



Insurance Act 2008

GUIDANCE NOTES FOR INSURANCE SPECIAL PURPOSE VEHICLES

*Laid before Tynwald
Coming into operation*

5 March 2015

The Supervisor issues these Guidance Notes under section 51(1) of the Insurance Act 2008 as binding guidance having carried out the consultation required under section 51(6) of that Act.

1. Title and commencement

The title of these Guidance Notes is the Guidance Notes for Insurance Special Purpose Vehicles and they shall come into operation on 5 March 2015.

2. Interpretation

In these Guidance Notes –

“**the Regulations**” means the Insurance (Special Purpose Vehicles) Regulations 2014,
and “**Regulation**” refers to a regulation therein; and

other terms have the same meaning as given in the Regulations.

3. Introduction to ISPVs

Generally, Insurance Special Purpose Vehicles (“ISPVs”) are a means of financing insurance risks via the capital markets in the form of transactions commonly known as ‘Insurance linked Securities’ (such as Catastrophe Bonds, Mortality Bonds, Sidecars, Industry Loss Warranties etc.) or other collateralised (re)insurance structures. Specifically, ISPVs are for the purpose of transferring genuine (re)insurance risks as part of legitimate (re)insurance arrangements.

This type of business enables underlying ceding insurers (or other sophisticated insureds on a direct basis) to obtain alternative sources of funding for the purpose of

transferring risk or managing capital; and at the same time enables third party investors to invest in particular insurance risk with opportunities to diversify their investment portfolios.

An ISPV itself is a limited purpose reinsurer (or potentially an insurer) that would normally be expected to fund its (re)insurance exposures by issuing financial instruments to market investors. A typical structure for an ISPV would be for the proceeds from its issued financial instruments to be held in an arrangement (such as a collateralised trust) to meet its (re)insurance obligations and ultimately repay its investors the remaining assets upon maturity, after settling all of its (re)insurance obligations and operating expenses. Investors in the ISPV's financial instruments would receive income out of (re)insurance premiums paid to the ISPV and/or income generated on the funds they have invested in the ISPV.

An ISPV's business is limited to the activities in respect of which it has been authorised and approved by the Supervisor, and is required to be fully funded which includes that the ISPV's obligations to its participants (see below) are contractually limited to its available assets.

Participation in an ISPV's business is restricted such that any parties wishing to be (re)insured by, or fund the (re)insurance exposures of, an ISPV (its 'participants') are required to be suitably equipped ('sophisticated') to manage the risks involved.

An ISPV is required to be established and operated transparently in order to ensure that its prospective participants are alerted to the nature of ISPVs and their regulation, and are able to obtain appropriate risk management information in relation to their prospective dealings with the ISPV and ongoing dealings if they subsequently become participants.

Due to the absence of vulnerable stakeholders in connection with ISPV business, and because ISPVs are required to have greatly reduced exposure to insolvency risk, ISPVs are subject to reduced regulatory requirements (for example, an ISPV is not required to hold a minimum margin of solvency above its liabilities, or to comply with the prescribed forms of reporting, applicable to other types of (re)insurers).

4. Cautionary notice to participants and prospective participants

Prospective participants should be mindful that the emphasis is on them to manage the risks associated with entering into a transaction with an ISPV, and their ongoing risks if they become a participant. In particular, this is because the ISPV's obligations to its participants are required to be contractually limited to the ISPV's available assets. Accordingly, if an ISPV were to encounter circumstances where it has insufficient assets to meet its liabilities, any unmet liabilities of the ISPV are required under contractual arrangements to abate and not be payable to its participants in accordance with the limited recourse arrangements it has agreed with those participants.

Prospective participants of an ISPV should ensure that they meet the qualifying criteria to become a participant of an ISPV. They should also take adequate steps to satisfy themselves that the ISPV and its business is structured and governed in a way that maximises the likelihood that their reasonable expectations will be met.

5. Application anticipated timescales

As a general guide, in normal circumstances, the authorisation process in relation to an ISPV is intended to take 5 working days or less once a full and final application has been received and explained as required.

6. IPA comments and ISPV confirmations

- (a) Any comments provided by, or on behalf of, the Supervisor prior to, or during, an application are provisional and subject to the Supervisor's receipt and examination of the full and final application, including the corresponding declarations required from the Board of Directors and Insurance Managers of the ISPV concerned, or prospective ISPV, upon which the Supervisor may place reliance.
- (b) Any comments, consents or other actions by, or on behalf of, the Supervisor must not be sought to be relied upon in connection with any declarations pursuant to applications as referred to in Regulations 6(1) and 6(2), or as required in accordance with Regulation 19(2) (as the case may be).

