Insurance

Life goes on...

Exploring the diversity and development of the life (re)insurance market in Bermuda

The Bermuda Life (Re)insurance Market Survey 2010

Contents

Introduction

Since the credit crunch of 2008 / early 2009, interest rates, investment spreads and volatility in the capital markets have presented significant challenges to the life (re)insurance industry. Global regulatory initiatives such as Solvency II in Europe and the Bermuda Monetary Authority's ("BMA") renewed focus on this industry is likely to be a catalyst for further changes in the requirements on life (re)insurers.

It was against this background that PricewaterhouseCoopers surveyed a substantial portion of the Bermuda life insurers and reinsurers (comprising both Bermuda domiciled companies as well as subsidiaries of international insurers and reinsurers) to find out how they are addressing their key business and operational challenges and their outlook for the year ahead.

In compiling this report, the following information was requested:

- In depth questionnaires from participants who, in the aggregate, provide a substantial portion of the underwriting capacity of the Bermuda life insurance and reinsurance market (the "Bermuda Market"). Participants reflect a broad spectrum of capitalisation, product classes, insurance and reinsurance writers, independent businesses and public (and subsidiary) organisations; and

- Face-to-face interviews with executives representing companies operating within the Bermuda Market.

The survey findings and interviews were further supplemented by significant desk research.

We are confident that you will find this report thought-provoking and insightful. Copies of this survey, along with our other publications are all available free of charge from our web site (www.pwc.com/bm).

If you would like to discuss any of the issues raised in this report, please speak to your usual contact at PricewaterhouseCoopers or one of the editorial board members listed at the end of this briefing. We would also appreciate your feedback on this report as it helps us to ensure that we are addressing the issues you are focussing on and would welcome suggested topics of analysis for future surveys.

1 In this publication, "PricewaterhouseCoopers" refers to PricewaterhouseCoopers (a Bermuda partnership) which is a member of the PricewaterhouseCoopers global network of firms, each of which is a separate and independent legal entity.

Executive summary

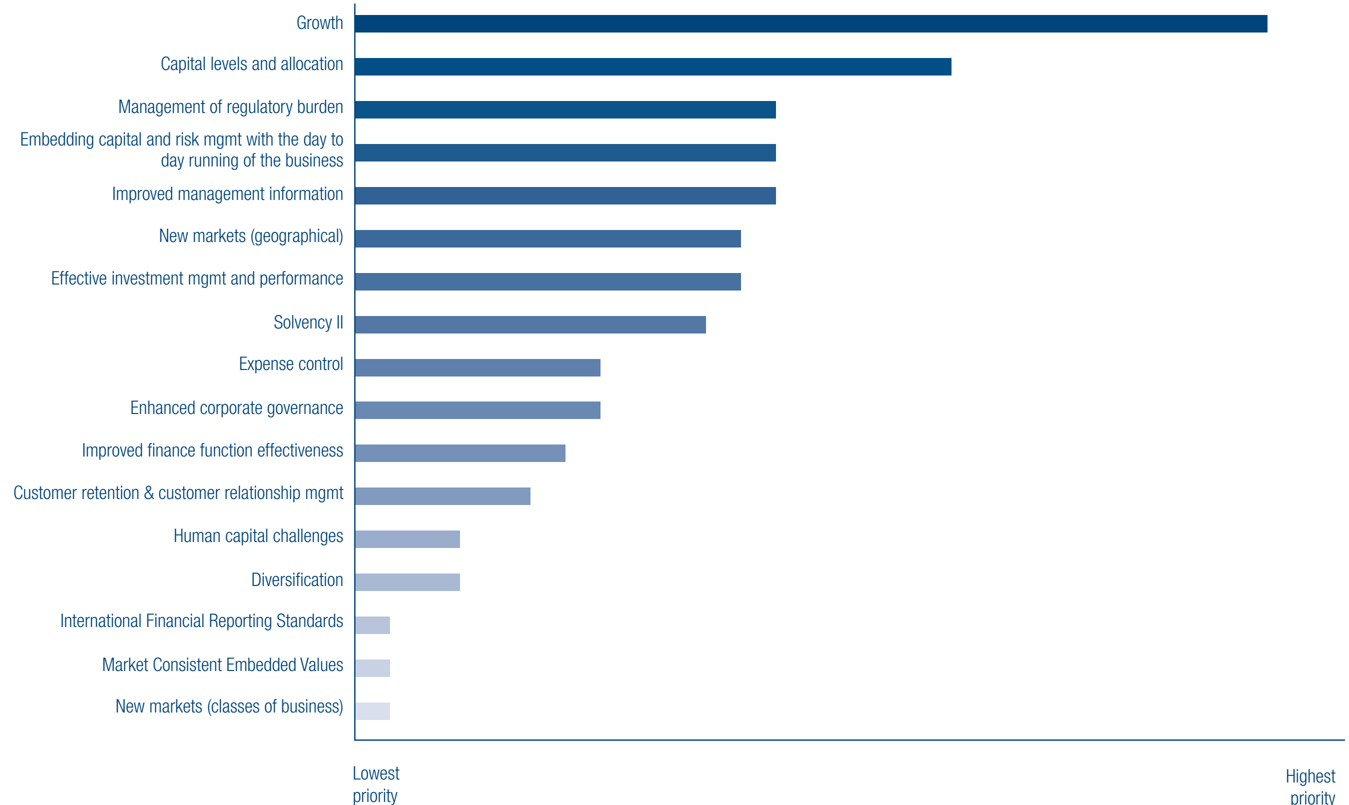
One eye on the past as companies look towards growth

