



INSURANCE COMMISSION
OF THE BAHAMAS

GENERAL INSURANCE CAPITAL ADEQUACY GUIDELINES

This Guideline outlines the capital adequacy requirements for general insurance companies. It details the approach to determining the required risk-based capital and the available capital taking into consideration the quality of available capital.

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Table of Contents

General Insurance Capital Adequacy Guideline 2

1. Citation 2

2. Definitions 2

3. Application..... 2

4. Regulatory Capital Available..... 3

 A. Tier 1 Capital 3

 B. Tier 2 Capital 4

 C. Deductions..... 5

5. Regulatory Capital Requirement 5

 A. Asset Default Risk Charge..... 5

 B. Off Balance Sheet Risk Charge..... 7

 C. Foreign Currency Mismatch Risk Charge..... 7

 D. Premium Adequacy Risk Charge..... 7

 E. Outstanding Claims Risk Charge..... 8

 F. Catastrophe Risk Charge..... 8

 G. Operational Risk Charge 10

 H. Diversification Credit 10

6. Regulatory Capital Ratio and Capital Management 11

7. Returns, Audit and Declarations..... 11

8. Grandfathering Provision..... 11

Schedule 1- Declarations..... 13

 Declaration by the Chief Financial Officer..... 13

 Declaration by the Actuary 13

 Declaration by a Director of the Company..... 13

General Insurance Capital Adequacy Guideline

Pursuant to s. 78, Insurance Act, 2005 and reg. 91, Insurance (General) Regulations, 2010

1. Citation

This Guideline may be cited as the General Insurance Capital Adequacy Guideline and supersedes and replaces all prior guidance, directives, and communications relating to capital adequacy requirements for General insurers.

2. Definitions

In this Guideline:

- i. “back-to-back placements” are reciprocal cross holdings (either directly or indirectly) in the common shares of insurance, banking and financial entities that occur between two or more companies, that are financially regulated institutions (e.g. Company A holds shares of Company B and Company B in return holds shares of Company A), and that are designed to inflate the capital position of institutions.
- ii. “foreign insurer” means a branch of a foreign insurance company, which is registered to carry on insurance business in The Bahamas;
- iii. “net claims” refers to the total general insurance claims paid in the immediately preceding twelve months, net of reinsurance;
- iv. “net premiums” refers to the total general insurance premiums received in the immediately preceding twelve months, net of reinsurance subject to the limit set out in Regulation 92 of the Insurance (General) regulations, 2010, and without any further adjustments;
- v. “net unearned premiums” means the amount as determined under section 75 of the Insurance (General) Regulations for general insurance business, net of reinsurance subject to the limit set out in Regulation 92 of the Insurance (General) regulations, 2010, and without any further adjustments;
- vi. “liability for incurred claims” means the obligation of an insurance company to pay valid claims that have already occurred including claims that have not yet been reported as determined under IFRS 17; and
- vii. “Regulatory Capital Available” is the total qualifying capital instruments available to be used in an insolvency event. It is the sum of Tier 1 and Tier 2 Capital, less the deductions from capital as summarized in Section 5;
- viii. “Regulatory Capital Requirement” is the minimum level of capital that the insurance company must maintain, determined based on the insurance company’s specific risk profile and applicable risk-based capital rules, with a minimum capital requirement of \$2 Million;
- ix. “Risk Adjustment” is needed under IFRS 17 and reflects the additional capital that the insurance company requires for bearing the non-financial risks associated with insurance contracts;
- x. “Regulatory Capital Ratio” means the calculated Regulatory Capital Available plus the Risk Adjustment divided by Regulatory Capital Requirement. It must exceed the mandated Regulatory Capital Threshold of 150%;
- xi. “Target Capital Ratio” is the insurance company’s internal target ratio for the Regulatory Capital Available plus the Risk Adjustment both divided by Regulatory Capital Requirement. It must exceed the mandated 150% “regulatory capital ratio threshold”;

3. Application

These Guidelines apply to domestic insurers in respect of insurance business both in and outside of The Bahamas. The term “liability for incurred claims” defined above applies equally to the liability for incurred claims both inside and outside of The Bahamas. The Regulatory Capital Available and Requirement are to be determined using the unconsolidated financial statements of the insurer. Insurance companies must apply this guideline consistently across insurance products. Methodology and assumptions must be documented and

subject to actuarial review. The Capital Adequacy Model template must be completed and submitted to the Insurance Commission of The Bahamas (“the Commission”) quarterly.

