) and Palermo Conventions have not been extended to Bermuda by the U.K.** While this is not entirely within the power of Bermuda to address, it is a situation that should be remedied without delay.

74. **Bermuda does not have a declaration or disclosure system in place for the physical cross-border transportation of cash and bearer instruments.** While the authorities have plans to implement such a system, it should, inter alia, provide for the declaration of both incoming and outgoing transfers.

Table 6. Summary Table of Observance and Key Recommendations[28]

FATF 40+9 Recommendations 1/		Key Assessor Recommendations
I. Legal System and Related Institutional Measures		
Criminalization of Money Laundering		• Increase investigations and prosecutions in order to maintain an effective AML/CFT framework, particularly given that there has only been one prosecution of ML in the last five years and limited numbers of ML investigations. • Fines under POCA with respect to summary convictions and certain convictions on indictment should be substantially increased.
R.1	LC	
R. 2	LC	
Criminalization of Terrorist Financing		• Amend the ATFA's definition of terrorism to include/cover (i) the acts covered by the nine conventions referred to in the SFT Convention; (ii) acts taken against international organizations; (iii) a reference to the financing of terrorist organizations; and (iv) extra-territorial acts relating to terrorist organizations.
SR.II	PC	
Confiscation, freezing, and seizing of proceeds of crime		• Explicitly provide in legislation that, for the purposes of confiscation of the benefits of ML offenses, the proceeds that are the basis of the offense may include any payments received by the defendant at any time in connection with the ML offense carried out by him or by another person. • With respect to the voiding of contracts, explicitly provide the authorities with the means to prevent actions to hinder the recovery of property subject to confiscation.
R.3	PC	
Freezing of funds used for terrorist financing		• Issue guidance to the financial services community concerning affirmative obligations to freeze assets of persons listed by the UNSCR 1267 Committee and the EU. • Develop and publish procedures for delisting requests and the unfreezing of funds associated with FT.
SR.III	PC	
The Financial Intelligence Unit and its functions		• The new FIA should be established and made operational, and provided with sufficient staff to enable an increased number of ML/FT-related investigations. • Maintain the level of experience and skills in financial investigations unit of the
R.26	LC	

[28] More comprehensive recommendations are provided in the DAR.

FATF 40+9 Recommendations 1/		Key Assessor Recommendations
		Commercial Crime Department.
Law enforcement, prosecution and other competent authorities		• Investigating and prosecuting ML/FT cases should be made a higher priority by law enforcement authorities, with sufficient resources allocated reflecting that priority**.**
R. 27	LC	
R.28	C	
Cross Border Declaration or disclosure		• Implement the currency declaration system now being considered by the authorities to include both outgoing and not just incoming transportation of currency as currently planned; • Substantially increase the scale of civil money fines and criminal penalties for customs violations; • Ensure sufficient information-sharing between Customs and other law enforcement authorities; • Consider: (i) granting the Customs Department with explicit legal authority to seize, detain, and confiscate currency in the event of a false declaration; and (ii) developing a procedure to notify other customs agencies of search and detention reports relating to precious metals and stones other than gold.
SR IX	NC	
2. Preventive Measures: Financial Institutions		
Risk of money laundering or terrorist financing		• Conduct a systemic review of ML and FT risks, particularly in the financial and DNFBP sectors, including in the life, annuity/investment, and captive components of the insurance sector.
Customer due diligence, including enhanced or reduced measures		• Extend the AML/CFT requirements to key sectors of the economy including life insurance business and expand its coverage in the investments (mutual funds) sector. • Extend the CDD requirements beyond customer identification, explicitly cover CFT issues, and reduce the CDD threshold for wire transfers to US/BD$1,000. • Require FIs to conduct enhanced CDD and monitoring for higher risk business (including for politically exposed persons and respondent banks) and require regular updating of CDD information. • Require FIs to address risks associated with non-face-to-face business relationships
R.5	NC	
R.6	NC	
R.7	NC	
R.8	NC	

FATF 40+9 Recommendations 1/		Key Assessor Recommendations
		or transactions, and to implement measures to prevent misuse of technological developments that could facilitate ML/FT.
Third parties and introduced business		• Enhance CDD and documentation requirements for FIs when relying on third parties, particularly when they are based in other countries.
R.9	NC	
Financial institution secrecy or confidentiality		• Consider amending the five regulatory acts and the BMA Act to provide gateways for disclosures to the FIA.
R.4	NC	
Record keeping and wire transfer rules		• Explicitly include AML/CFT recordkeeping requirements in the regulatory laws and require in the Guidance Notes the need to retain transaction records beyond details of securities and investments transactions. • Reduce the minimum recordkeeping threshold for wire transfers to the equivalent of US$1,000, and require that full originator information be obtained and retained for the minimum period in accordance with SR VII. • Include lack of complete originator information as a basis for determining whether a suspicious activity report is filed with the FIU.
R.10	LC	
SR.VII	NC	
Monitoring of transactions and relationships		• Require FIs to monitor and record information on complex, unusually large, or unusual patterns of transactions that have no apparent economic or lawful purpose. • Require FIs to pay special attention to relationships/transactions with persons from countries that which do not sufficiently apply the FATF Recommendations.
R.11	NC	
R.21	NC	
Suspicious transaction reports and other reporting		• Extend explicit protection against criminal liability for filing SARs. • Extend the “tipping-off” offense to explicitly cover any information about a SAR filing and the contents, and limit the scope of the exemption granted to lawyers. • Develop guidance for FIs and DNFBP relating to latest industry-specific typologies and additional preventive measures.
R.13	PC	
R.14	PC	
R.19	C	
R.25	PC	