Lower interest rates, concern over liquidity in the investment markets and a soft economic environment created a significant amount of uncertainty for the Bermuda market. It was against this background that we asked each company to identify the top five issues on their agendas in 2010.

With most of the major world financial centres now experiencing some economic growth (albeit at relatively low rates), growth in the Bermuda marketplace is likely to continue, although market conditions remain challenging.

From the responses, there are three general themes that management are focussed on in 2010; growth, managing capital and regulation.

Figure 1 Please indicate the top five issues on your company's agenda in 2010.



Source: PricewaterhouseCoopers

The Top Five…

Growth

Growing the in-force business is the top priority for Bermuda Market companies. The industry has gone through a turbulent time with a number of new entrants entering the market, with some of those entrants leaving the market shortly thereafter, in addition to established companies closing down. During this period, retail consumers have become wary of certain products due to volatility and credit concerns.

Capital levels and allocation

The importance that respondents placed on capital levels and the allocation of capital is a direct response to the volatility in the capital markets in the last couple of years. Despite Bermuda historically having a low regulatory capital requirement, companies have been taking steps to strengthen their capital position in response to rating agency concerns and downgrades, which have affected reinsurer's ability to attract and retain clients.

Management of regulatory burden

With the BMA's commitment to re-evaluating the capital and solvency framework for life (re)insurers, to gain Solvency II equivalence, and the appointment of dedicated staff to regulate the life industry, it is not surprising that the management of regulatory burden was one of the key areas of focus for companies in the Bermuda Market.

Embedding capital and risk management within day-to-day operations

Allied to the increased importance in capital levels and allocation to companies is the desire to embed the management of capital and risk across all levels of the companies' operations.

Improved management information

Number five on the list of issues that management teams will be focusing on over the coming year is improved management information. The unpredictable nature of the capital markets and increased focus of regulators and shareholders on good corporate governance has demonstrated a need for real-time, quality information to be available to management and those charged with governance.

… and the rest!

As might be expected in the prevailing financial climate, effective investment management and performance was identified as an area of management focus.

For a large number of respondents, identifying new geographic markets is an area of focus, consistent with companies looking to grow their business.

The decline in investment returns for Bermuda Market companies, whose investment portfolios extend across a wide range of investment classes and territories, will ensure that monitoring investment performance remains high on the agenda.

In addition to managing the regulatory burden, companies are also closely monitoring Solvency II developments in Europe whilst the BMA press ahead with and make plans to ensure that equivalence is achieved.

Relatively few respondents identified International Financial Reporting Standards (IFRS) as a key item to address in 2010. Whilst the SEC has delayed the decision on when U.S. public companies will move to one accepted international framework for financial reporting, we support the goal of moving toward a single set of high-quality global accounting

standards and believe that the convergence between US GAAP and IFRS wil continue, followed by ultimate conversion.

In the face of other challenges, it is understandable that the subject of IFRS is not at the forefront of most respondents minds, though we'd expect that to change in the future as U.S. GAAP and IFRS continue to converge and the SEC clarifies the position with respect to adoption by public companies in the United States.