4. Regulatory Capital Available

Regulatory Capital Available represents the quality and quantity of financial resources an insurer can reliably draw upon to absorb losses and protect policyholders. Financial instruments will only be considered for regulatory capital where these instruments:

- i. are permanent;
- ii. are free of mandatory fixed charges against earnings; and
- iii. have a subordinated legal position to the rights of policyholders and other creditors.

Total Available Capital consists of Tier 1 (core capital) and Tier 2 (supplemental capital). Tier 1 capital comprises the highest quality elements. Tier 2 elements fall short of either of the first two capital qualities but contribute to the overall strength of the company as a going concern.

All capital instruments must be issued and fully paid for in cash or, with the approval of the Insurance Commission of The Bahamas (“the Commission”), in property.

Regulatory Capital Available for a domestic insurer is the sum of Tier 1 and Tier 2 Capital, less the deductions from capital as summarized in Part C of this section. Tier 2 capital is capped and shall not exceed 100% of the Net Tier 1 Capital.

For a foreign insurer, the Regulatory Capital Available is the sum of the total amount of initial deposit in accordance with s. 43, Insurance Act, 2005 (“the Act”), the statutory funds held in trust in accordance with s. 45(4) of the Act, any excess assets in The Bahamas plus the net contractual service margins associated with title insurance contracts less the total liabilities and reserves required in The Bahamas. The net contractual service margin associated with title insurance contracts are the contractual service margins that are reported as liabilities in the financial statements less contractual service margins that are reported as assets in the financial statements.

A. Tier 1 Capital

Net Tier 1 (or core) Capital shall be the amount by which the value of Gross Tier 1 Capital defined in subsection (a) exceeds the total of the deductions defined in subsection (b).

- a) Gross Tier 1 Capital shall be the sum of:
 1. ordinary share capital (issued and fully paid up);
 2. contributed surplus;
 3. retained earnings (or deficit);
 4. net contractual service margins associated with title insurance contracts;
 5. preference shares or other financial instruments that meet the requirements of Tier 1 Capital as outlined in this section;
 6. revaluation reserves approved by the Commission; and
 7. non-controlling interest.

- b) The amount to be deducted from Gross Tier 1 Capital shall be any unrealized gains on assets included in retained earnings and revaluation reserves. The amount is then reintroduced in Tier 2A Capital, limited to 20% of Net Tier 1 Capital.
- c) Financial instruments, unless specifically approved as Tier 1 capital by the Commission, may only be included in Tier 1 Capital if they meet the following conditions:
 - a. they are of perpetual duration and fully paid;
 - b. there is no option for redemption at the request of the holder;
 - c. they are fully subordinated to the interests of policyholders and other creditors;
 - d. dividends are not cumulative in the event of non-payment; and
 - e. the amount does not exceed 33% of Tier 1 Capital excluding preference shares.

Net Tier 1 Capital must exceed the minimum stated capital prescribed in regulation 60 of the Regulations.

B. Tier 2 Capital

Tier 2 Capital is divided into Tiers 2A and 2B and shall not exceed 100% of Net Tier 1 Capital.

Tier 2A Capital comprises the following:

- a. preference shares or other financial instruments that would have been included in Tier 1 Capital but for the limit in Tier 1 Capital;
- b. hybrid capital instruments that do not meet the definition of Tier 1 Capital but meet the requirements for Tier 2A outlined below;
- c. unrealized gains excluded from Tier 1 Capital with unrealized gains on real estate limited to 20% of Net Tier 1 Capital.

