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Bermuda Insurance Companies

Foreword

This memorandum has been prepared for the assistance of those who are considering the formation of an insurance or reinsurance company in Bermuda. It deals in broad terms with the requirements of Bermuda law for the establishment and operation of such companies under the Insurance Act 1978. It is not intended to be exhaustive but merely to provide brief details and information on the topic. We recommend that persons seek legal advice in Bermuda on any specific proposals they may have before taking steps to implement them. In addition, before proceeding with any such proposals, persons are advised to consult with their tax, legal and other professional advisers in their respective home jurisdictions.

Copies of the Insurance Act 1978 together with the regulations promulgated thereunder are available on request.

This memorandum has been prepared on the basis of the law and practice as at the date set out below.

Conyers Dill & Pearman

1 January 2012

TABLE OF CONTENTS

1. **INTRODUCTION**
2. **INSURANCE REGULATORY FRAMEWORK**
 - 2.1 Insurance Licensing and Regulatory Legislation
 - 2.2 The Bermuda Monetary Authority
3. **REGISTRATION UNDER THE INSURANCE ACT**
 - 3.1 Incorporation of New Insurance Companies
4. **GENERAL BUSINESS INSURERS**
 - 4.1 General Business Classifications
 - 4.2 Minimum Paid Up Share Capital
 - 4.3 Minimum Solvency Margins
 - 4.4 Enhanced Capital Requirements
 - 4.5 Eligible Capital Requirements
 - 4.6 Minimum Liquidity Ratio
 - 4.7 Loss Reserve Specialist
 - 4.8 Restrictions on Dividends & Distributions
 - 4.9 Reduction of Capital
5. **LONG-TERM INSURERS**
 - 5.1 Class of Registration for Long-Term Business
 - 5.2 Minimum Paid Up Share Capital
 - 5.3 Minimum Solvency Requirements
 - 5.4 Enhanced Capital Requirements

5.5 Eligible Capital Requirements

5.6 Actuaries

5.7 Record Keeping

5.8 Payments

5.9 Restrictions on Dividends & Distributions

5.10 Reduction of Capital

5.11 Life Insurance Act 1978

6. COMPOSITE INSURERS

7. SPECIAL PURPOSE INSURERS

8. SUNDRY REQUIREMENTS OF THE INSURANCE ACT

8.1 Principal Representative and Principal Office

8.2 Auditor

8.3 Group Supervision

8.4 Fit and Proper Controllers

8.5 Notification of Material Changes

8.6 Statutory Financial Statements and Returns

8.7 Exemptions

8.8 Code of Conduct

8.9 Maintenance of Records in Bermuda

8.10 The BMA's Powers of Intervention, Obtaining Information, Reports and Documents and Providing Information to Other Regulatory Authorities

9. THE SEGREGATED ACCOUNTS COMPANIES ACT 2000



10. THE INVESTMENT BUSINESS ACT 2003

11. TAXATION, GOVERNMENT FEES, STAMP DUTY AND EXCHANGE CONTROL

11.1 Taxation

11.2 Government Fees

11.3 Stamp Duty

11.4 Exchange Control

1. INTRODUCTION

Bermuda's insurance "industry" began in 1947 when the founder of the American International Group (C.V. Starr) based the group's international business in Bermuda. In the 1960s, Bermuda became a pioneering domicile for "captive" insurance companies and is now the world's second largest domicile for captive companies, after the United States. Alongside the "captive industry", Bermuda has also attracted a large number of general business and long-term commercial insurers which write a wide range of insurance and reinsurance products.

Recognising that a system of regulation is essential to maintain a healthy insurance industry, the public and private sectors worked together to produce the Insurance Act 1978. Since that time the laws and regulations pertaining to Bermuda's insurance industry have been regularly amended to recognize the diverse range of underwriting activities conducted by Bermuda insurers and reinsurers. With the aim of attaining Solvency II equivalency, Bermuda is currently in the process of phasing in a number of new regulations designed to bolster its regulatory and supervisory framework, particularly as it relates to its commercial insurers. Full implementation of these new regulations is not expected to be completed before the 2015 financial year-end filings are due.

2. INSURANCE REGULATORY FRAMEWORK

2.1 Insurance Licensing and Regulatory Legislation

The insurance licensing and regulatory regime in Bermuda is primarily comprised of the Insurance Act 1978 and the regulations promulgated thereunder (the "**Regulations**"). References herein to the "**Insurance Act**" are to the Insurance Act 1978 and the Regulations.

The Insurance Act applies to any person carrying on insurance business in or from within Bermuda, including local companies (companies that are predominantly owned by Bermudians and which carry on business mainly within the domestic

economy), exempted companies (companies that are predominantly owned by non-Bermudians and which carry on business from Bermuda but not within the domestic economy unless licensed to do so), non-resident insurance undertakings carrying on domestic business pursuant to a permit granted under the Non-Resident Insurance Undertakings Act 1967 and overseas permit companies carrying on non domestic insurance business from an office in Bermuda. All persons carrying on business in or from within Bermuda as an insurance manager, broker, agent or salesman are also required to be registered under the Insurance Act.

The Insurance Act distinguishes between long term business, special purpose business and general business.

Long term business consists of life, annuity, accident and disability contracts in effect for not less than five years and certain other types of contracts which do not include “excepted long-term business” (as defined in the Insurance Act).

Special purpose business includes insurance business under which an insurer fully funds its liabilities to its insureds through the proceeds of a debt issuance, cash, time deposits or other financing mechanism.

General business is any insurance business which is not long-term or special purpose business.

The Insurance Act does not distinguish between insurers and reinsurers: companies are registered (licensed) under the Insurance Act as “insurers” (although in certain circumstances a condition to registration may be imposed to the effect the company may carry on only reinsurance business). The Insurance Act uses the defined term “insurance business” to include reinsurance. References herein to insurance companies include reinsurance companies.

2.2 The Bermuda Monetary Authority

The regulation of those matters pertaining to the Insurance Act is the responsibility of the Bermuda Monetary Authority (the “**BMA**”).

In particular, the Insurance Division of the BMA is responsible for the licensing, supervision, regulation and inspection of Bermuda’s insurance companies and for the licensing of all insurance brokers, agents, managers and salesmen.

