BIBA Roundtable – New York
September 30 2008
Keynote Speech – Matthew Elderfield

Good evening ladies and gentlemen.

It's been a full and, I hope you'll agree, an informative and useful day. I know I'm the only thing standing between you and a dark and stormy cocktail. As a regulator I would assess that position as about as risky as owning a sub prime CDO, so let me be brief, and let me start by congratulating BIBA for organising another successful Roundtable event, and providing everyone who attended with the opportunity to learn about how Bermuda can help you to develop your business. You have heard about Bermuda's capabilities as a financial centre in relation to hedge funds and alternative investments, fund administration and wealth management, commercial insurance and reinsurance, and of course captive insurance. And we have also briefed you on the regulatory framework that underpins these businesses.

I hope you have also learned about the broader benefits that add to Bermuda's attractiveness for business: a stable political environment; a firm commitment from the Government to the development of international business; a concentration of both intellectual capital and financial capital; the proximity to the East Coast of the U.S.; the strong telecommunications and physical infrastructure; being able to rely on English jurisprudence including the appeal to the Privy Council.

Regulation is also an increasingly important part of Bermuda's quality and success as a financial jurisdiction.

Right now I want to cover briefly three areas about regulation from Bermuda's perspective: the BMA's philosophical approach to regulation; our current programme to ensure mutual recognition under the EU's Solvency II Directive for commercial insurers; and a brief update on our work in relation to the sub prime issue.

The BMA's regulatory approach is based on our risk-based regulatory philosophy. What this means is that we ensure our regulation and supervisory regime is calibrated to the particular risks that firms pose to Bermuda's financial markets and the users of those markets. We have a systematic and structured risk model that lets us monitor and assess the firms that are subject to our supervision. Based on our risk impact assessments we are able to apply different levels of supervisory activity to our regulated entities. This allows our supervisors to apply more resources to those particular firms that pose the greatest risk, and presenting companies with regulatory requirements that are proportionate to the nature of their business and sophistication of their clients. Overall, the risk-based regulations governing financial companies in Bermuda have been designed to provide an environment in which companies can compete internationally and be innovative in developing new products or raising capital, while at the same time ensuring that firms operate responsibly within strict margins of solvency.

This framework remains effective and appropriate for Bermuda's overwhelmingly wholesale market. There is a local retail market for financial services in Bermuda; however, the bulk of our market is distinctly wholesale in nature – large, institutional, highly sophisticated buyers and sellers. This runs true for the various sectors within the market, whether it is the high net worth clients of our trust sector and investment funds clients or, the large commercial firms active in our reinsurance market.

We take this wholesale environment into account when applying our risk-based approach when deciding on the type of legislation and rules that are drafted and put into place to support our regulatory framework. Our standards and rules are segmented according to the wholesale or retail nature of business, to ensure that practical and appropriate levels of regulatory requirements are applied to companies.

The recent amendments to the Investment Funds Act are an example of this policy. The changes provided a clear differentiation between wholesale and retail investment funds. The Authority requires and retains prudent entry criteria for both sets of funds, including the need for a prospectus which is subject to the BMA's review, however, we have carefully differentiated the ongoing monitoring and compliance burden of each set of participants. This means that wholesale funds have less reporting obligations than their retail counterparts, for example.

Overall then, the BMA's practical, risk-based regulatory approach is key to the effective application of regulation in Bermuda. It allows as us to use our supervisory resources efficiently and to differentiate between wholesale and retail businesses effectively.

The Authority is also committed to transparency as it conducts its work, that is, to be transparent to those operating in our market regarding proposed or planned changes in Bermuda's regulatory regimes. The publication of the Authority's business plan, which is on our website and provides information about our supervisory work plan for the year, supports this commitment, along with our consultation process with industry as new policy initiatives are in development.

Our work plan for this year has focused to a large degree on building the foundation for Bermuda to achieve mutual recognition in key overseas markets for our regulatory framework. Mutual recognition is the process by which regulatory authorities assess the standards set by other jurisdictions. Where a jurisdiction is deemed to be of an appropriate standard, access to global markets improves and duplicative regulation is eliminated.

The issue of maintaining compliance with international standards has become an increasing priority for insurance regulators worldwide. In recent years the movement toward the standardisation of insurance regulation

globally has gained momentum, as the industry itself has become globalised. Regulators are increasingly required to 'think global' as they develop their regulatory framework, and are challenged to ensure they balance national requirements with international expectations.