However, the joint project by the FASB & IASB to introduce new guidance on how insurance contracts are to be accounted for further increases the likelihood of change in this area, and will significantly impact the life insurance industry.

Survey results

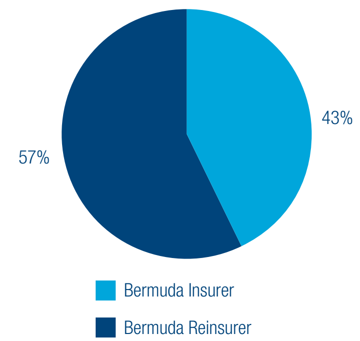
Size and status of the Bermuda Market

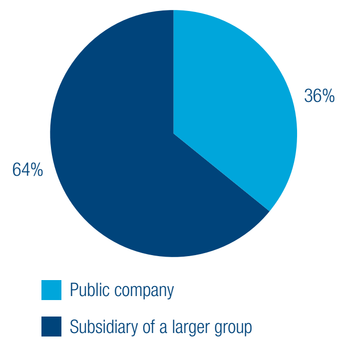
As this is our first survey of the life (re)insurance market in Bermuda, we thought a perspective on the size of the market and its participants would be helpful. Over time, we hope to be able to share our perspectives on the changes and trends in the market.

75% of the Bermuda Market actively writes/assumes new business, with 58% acquiring or managing closed books of business and one-third doing both.

Our survey results also showed that the Bermuda Market has a mixture of experience in the industry, with approximately 25% of the survey respondents being established within the last three years and at the other end of the spectrum, 42% have been established for ten or more years.

Figure 2 Please describe your organisation



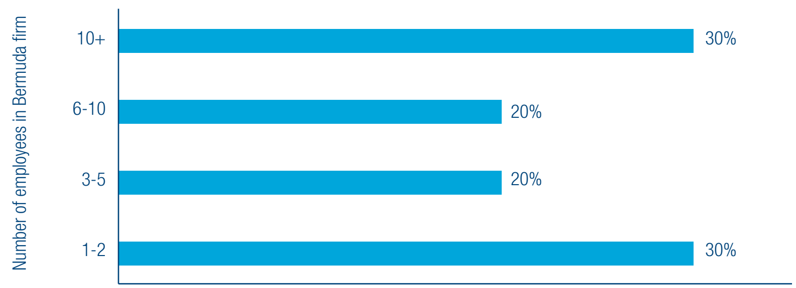


Source: PricewaterhouseCoopers

The slices in each chart within this document run from the vertical line at the top of the chart, clockwise. The first slice of the chart corresponds with the first label in the key and follows the clockwise order of the individual slices.

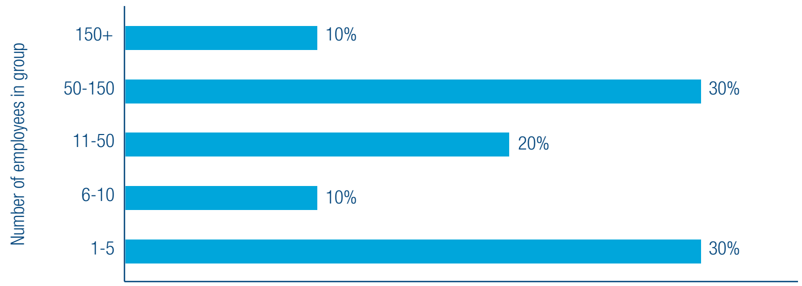
Survey results (cont'd)

Figure 3 Approximately how many employees does your company have in Bermuda?



Source: PricewaterhouseCoopers

Figure 4 Approximately how many employees does your group of companies have in Bermuda?

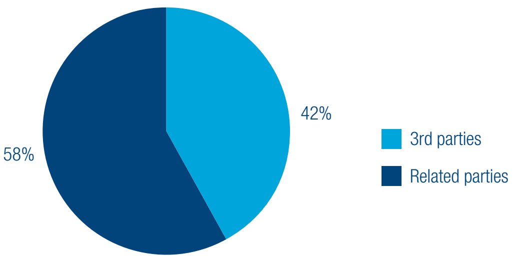


Source: PricewaterhouseCoopers

Both the number and size of life organisations in Bermuda frequently surprises those not close to the market. While the established local insurance companies have been writing long term business for a number of years, the last few years have seen healthy growth of new start-ups, typically starting out with one or two key staff members, but growing the teams as the business flourishes. A recurring theme in our analysis is that there really is no 'typical' Bermuda long term insurer.