Under the Insurance Act, an Insurance Advisory Committee (the “**IAC**”) has been established to advise the BMA on any matter relating to the development of the insurance industry in Bermuda which is referred to it by the BMA. As well, the IAC may advise the Minister of Finance on any matter relating to the development of the insurance industry in Bermuda.

Sub-committees of the IAC have been appointed for advising on and reviewing the law and practice of insurance in Bermuda, including accounting and administrative provisions and procedures. The membership of these sub-committees is drawn from the legal and accounting professions and the insurance industry itself.

The nature of regulation under the Insurance Act is a combination of self-regulation, filings of statutory financial statements and certifications as to compliance with the applicable statutory requirements, together with review and investigation by the BMA in specified circumstances.

3. REGISTRATION UNDER THE INSURANCE ACT

All persons seeking to carry on insurance business in Bermuda are required to be registered (licensed) under the Insurance Act. Applications for registration are subject to BMA approval. When making a licence application, the applicant must, among other things, submit an acceptable business plan.

When considering whether or not to approve an application, the BMA is bound by the Insurance Act to have regard to whether the applicants (or where the application relates to a corporate entity, its controllers and officers) are fit and proper persons to be engaged in “insurance business” and, in particular, whether they have, or have available to them, adequate knowledge and expertise.

Where the applicants are seeking registration as an insurance manager, broker, agent or salesman, the BMA requires evidence that the prospective registered entity has in place at least \$1 million of professional indemnity insurance coverage.

The BMA has the discretion to approve or decline any registration application or to impose conditions if it feels it is appropriate to do so. The BMA is required to exercise its discretion in the public interest.

3.1 Incorporation of New Insurance Companies

Ordinarily a pre-incorporation application for registration as an insurer is submitted to the BMA at the same time the incorporation application is made to the Registrar of Companies. As insurance licence applications are considered by the BMA’s Authorisation & Licensing Sub-Committee which only meets on Fridays, it is often the case that a new company will be incorporated before its insurance licence has been considered for approval. It is possible to delay incorporation until the insurance licence application has been approved but many applicants prefer to incorporate and organise the companies so they can proceed with opening bank accounts and other organisational matters. Organisation describes the process of getting the company up and running and includes the allotting and issuing of shares, the adoption of bye-laws and the appointment of directors and officers. Once the necessary capital (as described in its business plan) has been paid in to the company, a formal application may then be made for the company to be registered as an insurer. This application closely resembles the pre-incorporation application, particularly if no change in circumstances has occurred between the pre-incorporation application and the time of the insurance registration application.

The incorporation submission and the application for registration do not form a part of any public file in Bermuda.

Registration under the Insurance Act, once granted, remains in force until cancelled by the BMA on any grounds specified in the Insurance Act.

4. GENERAL BUSINESS INSURERS

4.1 General Business Classifications

There are six classes of general business insurer ranging from pure captives (companies established with the specific objective of financing risks emanating from its parent or parent group) to very large commercial insurers writing excess liability or property catastrophe reinsurance business.

Brief descriptions of the criteria applicable to the various general business insurance classifications are as follows:

Class 1 Insurers

A body corporate carrying on general business is registrable as a Class 1 insurer where it is wholly owned by one person and intends to carry on insurance business consisting only of insuring the risks of that person or it is an affiliate of a group and intends to carry on insurance business consisting only of insuring the risks of any other affiliates of that group or of its own shareholders.

Such insurers are often referred to as “pure captives” and are subject to the least rigorous regulatory oversight of all the classes of general business insurer.

Class 2 Insurers

A body corporate carrying on general business is registrable as a Class 2 insurer where it is wholly owned by two or more unrelated persons and intends to carry on

insurance business not less than 80% of the net premiums written in respect of which will be written for the purpose of:

- (i) insuring the risks of any of those persons or of any affiliates of any of those persons, or
- (ii) insuring risks which, in the opinion of the BMA, arise out of the business or operations of those persons or any affiliates of any of those persons.

While still regarded as “captives”, such companies differ from pure captives in two ways: (1) they have more than one owner, and (2) as much as 20% of the risks that they insure may come from outside their ownership group.

Save for Class 1 insurers, the Class 2s are subject to the least rigorous regulatory oversight of all classes of general business insurer.

Class 3 Insurers

A body corporate carrying on general business is registrable as a Class 3 insurer where it is not otherwise registrable as a Class 1, Class 2, Class 3A, Class 3B, Class 4 or Special Purpose Insurer.

Historically, Class 3 insurers included a wide range of general business operations including pure commercial insurers with less than \$100 million in capital, sidecars (unaffiliated reinsurers writing 100% of their business from a single cedant), segregated accounts companies and rent-a-captives (companies operating “cells” whose assets and liabilities are “ring-fenced” and legally or contractually protected from the creditors of other cells and the general creditors of the company), SPVs and captives writing more than 20% non-related business.

In 2008, new Class 3A, 3B general business and “special purpose” classifications were introduced and any former Class 3 insurers meeting the specified criteria were re-classified accordingly. Following re-classification, Class 3 insurers now consist of

those insurers that are not otherwise registrable under any other general business classification or as a special purpose insurer, together with those companies that the BMA has permitted to be, or remain, registered as Class 3 insurers.

For regulatory purposes, Class 3 insurers are generally regarded as “captives” and are subject to less rigorous regulation than is, or soon will be, applicable to the commercial general insurers (the Class 3As, 3Bs and 4s).

Class 3A Insurers

A Class 3A insurer is a body corporate that intends to carry on general business in circumstances where:

- (i) 50% or more of the net premiums written; or
- (ii) 50% or more of the loss and loss expense provisions represent unrelated business and its total net premiums written from unrelated business are less than \$50 million.

Class 3As are regarded as small commercial insurers and while they have historically been regulated as Class 3 insurers, beginning in 2012, the BMA will begin to apply a more rigorous regulatory regime to the Class 3As, especially in regards to public and regulatory disclosures, self risk assessment and capital adequacy.

Class 3B Insurers

A Class 3B insurer is a body corporate that intends to carry on general business in circumstances where:

- (i) 50% or more of the net premiums written; or
- (ii) 50% or more of the loss and loss expense provisions represent unrelated business and its total net premiums written from unrelated business are \$50 million or more.

Class 3Bs are regarded as large commercial insurers and attract more or less the same level of regulatory oversight as the Class 4s.

