

Supervisory Statement | SS8/17

Authorisation and supervision of insurance special purpose vehicles

May 2020
(Updating December 2017)



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Superseded





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Superseded

1 Introduction

1.1 This Supervisory Statement (SS) sets out the Prudential Regulation Authority's (PRA's) approach and expectations in relation to the authorisation and supervision of insurance special purpose vehicles (ISPVs).

1.2 This SS is relevant to parties who wish to apply for, or have obtained authorisation as, an ISPV. It is also relevant to insurers and reinsurers seeking to use UK ISPVs as risk mitigation in accordance with Solvency II.

1.3 In accordance with Article 2 of the Implementing Regulation,¹ an ISPV that takes on more than one contract for risk transfer from one or more 'cedants'² is referred to as a multi-arrangement insurance special purpose vehicle (MISPV).³ All references made to ISPVs in this SS are equally applicable to MISPVs, unless otherwise specified.

1.4 Chapters 2, 3 and 4 should be read in conjunction with the:

- Risk Transformation Regulations 2017 (SI 2017/1212) (RTR);
- Financial Services and Markets Act 2000 (FSMA) as modified by the RTR;
- Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) (the RAO) as modified by the RTR;
- Directive 2009/138/EC (Solvency II Directive);
- Commission Delegated Regulation (EU) 2015/35 (Delegated Regulation);
- Commission Implementing Regulation (EU) 2015/462 (Implementing Regulation);
- Insurance Special Purpose Vehicles, Insurance – Fitness and Propriety, Insurance – Senior Management Functions, Insurance – Senior Managers Regime – Applications and Notifications, and the Key Function Holder – Notifications Parts of the PRA Rulebook;
- Financial Conduct Authority (FCA) Policy Statement 17/24 – authorising and supervising insurance special purpose vehicles;⁴ and
- FCA Statement – authorising and supervising insurance special purpose vehicles.⁵

1.4A Attention is also drawn to information on the PRA's website regarding ISPVs.⁶

1.5 In this SS, reference to 'the regulators' means the PRA and FCA.

¹ Commission Implementing Regulation (EU) 2015/462.

² References to 'cedant' in this SS mean the undertaking that transfers risk to the ISPV.

³ See also paragraph 3.29.

⁴ Available at: www.fca.org.uk/publications/policy-statements/ps17-24-handbook-changes-insurance-linked-securities.

⁵ See above footnote.

⁶ Available at: www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles.

2 Authorisation of insurance special purpose vehicles

Overview of authorisation process

2.1 Entities wishing to operate in the United Kingdom as an ISPV will need to apply to the PRA for permission to perform the regulated activity of insurance risk transformation set out in Regulation 13A of the RAO.

2.2 The PRA will only grant authorisation in accordance with Part 4A of FSMA where the ISPV demonstrates that the conditions specified in Article 318 of the Delegated Regulation are satisfied.

2.3 All ISPVs are dual regulated by the PRA and FCA, and applications will be reviewed jointly by the regulators. As for other dual-regulated firms, the PRA will lead the authorisation process and require the FCA's consent before granting authorisation.

MISPVs

2.4 An MISPV is permitted within the Solvency II framework provided that it complies with the requirements of Articles 318 to 324, 326 and 327 of the Delegated Regulation and Article 7 of the Implementing Regulation (and is capable of meeting the requirements of Article 325 of the Delegated Regulation).

Pre-application discussions

2.5 Given the often time-sensitive nature of insurance-linked securities transactions, the PRA will offer the opportunity for prospective ISPV applicants to discuss their proposals prior to application. Although this is not a requirement, the PRA encourages applicants to make use of a pre-application stage. Engagement prior to the application gives applicants the opportunity to receive early feedback from the regulators regarding their plans, highlighting any potential concerns in good time, and also informs regulators when they should expect to receive an application.

2.6 In particular, the pre-application process can be beneficial for both the regulators and the applicant as it provides a forum for constructive discussion on matters such as the scope and structure of the intended ISPV, the type and effectiveness of the risk transfer, the shareholder structure of the vehicle, the proposed investment strategy, and how the requirement to be fully funded is met. The pre-application process will also allow applicants to share details of individuals identified for controlled functions as part of the Senior Managers and Certification Regime (SM&CR). This should help applicants to submit a complete application.

Applications for authorisation of an ISPV

2.7 Applications for ISPV approval should be made through submission of:

- an ISPV Application Form⁷ for the authorisation of the ISPV; and
- application forms for individuals (Senior Managers Regime, and FCA Controlled Functions (where applicable)) in line with paragraphs 3.1 to 3.5.

2.8 The material requested within the ISPV application form reflects the requirements set out in Article 5 of the Implementing Regulation, which includes the documentation required in Annex I to that Regulation.

⁷ Available at: <https://www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles>.

Documentation requirements

2.9 The PRA expects final documentation to be submitted with applications where possible. In the case where final transaction documentation is not available at the point of application, draft transaction documentation will be accepted. The PRA does not expect changes to be made during the submission phase where this could impact how the relevant requirements are proposed to be met. If such changes are made, the PRA expects the applicant to submit an analysis of the changes and their impact on the relevant requirements at the first opportunity. Substantive changes following submission of the application are likely to extend the assessment period.