7. Support to Board of Directors and Insurance Manager

The principal party, or parties, involved in sponsoring the establishment of an ISPV are expected to enable the Board of Directors and Insurance Manager of the ISPV to obtain any necessary advice to ensure that they are in a position to provide the declarations pursuant to applications as referred to in Regulations 6(1) and 6(2), and as required in accordance with Regulation 19(2) (as the case may require). The Supervisor may request copies of any such advice during the course of an application.

8. Pre-application discussions (Regulation 6(3)(a))

- (a) Pre-application discussions may include, for example –
 - (i) the IPA providing information on the regulatory process to a potential applicant, or discussing key areas or unusual features of a prospective application, in order to facilitate application turnaround times as referred to in Guidance Note 5; or
 - (ii) provision of a draft application for the purpose of obtaining a decision in principle from the Supervisor as to whether a formal application for authorisation as an ISPV would be likely to succeed (this may be relevant in cases, for example, where proposers wish to explore in detail the

viability of an application prior to establishing a company and appointing directors etc.).

- (b) In relation to pre-application discussions, any confirmations, information, documents or other thing involved in pre-application discussions which the applicant wishes to be considered as part of the full and final application must be included in the final application either by way of resubmission, or by including specific reference to documents (or parts of documents, as applicable) already held by the IPA and detailing how they are to be included.

9. Post-authorisation deliverables (Regulations 6(3)(b), 6(4) and 6(5))

- (a) Post-authorisation deliverables may include any confirmations, information, documentation, action or any other thing required as part of the application process which, if not available or finalised at the date of authorisation, may with the agreement of the Supervisor be subsequently provided in full and final form, or confirmed as carried out (as the case may be); and any further matters arising as a consequence of finalising a post-authorisation deliverable shall be deemed as part of that deliverable.
- (b) In the case of applications subject to post-authorisation deliverables, the corresponding declarations required of the Board of Directors and Insurance Manager must be resubmitted, or confirmed, to include the post-authorisation deliverables once those deliverables have been provided in full and final form, or confirmed as carried out (as the case may be).
- (c) Agreement for an ISPV to commence certain business in accordance with Regulation 6(4) will not be given until all of its post-authorisation deliverables have been provided to, and accepted in writing by, the Supervisor, and the corresponding final declarations from the Board of Directors and Insurance Manager of the ISPV have been provided to the Supervisor. However, if the deliverables outstanding in relation to an application are not considered by the Supervisor to pose a significant risk in relation to the authorisation overall, the ISPV may commence some or all of the business at such earlier date as may be agreed in advance by the Supervisor in writing.

10. Key matters for which verification may be required (Regulation 6(1) and 6(2))

In connection with an application to the Supervisor as referred to in Regulation 6(1) or 6(2) (as the case may be), the Supervisor may require compliance with the mandatory contract terms contained in any or all of Regulations 12, 13(1) (as may be modified by a waiver under Regulation 13(2)), 13(3), 15 and 16 to be verified in a manner as may be specified by the Supervisor.

11. Insurance Managers and Auditors (Regulation 8)

- (a) A proposed Insurance Manager or Auditor (as the case may be) of an ISPV must be able to demonstrate to the Supervisor that it has adequate knowledge and experience in relation to the business, or prospective business, of the ISPV (as applicable).
- (b) A proposed Insurance Manager or Auditor (as the case may be) of an ISPV must also be able to demonstrate to the Supervisor that it has an appropriate level of professional indemnity insurance in connection with the services it provides, or proposes to provide, to the ISPV, (as applicable) including at least a minimum limit of indemnity of £25,000,000 each and every loss and aggregate per year.

12. Sophisticated participants (Regulation 11 and Schedule 2 to the Regulations)

A prospective participant of an ISPV must have sufficient knowledge, experience and resources to manage the risks involved in entering into a contract of insurance with an ISPV, or invest in a funding mechanism of an ISPV, (as applicable). Each prospective participant should ensure that they are so equipped (including taking appropriate advice where necessary) to manage their risks, notwithstanding that they qualify under any of the identified categories of person permitted to be a participant as set out (as applicable) –

- (a) in relation to insureds, in Part I of Schedule 2 to the Regulations; or
- (b) in relation to funding providers, in Part II of Schedule 2 to the Regulations.