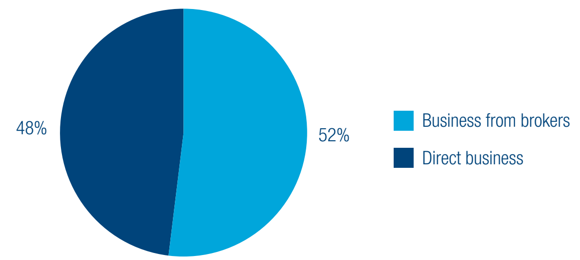
Survey results (cont'd)

Figure 5 Please specify the proportion of your life business distributed via third parties and related parties:



Source: PricewaterhouseCoopers

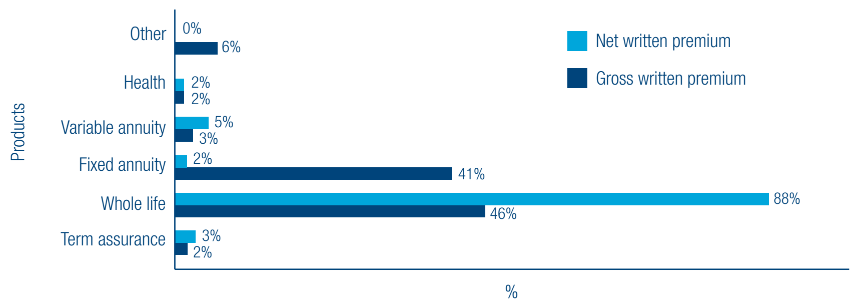
Figure 6 What proportion of your life business originates from brokers or is directly written:



Source: PricewaterhouseCoopers

Figures 5 and 6 demonstrate an approximate 50/50 split between 3rd party and related party business, and between broker and direct business.

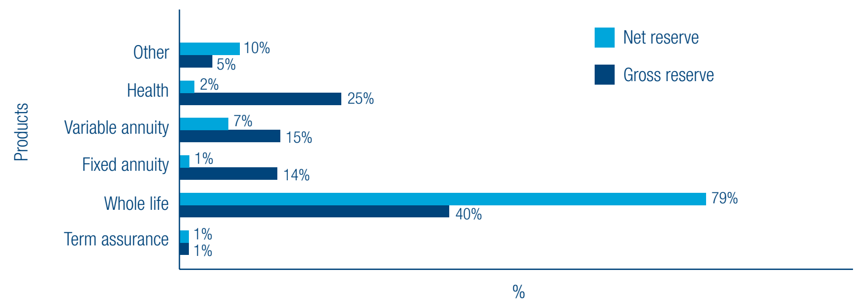
Figure 7 Please sub-divide your expected level of written premium in 2009 according to each of the following classes of business



Source: PricewaterhouseCoopers

Figure 7 shows that while whole life and fixed annuity business together comprise 87% of the gross written premium of respondents, whole life business accounts for almost 88% of the total net premium written. This is largely due to one respondent writing and retaining a significant amount of whole life business.

Figure 8 Please sub-divide your expected Bermuda statutory reserves in 2009 according to each of the following classes of business

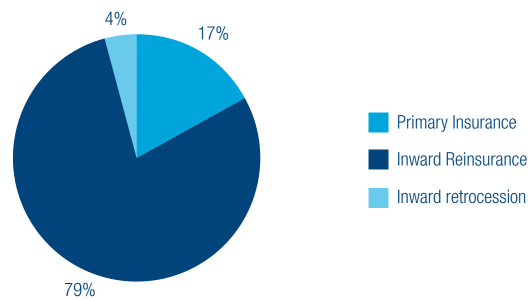


Source: PricewaterhouseCoopers

Similar to Figure 7, the whole life business comprises a more significant portion of the net reserves than it does on the gross reserves, again largely due to one respondent carrying significant gross and net reserves on whole life business.