Class 4 Insurers

A body corporate carrying on general business is registrable as a Class 4 insurer where:

- (i) it has at the time of its application for registration, or will have before it carries on insurance business, a total statutory capital and surplus of not less than \$100,000,000; and
- (ii) it intends to carry on insurance business including excess liability business or property catastrophe reinsurance business.

While Class 4 insurers currently undergo the most rigorous regulatory oversight of any class of general business insurer, the regulatory and supervisory regime pertaining to the Class 4s is in the process of being bolstered further still, particularly in the areas of capital adequacy, own risk and solvency assessment, group supervision (where the company is a member of a group) and increased public disclosure and transparency.

4.2 Minimum Paid Up Share Capital (General Business)

The minimum amount of fully paid-up share capital for all classes of general business insurer other than Class 4s is \$120,000. The minimum paid-up share capital for a Class 4 insurer is \$1,000,000.

4.3 Minimum Solvency Margins (General Business)

All general business insurers' statutory assets must exceed their statutory liabilities by an amount greater than or equal to a prescribed minimum solvency margin which varies depending on the category of their registration and their net premiums written and loss reserves posted (the "**Minimum Solvency Margin**").

The Minimum Solvency Margin for a Class 1 insurer is the greater of:

- (i) \$120,000, or
- (ii) 20% of the first \$6 million of net premiums written; if in excess of \$6 million, the figure is \$1.2 million plus 10% of net premiums written in excess of \$6 million, or
- (iii) 10% of net discounted aggregate loss and loss expense provisions and other insurance reserves.

The Minimum Solvency Margin for a Class 2 insurer is the greater of:

- (i) \$250,000, or
- (ii) 20% of the first \$6 million of net premiums written; if in excess of \$6 million, the figure is \$1.2 million plus 10% of net premiums written in excess of \$6 million, or
- (iii) 10% of net discounted aggregate loss and loss expense provisions and other insurance reserves.

The Minimum Solvency Margin for Class 3, Class 3A and Class 3B insurers is the greater of:

- (i) \$1 million, or
- (ii) 20% of the first \$6 million of net premiums written; if in excess of \$6 million, the figure is \$1.2 million plus 15% of net premiums written in excess of \$6 million, or
- (iii) 15% of net discounted aggregate loss and loss expense provisions and other insurance reserves.

The Minimum Solvency Margin that must be maintained by a Class 4 insurer is the greater of:



- (i) \$100 million, or
- (ii) 50% of net premiums written (with a credit for reinsurance ceded not exceeding 25% of gross premiums) or
- (iii) 15% of net discounted aggregate loss and loss expense provisions and other insurance reserves.

Beginning in 2012, any insurer which at any time fails to meet its Minimum Solvency Margin must, within 30 days of becoming aware of such failure, file a report with the BMA detailing the circumstances that gave rise to the failure and describing how the company intends to bring itself back into compliance (currently only Class 3, Class 3A, Class 3B and Class 4 insurers are required to file such a report).

4.4 Enhanced Capital Requirements (General Business)

Currently all Class 3B and Class 4 general business insurers are required to maintain available statutory capital and surplus at a level equal to or in excess of their enhanced capital requirement ("ECR"). The ECR applicable to qualifying insurers is established by reference to either the Bermuda Solvency Capital Requirement model (a standard mathematical model used to determine an insurer's capital adequacy) or a BMA-approved internal capital model.

Beginning in 2012, Class 3A insurers will also be required to maintain their available statutory capital and surplus at a level equal to or in excess of an ECR which will be established by reference to either the Bermuda Solvency Capital Requirement - Small/Medium-sized Entities model or a BMA-approved internal capital model; however the ECR for Class 3A insurers will be phased in over a period of three years (50% of the computed figure for the financial year ending in 2011, 75% for the financial year ending in 2012 and 100% for the financial year ending in 2013).

Any insurer that fails to comply with its ECR must, within 14 days of becoming aware of such failure, file a report with the BMA detailing the circumstances that gave rise to the failure and describing how the company intends to rectify it. Furthermore, within

45 days, such insurer must furnish the BMA with (i) unaudited interim statutory financial statements, (ii) an opinion from its loss reserve specialist in relation to its outstanding loss and expense reserves (including IBNR), (iii) a general business solvency certificate in respect of such interim statutory financial statements, and (iv) a capital and solvency return reflecting an ECR prepared using post failure data.

While not specifically set out in the Insurance Act, the BMA has also established a target capital level ("TCL") for each insurer subject to an ECR equal to 120% of its ECR. While qualifying insurers are not currently required to maintain their statutory capital and surplus at this level, the TCL serves as an early warning tool for the BMA and failure to maintain statutory capital at least equal to the TCL will likely result in increased BMA regulatory oversight.

4.5 Eligible Capital Requirements (General Business)

For each insurer subject to an ECR, the BMA has introduced a three-tiered capital system designed to assess the quality of capital resources that a company has available to meet its capital requirements. The new system classifies all capital instruments into one of three tiers based on their "loss absorbency" characteristics. Highest quality capital is classified as Tier 1 Capital; lesser quality capital is classified as either Tier 2 Capital or Tier 3 Capital. Under the proposed regime, up to certain specified percentages of Tier 1, Tier 2 and Tier 3 Capital (determined by registration classification) may be used to support the company's Minimum Solvency Margin, ECR and TCL.

4.6 Minimum Liquidity Ratio

All general business insurers are required to maintain the value of their "relevant assets" at not less than 75% of the amount of their "relevant liabilities".

The term "relevant assets" is defined by reference to certain items contained in the insurer's statutory balance sheet for general business. These items include (1) cash and time deposits, (2) quoted investments, (3) unquoted bonds and debentures, (4)

investments in first mortgage loans on real estate, (5) investment income due and accrued, (6) accounts and premiums receivables, (7) reinsurance balances receivable and (8) funds held by ceding reinsurers. It should be noted that unquoted equities, investments in and advances to affiliates, real estate and collateral loans are not relevant assets but the BMA, on application by the insurer, may designate such assets as relevant assets for the insurer.

“Relevant liabilities” are total general business insurance reserves and total other liabilities less deferred income tax, sundry liabilities (i.e. those not specifically defined) and letters of credit and guarantees.