13. Full funding (Regulation 12)

If an ISPV, or prospective ISPV, wishes to have exposure under more than one contract of insurance it must, upon application to the Supervisor as referred to in Regulation 6(1) or 6(2) (as the case may be), explain in relation to its existing contractual arrangements and proposed contractual arrangements (as applicable) –

- (a) its rationale for doing so; and
- (b) how it will prevent any unintended risk exposures arising in connection with each of its contracts of insurance and corresponding funding mechanisms from affecting its participants in connection with any of its other contracts of insurance and corresponding funding mechanisms (for example, the proposers of an ISPV wishing to have exposure under more than one contract of insurance might wish to establish the ISPV as a PCC in order that the assets and liabilities relating to its different contracts are statutorily segregated from one another to prevent any unintended cross contagion of risk to participants).

14. Dispute resolution arrangements (Regulation 16(a))

At a minimum, an ISPV's contracts of insurance and funding mechanisms should specify that any disputes or difference which cannot be resolved by discussion between the parties shall be submitted to the courts of a specified jurisdiction or, if appropriate, to specified binding arbitration.

15. Information to participants and prospective participants (Regulation 18)

(a) Pursuant to Regulation 18(3)(c), an ISPV must provide the following minimum information to its prospective insureds (and maintain documentary evidence demonstrating that it has done so) –

- (i) that the maximum amount the prospective insured might recover from the ISPV under any prospective contract of insurance the prospective insured may enter into with the ISPV must be limited to the ISPV's available assets;
- (ii) specifically the fact that the ISPV having insufficient available assets to meet its obligations to the prospective insured under such a contract of insurance will be a risk factor for the prospective insured;
- (iii) that qualifying criteria apply in order to be permitted to be an insured of an ISPV, as detailed in Part I of Schedule 2 to the Regulations, and that compliance with the criteria is the prospective insured's responsibility; and
- (iv) that the prospective insured should seek and obtain appropriate information in relation to the ISPV such that the prospective insured may make an informed decision about entering into a contract of insurance with the ISPV, and any other relevant arrangement with the ISPV, with due regard for the risks involved.

(b) Pursuant to Regulation 18(3)(c), an ISPV must provide the following minimum information to its prospective funding providers (and maintain documentary evidence demonstrating that it has done so) –

- (i) that the maximum amount the prospective funding provider might recover from the ISPV under any funding mechanism the prospective funding provider might enter into with the ISPV must be limited to the ISPV's available assets;
- (ii) specifically of the fact that the ISPV having insufficient available assets to meet its obligations to the prospective funding provider under such a funding mechanism will be a risk factor for the prospective funding provider;
- (iii) that qualifying criteria apply in order to be permitted to be a funding provider of an ISPV, as detailed in Part II of Schedule 2 to the Regulations, and that compliance with the criteria is the prospective funding provider's responsibility; and
- (iv) that the prospective funding provider should seek and obtain appropriate information in relation to the ISPV such that the prospective funding

provider may make an informed decision about entering into an arrangement to provide funding to the ISPV, and any other relevant arrangement with the ISPV, with due regard for the risks involved.

(c) Pursuant to Regulation 18(5), information might include, for example, details of any of the following (where relevant and material) as might affect the participant, or prospective participant, of the ISPV concerned (as applicable) –

- (i) the ISPV's –
 - legal and beneficial ownership;
 - management and administration;
 - outsourcing arrangements;
 - risk management systems;
 - key internal policies and controls, including, for example, those in respect of the ISPV's –
 - legal and regulatory compliance;
 - contractual compliance;
 - underwriting / risk acceptance;
 - funding of its obligations under its contract(s) of insurance;
 - use of reinsurance or any other risk mitigation techniques;
 - provisioning or reserving in respect of its insurance obligations;
 - claims management;
 - asset-liability management;
 - investment risk;
 - credit risk;
 - liquidity risk;
 - concentration risk; and
 - operational risk;
- (ii) any conflict of interest of the ISPV (of which the ISPV is aware) which might affect the participant;
- (iii) the credentials of any agents, advisors, auditors or providers of an outsourced function of the ISPV;
- (iv) the ISPV's contractual arrangements;
- (v) claims and expenses incurred by the ISPV under its contracts of insurance;
- (vi) provisioning or reserving for other costs and expenses of the ISPV;
- (vii) the nature, composition and value of the ISPV's assets and available assets;
- (viii) any triggering, or prospective triggering, of the ISPV's limited recourse arrangements,

and includes any prospective changes to the above mentioned matters as might affect the participant or prospective participant (as applicable).