Hybrid capital instruments may only be included in Tier 2A Capital if they meet the following conditions:

- a. they are of perpetual duration and fully paid up;
- b. there is no option for redemption at the request of the holder;
- c. they are fully subordinated to the interests of policyholders and other creditors;
- d. dividends or interest are able to be deferred (as for example with cumulative preference shares) where the profitability of the company would not support payment; and
- e. must not contain restrictive covenants or default clauses that would allow the holder to trigger acceleration of repayment in circumstances other than the insolvency, bankruptcy or winding-up of the insurer.

Tier 2B Capital includes limited-life instruments that meet the following criteria:

- a. the initial minimum term is greater than five years;
- b. they are fully paid up in cash or, with the approval of the Commission, in real or personal property;
- c. they are fully subordinated to the interests of policyholders and other creditors; and
- d. if the remaining term of the instrument is less than five years, the amount of the instrument included in Tier 2B Capital is amortized according to the following schedule:
 - i. remaining term 4 years but less than 5 years 80%
 - ii. remaining term 3 years but less than 4 years 60%
 - iii. remaining term 2 years but less than 3 years 40%
 - iv. remaining term 1 year but less than 2 years 20%

- v. remaining term less than 1 year nil

Limit: Tier 2B Capital shall not exceed 50% of Net Tier 1 Capital.

C. Deductions

The sum of Tier 1 and Tier 2 Capital shall be reduced by the following:

- a. goodwill and other intangible assets;
- b. capital issues between two or more companies that represent either directly or indirectly, back-to-back placements;
- c. pension plan assets; and
- d. investment in financial subsidiaries.

5. Regulatory Capital Requirement

The Regulatory Capital Requirement is the sum of the following less a Diversification Credit:

- A. Asset Default Risk Charge;
- B. Off Balance Sheet Risk Charge;
- C. Foreign Currency Mismatch Risk Charge;
- D. Premium Adequacy Risk Charge;
- E. Outstanding Claims Risk Charge;
- F. Catastrophe Risk Charge; and
- G. Operational Risk Charge

A. Asset Default Risk Charge

Asset Default Risk Charge is the sum of the various asset class amounts multiplied by an appropriate risk factor for each asset class as shown in Table 1. The asset values are based on the IFRS 17 fair-value calculation as of the valuation date.

Table 1

Asset Class	Factor
Cash, bank balances and bank deposits	0.00
Bank certificates of deposit	0.00
Treasury bills	0.00
Treasury notes/bonds	0.00
Government and government guaranteed securities	0.00
Government corporation/agency bonds (not guaranteed)	0.10
Corporate bonds – listed	0.20
Corporate bonds - not-listed	0.20
Real estate / Investment Property	0.15
Equity securities – listed	0.20
Equity securities - not-listed	0.20
Preferred shares – listed	0.15
Preferred shares - not-listed	0.15
Other debt instruments - listed	0.20

Asset Class	Factor
Other debt instruments - not-listed	0.20
Mortgage loans – performing	0.00
Mortgage loans - non-performing (overdue 90 days or more)	0.20
Mutual funds	0.20 ¹
Investment in financial subsidiaries	0.00
Investment in related parties if not financial subsidiary	1.00
Other investments	0.25
Reinsurance Contracts Held Assets:	
<i>Reinsurer at least investment grade rated (S&P BBB- and above)</i>	0.02
<i>All other reinsurers</i>	0.15
Asset for insurance acquisition cash flows	1.00
Receivables from agents ² :	
<i>0 - 30 days outstanding</i>	0.10
<i>31 - 60 days outstanding</i>	0.15
<i>Over 60 days outstanding</i>	0.25
Premium receivables ² :	
<i>0 - 30 days outstanding</i>	0.00
<i>31 - 60 days outstanding</i>	0.15
<i>Over 60 days outstanding</i>	0.15
Interest receivable on investments	0.00
Goodwill and other intangible assets	0.00
Land and building (used in operations)	0.15
Accounts receivable	0.15
Prepayments	0.15
Equipment and machinery	0.15
Office, furniture and fixtures	0.15
Computer software	0.15
Leasehold improvements	0.15
Motor vehicles	0.15
Other assets	0.25

¹ Alternatively, the “look through” approach may be used for the underlying assets of the fund; using the corresponding factors on a pro rata basis.

