MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Consultation Document

Proposals for Reinsurance Special Purpose Vehicles Regulations

[MFSA REF: 10/2013]

31st May 2013

Closing Date: 17th June 2013

Note: The documents circulated by the MFSA for the purpose of consultation are in draft form and consist of proposals. Accordingly these proposals are not binding and are subject to changes and revisions following representations received from Licence Holders and other involved parties. It is important that persons involved in the consultation bear these considerations in mind.

Note for Consultation

PROPOSED REINSURANCE SPECIAL PURPOSE VEHICLES REGULATIONS 2013

1. PURPOSE

The MFSA is issuing for consultation the proposed Reinsurance Special Purpose Vehicles Regulations (hereinafter referred to as 'the draft Regulations'), to be issued under the Insurance Business Act (Chapter 403 of the Laws of Malta). Any comments and feedback are to be addressed to the Regulatory Development Unit by email on elofaro@mfsa.com.mt. Interested parties are kindly asked to submit any comments in writing by not later than, 17th June 2013.

2. INTRODUCTION

Directive 2005/68/EC of the European Parliament and of the Council of the 16 November 2005 on reinsurance and amending Council Directives 73/239/EEC, 92/49/EEC as well as Directives 98/78/EEC and 2002/83/EC (the "Reinsurance Directive") provides Member States with the framework to allow special purpose vehicles to assume risks from insurance or reinsurance undertakings. Article 46 of the Reinsurance Directive provides that where Member States decide to allow the establishment, within their territory, of special purpose vehicles, they shall require prior official authorisation thereof and lay down the conditions under which the activities of such vehicles are to be carried out. As a consequence, the MFSA is proposing to issue the draft Regulations for the authorisation and regulation of reinsurance special purpose vehicles in Malta.

It is important to bear in mind that under Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance ("the Solvency II Directive"), specific rules on the regulation of special purpose vehicles will also be introduced as Level II and Level III measures and therefore, as soon as these come into force, the draft Regulations may need to be aligned with the provisions found in the Level II and Level III measures issued under the Solvency II Directive.

A Reinsurance Special Purpose Vehicle (hereinafter referred to as a 'RSPV'), is defined in the draft Regulations, as "*an undertaking, other than an existing insurance undertaking or reinsurance undertaking, which assumes risks from a ceding undertaking and which fully funds its exposure to such risks through the proceeds of a debt issuance or any other financing mechanism where the repayment right of the providers of such debt or financing mechanism are subordinated to the reinsurance obligations of such a vehicle*". This is largely modelled on the definition found in article 2(1)(p) of the Reinsurance Directive.

Reinsurance Special Purpose Vehicles can play a major role in facilitating alternative risk transfer, thus offering management solutions that enable insurance and reinsurance undertakings to better align their risk profile with their risk tolerance. These vehicles may also provide additional reinsurance capacity at times in which cover through more traditional channels is limited.

In a typical RSPV transaction, an insurance or reinsurance undertaking, collectively termed as a 'ceding undertaking' in the draft Regulations, uses a RSPV to cede risks through a reinsurance contract, or similar arrangement. The ceding undertaking transfers risks to the RSPV upon paying an agreed premium. The RSPV funds its maximum liability under the contract through the issuance of notes or bonds to the capital market, and invests its assets for profitability. The MFSA recognises that though RSPVs enter into reinsurance obligations, they differ from traditional reinsurance companies in many respects and are therefore better regulated under a specific regime.

Although RSPVs will be authorised under the draft Regulations issued in terms of the Insurance Business Act, the applicability of the Securitisation Act to RSPVs is currently being evaluated. RSPVs which operate as securitisation vehicles for the purposes of the Securitisation Act will be subject to the provisions of that Act in so far as those are consistent with the provisions of the draft Regulations.

3. SALIENT FEATURES OF THE REINSURANCE SPECIAL PURPOSE VEHICLES REGULATIONS

The Regulations as proposed would regulate RSPVs as to the following aspects:

A. Authorisation

An RSPV is required to be authorised by the MFSA in order to carry on its business in Malta. The draft Regulations only allow limited liability companies formed in Malta to apply for authorisation as RSPVs. The objects of the company must be restricted to operating as an RSPV, and the company is restricted from engaging in activities other than accepting insurance or reinsurance risks from a single ceding undertaking. An authorisation issued under the draft Regulations would be for a specific use or uses stated on the authorisation document itself.

B. Mandatory Conditions for all Contractual Arrangements

Regulation 6 of the draft Regulations requires that the contractual arrangements entered into by an authorised RSPV ensure an effective and unequivocal transfer of risk from the ceding undertaking to the RSPV and thereby to its investors. The contractual arrangements relating to the first stage of risk transfer, from the ceding undertaking to the RSPV, should ensure that the RSPV always satisfies the solvency requirements stipulated by the draft Regulations. The contractual arrangements for the whole process of risk transfer, therefore from the ceding undertaking to the RSPV and thereby to the investors, must ensure that the claims of the providers of financing of the RSPV, are at all times subordinated to the reinsurance obligations of the RSPV to the ceding undertaking.

C. Governance Requirements

The draft Regulations require all persons who effectively direct or manage an authorised RSPV to be fit and proper persons. The RSPV is required to notify the MFSA of the identity of these persons and of any changes in this respect. Moreover, the RSPV must have a system of governance that is appropriate to the nature, scale and complexity of the risk that the RSPV assumes, and the uses for which the RSPV is authorised. An authorised RSPV requires, inter alia, written policies to ensure sound administrative and accounting procedures, appropriate internal controls and an effective risk management system.

D. Supervisory Reporting

According to regulation 9 of the draft Regulations, the MFSA may request any information from the authorised RSPV as it deems necessary in order to supervise such a vehicle. In particular, the RSPV must report to the MFSA on the value of its assets, its aggregate maximum exposure as defined in the draft Regulations themselves, any conflicts of interest, as well as any significant transactions entered into within a reporting period to be stipulated by the MFSA.

E. Solvency Requirements

An authorised RSPV must be fully funded at all times, meaning that it has at all times assets the value of which is equal to or exceeds the aggregate maximum risk exposure, and the RSPV is able to pay the amounts it is liable for as they fall due. The assets of the RSPV should be valued in accordance with generally accepted accounting principles and practices. It is the fully funded requirement that differentiates an RSPV from a traditional insurance or reinsurance company. The onus is on the RSPV to demonstrate to the MFSA that the fully funded requirement is being observed. The RSPV must inform the MFSA immediately where it observes that the fully funded requirement is, or is at a risk of not being complied with. The RSPV has a period of one month following the observation of non-compliance, or risk of non-compliance in the following three months, to submit to the MFSA a realistic financial scheme to restore compliance with the fully funded requirement. In order to ensure the security of its assets, the RSPV should only invest in assets and instruments whose risk the RSPV understands in accordance with the prudent person principle.

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