FATF 40+9 Recommendations 1/		Key Assessor Recommendations
SR.IV	PC	
Internal controls, compliance, audit and foreign branches		• Explicitly require FIs to implement comprehensive AML/CFT policies, procedures, and controls, including for the full range CDD and recordkeeping requirements (See R. 5 and R. 10). • Expand the role of the AML/CFT compliance function beyond suspicious activity reporting and require internal audit to cover AML/CFT issues. • Expand the scope of the staff training requirements and include employee screening requirements for AML/CFT purposes. • Require implementation of AML/CFT measures in overseas branches and subsidiaries, including the need to inform the Bermudian authorities when their overseas operations cannot observe appropriate AML/CFT measures in the host countries.
R.15	PC	
R. 22	NC	
Shell banks		• Introduce an explicit prohibition on the licensing of shell banks and explicitly require banking entities to maintain a significant presence in Bermuda.
R.18	LC	
Supervisory and oversight system–competent authorities and SROs		• Enact legislation for civil money penalties and conservatorship powers to be applied by the BMA, and increase fines with respect to summary convictions and certain convictions on indictment. • Review the effectiveness of enforcement and sanctioning practice for AML/CFT. • Implement comprehensive risk-based AML/CFT off-site and on-site supervision processes, including on a consolidated basis across all sectors. • Enhance the on-site review of the sufficiency and quality of SAR reporting systems, and consider expanding the role of external auditors for AML/CFT purposes. • Expedite the licensing/registration process for money services firm(s) and review regulatory provisions for agents/subagents of remittance firms. • Conduct a systemic review to ascertain the existence of financial activities covered by the FATF Recommendations not subject to the current AML/CFT regime, e.g. leasing operations. • Update the GNs for relevance to the FATF Recommendations and the current needs
R. 17	PC	
R.23	NC	
R.25	PC	

FATF 40+9 Recommendations 1/		Key Assessor Recommendations
		of industry. • Establish an explicit mandate for the BMA to monitor, enforce and sanction for compliance with the AML/CFT legal obligations.
Money value transfer services		• Require money transfer services, when licensed, to maintain a list of their agents.
SR.VI	PC	
3. Preventive Measures: Nonfinancial Business and Professions		
Customer due diligence and record-keeping		• Require lawyers, accountants, company service providers, dealers in precious metals and stones including jewelers, and real estate agents to implement appropriate AML/CFT programs consistent with the FATF Recommendations. • Provide adequate powers for the designated supervisor to review and enforce AML/CFT requirements for DNFBPs irrespective of any SRO arrangements. • Familiarize DNFBPs with their responsibilities and obligations under proposed new AML/CFT laws and regulations.
R.12	NC	
Suspicious transaction reporting		• Ensure that the SAR reporting requirement conforms to the applicable FATF Recommendations., including for legal professionals. • Revise relevant legislation with respect to tipping off prohibitions for lawyers, in order to protect the confidentiality of SAR information. • Apply the preventive measures under the FATF Recommendations. to DNFBPs including the need to have policies, procedures, and controls to monitor and report suspicious transactions.
R.16	NC	
Regulation, supervision, monitoring, and sanctions		• Implement effective supervisory arrangements for DNFBPs, including powers for the supervisors to monitor and sanction, and adequate resources to carry out the supervisory function. • Introduce updated guidance for all DNFBPs.
R.24	NC	
R.25	PC	

FATF 40+9 Recommendations 1/		Key Assessor Recommendations
Other designated nonfinancial businesses and professions		None.
R.20	C	• Require money transfer services, when licensed, to maintain a list of their agents.
4. Legal Persons and Arrangements and Nonprofit Organizations		
Legal Persons–Access to beneficial ownership and control information		None.
R.33	C	
Legal Arrangements–Access to beneficial ownership and control information		None.
R. 34	C	
Nonprofit organizations		• Review applicable laws and regulations related to NPOs to help prevent their use for financing of terrorism. • Establish recordkeeping requirements for NPOs in line with SR VIII 3.4. • Implement measures to enable effective investigation and access to information on NPOs, as called for in SR VIII.4
SR.VIII	PC	
5. National and International Cooperation		
National cooperation and coordination		• Appoint a national AML/CFT coordinator and energize the policy development role of the NAMLC. • Develop and implement systematic mechanisms for coordination among and between all the relevant AML/CFT agencies and departments.
R.31	PC	
The Conventions and UNSC Resolutions		• Request that the U.K. extends the SFT and Palermo Conventions to Bermuda.
R.35	PC	
SR.I	PC	

