

GUIDANCE NOTES: RECLASSIFICATION OF BERMUDA CLASS 3 INSURERS

David Doyle & Kent Smith – December 2008

The Bermuda Monetary Authority (“BMA”) has recently issued Guidance Notes in connection with the reclassification of Bermuda’s Class 3 insurers. The Insurance Amendment Act 2008 (“Amendment Act”) came into force on July 30, 2008 and created three new classes of insurers: Class 3A, Class 3B and Special Purpose Insurers. The Guidance Notes provide additional information in connection with the reclassification application process.

All Class 3 insurers qualifying for reclassification are required to submit a reclassification application to the BMA by December 31, 2008. Any Class 3 insurer otherwise qualifying for reclassification as a Class 3A or Class 3B general business insurer that fails to apply for reclassification within the prescribed time may have its registration cancelled by the BMA.

Additionally, it should be noted that all Class 3 insurers (whether or not they meet the new licensing criteria for reclassification) must still submit the prescribed form (Form T-1). Those companies that otherwise would not qualify to be reclassified are required to provide a brief description of why they believe they should remain licensed as a Class 3 insurer. In such cases, no fee will be charged for this filing.

The specific criteria to be applied in determining whether an existing Class 3 insurer qualifies for reclassification as a Class 3A, 3B or Special Purpose Insurer are set out in our June 2008 memo. A copy of this memo is available from the Articles section of our website.

Notwithstanding that the application of these criteria might otherwise indicate a different license classification, the BMA has the power, based on the insurer’s business model, international profile and/or conditions of its license (including Section 56 directions and any other regulatory approvals), to register that insurer in a class for which it may not technically be qualified.

When determining whether or not to exercise this discretion, the BMA will take into account (i) the nature of the intended relationship between the insurer and its policyholders, the interests of those policyholders and of the public generally and (ii) the level of regulation which is applicable to the different classes of insurer. Thus, this could result in an insurer that qualifies to be registered in a class with increased regulatory oversight being permitted to register in a lower class and vice versa.

GUIDANCE ON THE BMA'S APPROACH TO THE RECLASSIFICATION PROCESS

Affiliated Reinsurers

An affiliated insurer or reinsurer currently registered as a Class 3 insurer (ie. an insurer writing affiliated reinsurance business where the ultimate insureds are unrelated to the owners of the business) is registrable as a Class 3A insurer if it only assumes reinsurance from an affiliated ceding insurer. An affiliated insurer will be allowed to assume non-affiliated reinsurance of up to 20% of its total net premium written and continue to be registrable as a Class 3A. However, if an affiliated reinsurer assumes in excess of \$50 million non-affiliated reinsurance, it will be registrable as a Class 3B.

Connected Business

The BMA defines “connected business” as “risk which, in the opinion of the BMA, arises out of the business or operations of those persons or any affiliates of any of those persons”. For the purposes of the reclassification process, connected business will be considered as related party business and shall not be included in the unrelated business percentage when determining the appropriate class of registration.

Should any insurer deem certain lines of its business to be connected business, the insurer must provide with its application a detailed description of the connected business providing a rationale for the business to be considered “connected” for licensing determination purposes. The business shall only be considered connected once the BMA has reviewed the details and issued a connected business certificate.

If a company, based on the amount of connected business written by it, believes that it should remain a Class 3 insurer, it must submit the prescribed form (Form T-1) together with a brief description of why the insurer should remain licensed as a Class 3 insurer.

The following are examples of the types of business that have been deemed to be “connected” by the BMA in the past: Credit and Credit Life; Malpractice Insurance (or other Professional Liability cover) of Non-employed Physicians; Employee Benefits; Risk arising from Joint Venture Projects; Warranty; Collision Damage Waiver; Care, Custody and Control; Agency Business (reinsurance only); and Supplier/Contractor Insurance. This list is not exhaustive and it should not be taken that such lines of business would automatically qualify as connected. An applicant would still need to demonstrate (and the BMA will need to agree) that the risks arise out of the operations of the shareholders or its affiliates.

Premium vs. Loss & Loss Expense Provisions

For the purposes of reclassification, any insurer whose net premiums written and/or loss provisions exceed the 50% unrelated test will be required to re-register as a Class 3A or Class 3B insurer, i.e. if a company is not writing in excess of 50% unrelated net premiums but its booked reserves include over 50% of unrelated loss & loss expense provisions, then that insurer would meet the criteria of a Class 3A insurer and accordingly would be required to make application to re-register. If the insurer is also

exceeding the \$50 million unrelated premium test then it would be required to re-register as a Class 3B even if such unrelated premiums are less than 50% of the net premiums written.

Net Premiums Written

For the purposes of the re-registration requirement the 50% unrelated test shall apply to an insurer's net writing position only. The gross written position is not considered.