² Insurance receivables (receivables from agents, premium receivables) are included in the asset default calculation despite these items no longer being explicitly shown as assets on the IFRS 17 balance sheet.

B. Off Balance Sheet Risk Charge

The Off Balance Sheet Asset Risk Charge is the sum of the exposure amount³ for off balance sheet transactions, including but not limited to structured settlements, letters of credit, synthetic assets, and derivative contracts, multiplied by the applicable risk factor based on the type of transaction, its term to maturity and the counterparty credit risk as stated in Table 1 above.

The Off-Balance Sheet Liability Risk Charge shall be based on the risk factor for the counterparty.

C. Foreign Currency Mismatch Risk Charge

The Foreign Currency Mismatch Risk Charge shall be

- a. 2% of the total of the net open positions in any other currency issued by countries rated BBB and above, expressed in Bahamian dollars; and
- b. 8% of the total of the net open positions in any currency issued by countries rated BBB- and below, expressed in Bahamian dollars.

The credit ratings referred to above shall be the Standard and Poor’s ratings.

The net open position shall be the absolute value of the assets denominated in a currency less the liabilities denominated in that currency. The value shall be converted to Bahamian dollars using the prevailing selling rate at the valuation date as determined by the Central Bank of The Bahamas.

Where the actuary can demonstrate that provisions for foreign currency mismatch have been established within the policy liabilities, then such provisions can be offset against this capital requirement.

D. Premium Adequacy Risk Charge

The Premium Adequacy Risk Charge shall be calculated by line of business, by multiplying the applicable risk factor by the greater of net unexpired coverage (after deducting the non-financial risk adjustment) and net premiums⁴ received in the past 12 months.

The applicable risk factors are as follows:

Table 2

Class of Insurance	Risk Factor
Personal Property	12.5%
Commercial Property	12.5%
Motor Vehicles	10%
Liability	20%

³ The off balance sheet exposure amount is the face value (for letters of credit) or the replacement cost obtained by marking to market (for structured settlements and for derivatives) net of any collateral or guarantees. Based on the nature of the transaction, it may be necessary to include an additional amount to reflect potential future credit exposure.

⁴ Net premiums = gross premiums received in the immediately preceding twelve months, net of associated reinsurance premiums paid subject to the limit set out in Regulation 92 of the Insurance (General) regulations, 2010, and without any further adjustments.

<u>Class of Insurance</u>	<u>Risk Factor</u>
Pecuniary Loss	20%
Marine, Aviation and Transport	15%
Title	12.5%
Other	20%

E. Outstanding Claims Risk Charge

The Outstanding Claims Risk Charge shall be calculated by line of business, by multiplying the applicable risk factor by the net liabilities for incurred claims (after deducting the non-financial risk adjustment). The risk charge cannot be less than zero for any one line of business.

The applicable risk factors are as follows:

Table 3

<u>Class of Insurance</u>	<u>Risk Factor</u>
Personal Property	12.5%
Commercial Property	10%
Motor Vehicles	12.5%
Liability	25%
Pecuniary Loss	20%
Marine, Aviation and Transport	20%
Title	15%
Other	25%

F. Catastrophe Risk Charge

Catastrophe risk shall be calculated using either Method 1 (Factor-based model) or Method 2 (Stochastic model) as described below. Method 2 will be used in the cases where it is provided.