FATF 40+9 Recommendations 1/		Key Assessor Recommendations
Mutual Legal Assistance		• Amend the relevant statute(s) to provide for external confiscation requests relating to instrumentalities used in a commission of an ML, FT, or other predicate offenses. • Arrangements for coordinating seizure and confiscation actions with other countries should be formalized. • Improve collection of information on mutual legal assistance and international requests for co-operation.
R.36	LC	
R.37	C	
R.38	LC	
SR.V	C	
Extradition		• Consider developing procedures facilitating expeditious action be taken or establishing precise timelines for response to MLA requests, including for extradition. • Review resources available at AGC and Police/FIU to ensure that MLA requests are acted upon in as efficient a manner as possible. • Improve collection of information on extradition requests.
R.39	LC	
R.37	C	
Other Forms of Cooperation		• Improve collection of data on formal requests to the FIU for assistance, including type of request and whether such assistance was granted. • Consider developing procedures or precise guidelines to facilitate expeditious responses to requests for cooperation.
R.40	C	
6. Other Issues		
Resources and Statistics		• Increase training for all agencies and at all levels, including typologies, analysis and international standards, as well as in fundamentals such as investigating and prosecuting white collar crime cases, managing complex cases, and criminal procedure. • Establish the FIA with adequate funding, staff and technical resources, particularly in terms of analytical expertise such as forensic accounting/auditing. • Enhance training for BMA staff to facilitate the identification of deficiencies relating to AML/CFT requirements for FIs, including, but not limited to internal controls, CDD, SARs filings, recordkeeping, MLRO qualifications. and operations.
R.30	PC	
R.32	PC	

FATF 40+9 Recommendations 1/		Key Assessor Recommendations
		Increased specialization and focus on AML/CFT supervision in the insurance and mutual fund sectors should be given priority. • The BMA should enhance its staff capacity to undertake more comprehensive AML/CFT supervision, including for the conduct of effective consolidated supervision whether as home or host supervisor. • Integrate use of available statistics and information in reviewing the effectiveness of AML/CFT systems on a regular basis.

1/ Compliant (C): the Recommendation is fully observed with respect to all essential criteria.
Largely compliant (LC): there are only minor shortcomings, with a large majority of the essential criteria being fully met.
Partially compliant (PC): the country has taken some substantive action and complies with some of the essential criteria.
Non-compliant (NC): there are major shortcomings, with a large majority of the essential criteria not being met.
Not applicable (NA): a requirement or part of a requirement does not apply, due to the structural, legal or institutional features of a country.

Authorities' Response

The Government of Bermuda is committed to completing the process of updating Bermuda's AML/CFT regime to reflect the most recent developments in financial crime and the revised international standards from the FATF.

Accordingly, the Bermuda authorities welcome the IMF assessment and would like to thank the assessors for their professionalism and diligence throughout the mission. We note the assessors' full recognition of both the robustness of the arrangements developed and applied in Bermuda over many years, and of the very substantial steps already taken by the authorities to further develop our regimes to reflect the revised FATF recommendations.

Bermuda has long had a reputation as one of the world's premier centers for international business and financial services, and our regulation, business practices and legal framework have long provided significant impediments to illicit, unethical, and sharp business dealings.

Equally, the authorities recognize the need to enhance and accelerate Bermuda's current efforts to strengthen the existing AML/CFT regime including the visible reflection of the standards in business systems and processes in the financial sector. The government intends to use the recommendations arising from the report to provide a roadmap for the various enhancements to the AML/CFT regime in Bermuda in both the public and private sectors. Some of the required changes are already in place and many are at an advanced stage of implementation. Still others are currently the subject of further consultation among those concerned, both in the public and private sectors, as we move through the 'to do' list in a risk-prioritized manner. It may be helpful to highlight just a few of the important changes on which the Bermuda authorities have been focusing during 2007:

(1) Three important laws were approved by the Bermuda Legislature in June 2007. These related to amendments to the POCA, the Criminal Justice International Cooperation Act, and a new FIA Act, providing for the establishment of a new autonomous administrative body that will function as a clearing house for SARs. Implementation and effective application of this new legislation will address a number of the specific recommendations made by the assessors for enhancement of our AML/CFT legal framework;

(2) Revised regulations under the POCA were already at an advanced stage of development at the time of the assessment visit. These modified regulations were intended to implement the significant number of aspects of the revised FATF Recommendations which are required to be undertaken by financial institutions and Designated Non-Financial Businesses and Professions through legislation or other enforceable means. Currently these regulations are being further enhanced with a view to achieving an even greater measure of compliance with the final assessors' recommendations;

(3) Authorities have approved the establishment of a National AML/CFT Coordinator to supplement the NAMLC, reflecting an important recommendation of the assessors with a view to ensuring the most effective liaison between all the relevant agencies and providing enhanced impetus to our efforts; and

(4) The Government of Bermuda has developed a detailed plan of action to address outstanding issues in this critical area. The additional private and public sector reforms when fully implemented will ensure that Bermuda's financial sector meets its obligations while maintaining Bermuda's competitive position in the provision of premier financial services to the global community.

