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Guernsey Financial
Services Commission

SPECIAL PURPOSE INSURERS - GUIDANCE NOTE

Issued December 2016
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INTRODUCTION

The class of Special Purpose Insurer was created by the provisions of the Insurance Business (Special Purpose Insurer) Rules [2016] (Collectively referred to as the "Rules"). The Rules were made under the provisions of the Insurance Business (Bailiwick of Guernsey) Law 2002, as amended (the "Law").

The Rules set out certain requirements applicable to Special Purpose Insurers. These requirements and the application of the Commission's powers under the Law as they relate to Special Purpose Insurers are further explained in this guidance.

Special Purpose Insurers may include certain types of insurance linked securities business in Guernsey, including collateralised reinsurance, catastrophe bonds, side-cars and life based securitisations. Special Purpose Insurers must be fully collateralised to the extent of their liabilities meaning that unlike traditional insurers, they carry no risk gap between their liabilities and assets.

Such structures also typically utilise independent trustees and security trusts to protect collateral and except for asset monitoring are typically inactive from inception until the termination of the underlying insurance / reinsurance contract.

Applying a risk-based approach, it is acknowledged that Special Purpose Insurers present lower regulatory risk than some other types of insurer and are supervised accordingly, e.g. Special Purpose Insurers are not subject to the risk-based solvency requirement applicable to other types of licensed insurer in Guernsey.

Special Purpose Insurers also typically apply standardised documentation and experience high volumes of transactions concentrated at particular points of the calendar year when the insurance and reinsurance markets go through renewal of their programmes. The concentration of renewals at certain times of the year implies a need for a prompt regulatory response to applications and in particular to cells in protected cell companies, provided that such entities remain within agreed operating limits and subject to appropriate conditions.

It is therefore appropriate and proportionate for the Commission to set out specific guidance and rules which apply to such structures. These are generally only a codification of the manner in which the Commission already applies its discretionary powers and has done for a number of years.

Characteristics of Special Purpose Insurers

Special Purpose Insurers are diverse and exist in an area of flux and innovation. A Special Purpose Insurer may have one or more of the following characteristics;

- Raise capital against a group of underlying insurance or reinsurance contracts, usually linked to catastrophe losses emanating from natural perils (whether triggered on a parametric basis or by specific indemnity limits);
- Generally only transact with other regulated parties and accept capital from appropriately regulated corporates and funds;
- Apply or raise capital against a specific reinsurance contract / retrocession or series or group of them, usually for a limited duration;

- Hold capital in secured, independent trust accounts for the benefit of the (re)insured;
- Limit liability contractually to the assets held in respect of the specified retrocession(s);
- Often utilise protected cells for the purpose of creating statutory protections against insolvency.

It is a requirement, however, that a Special Purpose Insurer is fully funded i.e. that at all times the Special Purpose Insurer has assets the value of which is equal to or exceeds the aggregate maximum risk exposure and the insurer or cell is able to pay the amounts it is liable for as they fall due.

Applications

The initial application for a Special Purpose Insurer (or a new controller of a Special Purpose Insurer) is like any other insurance application. It involves the submission of the appropriate application form, due diligence and a detailed business plan. The initial application for a new structure is likely to take a longer period than applications for new cells / variations to underwriting criteria. Of key importance to the Commission is reassurance as to the assumption of risk and the criteria which will be applied to ameliorate risk, in particular security, statutory ring fencing of assets between deals (for example by the use of protected cells) and contractual limitations of liability. Applicants for new structures are advised to discuss their requirements with the Commission's staff prior to making an application as an introduction may facilitate the speed of the approvals process.

Once a new structure is created, the Commission is prepared to pre-approve groups of further cells / transactions provided that they fall within the criteria set out in the relevant business plan.

For established SPI structures the Commission may waive the requirement for submission of application documentation and fee for a period of up to 7 days after deal closing. Relevant documentation must be maintained at the business premises of the SPI for inspection by Commission staff if required.

Collateral Requirements

Typically, cash assets will be applied against liabilities, however the Commission recognises that the commercial intentions of counterparties may be satisfied by the use of (re)insurance, letters of credit, or partly paid shares and the Commission may apply its discretion to approve the use of such assets (or a combination of them). When considering approval of the use of contingent assets the Commission will take into account the regulatory status, regulatory domicile, financial credit rating of the counterparty and any other information it deems relevant.

The Commission will consider the use of partly paid capital for contracts involving long term insurance, such as mortality swaps, where the reinsurance contract is for not longer than 5 years but will require that the use of such funding be disclosed to the cedant.

Monitoring and Reporting

An SPI is not subject to the solvency and capital requirements applicable to other types of licensed insurer. The Insurance Business (Solvency) Rules 2015 as amended provide that a

Special Purpose Insurer is a Category 6 body. As such, in accordance with rules 46, 56 and 200 of the Rules, Special Purpose Insurers shall not be required to maintain the Minimum Capital Requirement, Prescribed Capital Requirement or to conduct an Own Risk and Solvency Assessment.

These measures do not obviate against the need for a Special Purpose Insurer's board to monitor other inter-related prudential aspects of its activities which could impact on solvency, in particular, legal risks associated with contractual documentation (and in particular limitations of liability), variation in collateral value, FX risk, and counterparty risk (in particular security trustees).

The general representative of the Special Purpose Insurer is expected to monitor, disclose and report upon collateral or solvency issues in common with the requirements for other licensees and the board is expected to properly oversee such activities.

Recycling Cells

The Commission will in certain circumstances allow the re-use of PCC and ICC cells once previous contracts have terminated, without further requirement for permissions, provided that there are no material changes to the business plan associated with the relevant cell.

“Material” in the Context of Business Plans

The Law requires that a material change of business plan should be notified to the Commission prior to the implementation thereof. There is no need for an insurer, having notified the Commission of a material change to its business plan, to wait for the Commission's approval of that plan. The Commission will not routinely acknowledge a change of business plan. If, having considered the notification, the Commission requires further information it will request it; recognising that the change may already have been implemented. If a licensee is in any doubt regarding a change of business plan please call the Commission and we can provide verbal guidance on whether a notification should be submitted.

In general terms, any change to a licensee's business which could give rise to a change in risk assumed or which might alter the Commission's perception of the prudential risk of a transaction or series of transactions should be considered material in the context of a licensee's authorisation and should be communicated to the Commission. The Commission expects that where variations in underwriting occur, that these will be appropriately collateralised.

Such alterations may comprise;

- Changes to the material facts disclosed in the original application (for example changes of controller, significant increase in counterparty risk)
- Changes to the capital structure of a vehicle outside of pre-determined limits or using different types of collateral or changing limited recourse provisions.

Dividends

The Commission does not require notification or prior consent be given to dividends being paid by a Special Purpose Insurer to its shareholders, or to the settlement of other types of financial instrument such as loan notes.

Application Fee and Annual Fees

SPI-specific fees are as prescribed under the Financial Services Commission (Fees) Regulations.

Audit and Filing Requirements

In addition to the Rules, it should be noted that Special Purpose Insurers, or in the case of cells, the associated protected cell company, remain subject to the provisions of the Insurance Business (Bailiwick of Guernsey) Law 2002.

For further information please contact the Commission – www.gfsc.gg

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