Method 1: The Catastrophe Risk Charge shall be determined by the following formula:

Risk Charge =

$$\sqrt{\sum_{t \neq 3,4,10,12} (c_t \times P_t)^2 + (c_3 \times P_3 + c_{12} \times P_{12})^2 + (c_4 \times P_4 + c_{10} \times P_{10})^2}$$

where

$P_{LoB(t)}$ = the annual net written premiums⁵ for the individual lines of insurance business (LoB).

LoB(t) and the factors c_t are as defined in Table 4.

Table 4

LoB (t)	Factor c_t
1. Motor, 3rd-party	0.15
2. Motor, other	0.075
3. Marine / Aviation / Transport	0.50
4. Fire/Property	0.75
5. Liability	0.15
6. Credit	0.60
7. Legal expense	0.02
8. Assistance	0.02
9. Miscellaneous / Other	0.25
10. Reinsurance (Property)	1.50
11. Reinsurance (Casualty)	0.50
12. Reinsurance (Marine /Aviation / Transport)	1.50

Method 2: Model Generated Method

If the insurer uses a model to estimate its Probable Maximum Loss (PML) from earthquakes or windstorms, then the Catastrophe Risk Charge shall be determined using Method 2 as follows:

Greater of (a) and (b) where:

(a) = PML_{250} for Windstorm less Reinsurance collectable for Windstorm; and

(b) = PML_{500} for Earthquake less Reinsurance collectable for Earthquake

The risk charge shall be greater than or equal to zero.

‘ **PML_{250} for Windstorm**’ refers to the Gross Probable Maximum Loss for windstorm estimated using a 250 year event return period at a 75 percent damageability confidence level for deterministic models or a 250 year loss return period at a 50 percent damageability confidence level for probabilistic models.

‘ **PML_{500} for Earthquake**’ refers to the Gross Probable Maximum Loss for earthquake estimated using a 500 year event return period at a 75 percent damageability confidence level for deterministic models or a 500 year loss return period at a 50 percent damageability confidence level for probabilistic models.

‘**Probable Maximum Loss (PML)**’ is the threshold dollar value of losses beyond which losses caused by a major earthquake or windstorm event are unlikely. Gross PML is the PML amount after deductibles but before catastrophic and other reinsurance protection.

⁵ Gross premiums received in the immediately preceding twelve months, net of associated reinsurance premiums paid.

‘Reinsurance collectable’ refers to amounts that would be collectable under the current documented reinsurance program for the insurer or branch if it were to sustain windstorm or earthquake losses that match the relevant return period and should be equal to an amount of reinsurance collectable for a loss of the size of the PML, net of retention.

‘Damageability confidence level’ refers to the probability that the actual damage ratio will be less than or equal to the damage ratio calculated by the model. Deterministic models follow known rules and are therefore predictable. Probabilistic models require the use of random variables that involve some degree of uncertainty in predicting their behaviour. Therefore, the higher confidence level is required for the more predictable method.

General insurers with material exposure to earthquake and windstorm risks are encouraged to use models to estimate their PML. Models include models licensed from various commercial vendors and maintained in-house or run by third parties on behalf of the insurer or can be an internal estimation technique or model developed by the insurer to the Commission’s satisfaction.

The insurer is also asked to provide the following data for both earthquake and windstorm catastrophe coverage:

- The company’s gross aggregate exposure net of deductibles but before reinsurance
- Total facultative coverage where the company retains partial risk
- Total facultative coverage where the company retains no risk

G. Operational Risk Charge

Operational Risk is the risk arising from inadequate or failed internal processes or systems, behaviour of personnel, or from external events. Operational risk includes legal risk and the portion of conduct risk that affects insurers but excludes strategic and reputational risk.

The required capital for Operational Risk is 10% of the total required capital before the provision for Operational Risk.