ANNEX III: Actions in Response to the Recommendations of the 2003 Assessments

Reference Principles	Recommendations	Actions as of 2007
IAIS Insurance Core Principles (2000)		
Organization of an Insurance Supervisor ICP 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 authorities have not seen a need to implement any change in the legislation. The IA does not make provision for the minister to intervene in insurance supervision. Nor does the provision in the BMA Act empower the minister to give directions to the BMA in relation to insurance supervision. Section 21(1A) of the BMA Act, which provides for ministerial directions to the BMA, has to be read in context. The subsection is contained in the section dealing with the BMA's relations with government. Under that section, the BMA is given functions of advisor to the minister and agent for the government. Those areas fall outside the scope of regulatory acts. Consequently, any direction that the minister might give under that sub-section could only be in relation to those areas and not in relation to supervisory functions of the BMA.
	The BMA should continue to improve its IT system and to recruit staff, both of which are priorities. Knowledge of actuarial techniques should be developed in the staff.	The BMA has carried forward significant IT development projects and is at an advanced stage in the construction of new relational databases providing much enhanced capacity to collate and review statistical and prudential information in support of its supervisory programs. Staffing in the ID, which had already expanded to some 25 by May 2004, has since increased again sharply on the back of significant ongoing recruitment efforts, both in Bermuda and internationally. By July 2007, the department's staff complement had more than doubled to in excess of 50 persons. This development has facilitated, in particular, a major expansion in the BMA's on-site inspection

Reference Principles	Recommendations	Actions as of 2007
		capability. The department has had in-house actuarial resources available to it since 2004; these were augmented from July 2007 with the arrival of two full-time in-house actuaries. The department also formed during 2007 an Insurance Sector Analysis Unit that is tasked with: a) providing actuarial and other support services to the department; b) assisting staff to develop expertise in financial analysis; c) designing tools to facilitate data review and interpretation; identifying international best practice and developing policies consistent with such practice; and closely monitoring industry trends/developments and determining key regulatory implications for the department.
Licensing and Changes in Control ICPs 2–3: Companies wishing to underwrite insurance in the domestic insurance market should be licensed. 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.	It is recommended that consideration be given to increasing the quorum requirements of the IAC Admissions Committee, completing the project to develop explicit fit-and-proper licensing criteria, and defining in detail the requirements of the business plan. The definition of long-term business should be more precise. Significant changes in ownership of public companies should be formally notified to the BMA.	The BMA has established an Assessment & Licensing Committee, charged with reviewing licensing applications and making recommendations to the Supervisor of Insurance. The committee comprises a range of senior management staff from the Insurance and BTI Departments as well as the BMA's Legal Services and Enforcement Department. The IA was amended in 2006, among other things to introduce a specific schedule of minimum licensing criteria, including requirements for all controllers and officers to be fit and proper persons. The act also provides for the BMA to publish a Statement of Principles in accordance with which the BMA acts. This includes a detailed commentary on the BMA's interpretation of the minimum licensing criteria

Reference Principles	Recommendations	Actions as of 2007
		including the fit and proper requirements. The Statement of Principles has been published for market consultation and was adopted formally by the BMA's Board in June 2007. The BMA has also developed a detailed check-list of matters and information that must be covered within a licensing application, including with regard to specifying business plans. Additional amendments made to the IA include the introduction of detailed provisions to deal with the notification and approval of ownership changes and to enable the BMA to take action in relation to a controller who is deemed unfit.
Corporate Governance and Internal Controls ICPs 4–5: It is desirable that standards be established in the jurisdictions which deal with corporate governance. 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.	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. Internal controls should be mentioned explicitly as a regulatory imposition. 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 hand in a detailed written report.	The minimum licensing criteria include requirements for business to be conducted in a prudent manner, which criterion includes a requirement for adequate systems of control. The requirements are further expanded upon in the Statement of Principles as well as in a Guidance Note (GN) on Risk Management and Internal Controls, issued by the BMA in early 2005 and which was reissued in March 2008. The recommendation with regard to interaction with external auditors was predicated on an assumption that the BMA would be looking directly to auditors to conduct additional work in support of the supervisory process. In fact, the BMA has since moved to step up its own in-house resources devoted to on-site inspection, and does not intend to rely routinely on additional work by external auditors.

Reference Principles	Recommendations	Actions as of 2007
Prudential Rules ICPs 6–10: Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction. Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. 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. 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. 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.	The BMA should consider establishing provisions defining the diversification of asset by type, limiting the amounts that can be held by asset and requiring appropriate matching of assets and liabilities. Regulation should require that reasonably secure assets cover adequately calculated insurance reserves. 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). The accounting standard used by the company should be explicitly stated in the statutory filings. A general rule limiting reinsurance recoverables should be set (excluding not rated or below investment grade reinsurers, for example). Regulation should explicitly allow for a premium insufficiency reserve. 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. The actuary’s report should include detailed indications on the method used for reserving and the verifications conducted. The compulsory disclosure of off-balance sheet items would increase the accuracy of the financial statements. The appropriateness of the reinsurance program to	In light of the nature of the Bermuda market, the BMA has not sought to stipulate specific diversification limits. Through the Statement of Principles and current guidance notes, as well as the Code of Conduct whose consultative draft was published in July 2007, the onus is placed on the boards of registered persons to assess and monitor risks effectively and to establish limits for asset allocation as part of their overall internal control environment which are appropriate for the business. The application of the new risk based capital provisions will also have the effect of further reinforcing prudence with regard to asset allocation and distribution through the impact on required regulatory capital. In March 2006, the BMA issued guidance note 14 on the appointment under the IA of a loss reserve specialist, approved by the BMA, whose role is to provide an opinion on the adequacy of general insurance reserves stated in the statutory financial statements. The BMA is at a late stage in the development and implementation of a new risk-based capital regime which will be applied in the first instance to Class 4 companies before being rolled out to those Class 3 companies for which it is appropriate. (See the July 2007 consultative paper). As part of this development, more detailed statutory filings will be required, covering the additional information set out in paragraph 13 of the consultative paper.