4.7 Loss Reserve Specialist

Each Class 2, Class 3, Class 3A, Class 3B and Class 4 general business insurer (and any Class 1 when directed to do so by the BMA) shall appoint an individual approved by the BMA to be its loss reserve specialist.

To qualify as an approved loss reserve specialist, an applicant must be an individual and possess adequate professional qualifications as a casualty actuary and/or possess adequate experience to assess the sufficiency of insurance reserves of the insurer.

Each Class 3, Class 3A, Class 3B and Class 4 insurer is required to submit annually an opinion of its approved loss reserve specialist with its statutory financial return in respect of its loss and loss expense provisions.

Class 2 insurers are required to submit in every third year (measured from the financial year in which it received its licence) an opinion of its approved loss reserve specialist with its statutory financial return in respect of its loss and loss expense provisions.

4.8 Restrictions on Dividends and Distributions (General Business)

Where an insurer fails to meet its Minimum Solvency Margin or Minimum Liquidity Ratio (the “**Relevant Margins**”) on the last day of any financial year, it is prohibited from declaring or paying any dividends during the next financial year without the prior approval of the BMA.

Furthermore, notwithstanding anything to the contrary in any other enactment, any insurer that fails to comply with its ECR is also prohibited from declaring and paying any dividends until the failure has been rectified.

In addition, no Class 3B or Class 4 insurer may declare or pay in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its previous financial year’s statutory balance sheet) unless it files (at least seven days before payment of such dividends) with the BMA an affidavit stating that it will continue to meet its Relevant Margins.

The restrictions on declaring or paying dividends and distributions under the Insurance Act are in addition to the solvency requirements under The Companies Act 1981 (the “**Companies Act**”) which restricts a company from declaring or paying a dividend or a distribution out of contributed surplus unless there are reasonable grounds for believing that the insurer is able, and after the payment of the dividend or distribution will be able, to pay its liabilities when they become due and that the realizable value of that company’s assets will, after payment of the dividend or distribution, be greater than the sum of its liabilities.

4.9 Reduction of Capital (General Business)

No general business insurer may reduce its total statutory capital, as set out in its previous year’s financial statements, by 15% or more unless it has received the prior approval of the BMA. Total statutory capital includes the amount paid in with respect to the issue of its shares as well as all contributed surplus.

Class 3B and Class 4 insurers (and beginning in 2012, Class 3A insurers) seeking to reduce their statutory capital, as set out in its previous year's financial statements, by 15% or more, must also submit an affidavit signed by at least 2 directors (one of whom must be a Bermuda resident director if any of the company's directors are resident in Bermuda) and the principal representative (discussed below) stating that the proposed reduction will not cause the company to fail its Relevant Margins.

5. LONG-TERM INSURERS

Any person seeking to carry out long-term insurance business is now required to be registered as either a Class A, Class B, Class C, Class D or Class E insurer under the Insurance Act.

5.1 Long-Term Business Classifications

Class A Insurer

A body corporate is registrable as a Class A insurer where it (a) is wholly owned by one person and intends to carry on long-term business consisting only of insuring the risks of that person; or (b) is an affiliate of a group and intends to carry on long-term business consisting only of insuring the risks of any other affiliates of that group or of its own shareholders.

Class B Insurer

A body corporate is registrable as a Class B insurer if it is wholly owned by two or more unrelated persons and intends to carry on long-term business not less than 80% of the premiums and other considerations written in respect of which will be written for the purpose of (a) insuring the risks of any of those persons or of any affiliates of any of those persons; or (b) insuring risks which, in the opinion of the BMA, arise out of the business or operations of those persons or any affiliates of any of those persons.

A body corporate is also registrable as a Class B insurer if it would be registrable as a Class A insurer but for the fact that (a) not all of the business which it intends to carry on, but at least 80% of the premiums and other considerations written, will consist of the long-term business prescribed for Class A insurers; or (b) it intends to carry on long-term business not less than 80% of the premiums and other considerations written in respect of which will, in the opinion of the BMA, arise out of the business or operations of the person by whom it is owned or any of the affiliates of that person.

Class C Insurer

A body corporate carrying on long-term business is registrable as a Class C insurer if it has total assets of less than \$250 million and is not registrable as a Class A or Class B insurer.

Class D Insurer

A body corporate carrying on long-term business is registrable as a Class D insurer if it has total assets of \$250 million or more, but less than \$500 million and is not registrable as a Class A or Class B insurer.

Class E Insurer

A body corporate carrying on long-term business is registrable as a Class E insurer if it has total assets of more than \$500 million and is not registrable as a Class A or Class B insurer.

5.2 Minimum Paid Up Share Capital (Long-term)

Currently, Class A insurers are required to maintain fully paid up share capital of at least US\$120,000. Class B insurers are required to maintain fully paid up share capital of at least US\$250,000. Class C, Class D and Class E insurers are required to maintain fully paid up share capital of at least US\$500,000 (although note that with effect from January 1, 2012, the minimum paid-up share capital for the Classes C, D and E

insurers will be reduced to \$250,000 to correspond with the phase-in provisions relating to the new Minimum Solvency Margins discussed below).

5.3 Minimum Solvency Requirements (Long-term)

All long-term insurers' statutory assets must exceed their statutory liabilities by an amount greater than the prescribed Minimum Solvency Margin.

The Minimum Solvency Margin for a Class A insurer is the greater of \$120,000 or 0.5% of assets.

The Minimum Solvency Margin for a Class B insurer is the greater of \$250,000 or 1% of assets.

The Minimum Solvency Margin for a Class C insurer is the greater of \$500,000 or 1.5% of assets.

The Minimum Solvency Margin for a Class D insurer is the greater of (a) \$4,000,000 or (b) 2% of the first \$250,000,000 of assets plus 1.5% of assets above \$250,000,000.

The Minimum Solvency Margin for a Class E insurer is the greater of (a) \$8,000,000 or (b) 2% of the first \$500,000,000 of assets plus 1.5% of assets above \$500,000,000.

Assets are defined as the total assets reported on an insurer's balance sheet in the relevant year less the amount held in a segregated account.

The new Minimum Solvency Margins for long-term insurers will be phased in over three years from 31 December 2010. The applicable Minimum Solvency Margin for the financial year ending in 2011 will be 50% of the amount specified above. The applicable Minimum Solvency Margin for the financial year ending in 2012 will be 75% of the amount specified above. The applicable Minimum Solvency Margin for the financial year ending in 2013 and beyond will be the full amounts specified above.