2.9A Where the applicant considers that the complete set of documentation will not be available at the point of application, the PRA expects applicants to discuss this with it to explain what is likely to be available and how this might affect the timing of the application.

2.9B Where the application is for a 'live' transaction, the PRA understands that the transaction documents may not be legally executed until after approval, and therefore some specific commercial terms may remain outstanding until the transaction is executed. However, the PRA expects the applicant to identify where this will be the case in the documentation prior to approval being granted. If approval is granted before the transaction documents are legally executed, the PRA expects the ISPV to submit the final documents to the PRA as soon as possible once they are legally executed.

2.10 For a single-arrangement ISPV, the applicant should submit documentation that is specific to the proposed transaction. Details of the specific transaction should be in the application form, eg specific details on the risk transfer, funding structure and investment strategy of the deal.

2.11 For an MISPV, the applicant should include sufficient detail in relation to all known transactions, including future planned transactions. Where an application includes information given in relation to potential future transactions, the PRA expects the applicant to demonstrate how these arrangements will satisfy the applicable requirements upon being entered into. Further details are included in paragraph 2.15A below.

2.12 The PRA does not generally expect to request applicants to submit independent third-party opinions (eg legal, accountant, or actuarial) in every case (eg straightforward applications), although the PRA may request applicants to provide the PRA with third party opinions where necessary, for example where the PRA considers it would assist it in making an assessment against the conditions for authorisation. The PRA considers that such opinions may be useful to support demonstration of compliance with the Solvency II requirements, in particular Articles 319, 320 and 321 of the Delegated Regulation, where the transaction contains complex or novel features, for example, including but not limited to:

- where a transaction includes complex connected transactions, eg complex trust or security arrangements, or any inter-cell arrangements; and/or
- the recognition and valuation of the ISPV's assets in accordance with Article 75 of the Solvency II Directive, where the ISPV invests in assets which are considered non-standard in nature.

2.12A Where contractual arrangements are material to the conditions for authorisation - in particular where contractual provisions are relied upon to meet Articles 319, 320 and 321 of the Delegated Regulation - and those arrangements are subject to foreign law, the PRA will expect a legal opinion on the effectiveness and enforceability of those arrangements under the relevant foreign law. In such circumstances the PRA would also expect an English law opinion confirming that

the operation of English law would not undermine the effect of the transaction and/or arrangements under the applicable foreign law.

Scope of Permission (SOP)

2.13 In line with Regulation 7 of the RTR, the PRA is required to exercise its discretion under Section 55F(4)(a) of FSMA. This requires the PRA to limit the scope of the regulated activities which the ISPV may carry on. In exercising its discretion under Regulation 7(1) of the RTR, the limitation imposed by the PRA must be determined by reference to some or all of the activities described in the application for Part 4A of FSMA permission. The permission granted to the ISPV in accordance with the process in this paragraph is referred to in this SS as the ISPV's SOP.

2.14 A SOP is a key component of an ISPV's authorisation, as it defines the boundaries within which the ISPV may carry on the regulated activity of insurance risk transformation. Information referred to in Article 5 of the Implementing Regulation will form the basis of the SOP granted by the PRA under Part 4A of FSMA.

2.15 The PRA expects applicants to provide sufficient information on each of the potential arrangements, structures, and/or mechanisms it wishes to form part of the SOP, so that the PRA can assess their compliance with the Solvency II requirements. Where an ISPV contemplates a range of potential arrangements, structures or mechanisms (particularly in the case of MISPVs that intend to create different options for future cells) applicants should include sufficient information on each of these options in their application. The PRA expects the applicant to submit the contractual wording/arrangements which would govern these future arrangements, if it wishes these future arrangements to be included in the ISPV's initial SOP. This will enable the PRA to assess all of the potential options upfront and, where appropriate, to include each of these options in the initial SOP. Alternatively the applicant may choose to submit a narrower range of arrangements as part of the initial approval, and seek a variation of permission for a wider SOP at a later stage.

2.15A Where an application is submitted with no proposed 'live transaction', consistent with the approach above, the PRA will expect applicants to submit sufficient information in the application to enable the PRA to judge whether future arrangements will be compliant with applicable requirements. The PRA expects applicants to submit template contractual arrangements which would be used in these future arrangements. For an MISPV, this will be the case whether the applicant intends for the MISPV to enter into future arrangements with the same cedant or multiple cedants. Upon the MISPV executing a live transaction, and assuming a new risk, it must follow the notification process in accordance with Insurance Special Purpose Vehicles 4.3 and outlined further in paragraph 2.27.

2.16 The PRA expects that in most cases the information in the table in the Appendix will be particularly relevant for the purposes of defining the SOP. However, this is not an exhaustive list and all of the information referred to in Article 5 of the Implementing Regulation will be relevant for the purposes of defining the SOP. Each application will be considered on a case-by-case basis.