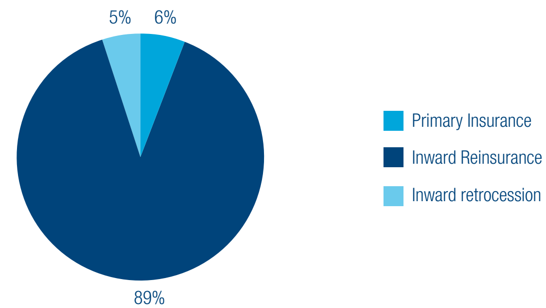
Survey results (cont'd)

Figure 9 Level of written premium in 2009 (Gross of reinsurance)



Source: PricewaterhouseCoopers

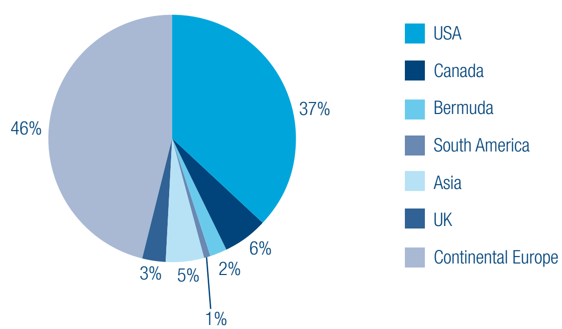
Figure 10 Level of written premium in 2009 (Net of reinsurance)



Source: PricewaterhouseCoopers

Unsurprisingly, Figures 9 and 10 confirm the reinsurance emphasis in Bermuda's long term business.

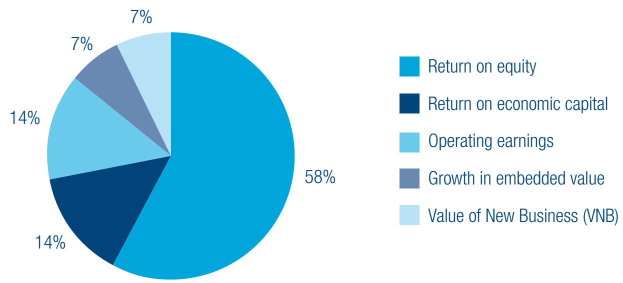
Figure 11 Please indicate the approximate split of premium income for each of the originating territories for your business



Source: PricewaterhouseCoopers

Survey results (cont'd)

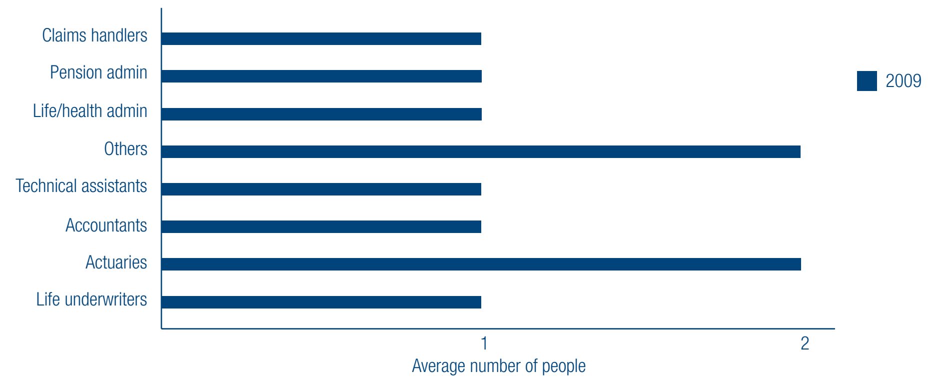
Figure 12 What is your primary profitability target?



Source: PricewaterhouseCoopers

Return on equity is the most popular profitability measure with only a minority using embedded value, despite growing interest in embedded value reaching beyond Europe.

Figure 13 What is the size of the life team within your Bermuda organisation?

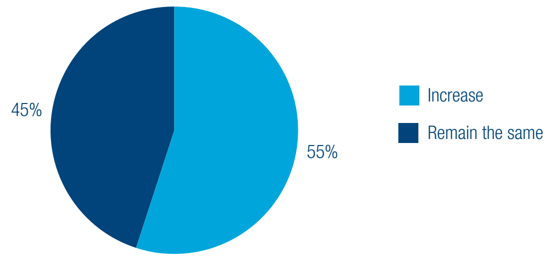


Source: PricewaterhouseCoopers

The significant emphasis on actuaries supports the traditional life business model, whereby actuaries frequently hold senior positions, and are often first on board with life start-ups. The "others" category includes marketing and administrative support staff.