Reference Principles	Recommendations	Actions as of 2007
	cover the profile of the risks underwritten should be checked, either by the insurance supervisor or by outsourcing to the auditor. Auditors should systematically write management letters.	
Market Conduct ICP 11: Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills, and integrity in dealing with their customers.	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). 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.	The BMA developed in early 2005 a detailed guidance note on market conduct for domestic business. This material was reissued in July 2007 as part of the consultative draft of the Code of Conduct (Section 9) for which the act now provides.
Monitoring, Inspection, and Sanctions ICPs 12–14: 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. The insurance supervisor should be able to carry out on-site inspections to review the business and company, including the inspection records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the	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, inter alia, data on the liquidation of the provisions. The BMA should require the actuary and/or the loss reserve specialist to give explicit written comments on reserving adequacy. The financial returns should be regularly updated. 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	See earlier comments: the BMA will be introducing a number of amendments to its statutory reporting requirements as part of its ongoing program of updating the insurance regime Class 1 insurers are now required to file financial statements. The BMA has moved over the past 3 years to increase sharply the in-house inspection resources available for on-site work in the commercial sector. Currently there are 4 separate on-site inspection teams deployed. Separate teams also undertake start-up reviews, generally within the first 12 months after licensing, as well as reviews of insurance managers. The amended IA includes ongoing minimum licensing criteria with regard to fitness and properness of controllers and officers and the

Reference Principles	Recommendations	Actions as of 2007
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. 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.	statements with the supervisor. The independent reviewers specifically mandated by the BMA should give the BMA access to their working papers. The BMA must have the capability, either directly or indirectly, of checking the reviewers' working papers. The number of appointed inspectors to conduct on-site inspections should be increased. It is essential that the supervisor be capable of verifying the information given by the company, directly or indirectly. To strengthen the authority to impose sanctions, it is recommended that: 1) Explicit powers be given to 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. Alternatively, it is recommended that the BMA 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 short of initiating insolvency proceedings in court; 2) Legislation be considered to allow the BMA the express legal authority to require the submission of a written recovery plan within a relatively short time. 3) An expanded range of civil penalties may be considered in instances where legal requirements are not met, but the failure to meet them does not rise to the level of criminal conduct.	composition of the board of directors, as well as a requirement for business to be conducted prudently and with integrity and appropriate professional skills. The BMA's intervention powers under section 32 of the act include provision for it to give directions to remove a controller or officer.
Cross-Border Operations, Supervisory	It is recommended that BMA's ability to regulate	The IA provides effective powers for the BMA to

Reference Principles	Recommendations	Actions as of 2007
Coordination and Cooperation, and Confidentiality ICPs 15–17: 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. 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. In order to share relevant information with other insurance supervisors, adequate and effective communication should be developed and maintained. 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. 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.	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. 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 IA along with the relevant parallel BMA Act, for purposes of clarity and organization.	cooperate by sharing information with foreign regulators, as well as powers to obtain information from licensed persons in order to assist another regulator. In practice, these provisions have operated satisfactorily The BMA does not need a bilateral MOU in order to be able to cooperate. It has also confirmed that it will be applying to be a signatory of the IAIS MMOU.
Basel Core Principles for Effective Banking Supervision (1999)		
CP 1.2 Independence	The MOF's powers to give directions to the BMA and the budgetary approval procedure have the	The authorities have reviewed the matter carefully but have not seen a need to implement any change

Reference Principles	Recommendations	Actions as of 2007
	potential of intruding on the operational independence of the latter. It is recommended that the law be reviewed to deal with the concern that the MOF's policy direction and budgetary approval powers may intrude on the performance of the BMA's functions. 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.	in the legislation. The ministerial power of direction in the BDCA is expressly limited to matters of a general policy nature relating to the performance of the BMA's functions under the act, and wording also makes it clear that the BMA could not be directed to act in a manner inconsistent with the duties imposed on it under the act. In practice, it remains the case that no directions have ever been issued. Similarly, following careful review, no changes to the BMA's budgetary process have been determined by government to be necessary. It should be noted that the BMA's proposed expenditure budgets have never been refused or restricted by the MOF.
CP 6 Capital adequacy and CP 12 Market risk	Envisage the replacement of the present proxy system for trading risk by a more appropriate capital requirement system.	The BMA has developed and implemented a full market risk framework, consistent with the Basel requirements, where institutions take on material levels of traded market exposure.
CP 8 Loan evaluation and loan loss provisioning .	The BMA relies principally on external auditors to evaluate the quality of assets and the adequacy of provisioning. BMA should consider undertaking its own evaluation of a bank's internal rating system to gain insight on implementation of credit risk management policies and management's ability to manage and monitor outstanding credit risk.	BMA's on-site reviews of banks' credit quality and processes now include fuller evaluation of their internal classification systems for credits.
CP 10 Connected lending	The BMA should enhance its current policy addressing connected lending by ensuring that banks have satisfactory means to monitor and control these relationships. BMA examiners should routinely review these relationships as part of the on-site examination program	The BMA has issued a revised policy paper, "The Management and Control of Credit Risks and the Implementation of the Statutory Provisions for Large Exposures". The new paper includes greater focus on connected lending issues within the overall assessment of banks' lending policies and controls; this aspect is routinely reviewed as part of on-site