Any long-term insurer which at any time fails to meet its Minimum Solvency Margin must, within 30 days of becoming aware of such failure, file a report with the BMA detailing the circumstances that gave rise to the failure and describing how the company intends to bring itself back into compliance (currently only Class C, Class D and Class E insurers are required to file such a report).

5.4 Enhanced Capital Requirements (Long-term)

Beginning with their 2011 financial year-end statutory filings, Class E long-term insurers will be required to maintain available statutory capital and surplus at a level equal to or in excess of an ECR which is established by reference to either the Bermuda Solvency Capital Requirement for long-term insurers model or its BMA-approved internal capital model.

If the Class E insurer fails to comply with its ECR, it must, within 14 days of becoming aware of such failure, file a report with the BMA detailing the circumstances that gave rise to the failure and describing how the company intends to rectify it. Furthermore, within 45 days, such insurer must furnish the BMA with (i) unaudited interim statutory financial statements, (ii) an opinion from its loss reserve specialist in relation to its outstanding loss and expense reserves (including IBNR), (iii) a general business solvency certificate in respect of such interim statutory financial statements, and (iv) a capital and solvency return reflecting an ECR prepared using post failure data.

While not specifically dealt with in the Insurance Act, the BMA has also established a target capital level ("TCL") for each insurer subject to an ECR equal to 120% of its ECR. While qualifying insurers are not currently required to maintain their statutory capital and surplus at this level, the TCL serves as an early warning tool for the BMA and failure to maintain statutory capital at least equal to the TCL will likely result in increased BMA regulatory oversight.

The ECR and TCL capital requirements are expected to be extended to Class D and Class C insurers commencing with their 2012 financial year-end filings.

5.5 Eligible Capital Requirements (Long-term)

Beginning with their 2011 financial year-end statutory filings, each Class E insurer will be required to assess the quality of the capital resources available to meet its capital requirements. The new eligible capital system will classify all capital instruments into one of three tiers based on their “loss absorbency” characteristics. Highest quality capital is classified as Tier 1 Capital; lesser quality capital is classified as either Tier 2 Capital or Tier 3 Capital. Under the proposed regime, the maximum amount of Tier 1, Tier 2 and Tier 3 Capital that may be used to support the company’s Minimum Solvency Margin, ECR and TCL will be imposed.

It is expected that the new eligible capital system will be applied to Class D and Class C insurers beginning with their 2012 financial year-end statutory filings.

5.6 Actuaries

A long-term insurer must appoint an actuary approved by the BMA. It is the approved actuary who prepares the annual actuary’s certificate for filing with the Statutory Financial Return. The actuary must be an individual and is usually a life actuary.

5.7 Record Keeping

A long-term insurer must maintain accounts in respect of its long-term business separate from any accounts kept in respect of any other business and all receipts of its long-term business shall form part of its long-term business fund.

5.8 Payments

The long-term business fund is a legally segregated pool of assets whose use is restricted under the Insurance Act. No payment may be made, directly or indirectly, out of the long-term business fund for any purpose other than the company’s long-term business except in so far as such payment can be made out of any surplus

certified by the company's approved actuary to be available for distribution otherwise than to policyholders.

5.9 Restrictions on Dividends & Distributions (Long-term)

A long-term insurer must refrain from declaring or paying any dividends during any financial year if it would cause the long-term insurer to fail to meet its Minimum Solvency Margin. Furthermore, a long-term insurer may not declare or pay a dividend to any person other than a policyholder unless the value of the assets of its long-term business fund (as certified by the company's approved actuary) exceeds the value of the liabilities of its long-term business and the amount of any such dividend shall not exceed the aggregate of that excess and any other funds properly available for the payment of dividends arising out of the company's non long-term business.

In addition to these restrictions under the Insurance Act, a long-term insurer remains subject to the provisions of the Companies Act which restrict it from declaring or paying a dividend or a distribution out of contributed surplus unless there are reasonable grounds for believing that the long-term insurer is able, and after the payment of the dividend or distribution will be able, to pay its liabilities when they become due and that the realizable value of that company's assets will, after payment of the dividend or distribution, be greater than the sum of its liabilities.

5.10 Reduction of Capital (Long-term)

No long-term insurer may reduce its total statutory capital, as set out in its previous year's financial statements, by 15% or more unless it has received the prior approval of the BMA. Total statutory capital includes the amount paid in with respect to the issue of shares as well as contributed surplus.

Class E insurers (and beginning in 2012, Class D and Class C insurers) seeking to reduce their statutory capital, as set out in its previous year's financial statements, by 15% or more, must also submit an affidavit signed by at least 2 directors (one of whom must be a Bermuda resident director if any of the company's directors are

resident in Bermuda) and the principal representative (discussed below) stating that the proposed reduction will not cause the company to fail its relevant margins.

5.11 Life Insurance Act 1978 (the “Life Act”)

To the extent that the long-term insurer issues life insurance policies which are made in Bermuda and governed by Bermuda law, the Life Act will also apply. The Life Act requires certain matters to be stipulated in the policies issued by the company and defines the meaning of insurable interest in respect thereof. Other provisions deal with the assignability of policies and the designation of beneficiaries.

6. COMPOSITE INSURERS

The Insurance Act states that an insurer which underwrites both general and long-term insurance business may be registered as a composite insurer (meaning that it will be granted both long-term and general business licenses); however, it should be noted that the BMA has indicated it intends to discontinue issuing dual insurance licenses beginning in 2012. A consultation paper setting out how such insurers are to be registered in future is expected to be published shortly.

Currently, the minimum paid up share capital for an insurer holding dual licenses is the aggregate amount of paid up capital required for each class for which it is registered.

7. SPECIAL PURPOSE INSURERS

Historically, special purpose vehicles were registered as Class 3 general business insurers; however, due to the growth in special purpose insurance transactions and securitizations, the Insurance Act was amended in 2008 to create a new classification: Special Purpose Insurer (“SPI”).

In an orthodox insurance securitization transaction, an SPI (also referred to as a special purpose vehicle) is established for the purpose of entering into a single

insurance contract. In order to fund its obligations under the contract, the SPI will issue some form of debt to investors in an amount equal to the company's maximum liability under the insurance contract. The notes will be limited recourse notes and provide that the company's obligation to pay interest and principal to the note holders diminishes by (and is subordinate to) an amount equal to the amount the company pays under the insurance contract.