Survey results (cont'd)

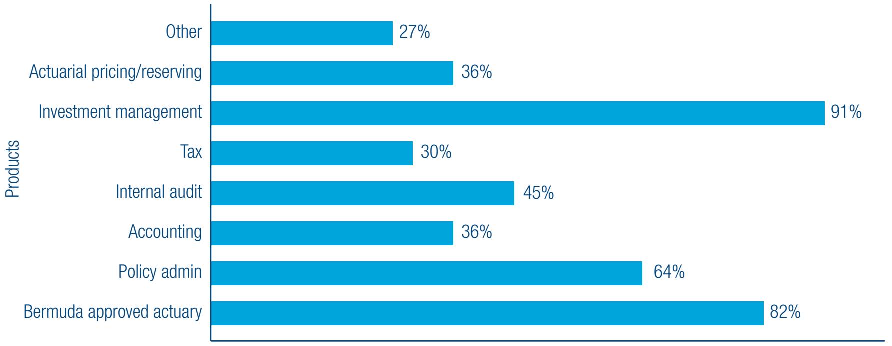
Figure 14 Do you expect that over the next 12 months the number of life professionals within your company will:



Source: PricewaterhouseCoopers

Consistent with the optimism surrounding business growth, continued investment in human capital is anticipated.

Figure 15 Which of the following functions do you outsource?

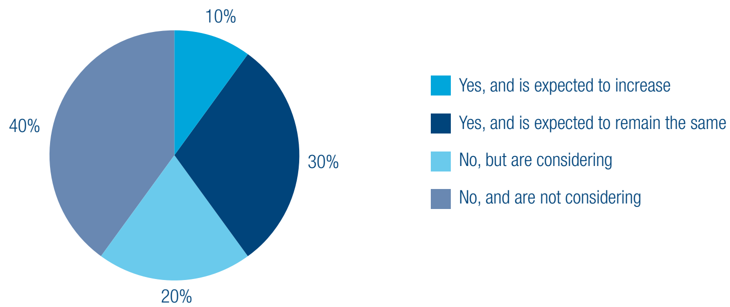


Source: PricewaterhouseCoopers

Interestingly, despite the large population of actuaries employed by Bermuda's life companies, a significant majority outsource the approved actuary function. The "other" category includes company secretarial functions and marketing.

Survey results (cont'd)

Figure 16 Did you use, or are you considering using, the capital markets for risk transfer in 2010 and what are your expectations regarding future levels of risk transfer through the capital markets?



Source: PricewaterhouseCoopers

Figure 17 Please grade the following factors when considering purchasing outwards reinsurance

Source: PricewaterhouseCoopers

Survey results (cont'd)

Prospects for 2010 onwards

Confidence in the growth prospects of the Bermuda Market was noticeable from the results of the 2010 Bermuda Life (Re)insurance Market Survey. Almost all respondents believed that there would be growth across most lines of business though this ranged from less than one-tenth of a percent to over 4.5%.

The majority of business written in Bermuda originates from the United States, at just over 37%, with a further 46% coming from Continental Europe. Of those respondents writing business in the US, the vast majority of them believe that their company will increase their business in that market. The same is true for those companies writing business in the U.K. and Continental Europe where companies are positive about growth.

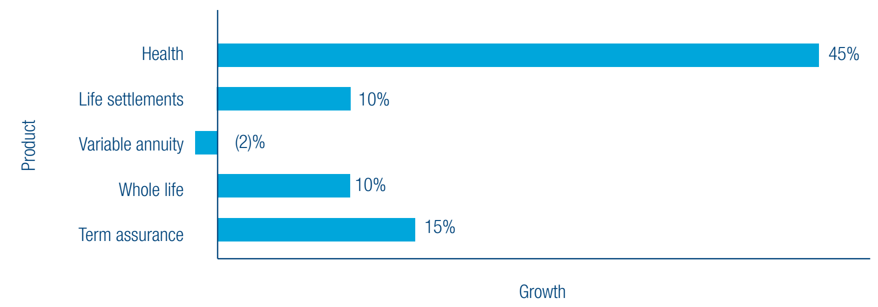
Of particular note was the mixed response from respondents with respect to the Asian market. Those already present in the market believed that there will be growth in their business within that territory, but it was surprising how few of the respondents not already in that market were considering entering.