H. Diversification Credit

Because losses arising across some risk categories are not perfectly correlated with each other, a company is not likely to incur the maximum possible loss at a given level of confidence from each type of risk simultaneously. Consequently, an explicit credit for diversification is permitted between the sum of credit and market risk requirements, and the insurance risk requirement so that the total capital required for these risks is lower than the sum of the individual requirements for these risks.

The diversification credit is calculated using the following formula.

$$\text{Diversification Credit} = (A + I) - (A^2 + I^2 + 2 \times R \times A \times I)^{1/2}$$

where:

A is the asset risk margin, which is the sum of capital required for:

- asset default risk;
- off balance sheet risk; and
- foreign exchange risk.

I is the insurance risk margin, which is the sum of capital required for:

- premium adequacy risk
- outstanding claims risk; and
- catastrophe risk.

R is the correlation factor between A and I, assumed to equal 50%.

6. Regulatory Capital Ratio and Capital Management

Regulatory Capital Ratio (RCR) means the Regulatory Capital Available plus the Risk Adjustment divided by Regulatory Capital Requirement expressed as a percentage. Risk adjustment reflects the non-financial risk only, cannot be below zero, and must be separately disclosed in the provided reporting.

Companies are required to establish a Target Capital Ratio Threshold in excess of a Regulatory Capital Ratio of 150% and manage their capital levels such that the regulatory capital ratio is always in excess of its TCR. The TCR should be determined based on the company's Own Risk and Solvency Assessment, necessary to cover the risks specified in the capital tests as well as all other risks of the insurer. The TCR should be based on stress testing and scenario testing to establish a capital buffer commensurate with the variability and risks in the business.

A RCR below the 150% Regulatory Capital Ratio Threshold will attract regulatory attention and require insurance companies to present a capital plan outlining how the company will return to a capital ratio in excess of the TCR. A drop in the capital ratio to a level below the Minimum Capital Ratio Threshold of 120% will attract the most severe regulatory intervention including suspension of registration under the Insurance Act.

All insurers are required to assess the quality and adequacy of capital resources to meet regulatory requirements and other capital needs. This must be reported in the insurer's annual capital management plan.

7. Returns, Audit and Declarations

- a. An insurer is required to submit to the Commission, Capital Adequacy Returns in such form as the Superintendent of Insurance may from time to time specify in accordance with the requirements of s. 58 of the Act;
- b. In addition to the Capital Adequacy Returns required to be submitted under this Guideline and the Act, an insurer shall provide a declaration by the Chief Financial Officer and a Director of the insurer in the format as set out in Schedule 1 of this Guideline. The Actuary shall provide a declaration annually for the year-end Capital Adequacy Return using data through Quarter 4 (December 31st).

8. Grandfathering Provision

Unrealized gains on real estate prior to the commencement of this Guideline that have not subsequently been realized, will be treated as though they were realized and shall not be subject to restrictions on regulatory capital in this Guideline.

Schedule 1- Declarations

Declaration by the Chief Financial Officer

I,, **Chief Financial Officer of Company Name, Address of Company** have reviewed the calculation of the Regulatory Capital Ratio of **Company Name**, as at **(Date)**. In my opinion, the calculation has been determined in accordance with the General Insurance Capital Adequacy Guideline and any applicable instructions of the Insurance Commission of The Bahamas.

Signature of the Chief Financial Officer

Date

Declaration by the Actuary

I,, **Actuary of Company Name, Address of Company** have reviewed the calculation of the Regulatory Capital Ratio of **Company Name**, as at **(Date)**. In my opinion, the calculation has been determined in accordance with the General Insurance Capital Adequacy Guideline and any applicable instructions of the Insurance Commission of The Bahamas.

Signature of the Actuary

Date

Declaration by a Director of the Company

I,, **Officer of Company Name, Address of Company** have reviewed the calculation of the Regulatory Capital Ratio of **Company Name**, as at **(Date)**. In my opinion, the calculation has been determined in accordance with the General Insurance Capital Adequacy Guideline and any applicable instructions of the Insurance Commission of The Bahamas.

Signature of a Director

Date