The principal features of this new SPI category are as follows: (i) minimum paid up share capital will be \$1.00; (ii) the margin of solvency requirement will require that the assets of the SPI exceed its liabilities at all times; (iii) an SPI will only be permitted to write "special purpose business" (as that term is defined); and (iv) the SPI will be restricted from entering into any other business save for ancillary agreements to effect its special purpose business.

An existing insurer that meets the criteria for classification as an SPI may elect to remain a Class 3 insurer or re-register as an SPI, at the insurer's discretion. However newly incorporated insurers meeting the SPI criteria are expected to register as SPIs.

8. SUNDRY REQUIREMENTS OF THE INSURANCE ACT

There are certain provisions of the Insurance Act that are applicable to all registered insurers.

8.1 Principal Representative and Principal Office

The Insurance Act requires every insurer to appoint a principal representative resident in Bermuda and to maintain a principal office in Bermuda.

The principal representative must be knowledgeable in insurance and will be responsible for arranging for the maintenance and retention of the statutory accounting records and for making the annual statutory financial return. The principal representative, who must be approved by the BMA, may be a salaried

director or manager normally resident in Bermuda or a Bermuda registered insurance management company.

The principal office can be the office of that director or manager, or the office of the management company, and will normally be distinct from the registered office of the company where the share register, minute book, seal, etc. are kept by the company secretary. Certain minimum records are required to be maintained at the principal office, e.g. premium registers, loss registers and general records on reinsurances.

The Insurance Act imposes various obligations on the principal representative. In particular, the principal representative has a statutory duty to report to the BMA when he or she considers there is a likelihood of the insurer becoming insolvent or upon the principal representative becoming aware or having reason to believe that the insurer has failed or defaulted in various matters set out in the Insurance Act. Neither the insurer nor the principal representative may terminate the principal representative's appointment with less than thirty days' notice to the BMA or such shorter notice as the BMA may permit.

8.2 Auditor

Every insurer must appoint an independent auditor (based in Bermuda), approved by the BMA, to report on the company's statutory financial statements. The auditor may be the same person or firm which reports to the shareholders.

8.3 Group Supervision

The BMA may, in respect of an insurance group, determine whether it is appropriate for it to be the group supervisor of that group. An insurance group is defined as a group of companies that conducts exclusively, or mainly, insurance business.

The BMA may make such determination where it ascertains that (i) the group is headed by a "specified insurer" (that is to say, it is headed by either a Class 3B or Class 4 general business insurer (and beginning in 2012, by a Class 3A or Class E

insurer) or another class of insurer designated by order of the BMA); or (ii) where the insurance group is not headed by a “specified insurer”, where it is headed by a parent company which is incorporated in Bermuda or (iii) where the parent company of the group is not a Bermuda company, where the BMA is satisfied that the insurance group is directed and managed from Bermuda or the insurer with the largest balance sheet total is a specified insurer.

Where the BMA determines that it should act as the group supervisor, it shall designate a specified insurer that is a member of the insurance group to be the designated insurer (the “**Designated Insurer**”) and it shall give written notice to the Designated Insurer and other competent authorities of its intention to act as group supervisor.

The BMA will maintain a register of particulars for every insurance group of which it acts as the group supervisor, detailing the names and addresses of (i) the Designated Insurer for the insurance group; (ii) each member company of the insurance group falling within the scope of group supervision; (iii) the principal representative of the insurance group in Bermuda; (iv) other competent authorities supervising other member companies of the insurance group; and (v) the insurance group auditors. The Designated Insurer must notify the BMA of any changes to the above details entered on the register of an insurance group.

As group supervisor, the BMA will perform a number of supervisory functions including (i) coordinating the gathering and dissemination of information which is of importance for the supervisory task of other competent authorities; (ii) carrying out a supervisory review and assessment of the insurance group; (iii) carrying out an assessment of the insurance group’s compliance with the rules on solvency, risk concentration, intra-group transactions and good governance procedures; (iv) planning and coordinating, through regular meetings (to be held at least annually) with other competent authorities, supervisory activities in respect of the insurance group, both as a going concern and in emergency situations; (v) coordinating any enforcement action that may need to be taken against the insurance group or any of

its members; and (vi) planning and coordinating meetings of colleges of supervisors in order to facilitate the carrying out of the functions described above.

In carrying out its functions, the BMA may make rules for (i) assessing the financial situation and the solvency position of the insurance group and/or its members; and (ii) to regulate intra-group transactions, risk concentration, governance procedures, risk management and regulatory reporting and disclosure.

Certain specified entities may be excluded from group supervision on the application of the Designated Insurer, or on the BMA's initiative. Companies that may be excluded must (i) be from countries or territories in which legal impediments to information exchange exist; (ii) have financial operations that would have a negligible impact on the operations of the insurance group; or (iii) be considered an inappropriate inclusion in light of the objectives of group supervision.

The BMA may withdraw from acting as group supervisor voluntarily following the request of a competent authority from an equivalent jurisdiction, or on the application of a Designated Insurer. For the purposes of the Insurance Act, a competent authority is a national authority that is legally empowered to supervise insurers and an equivalent jurisdiction is one possessing supervisory standards deemed equivalent by the BMA to those under the Act.

8.4 Fit and Proper Controllers

The BMA maintains supervision over the controllers of all registered insurers in Bermuda.

A controller includes (i) the managing director of the registered insurer or its parent company; (ii) the chief executive of the registered insurer or of its parent company; (iii) a 10%, 20%, 33% or 50% shareholder controller; and, (iv) any person in accordance with whose directions or instructions the directors of the registered insurer or of its parent company are accustomed to act.

The definition of shareholder controller is set out in the Insurance Act but generally refers to (i) a person who holds 10% or more of the shares carrying rights to vote at a shareholders' meeting of the registered insurer or its parent company, or (ii) a person who is entitled to exercise 10% or more of the voting power at any shareholders' meeting of such registered insurer or its parent company, or (iii) a person who is able to exercise significant influence over the management of the registered insurer or its parent company by virtue of its shareholding or its entitlement to exercise, or control the exercise of, the voting power at any shareholders' meeting.

