

Special Purpose Insurers in Bermuda



BY TIMOTHY FARIES

Recent legislation passed by the House of Assembly has addressed the concept of Special Purpose Insurers (“SPI”) in Bermuda. The Insurance Amendment Act 2008 came into force on 31 December 2008.

An SPI is, in its basic form, a special purpose, single transaction – or single customer – (re)insurance company that assumes reinsurance risks. It typically funds its exposure to such risks through the proceeds of a debt issuance or some other financing mechanism. The repayment rights of the providers of such debt, or other financing mechanism, are subordinated to the (re)insurance obligations of the vehicle.

Most SPI structures will contain contractual language obliging the SPI to pay the reinsured an amount up to a stated value at the time of the occurrence of a covered event. The maximum recovery under the contract is limited to the lower of the stated contract limit, and the available assets of the SPI. These SPI contractual payouts may include, but are not limited to, language limiting the SPI contract to a specific fixed dollar aggregate, probable maximum loss, loss ratio cap, tail value at risk, or other prescribed amounts.

An SPI may only enter into contracts, or otherwise assume obligations, that are solely necessary for it to give effect to the (re)insurance special purpose for which it has been established. An SPI must ensure that,

to the extent that more than one (re)insurance contract is in place within the SPI, each of the (re)insurance contracts is structured so that the SPI meets the fully funded requirements individually for each contract.

An SPI is subject to a more streamlined application and ongoing supervisory process because it is fully funded to meet its (re)insurance obligations, and is therefore not exposed to insolvency. The application process is intended to facilitate the fully funded, single transaction nature of the SPI.

The Bermuda Monetary Authority (“BMA”) will evaluate an SPI application based upon the sophistication of the policyholders or the sophistication of the parties to a debt issuance, or other funding mechanism. Participants in the SPI process will be expected to be sufficiently sophisticated to engage in this highly specialised form of business. On that basis, the BMA will expedite the approval of a completed SPI application.

“Sophisticated participants” will include:

- High income private investors;
- High net worth private investors;
- Sophisticated private investors;
- Investment funds approved by the BMA;
- Bodies corporate, each of which has total assets of not less than \$5 million;

- Bodies corporate, all of whose shareholders fall within one or more of the above categories;
- Partnerships, all of whose members fall within one or more of the above categories;
- Trusts, all of whose beneficiaries fall within one or more of the above categories;
- Unincorporated associations, partnerships, or trusts, each of which has total assets of not less than \$5 million;
- Any company quoted on a recognised stock exchange, and;
- Any party deemed to have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment.

An SPI is expected to operate with a high degree of transparency, fully disclosing its investment guidelines and asset values. The company must make available to the cedent/insured, and relevant counterparties, data regarding the total composition of the assets of the SPI, the latest available market value of the assets, and the latest available net asset value of each asset.

The BMA recognises contingent assets (reinsurance, LOCs) as acceptable instruments for inclusion in the funding structure of an SPI. However, where an SPI is funded through a balance of contingent assets, the SPI must demonstrate that any issuer of these assets is a regulated institution that has achieved a financial rating (counterparty, credit, or financial strength, as

applicable) of at least A- as of the date of the application, or is otherwise of a sound financial quality.

The SPI's Principal Representative has a duty to inform the BMA when an SPI's available assets fall below the value of the expected (re)insurance recoveries or aggregated liabilities by a specified margin. Where there is some deterioration in asset value, some SPI structures will require that a named entity "top up" the assets of the SPI. Such provisions must form part of the contract language and be clearly disclosed at the time of application.

The BMA will allow a Bermuda (re)insurer to treat amounts recoverable from an SPI as a recoverable asset – as well as (re)insurance for the purposes of calculating its technical reserves and/or reinsurance having the effect of reducing its enhanced capital requirement – but only to the extent that the ceding (re)insurer can demonstrate its ability to adequately manage all key risks associated with the SPI transaction.

The Insurance Act 1978 exempts SPIs from the need to final annual loss reserve specialist opinions. The BMA shall, on a case-by-case basis, exercise its discretion under section 56 to modify the usual accounting provisions in respect of an SPI, making them more streamlined.

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