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Regulatory Outlook for the 'New' BMA
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Good afternoon. It's a pleasure to be here to provide some perspective on developments both at the BMA and in regulatory standards generally for Bermuda's financial services sector.

As you all know, recently there has been increasing pressure globally to strengthen regulation of the financial services industry, including the insurance sector. The on going evolution of international standards is driving changes in regulatory frameworks at a national level for all jurisdictions operating within the global economy. This move toward higher standards and increased transparency within and across financial markets has developed due to several key factors. First, there have been concerns about global financial stability and the risk that poor regulatory standards in one country might be duplicated in other markets if companies with international operations are permitted to conduct business imprudently. The concern is that these risks could have major impacts on the financial sector, with potentially dramatic effects on economic growth.

In addition, further pressure arises from factors such as the need to prevent abuse of the financial system by criminal and, more recently, international terrorist elements. Consequently, high profile incidents of abuse or questionable practices by companies in the banking, investment or insurance sectors are seen as impacting consumers or the wider economy and continue to result in political pressure to increase the scope or intensity of supervision of financial services. As a result, industry is now adjusting to much greater regulatory and compliance requirements and the financial costs associated with them. Clearly, these are all issues that any regulator operating within today's global economy cannot ignore.

The challenge for financial regulators however — and this is also the case, of course, for the BMA — is to strike the right balance between maintaining an effective regulatory framework while avoiding requirements where the cost burdens imposed on industry are out of proportion to the resulting public interest benefits achieved from the regulation. Basically, most credible jurisdictions are trying to strike the right balance between maintaining a regulatory framework that meets relevant international standards and ensures high standards of behaviour, while fostering an

environment that remains attractive to businesses and enables them to grow and develop successfully.

So how has the Bermuda Monetary Authority (BMA) as the regulator of Bermuda's financial services sector responded to this new era of global regulatory enhancement? How are we rising to this challenge of finding the right balance?

I think it's fair to say that overall, as our international business sector has grown over the years, Bermuda's track record in terms of trying to maintain that delicate balance has been good. We have successfully demonstrated an ability to establish tailored regulatory regimes appropriate to the risks in each business based in the jurisdiction, which effectively encourage prudent conduct and high standards of corporate behaviour without stifling innovation and business development, particularly in the insurance industry.

And as Bermuda's market has grown and the international regulatory environment has become more demanding, the Authority's responsibilities have by necessity expanded. In the past five years our organisation has evolved further to meet the demands of ongoing international regulatory initiatives, as well as continuing changes in Bermuda's business environment and the wider economy. From an operational standpoint, as you are aware, the Authority has experienced a period of significant growth and

change over the past five years. Among the major changes has been the separation of the BMA from government, formalising our independence as the financial services regulator in Bermuda. Part of that process was another major change — the move of the Insurance Department from the Registrar of Companies to the BMA in 2002. That move was a major step in the Authority's evolution from primarily managing foreign exchange and supervising the banking sector to being responsible for all markets of Bermuda financial services sector.

In the next logical phase of our evolution the Authority's responsibilities have expanded, against the challenging backdrop of emerging additional standards and demanding expectations within the international regulatory environment, and our own on going review of Bermuda's framework. The 'new' BMA now has licensing, supervisory and enforcement powers with respect to banking, investment, trusts and of course the insurance market that reflect our pivotal role in protecting and enhancing Bermuda's position and global profile as a significant financial centre. We have increased our resources and staff as a necessity to meet the requirements of our expanded responsibilities. It has been a remarkable period of adjustment for us as regulators as well as for industry, but I think that everyone concerned recognises that taking

this direction was necessary given the overall climate in which we all operate today. Bermuda is serious about doing the job as regulators to a high standard, and the Authority's new structure reflects that fact. We have a market that is cutting edge, particularly with respect to the insurance industry, and everyone, including other regulators, recognises the significance of Bermuda in terms of maintaining stability in the global economy. Fundamentally, if we are not seen to be credible regulators, clearly we wouldn't be able to keep quality business here for long.

However, while we have enhanced Bermuda's regulatory framework relatively quickly over the past five years — which has resulted in the enactment of several new and amended statutes within the jurisdiction's suite of financial services legislation — we have always been mindful of maintaining a balanced and appropriate approach to regulation.

Our goal has always been to ensure Bermuda regulation meets international standards without stifling business innovation and development, and that remains a priority today and moving forward. Our risk-based approach to regulation has served the jurisdiction well across all markets. Developing regulatory regimes that take into account the sophisticated nature of those involved in

the business being conducted and its underlying risk is both effective and practical. It is an approach that requires a very good understanding of the business, as well as obtaining a high level of cooperation from industry, two areas that receive our constant attention and which we see as being of great importance. This is one of the reasons why extensive consultation with industry is, in our view, a key part of the process as regulations are developed in Bermuda. Many of you here today may, at some time or another, have been part of those consultations. It is a complex and time-consuming process even in a jurisdiction of Bermuda's relatively small size. However, in our experience this high level of consultation, which helps us to assess the practical implications of proposed regulation at a very early stage, has proved to be invaluable, and typically has resulted in a smooth transition once new regulations are put into place.

Therefore, it is our firm intention that our current risk-based approach to regulation, along with the detailed consultative process with industry, will not change even as further enhancements to the framework may be required. We will ensure that Bermuda continues to meet international standards as those enhancements take place, but we will not be changing our fundamentally pragmatic approach to regulation. It is an approach that has

generally been endorsed overall by the various independent reviews of Bermuda's regulatory framework, the most recent being the International Monetary Fund (IMF) review in 2003.