Reference Principles	Recommendations	Actions as of 2007
		examinations of credit.
CP 11 Country risk	The BMA should establish a formal reporting methodology to facilitate the monitoring of country risk exposure in its banks.	Rather than developing standardized reporting, BMA has requested ad hoc reports of country risk exposure from banks. However, standardized reports are likely to be developed as part of the review of banks' reporting that is now underway, as part of BMA's preparations for implementing Basel 2.
CP 13 Other risks	The 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. Issuance of a policy on outsourcing of bank operations should also be considered.	The BMA has issued revised policy papers "The Monitoring and Control of Interest Rate Risk", "The Measurement and Monitoring of Liquidity", and "The outsourcing of Services or Functions by Institutions Licensed under the banks and Deposit Companies Act 1999" . The BMA has also issued a new policy paper, "The Management of Operational Risk". The on-site examination processes and inspection manual have been augmented to cover the requirements of these policies.
CP 16 On-site and Off-site supervision	The maintenance of adequate staff resources remains critical in view of the bank supervision mandate assigned to the BMA. Some further increase in the number of professionals and the breadth of their expertise should be considered. 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. A more standardized regimen to document examination conclusions is also warranted by adopting a more formalized system of working papers reflecting the work performed during on-site examinations.	The BMA has restructured its BTI department to support a risk-based approach to supervision which involves the application of standardized analysis and assessment in order to identify higher risk banks; thereby providing for supervision that is more effective and permitting a more efficient allocation of BMA's resources. There has also been a significant increase in the department's staffing levels, experience, and expertise. Budgeted department headcount has increased from 23 to 28, with presently 4 vacant positions. A comprehensive examination manual has been created that reflects current policy and procedure, and promotes the maintenance of standardized

Reference Principles	Recommendations	Actions as of 2007
		working papers.
CP 18 Off-site supervision	The BMA should consider enhancing the off-site supervision function by analyzing the data obtained in prudential returns more fully, in addition to utilizing the data for checking compliance with law and regulation. The data can be used to compare performance of the banks in the system, analyze trends, and to create an early warning system.	The analysis of data has been enhanced with the restructuring of the department and the creation of a new Risk Analysis Unit. Data received from the institutions, including Prudential Information Returns (PIR), financial statements, management accounts, strategy documents, business plans, and budgets are thoroughly reviewed on a quarterly basis.
CP 19 Validation of supervisory information	It would be useful for the BMA to employ the provisions of section 39 of Banks and Deposit Companies Act, 1999 (BDCA) more widely as a means to increase synergies with external auditors. The BMA could request external auditors to perform additional work to complement the BMA's examination regimen in capital markets activities, information technology, or in other predetermined areas. This would enable the 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.	Reporting accountants have been used routinely for some years to provide reassurance that prudential and statistical data provided by banks are reliable. During 2006, BMA initiated discussions with the Institute of Chartered Accountants in Bermuda (ICAB), with a view to agreeing standard arrangements governing the extension of the section 39 power to include the commissioning of reports on the effectiveness of aspects of institutions' internal control environment. These discussions are ongoing.
CP 22 Remedial measures	Legislation providing the BMA with more direct intervention tools in the event of an impending bank failure should be enacted by the Bermuda government. The BMA should also 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.	The authorities have been carefully reviewing the options for enhancing the tools available to deal with such a situation. Following the mission BMA indicated that it is preparing a consultative paper that will propose the inclusion of new mechanisms in the BDCA. Inspection reports, including findings and recommendations, are now formally addressed to each bank's board of directors.

Reference Principles	Recommendations	Actions as of 2007
IOSCO Objectives and Principles of Securities Regulations		
Principles Relating to the Regulator (P 1–5)	Remove BMAA authority given to the MOF to direct the BMA . Grant BA budgetary autonomy. Create a separate internal process for reporting under the employee code of conduct.	The authorities have not seen a need to implement any change in the legislation. The provision in the BMA Act does not empower the minister to give directions to the BMA in relation to investment supervision. Section 21 (2) of the BMA Act, which provides for ministerial directions to the BMA, has to be read in context. The subsection is contained in the section dealing with the BMA's relations with government. Under that section the BMA is given functions of advisor to the minister and agent for the government. Those areas fall outside the scope of regulatory acts. Consequently, any direction that the minister gives under that subsection could only be in relation to these areas and not in relation to supervisory functions of the BMA. Following careful review, no changes to the BMA's budgetary process have been determined by government to be necessary. It should be noted that the BMA's proposed expenditure budgets have never been refused or restricted by the minister. The BMA amended the staff handbook Personal Dealing Rules and Procedures in January 2006 with reports now being submitted to the Director, Legal Services and Enforcement.
Principles for the Enforcement of Securities Regulation (P 8–10)	Improve authority to inspect collective investment schemes. Create authority to sanction issuers and trading systems.	New primary fund legislation has been introduced. This legislation, among other provisions, provides full powers of information gathering and inspection, which are consistent with those of the IBA 2003. This recommendation has been addressed under the IBA 2003 Part IV. It establishes a framework for