No person may become a holder of at least 10%, 20%, 33% or 50% of the voting shares of an insurer whose shares or the shares of its parent company are not traded on any stock exchange unless he has notified the BMA in writing that he intends to become such a controller. The BMA has 45 days from the date of service of that notice to object or request further information.

A person who becomes a holder of at least 10%, 20%, 33% or 50% of the voting shares of an insurer whose shares or the shares of its parent company are traded on any stock exchange recognized by the BMA for this purpose must notify the BMA in writing within 45 days of becoming such a controller.

Where it appears to the BMA that a person who is a controller of any description is not or is no longer a fit and proper person to be such a controller, it may serve him with a written notice of objection to his continuing as a controller of the registered person.

Once there has been a change of shareholder controller or officer, all Class 3, Class 3A, Class 3B, Class 4, Class C, Class D and Class E insurers are required to notify the BMA in writing within 45 days of becoming aware of such change taking place.

Class 1 and Class 2 insurers, Special Purpose Insurers, and Class A and Class B insurers are required, at the time of filing annual financial statements, to file with the BMA (a) a list of every person who has become or has ceased to be a shareholder controller or director of the insurer; and (b) where no registered insurance manager

has been appointed to manage the affairs of the insurer, a list of every person who has become or has ceased to be an officer of that insurer, during the financial year to which the financial statements relate.

An officer in relation to an insurer means a director, chief executive or senior executive performing duties of underwriting, actuarial, risk management, compliance, internal audit, finance or investment matters.

8.5 Notification of Material Changes

All registered insurers, and any Designated Insurer in respect of the group of which it is a member, are required to give notice to the BMA of certain measures that are likely to be of material significance to the BMA in the discharge of its functions under the Insurance Act.

For the purposes of this provision, a material change includes (i) the transfer or acquisition of insurance business being part of a scheme falling under section 25 of the Insurance Act or section 99 of the Companies Act, (ii) the amalgamation with or acquisition of another firm, (iii) engaging in non-insurance business and activities related thereto where such business is not ancillary to its insurance business; and (iv) engaging in unrelated business that is retail business.

No registered insurer shall take any steps to give effect to a material change, and no Designated Insurer shall, subject to the immediately following paragraph, permit any member of its group to take steps to give effect to a material change, unless it has first served notice on the BMA that it intends to effect such material change and before the end of 14 days, either the BMA has notified such company in writing that it has no objection to such change or that period has lapsed without the BMA having issued a notice of objection.

Before issuing a notice of objection, the BMA is required to serve upon the person concerned a preliminary written notice stating the BMA's intention to issue formal notice of objection. Upon receipt of the preliminary written notice, the person served

may, within 28 days, file written representations with the BMA which shall be taken into account by the BMA in making its final determination.

A Designated Insurer shall not be required to serve notice of a material change if the member of the group in question is regulated by a competent authority in an equivalent jurisdiction and has within 90 days of the event filed written notice of the material change with the BMA.

8.6 Statutory Financial Statements and Returns

The Insurance Act requires every insurer to prepare annual statutory financial statements and file these statements with the BMA together with a statutory financial return. The rules for preparing these statements are set out in the Regulations and include a uniform format of the balance sheet, income statement, statement of capital and surplus and rules for valuation of assets and determination of liabilities. The statutory financial statements are not prepared in accordance with GAAP.

The statutory financial return includes a business solvency certificate and a declaration of statutory ratios, both of which must be signed by at least two directors of the insurer (of whom one must be a director resident in Bermuda if the insurer has a Bermuda resident director) and the insurer's principal representative in Bermuda. In signing the business solvency certificate, the directors and the principal representative are required to state whether the business solvency margin and (for general business insurers) the minimum liquidity ratio have been met. Further, the auditor is required to state whether, in the auditor's opinion, it was reasonable for the directors to so certify and whether the declaration of statutory ratios complies with the requirements of the Regulations.

The statutory financial statements and the statutory financial returns do not form a part of any public file in Bermuda for members of the public to examine.

In addition to preparing statutory financial statements, all Class 3B and Class 4 insurers (and beginning in 2012, Class 3A insurers) must also file with the BMA

audited financial statements in respect of their insurance business prepared in accordance with generally accepted insurance principles or international financial reporting standards. It is expected that the BMA will publish copies of the audited GAAP financial statements on its website, together with the notes to those statements and the auditor's report.

8.7 Exemptions

Section 56 of the Insurance Act states that the BMA may, upon the application, or with the consent, of the insurer, issue directions (known as "**Section 56 Directions**") that certain provisions of the Insurance Act shall not apply to that insurer or shall apply to it subject to specific modifications. In general, Section 56 Directions will deal with a company's margin of solvency, solvency certificate, statutory financial statements and its statutory financial returns.

Section 57A of the Insurance Act states that the BMA may, upon receipt of an acceptable application, issue a direction (known as a "**Section 57A Direction**") that a certain qualifying contract shall be deemed a "designated investment contract" for the purposes of the Insurance Act.

A qualifying contract is one where the contract (which can be an investment, a security, an option contract, a swap contract, a derivative contract or a contract for differences) has the purpose of securing a profit or avoiding a loss (i) by reference to fluctuations in value or price of property of any description, or in an index, or other factor, specified for that purpose in the contract, or (ii) based on the happening of a particular event specified for that purpose in the contract.

A designated investment contract does not constitute a contract of insurance for any purpose under the Insurance Act. Accordingly, a party to a designated investment contract (which includes being an issuer as well as an investor) is not considered to be carrying on "insurance business" and will not therefore be required to register as an insurer under the Insurance Act solely by reason of it being a party to such contract.

8.8 Code of Conduct

All Bermuda insurers must comply with the Insurance Code of Conduct which prescribes duties and standards to be complied with under the Insurance Act. Failure to comply with these requirements will be a factor to be taken into account by the BMA in determining whether an insurer is conducting its business in a sound and prudent manner under the Insurance Act.

A memorandum describing the requirements of the insurance Code of Conduct is available on request.

8.9 Maintenance of Records in Bermuda

Apart from being required to keep its statutory financial statements at its principal office for a period of 5 years, the BMA may also direct an insurer to maintain proper records of account in Bermuda with respect to (i) all sums of money received and expended by the insurer and the matters in respect of which the receipts and expenditures take place; (ii) all premiums and claims relating to the insurer; and (iii) all assets, liabilities and equity of the insurer.