16. Regulatory returns (Regulation 19)

- (a) Under Regulation 19(1), the Supervisor may agree the form and frequency of an ISPV's regulatory returns based on obtaining copies of any reports specified in the application to the Supervisor as referred to in Regulation 6(1) or 6(2) (as the case may be). However, if such reports are not considered to be sufficient for regulatory purposes, the Supervisor may require additional information.

For example, the Supervisor may be expected to require periodically, in accordance with Regulation 10(2), a statement of the ISPV's –

- (i) balance sheet; and
- (ii) agreed contingent assets (if any),

as is necessary to report its solvency position.

In addition, the Supervisor may be expected to require a statement of the ISPV's –

- (i) maximum potential aggregate liability under its contracts of insurance before the application of any of its limited recourse arrangements; and
- (ii) details of any significant changes to the business or circumstances of the ISPV since last reported to the Supervisor.

- (b) For an ISPV that is an ICC or IC, where an election has been made in accordance with paragraph (c) to combine the accounts, or the accounts and audit, of the ICC and any of its ICs (or any of the ICs of the ICC), the combined audited accounts must, unless otherwise agreed in writing by the Supervisor, include in columnar format –

- (i) amounts applicable to the ICC in a separate column (if the election includes combining the accounts of the ICC);
- (ii) the amounts applicable to every IC involved in the election in a separate column for each; and
- (iii) the combined total of the amounts referred to in sub-paragraphs (i) and (ii) in a separate total column.

- (c) An election referred to in paragraph (b) means –

- (i) in the case of an IC incorporated under the Companies Act 1931, means an election made under paragraph 3(3) and/or paragraph 8 of Schedule 1 to the Incorporated Cell Companies Act 2010; or
- (ii) in the case of an IC incorporated under the Companies Act 2006, means an election made under paragraph 2(2) and/or paragraph 5 of Schedule 3 to the Incorporated Cells Regulations 2011¹.

¹ SD 387/11

- (d) The audited accounts of an ISPV that is a PCC must, unless otherwise agreed in writing by the Supervisor, include in columnar format –
- (i) the amounts applicable to its core (non-cellular business) in a separate column;
 - (ii) the amounts applicable to all of its protected cells in a separate column for each; and
 - (iii) the combined total of the amounts referred to in sub-paragraphs (i) and (ii) in a separate total column.

17. Non-indemnity triggers

Non-indemnity triggers, in relation to an ISPV's contract of insurance, link payments to insureds under the contract of insurance to something other than an actual loss of the insured. Non-indemnity triggers may take various forms such as –

- (a) 'index triggers', linking payments to industry wide estimates of losses relating to the insured event, as derived from an authoritative independent source;
- (b) 'parametric triggers', linking payments to the physical characteristics of the insured event, such as hurricane intensity, earthquake magnitude or shift in mortality rate, as derived from an authoritative independent source; and
- (c) 'modelled loss triggers', linking payments to the results of applying the insured event to a loss model acting as an approximation of the insured's own exposure, as carried out by an independent modelling firm.

Non-indemnity triggers may be used as a component of a contract of insurance of an ISPV in accordance with item (e) of the definition of "insurance business" under section 54 of the Act.

18. Continuation and discontinuation of ISPVs

Redomiciliation is not anticipated to be required currently in relation to ISPV business. For the time being therefore the following shall apply.

- (a) For the purposes of the Companies (Transfer of Domicile) Act 1998, as amended by Schedule 4 to the Act, no consent shall be granted by the Supervisor for continuation in the Island of any offshore insurer as an ISPV, nor for any ISPV to be discontinued in the Island and continued in a country or territory outside the Island.
- (b) For an ISPV which does not otherwise require the Supervisor's consent to be discontinued in the Island and continued in a country or territory outside the Island it is hereby a condition of its authorisation under section 8(a) of the Act

that it must not seek to be discontinued in the Island and continued in a country or territory outside the Island.

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D.A. VICK
Supervisor, Insurance and Pensions Authority