De minimus Premiums Written

The Amendment Act makes no provision for registration as a Class 3 insurer if an insurer meets the criteria for registration as a Class 3A insurer, however the amount of net premium written is de minimus. Any insurer writing in excess of 50% unrelated net premiums will be required to make application to be registered as a Class 3A insurer regardless of the dollar amount of its net premium written.

However, as noted previously, the BMA has the discretion to register an insurer in any particular class even if that company does not otherwise qualify to be registered in such class, should the BMA deem such registration appropriate. Should an applicant wish to have the BMA consider its continued registration as a Class 3 insurer, the applicant will need to include with its application a detailed description of the rationale for why it would be more appropriately registered as a Class 3 insurer rather than being reclassified as a Class 3A insurer. The BMA has indicated that it will consult with individual firms prior to making a final registration recommendation.

In force Regulatory Approvals

All existing regulatory approvals including but not limited to section 56 directions, relevant asset approvals and other fixed capital approvals will remain in force notwithstanding the reclassification of the insurer.

The BMA will review all such approvals as it reviews the application for re-registration to ensure that such approvals remain appropriate. Should the BMA deem any such prior approval to no longer be appropriate during its review of the re-registration application, the BMA will consult with the applicant prior to amending or revoking any such approval.

Segregated Accounts Companies/Rent-A-Captives

For the purposes of the re-registration process, all Segregated Accounts Companies and/or "Rent-a-Captives" will be allowed to remain registered as Class 3 insurers at this time. However, the BMA has announced that as part of its 2009 Business Plan it intends to review this sector of the market with a view to proposing additional amendments to both the regulatory regime and the fee structure commencing 2009/2010.

Permit Companies

Existing Class 3 insurers operating in Bermuda via a permit under the Companies Act that have also been granted a Section 56 Direction giving approval to file a modified return will also be allowed to retain their current Class 3 license at this time.

In this context, a modified return means the Financial Statements and Returns and other information filed with the Insurance Regulatory Authorities in the country in which the company is incorporated.

As with Segregated Accounts Companies, the BMA has announced plans to review its current regulatory regime with respect to such permit companies and will be proposing amendments to the current regulatory regime to come into effect in 2009/2010.

Sidecars

Existing Class 3 “Sidecars” established with “fully collateralized” reinsurance policies will not be required to reregister as Class 3A or Class 3B. In this regard “fully collateralized” reinsurance policies means reinsurance policies in respect of which the maximum liability to be incurred thereon at predetermined future dates is assessed at the time of issuance of said policies, and provisions made therein for the meeting of those liabilities in full.

At this time the BMA will not require existing Sidecars or other special purpose type insurance vehicles which were previously registered as Class 3 insurers to re-register as Special Purpose Insurers. However, should any entity wish to avail themselves of this new category of registration, the company will need to make application to the BMA for a change of Class. Such applications will be considered outside of this Class 3 re-classification exercise and be addressed as a routine change of Class by the Licensing & Authorizations Team at the BMA.

Run-off Companies

As per the discussion above, an existing Class 3 insurer which has entered into run-off and is not currently writing any premium will still be required to make application to re-register as a Class 3A insurer if that insurer would qualify as such based on the percentage of unrelated loss provisions included in line 17 of the statutory balance sheet.

Mutual Companies

For the purposes of the current re-classification exercise, insurance and/or reinsurance business written by “mutual” insurance companies will be considered related party business as long as said mutual insurer is insuring or reinsuring the risk of its members only.

Composites

The re-registration requirement is only applicable to the general business insurance license. Long-term licences are not affected by this process.

Financial Information

All financial information required to determine the appropriate class of registration of any applicant must be based on audited Bermuda statutory financial statements.

Financial information based on Generally Accepted Accounting Principles will not be considered.

In addition all financial information included with the application should be based on the 2007 audited accounts or the 2008 audited accounts if such accounts have been finalised at the time of application.

APPLICATION PROCESS

The following documents must accompany the prescribed (T-1) application form:

- a. The company's original Certificate of Registration
- b. An updated business plan (see 4.1.2 below)
- c. Most recent audited statutory financial statements
- d. Management accounts as at June 30, 2008 or more recent, if available
- e. The applicable application fee \$500 in the case of Class 3A and \$1000 for Class 3B.

All business plans must include (at a minimum) the following information:

- a. Executive Summary which discusses the basis for the class of registration for which the company has made application.
- b. Ownership details.
- c. Description of insurance program(s).
- d. 3 year pro-forma statutory financial statements which shall estimate the percentage of unrelated business and BD\$ amount of net premiums written over the succeeding 3 year period.
- e. Assumptions supporting pro-forma statements.
- f. Any additional information the applicant may deem relevant to support its application in the light of the advice detailed in the Guidance Notes.

This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

Notes to Editors

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