Reference Principles	Recommendations	Actions as of 2007
		the recognition and regulation of recognized investment exchanges and clearing houses by the BMA. The BMA has the power to give directions or revoke recognition in certain circumstances.
Principles for Issuers (P 14–16)	Grant BMA authority and responsibility for regulating all public issuers including review of prospectuses and on-going monitoring of continuous disclosure. Develop insider trade reporting requirements and system of transparency for insider activity. Develop rules related to take-over bids, mergers, changes of control and related party transactions.	Issues of non-listed securities are extremely rare in Bermuda. The authorities are still considering the best approach. The role of the BSX, including its review of listed offerings, is now fully within the ambit of the IBA framework. An insider reporting regime has yet to be implemented by the BSX. Directors of BSX domestic companies are, however, required to state in the company's annual accounts the aggregate number of shares held by themselves and by the company's officers. This is not a priority given the size of the domestic market and low incidence of takeover bids. The authorities are reviewing what approach to take in the medium-term.
Principles for Collective Investment Schemes (P 17–20)	Further develop staff technical skills for inspections. 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.	With the introduction of the IFA, the BMA has also established a dedicated Investment Funds Team headed by a principal with over 10 years of fund administration industry experience and supported by a senior analyst also with direct industry experience. The first Fund Administration licence was issued in June 2007 with new licences expected to be issued during a window ending in March 2008. It is the BMA's intention to conduct start-up on-site reviews for all new licences within 12 months of licensing. We have developed and implemented new primary legislation which, among other matters, provides for fund and prospectus rules. Initial fund and

Reference Principles	Recommendations	Actions as of 2007
		prospectus rules have been introduced and the need for these to be developed further and refined is kept under regular review.
Principles for Market Intermediaries (P 21–24)	Grant BMA clearer inspection rights. Develop staff technical skills for inspections. Develop a contingency plan for failure of an intermediary. Consider carrying out on-site prudential inspections of financial conditions for firms handling client assets.	Clearer inspection rights have been granted to the BMA with the introduction of the new IBA 2003. Following the last IMF inspection in 2003 the BMA has revised its inspection program for IBA licencees to provide clearer guidance for inspections. The BMA has continued to use both internal and external training sources to increase existing staff technical securities industry knowledge and has also focused recruitment to ensure that there is sufficient technical expertise within the relevant team. BTI has recruited two CFA charterholders and is supporting another staff member in their pursuit of this designation. There are very low levels of trading in our domestic market and as such, the development of such a plan is not a high priority. The BMA continues to pay close attention to management information on investment providers' financial condition, which is received regularly from all licencees, including those where audited financial statements are not required.
Principles for the secondary market (P 25–30)	Increase oversight of clearing and settlement systems. Develop staff skills with respect to clearing and settlement and trading systems. Fully dematerialize securities. Develop standards for performance and risk management of clearing and settlement systems. Criminalize insider trading and market	The introduction of the IBA 2003 has granted the BMA for the first time the authority to license and supervise clearing and settlement systems. At this time only the BSX is providing such a system in Bermuda and volumes remain low. In the case of the Bermuda Securities Depository on-going supervision is combined with that of the BSX, which operates the system. The principal heading the team responsible for the

Reference Principles	Recommendations	Actions as of 2007
	manipulation.	supervision of the BSX and BSD is a CFA holder with a decade of trading and securities experience. In addition several members of BTI staff have visited the BSX to familiarize themselves with the operation of the exchange and the BSD. Since the first visit by the IMF team to the BSX all domestic securities have been made depository eligible and can only be traded on the BSX if fungible de-materialized positions are held within the Bermuda Securities Depository. Neither the BSX nor any Bermuda based regulator can force a shareholder to de-materialize a security position under current legislation but it is felt that the current situation provides a realistic and modern approach to this issue. The BSX trading engine (BEST) will not permit an order to enter the market prior to checking the fungibility of a position in the depository. Currently, over 34 percent of all shares issued and outstanding for domestic listed issuers are de-materialized and lodged within the BSD. This percentage within the BSD is in line with the percentage of securities lodged in central depositories in most mature jurisdictions. At this time there is no required reporting of settlement failures and there is no inspection program for the clearing and settlement system. No specific requirements or performance standards have been set for the system. The Criminal Code Amendment Act 2004 introduced the offence of market manipulation and insider dealing.