Expectations about growth in each territory identified in the survey were also mixed. On the whole, markets in the U.S., U.K., Asia and Bermuda were expected to experience strong or some growth. Canada, the Caribbean and South America were expected to remain flat or to experience a small amount of growth. Only Continental Europe was considered likely to demonstrate a decline in business for those writing business in that territory.

Despite instances in the Bermuda property and casualty market in which companies have re-domiciled, the Bermuda life (re)insurance companies are not following suit. 73% of respondents haven't considered re-domiciling, with the remaining 27% considering such a move. Of those considering a move, the outcome of the BMA's consultation on replacing the existing capital solvency regime is a key factor.

Staffing and work permit issues was another challenge of operating in Bermuda that was specifically identified by over half of the respondents, with almost a quarter of respondents also noting the cost of operating in Bermuda as a factor.

Figure 18 How do you expect each of your lines of business to grow over the next 12 months?



Source: PricewaterhouseCoopers

The significant increase in health business is skewed by one respondent expecting premium on this line to double within the year and the low number of respondents with health business.

Survey results (cont'd)

Regulatory framework and environment

Bermuda has historically been renowned for its efficient and proportionate regulation and the vast majority of respondents indicated that the reasonableness of the regulation was the primary reason for choosing Bermuda as the domicile for their companies.

The second most important factor in the selection of Bermuda as a domicile is the tax efficiencies gained by having a Bermuda operating company, followed by the statutory relief gained through reinsuring to a Bermuda company.

Unsurprisingly, given the significance of the regulatory regime to the choice of domicile, Bermuda's current minimum solvency requirement ($250,000) for long-term insurers is considered beneficial by many Bermuda Market participants. Notwithstanding this, the vast majority of respondents indicated that they utilised guidelines other than the Bermuda solvency minimum for determining their own solvency margin with over half of the respondents following NAIC or rating agency guidelines.

The BMA's initiative to replace the current solvency regime is ongoing. On August 31, the BMA published its consultation paper on the solvency framework and invited comments by October 29, 2010.

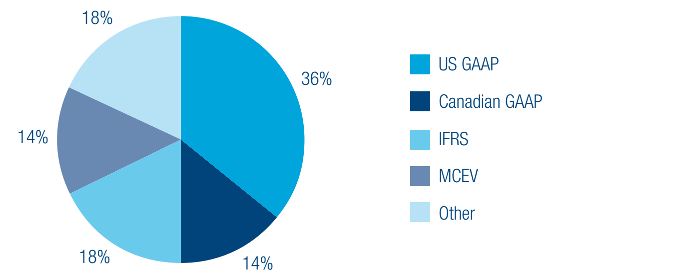
Certain aspects of the proposed solvency framework will come into operation on December 31, 2011.

Whilst a quarter of the survey respondents were in favour of maintaining the status quo, 43% suggested that a principles based approach be adopted. The introduction of a Solvency II or similar model was favoured by only 13% of the respondents, contrasting sharply with the property and casualty sector.

The respondents were split as to the impact for the Bermuda Market if the solvency regime is unchanged. Whilst a large number of respondents felt that there would be no impact on the Bermuda Market from maintaining the status quo, some respondents did feel that it may adversely affect the business ceded by European markets to Bermuda.

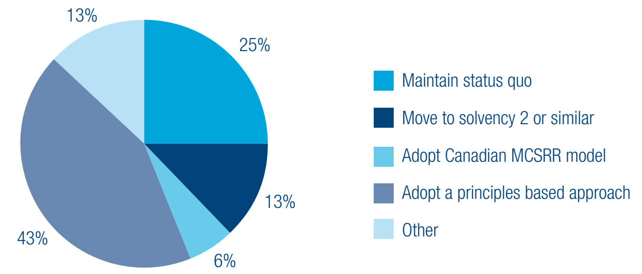
When asked what the implications would be for the Bermuda Market if the BMA implemented the proposals from the discussion paper, respondents believed that the volume of business written in Bermuda could decrease if the new requirements were too onerous, though a large number of respondents thought that the BMA's discussion paper hadn't provided sufficient detail about the proposals, making it difficult to determine the potential impact.

