



NO ISLAND IS AN ISLAND

EU mutual recognition provides both challenges and opportunities for Bermuda reinsurers, write **Guy Soussan** and **Gavin Coull**



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Until recently, the “light touch” regulatory approach in Bermuda acted as a magnet for both start ups and foreign reinsurers. However, the Bermudian reinsurance market is now at a crossroad, grappling with the question of remaining an attractive domicile for reinsurers whilst ensuring continued access to the European Union (EU) market on non-discriminatory terms.

Bermuda based reinsurers, just like any other non-EU domiciled reinsurers, now face in Europe the regulatory mutual recognition test, contained in two key legislative initiatives (the Reinsurance Directive and the proposed Solvency II Directive). This regulatory framework makes it a prerequisite for full access and equal treatment that the non-EU domicile applies prudential and supervisory standards equivalent to the EU.

As such, any lack of mutual recognition, as is currently the position for Bermuda, will significantly influence the conditions for establishment of EU branches, as well as the conduct of cross-border business. Absent mutual recognition, EU Member States may impose additional requirements on doing business to ensure that a third-country reinsurer does not benefit from a more lenient supervisory regime than their own. Whilst to date the majority of Member States (France being a notable exception) have not, for example, extended collateral requirements for business ceded to non-EU reinsurers, this is certainly not guaranteed for the future, and remains a cause for concern.

A second and perhaps even more pressing concern is obtaining the benefit of group supervision under Solvency II, again dependent upon achieving mutual recognition status. In the absence of mutual recognition, a Bermudian domiciled reinsurance group with significant subsidiaries in the EU would not be able to take advantage of the benefits of group supervision.

Falling outside of group supervision will lead to serious prudential consequences, as the Bermuda-

held capital and the diversification benefits of the worldwide business of Bermudian groups will not be taken into account in the solvency calculations of their EU operations. Without equivalence it is open to EU supervisors to oblige Bermudian groups to establish an EU-based holding company to facilitate group-wide supervision of their EU business. As a result, the cost of regulatory capital for Bermudian domiciled reinsurers would be significantly higher than that of EU-based groups, creating a clear competitive disadvantage.

Conversely, from a regulatory perspective EU supervisors would not recognize or rely upon group supervision already carried out under the “home” Bermudian framework. Lack of recognition would also prevent group support (under which a parent could transfer funds to a subsidiary if required) being made available, a clear impairment to the efficient utilisation of capital.

There is a real concern that Bermuda will not be granted mutual recognition status. Given the potential ramifications for the Bermudian market, the Bermuda Monetary Authority is striving to address concerns, issuing its “Roadmap to Solvency II Equivalence”. Whilst the majority of Bermudian-domiciled reinsurers are still sitting tight, in the hope that Bermuda will match Solvency II requirements, if the roadmap is not followed, it is likely that all options will be reviewed.

As a final observation it is worth noting that Bermuda is not just competing with EU domiciled markets, but also with other third-country domiciles (in particular Switzerland). At the end of the day, as Solvency II approaches adoption in early 2009, Bermuda and other third-country domiciles such as Switzerland share the same concerns and have the same objectives, namely to ensure that the European marketplace is accessible to all on equal terms through mutual recognition. Just as “no man is an island entire of itself”, the positive indications are that Bermuda’s regulators will ensure that Bermuda will not be just “an island”, but will take all steps necessary to achieve mutual recognition and equivalency, and remain a key part of the international reinsurance market place.

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