These are some of the reasons why a strategic priority for the BMA in 2009 and the next few years is to achieve mutual recognition for Bermuda, with a focus on EU and US markets, and in particular for our insurance regulations. The most recent review of Bermuda's regulatory regimes by the International Monetary Fund concluded that Bermuda insurance regulations are highly compliant with international standards. From this base, the Authority's regulatory agenda is geared to achieving mutual recognition in relation to key jurisdictions, with a particular focus on Europe's Solvency II Directive.

Solvency II is a risk-based, capital adequacy regime that will be applied to insurance companies based in Europe – and into Europe. It seeks to standardise and enhance the effectiveness of insurer solvency regulations and requirements across the EU. This Directive will also provide for group supervision of insurers and mutual recognition with non-EU countries, and is important to Bermuda given the significant amount of re/insurance business conducted between Bermuda and Europe.

The BMA is well advanced in its work on mutual recognition. Our starting point is one of high compliance with international standards. But we are not resting on our laurels and have a programme of enhancements to the solvency regime for commercial insurers. We have introduced a new risk0based approach for the largest commercial insurers, including a sophisticated assessment of cat risk. We are also exploring the use of economic capital modelling and are developing proposals for looking at solvency on a group basis.

I want to be clear on two points concerning our work. First, that this programme is focused on large commercial insurers. Our effective regime for captives will remain unchanged, and ensure that a cost-effective framework continues for that sector. Second, these changes are also focused on solvency regulation, maintaining our attention on wholesale market issues. These points provide a practical illustration of the risk-based approach I discussed earlier.

In light of this work, I believe the Bermudian market is very well placed for mutual recognition with both EU and US regulators. We are one of a few countries that are ahead of the pack in terms of substantive preparations for Solvency II. I'm confident that Bermudian regulation will receive a favourable equivalence assessment.

Now, I made reference earlier to the sub prime situation, a topic that has been on the minds of all of us for the past year and especially over the past few weeks. Even though the genesis of this dislocation in the financial markets has primarily arisen from major onshore banking centres, all financial jurisdictions around the world have been touched by its ripple effects. The BMA continues to monitor the impact of sub prime on the Bermuda market, which has to date proved to be resilient. There remains the potential for further dislocation in global markets, and we are maintaining our active monitoring of the three sectors within our market that are the most impacted by sub prime: investment funds, banks and insurance. We have taken a proactive approach to monitoring potential impact, conducting periodic market surveys as far back as August of last year to assess exposure to sub prime. Bermuda's banks have limited exposure to financial loss from investments in sub prime securities and have fully disclosed their positions to the Bermuda Monetary Authority. No Bermuda bank has suffered a credit rating downgrade as a result of the sub prime crisis. Bermuda's banks are required by the BMA to hold capital levels which are significantly above minimum international standards, which provide an important buffer against financial problems. Bermuda itself has not witnessed the reckless lending practices associated with sub prime and we have a strong housing market. Therefore, Bermuda's banking system remains well-capitalised, and we are in close liaison with the management of institutions to monitor developments.

In terms of the insurance sector, the surveys we have undertaken in the market have assessed companies' exposure with respect sub prime risks in both their investment portfolios and underwriting exposures. This involved conducting rigourous stress tests in relation to their solvency and liquidity positions. This resulted in enhanced monitoring of a handful of the most affected entities – financial guaranty firms. We have over the past few months achieved success in terms of working with those firms on acceptable commutation agreements, but it's fair to say that others may still struggle and be at risk if re-structuring plans are not confirmed in the short-term. Again, we continue to monitor the situation and to work with the few firms that are most impacted.

More recently Bermuda has played an active role in working with other international regulators to manage troubled firms. We are, for example, part of a task force set up to manage the process of selling AIG assets.

In the current environment then, regulation is an important consideration for market participants. I hope I have been able to demonstrate three things:
First, that the BMA is taking an proactive role in managing the ripple effects of sub prime on Bermuda in a way that mitigates risk effectively;
Secondly, that we are not being knocked off course from our programme to ensure that Bermuda's regulatory framework is ready for the market liberalization offered by mutual recognition.

And thirdly, that in our approach to these challenges we are resolved to take a risk-based approach that ensures that our regulatory regime is appropriately calibrated to the wholesale nature of our markets.

Thank you for your participation today and for your attention.