Figure 19 Which of the following reporting frameworks do you currently adhere to:



Source: PricewaterhouseCoopers

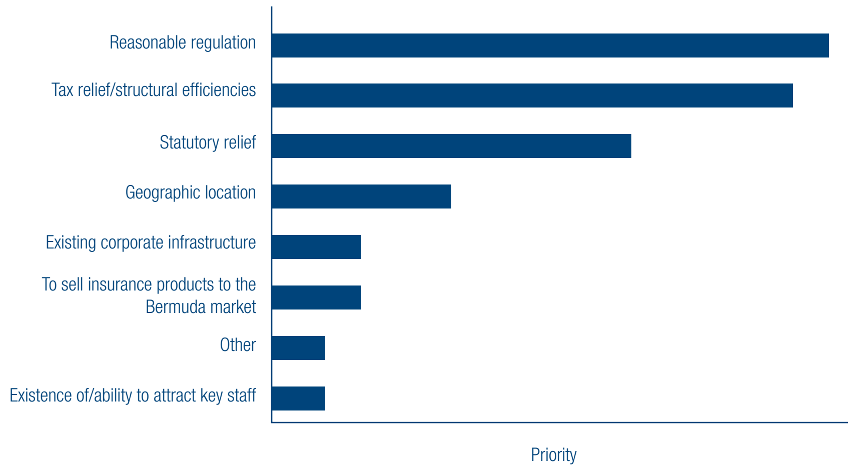
Figure 20 The Bermuda Monetary Authority has recently announced that it will be reviewing the solvency regime for life business. What would be your preferred outcome of such a review?



Source: PricewaterhouseCoopers

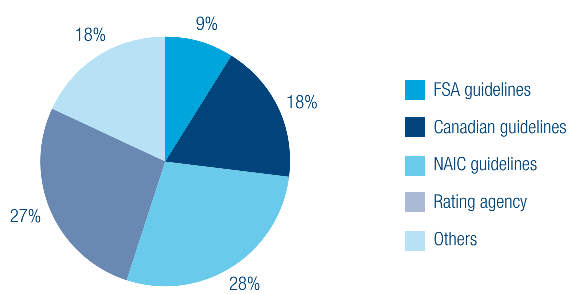
Survey results (cont'd)

Figure 21 Why did you choose to domicile your life (re)insurance company in Bermuda?



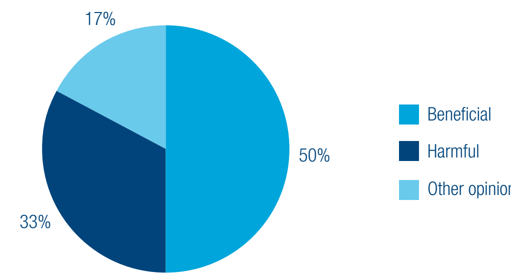
Source: PricewaterhouseCoopers

Figure 23 What guidelines or practices does your company use for its minimum solvency standard?



Source: PricewaterhouseCoopers

Figure 22 What is your view of the current Bermuda minimum solvency requirement for long-term/life business?



Source: PricewaterhouseCoopers

Those respondents in the "other opinion" category didn't consider the current requirements to be harmful or beneficial as the current Bermuda minimum solvency requirement wasn't the minimum solvency standard used by their company.

Contacts

If you would like to discuss any of the issues raised in this report, please speak to your usual contact at PricewaterhouseCoopers or one of the editorial board members listed below:

Daniel A. Grady
Partner
Phone: +1 (441) 299-7166
Email: dan.grady@bm.pwc.com

Colm A. Homan
Partner
Phone: +1 (441) 299-7116
Email: colm.homan@bm.pwc.com

Stewart Ritchie
Senior Manager
Phone: +1 (441) 299-7262
Email: stewart.ritchie@bm.pwc.com

Survey participants

We would like to take this opportunity to thank all those organisations and executives who agreed to participate in the development of this survey. We are extremely grateful for the time that they gave us, especially for the openness with which they discussed the key issues facing their industry.

Additional copies

For information on other insurance and financial services related publications or if you would like additional copies of this survey, please contact Erica Martin, Manager, Bermuda Marketing, on +1 (441) 299-7275 or email erica.martin@bm.pwc.com.