In terms of insurance regulation for example, the IMF recognised the effectiveness of much of the framework for insurance. The IMF report appreciated the dynamism and professionalism of Bermuda's insurance sector and the high quality of the counterparties involved. They also acknowledged the demonstrated effectiveness of the BMA's supervisory approach and the robust legal provisions available to underpin it. Equally, however, the assessors identified a number of areas where our insurance legislation and practice required enhancement in order to fully comply with the new Insurance Core Principles adopted by the International Association of Insurance Supervisors (IAIS) in October 2003, as well as the IAIS agreed standards for the supervision of reinsurers. This was not surprising since international standards have been evolving very quickly and insurance regulators, like businesses, around the world are having to work hard to keep up with the rapidly evolving regulatory environment.

As a result of our own on going reviews of the insurance framework, some of the IMF recommendations and our assessment of the framework against the new IAIS standards and other significant international developments, we have made some changes. The resulting amendments to the Insurance Act and the introduction of an enhanced Supervisory Model for insurance have addressed issues related to enhancing transparency further and developing a more systematic assessment framework for identifying and monitoring supervisory risk among insurance companies. However, we have not seen a need for any fundamental changes in our supervisory approach. The pre-existing insurance supervisory legislation already had a broad scope, including applying the same level of supervision to reinsurance business as that which is applied to direct insurance business, thereby meeting some important tests from an international regulatory perspective, and helping us to maintain regulation that is suitable for the market.

In fact we are firmly committed to applying regulation in a manner that is appropriate for Bermuda. There is no point, in our view, of implementing regulation for regulation's sake, and inappropriate regulation can end up being as burdensome for the regulator as it can be for industry. Therefore, we have taken a proactive approach

and dedicated additional resources to assessing international regulatory developments in the context of the possible impact on the Bermuda market. We remain fully engaged in regulatory developments from the global perspective that could have implications for Bermuda via our membership and active involvement with national and international standard setting bodies such as the IAIS, the National Association of Insurance Commissioners and the International Association of Securities Commissions (IOSCO).

Whether contributing as members of technical committees or providing input to guidance papers that are precursors of new standards or providing the Bermuda perspective at key meetings, we seek to influence as much as possible positive, practical developments, and to ensure that Bermuda's long-term interests are not compromised. For example, the IAIS began giving attention to the regulation of captives earlier this year, with the possibility that they should be regulated in the same way as commercial insurers. The Authority has been part of a working group developing a background paper for the IAIS related to this issue, in order to educate them about the nature of captives. In our contributions we have consistently reiterated the point that given the nature of most captives, which are primarily writing no third

party risk, it would be inappropriate to regulate them in a similar way to commercial insurers. We have also actively participated in recent discussions at the IAIS regarding the status of finite reinsurance and the potential of abuse. As recently as last month the IAIS adopted a guidance paper on finite reinsurance and the Authority will continue to monitor developments in this area and any possible regulatory implications for the Bermuda market. Again, regulation for regulation's sake serves little positive purpose, and could in fact be harmful to the stability of a market.

It is clear, however, that regulation is an even bigger fact of life in today's business environment than ever before — that is the simple reality for all of us. It is unlikely that the pace and scope of regulatory change globally will slow down for the foreseeable future. For example, the latest 'hot issue' with respect to regulation for a specific sector is hedge funds, which have been on the regulatory radar for some time, but are highly topical given recent negative media coverage and the looming deadline in the US of January 2006 requiring the registration of hedge funds managers. In Europe, financial regulators are still grappling with standardisation issues and sorting through the practicalities of implementing blanket taxation initiatives like the European Union Savings Directive, designed to tax income EU residents receive

from savings held overseas. Similarly in the US, the debate of the pros and cons swirling around the perennial question of federal versus state regulation across financial services markets has been given another breath in the wake of the Refco scandal.

I make note of these particular issues to say simply that, as the regulator in this jurisdiction, the BMA is obviously keenly aware of how these types of developments may impact Bermuda to varying degrees, directly and indirectly. We put our own proposals for regulatory developments here in the global context every day, while ensuring that the framework here remains practical for the market. We are maintaining this balancing act as we continue our on going review of local financial services regulations. And while further enhancements are planned, they will be introduced carefully, in full consultation with industry, and are not designed to tip the balance but rather to refine and build on Bermuda's very sound and effective existing regimes. They also should not come as shock to industry. In the investment area for example, the proposed Collective Investment Schemes Act will require among other things registration of fund administrators. This is a practical change that is in line with global standards and not a particularly onerous or unexpected requirement for the industry, which has had extensive input as the legislation has been developed. On the

banking side, the Authority is working with Bermuda's banks in preparation for implementing the new Basel II Accord, which will set new standards for capital adequacy and risk management requirements for the banking sector globally. And in terms of the insurance market, the BMA will be consulting insurers on a small number of remaining elements of the new Insurance Core Principles I mentioned earlier, where it is evident that some further development will be needed to the policy framework and approach that is currently applied. This parallels the position in other major jurisdictions where the implications of certain of the principles also have to be assessed and appropriate enhancements developed.

As the regulator for Bermuda's entire financial services sector our objective at the BMA is always to put in place supervisory arrangements that are transparent, consistent with international standards and which encourage good corporate conduct, while remaining suited to the particular business profile of firms. This is consistent with the cautious, well-managed approach to regulation that has been one of the attractions of the Bermuda market for companies looking for a quality financial jurisdiction. Therefore, the BMA's approach will continue to place quality over quantity in terms of the type of business permitted to operate in Bermuda. Our regulations will remain risk-based and will be applied in a manner

that is appropriate for the Bermuda market. And we will continue to be practical in terms of regulatory development and seek the very important input of industry on an on going basis. We believe that in this way Bermuda's regulatory framework will remain effective and support the best interests of all stakeholders in the market here.

Thank you.