8.10 The BMA's Powers of Intervention, Obtaining Information, Reports and Documents and Providing Information to other Regulatory Authorities

The BMA may appoint an inspector with extensive powers to investigate the affairs of an insurer if the BMA believes that an investigation is required in the interest of the insurer's policyholders or persons who may become policyholders. In order to verify or supplement information otherwise provided to them, the BMA may direct an insurer to produce documents or information relating to matters connected with the insurer's business. Moreover, the BMA has the power to appoint professional persons to prepare reports about registered insurers. If it appears to the BMA to be desirable in the interests of policyholders, the BMA may also exercise these powers in relation to subsidiaries, parents and other affiliates of registered insurers.

In addition to being given powers to investigate the affairs of an insurer, the BMA may also demand that certain additional information be provided to them by the insurer or certain other persons.

The BMA has the power to assist other regulatory authorities, including foreign insurance regulatory authorities, with their investigations involving insurance and reinsurance companies in Bermuda if it is satisfied that the assistance being requested is in connection with the discharge of regulatory responsibilities and that such cooperation is in the public interest. The grounds for disclosure by the BMA to a foreign regulatory authority without consent of the insurer are limited and the Insurance Act provides for sanctions for breach of the statutory duty of confidentiality.

9. THE SEGREGATED ACCOUNTS COMPANIES ACT 2000

An insurer wishing to operate segregated accounts may either petition the Bermuda Parliament for private legislation or it may register under The Segregated Accounts Companies Act 2000 (the “**SAC Act**”). The SAC Act sets out rules for governing the operation of segregated accounts.

Pursuant to the SAC Act, a segregated accounts company (“**SAC**”) is permitted to create and operate segregated accounts. Any asset which is linked by the SAC to a segregated account shall be held by the SAC as a separate fund which is not part of the Company’s general account and shall be held exclusively for the benefit of the segregated account owners and any counterparty to a transaction linked to that segregated account. The assets linked to a segregated account are available only to meet liabilities to the account owners and creditors of that segregated account and are not available, and may not be used, to meet liabilities to, and shall be protected from, the general shareholders and from the creditors of the company who are not creditors with claims linked to that segregated account.

Except for those provisions which are specifically amended pursuant to the SAC Act, a SAC insurer is otherwise subject to all the provisions of the Companies Act and the Insurance Act.

To assist clients, Conyers Dill & Pearman has produced a memorandum on the SAC Act which is available upon request.

10. THE INVESTMENT BUSINESS ACT 2003

Pursuant to the Investment Business Act 2003 (the “**IBA**”), no person shall carry on an investment business (as defined under the IBA) in or from Bermuda unless that person is licensed under the IBA or granted an exemption from being licensed. The licensing system is operated and supervised by the BMA. There are exemptions covering the Bermuda insurance and reinsurance industry. However, it is advisable to seek advice specifically on the IBA with respect to proposed activities or transactions.

11. TAXATION, GOVERNMENT FEES, STAMP DUTY AND EXCHANGE CONTROL

11.1 Taxation

There is currently no Bermuda income, corporation or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by an exempted company or its shareholders, other than shareholders ordinarily resident in Bermuda. An exempted company is a Bermuda company which is exempted from having to comply with the Bermudian ownership and control requirements set out in the Companies Act 1981.

An exempted company may apply for and is likely to receive from the Minister of Finance under the Exempted Undertakings Tax Protection Act 1966 an undertaking that, in the event of there being enacted in Bermuda any legislation imposing tax computed on profits or income, or computed on any capital assets, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, such tax shall

not until 31 March 2035 be applicable to such company or to any of its operations or to the shares, debentures or other obligations of such company except insofar as such tax applies to persons ordinarily resident in Bermuda (such as Bermudians holding shares in the exempted company) or to any Bermuda land held by or leased to the company.

11.2 Government Fees

All exempted insurance companies are required to pay an annual government fee based on assessable capital. For a company with share capital, the assessable capital is the aggregate of its authorized share capital and share premium account. Where the company is a mutual company, the assessable capital is the amount of the company's reserve fund.

An annual declaration is submitted each year at the time of payment of the annual government fee. This declaration states the type of business carried on by the company, the amount of its assessable capital and how the assessable capital has been calculated. In addition to the annual government fee, an insurance company is required to pay an initial registration fee and thereafter an annual insurance registration fee. There are various government fees payable regarding particular matters such as applications for directions under sections 56 and 57A of the Insurance Act. Further, fees are payable by SACs under the SAC Act.

Please contact Conyers Dill & Pearman Limited for a current listing of these fees.

11.3 Stamp Duty

Generally, stamp duty is not payable by, or in respect of matters concerning, exempted companies, whether in respect of share capital or otherwise (except for Bermuda property).

11.4 Exchange Control

Bermuda's exchange control regime is governed by the Exchange Control Act 1972 and related regulations. Exempted companies are designated non-resident for exchange control purposes. The non-resident designation allows these companies to operate free of exchange control regulations and enables them to make payments of dividends, distribute capital, open and maintain foreign bank accounts and purchase securities, without reference to the exchange control authorities. Note, however, an exempted company will require the prior approval of the BMA for the issue and transfer of its shares and other securities unless such transfers satisfy the criteria set out in the general permissions issued by the BMA in June 2005 in which case details of the transfers need only be notified to the BMA.

This publication is not a substitute for legal advice nor is it a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

About Conyers Dill & Pearman

Conyers Dill & Pearman advises on the laws of the Cayman Islands, British Virgin Islands, Bermuda, Mauritius and Cyprus. Conyers' lawyers specialise in company and commercial law, commercial litigation and private client matters.

The combination of Conyers' structure, culture and expertise enables the highest quality, responsive, timely and thorough legal advice. Conyers' strategic global presence in major international business centres allows a seamless 24 hour service.

Conyers' sophisticated client base includes FTSE 100 and Fortune 500 companies. Working with leading local and international firms, Conyers advises on highly complex multi-jurisdictional projects.

Affiliated companies (Codan) provide a range of trust, corporate secretarial, accounting and management services.

Founded in 1928, Conyers has 600 staff, including more than 150 lawyers, operating from offices in Bermuda, the British Virgin Islands, the Cayman Islands, Cyprus, Dubai, Hong Kong, London, Mauritius, Moscow, São Paulo and Singapore.

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