Reference Principles	Recommendations	Actions as of 2007
	Resolve cash account risk.	It is the BSX's position that the maintenance of payment accounts along with insurance coverage at the individual firm level mitigate systemic settlement failures. The BSX requires that cash and securities held on behalf of clients are held in a fully segregated account from that of the firm. This is industry practice. The BSX is of the opinion that this separation of assets is a very clear ring fence for customers' funds in the event of a financial crisis at a member firm. The BMA is working with the BSX to strengthen its understanding and effective oversight of the exchange, as part of which legal issues over the status of collateral and guarantees will be reviewed.

Annex IV. Authorities' Responses to Key Recommendations

Recommendation	Response
Bermuda Monetary Authority	
The Authority has already made a considerable effort and progress in increasing skilled staff. However, to meet the standard it has set itself of becoming a leading regulator, the Authority must continue to work to attract and retain a range of skilled staff.	The Authority has been in a period of significant growth in staffing resources and has targeted further increases in supervisory and other resources for the remainder of 2008. These efforts have meant we have increased the size of our insurance and banking, trust and investment supervisory teams; have developed an independent risk and policy unit; have set up a dedicated insurance run-off team and have created an in-house actuarial unit. The Authority is making a significant investment in learning and development in its staff with a multi-tier program of core, intermediate, and specialist training and sponsored study and accreditation
Insurance	
The Authority should periodically review its relationship with industry to preserve regulatory independence.	The Authority values maintaining a strong working relationship with its external stakeholders in the various segments of the insurance industry. We will shortly publish a statement of policy on our approach to consultation with industry to set out a transparent framework for engaging with stakeholders on legislative and regulatory change. In our supervisory operations, our increased resources and enhanced on-site risk assessment and solvency frameworks allow the Authority to engage in a challenging dialogue with individual firms. The Authority has implemented other measures to enhance transparency around its independence, including overhauling its licensing process, restructuring to a dedicated Licensing and Assessment Team and related governance structures, with an advisory role for industry subordinate to decision-making by Authority staff.
Supervisors should proceed, as planned, to implement the full rollout of the new supervisory framework .	Since the IMF assessment, the Authority has made further progress in the roll out of its supervisory program for insurance, including further on-site assessment, enhanced solvency standards, and specialist risk reviews. Our 2008–09 Business Plan sets out the BMA's road-map to implement the remaining elements of the framework. The Authority has drafted legislation, expected to be tabled in the Legislature in June 2008, that subdivides the heterogeneous Class 3 sector to facilitate the new supervisory framework to the entire commercial market.
The insurance department should formulate a pragmatic approach, and start closer cooperation with other authorities in order to implement group supervision, given the global systemic nature of the companies headquartered in Bermuda.	The Authority's existing risk-based framework allows it to assess group governance, controls and risk management arrangements as part of its solo supervisory monitoring. The Authority's 2008–2009 Business Plan sets out our intention to publish a discussion paper on insurance group supervision in the first quarter of 2009 and to move to implement a group supervision framework by 2011. In the meantime, the Authority is hosting a number of supervisory colleges to facilitate supervisory cooperation on our largest insurance companies.

Recommendation	Response
The Authority should enhance transparency about companies, including through implementation of the IAIS standard on disclosure	Following the IMF assessment, the Authority has introduced a requirement for Class 4 insurance companies to publish their GAAP accounts. The Authority will consult on extending this requirement to the largest Class 3 companies and on further types of disclosure. The Authority is also in the process of reviewing and considering the appropriateness of other risk disclosures to enhance transparency.
As part of the staffing mentioned above, the Authority will need specialized resources to validate the risk management models of, and communicate effectively with, the companies.	The Authority has already taken steps to improve our specialist risk management resources through the formation of an in-house actuarial team and a separate risk and policy unit. We will continue to build our capability in this area, through a combination of additional recruitment, outsourcing and training of existing staff.
Banking	
Legislation should be enacted to provide the Authority with more direct intervention tools in the case of a troubled bank.	The Authority currently has a wide range of intervention powers for banks. We will however review the detailed recommendations in this area to assess whether further enhancements are required.
AML/CFT	
Update legislation and regulations, and amend procedure and implementation as detailed in the AML/CFT ROSC.	The Legislature enacted AML legislation in the summer of 2007. This comprised the Proceeds of Crime (Amendment) Act 2007: the Financial Intelligence Agency Act 2007; and the Criminal Justice International Cooperation (Bermuda) (Amendment) Act 2007. Since then, the Bermuda authorities have continued to work on further enhancing the jurisdiction's AML/CFT framework, and have prepared additional primary and secondary legislation further amending the Proceeds of Crime Act 1997, the Anti-Terrorism (Financial and Other Measures) Act 2004, and new regulations to replace the Proceeds of Crime (Money Laundering) Regulations 1998. We expect that two bills (Proceeds of Crime (Amendment) Bill 2008 and the Anti-Terrorism (Financial and Other Measures) (Amendment) Bill 2008 will be tabled in the House in July and enacted before the end of that month. The Authority is currently involved in market consultation with respect to a third bill expected to be tabled in the November 2008 Parliamentary session. In anticipation of the bill being enacted, the Authority has issued draft guidance notes for consultation. The bill is expected to broaden the scope of entities falling within the new AML/ATF Regulations and expand the mandate of the Authority in its supervision and monitoring of financial institutions for compliance with AML/CFT requirements.