2.17 Consistent with Part 4A of FSMA, the ISPV may not act outside the scope of its SOP. This means that in the case of an MISPV, future arrangements must fall within the scope of the SOP.

2.18 Where an ISPV contemplates activities that are outside the scope of its SOP, it must apply to the PRA for a variation of permission (VOP). Upon granting a VOP, a new limitation will be placed on the scope of the ISPV's permission which will form an updated SOP. Applications for a VOP will require a reasonable timeframe for the PRA to review, and more complex changes will require greater scrutiny.

Timelines for review of applications (including VOP applications)

2.19 Consistent with Article 4(1) of the Implementing Regulation, the PRA will determine complete applications for authorisation as an ISPV within six months of receipt. The PRA anticipates that ISPV applications will range in complexity. The PRA considers that where applications represent a relatively straightforward proposal, and are supported by good quality documentation this should allow a determination to be reached within 6-8 weeks. In addition, where effective pre-application engagement has taken place 6-8 weeks is more likely to be feasible. The PRA will process applications as quickly as possible and approval may be possible more quickly in some circumstances. For applications that are complex or novel, applicants should recognise the need for additional review time. The PRA will keep these matters under review as experience develops.

2.19A Where an applicant proposes arrangements that are sufficiently similar to arrangements that have previously been assessed by the PRA in respect of the same applicant, such as a previous transaction with the same cedant and substantially the same transaction documentation, the PRA will consider all relevant factors but will aim to leverage (to the extent appropriate) any work done in the previous application, to minimise duplication. In such circumstances, the PRA expects applicants to discuss with the PRA the level of changes they envisage so that the review can be focused as much as possible on the key changes.

2.20 The statutory timeframe for determining an application for a VOP, as set out in FSMA, is six months for a complete application. The quality of the documentation and complexity of the proposed amendment will determine the time taken for the PRA to review the VOP application, as will the level of pre-application engagement where possible.

Submission of an application

2.21 The ISPV application form referred to in paragraph 2.7 details the information to be submitted for an application. The PRA expects applicants to review this in detail prior to submission. The PRA will notify the applicant as soon as it has reached a decision on the completeness of the application. The PRA will endeavour, where possible, to provide this within ten working days of receipt. Incomplete submissions will delay the final decision on applications for approval.

Consultation and ongoing cooperation with EEA supervisory authorities

2.22 Under Articles 8 and 9 of the Implementing Regulation, the supervisory authority in the jurisdiction of the ISPV is required to consult prior to authorisation and cooperate on an ongoing basis with the supervisory authority of cedants located in the European Economic Area (EEA).

2.23 The PRA encourages applicants, where possible, to confirm as part of its application that the supervisory authority of any EEA cedant has been notified of the proposed transaction, and

supply details of the relevant contact for such supervisory authority. This will assist the PRA in its consultation with the cedant's supervisory authority.

2.24 Where possible, the PRA expects an MISPV to include within its application the proposed jurisdictions from which it expects to assume risks. Upon submission of the MISPV New Risk Assumption Notification Form,⁸ the MISPV is encouraged to include confirmation that the supervisory authority of any EEA cedant has been notified of the proposed transaction, and supply the details of the relevant contact for the supervisory authority.

⁸ See Insurance Special Purpose Vehicles 6.1.

Decisions

2.25 The PRA will lead in the assessment of the application, and will require the consent of the FCA before granting authorisation. If a decision is made to approve the application, the PRA will notify the applicant. If the decision is that the application is not successful and the PRA and/or the FCA proposes to refuse it, the PRA will inform the applicant about the procedure and the options open to the applicant to challenge the decision.

2.26 Where an ISPV is considered compliant with all other applicable requirements the PRA expects it will be able to grant an approval that is effective prior to the date that funding is received, if the ISPV can demonstrate that it will receive the relevant funding before the risk transfer to the ISPV becomes effective. The PRA will expect the application to demonstrate that all expenses and operating costs will be met appropriately, whether or not they form part of the ISPV's Aggregate Maximum Risk Exposure (AMRE).⁹

MISPV notification process

2.27 Once authorised, an MISPV must notify the PRA within five working days of assuming a new risk (pursuant to Regulation 60 of the RTR). In accordance with Insurance Special Purpose Vehicles 4.3 this post-transaction notification must be submitted using the MISPV New Risk Assumption Notification Form. The form requires MISPVs to provide details and documentation on the specific risk transfer arrangement to which it relates (including the documentation specified in the SOP), confirmation that it is in line with the MISPV's SOP, and a signed declaration by two directors that all information in the form is accurate. Additionally, the form requires the MISPV to provide summary details of all the current risk transfer arrangements, including the AMRE of each of the individual arrangements as well as the aggregate AMRE of the MISPV.

3 Requirements of ISPVs

PRA Senior Managers and Certification Regime (SM&CR) requirements

3.1 All individuals who are 'effectively running' the ISPV must satisfy the fit and proper criteria set out in the Insurance – Fitness and Propriety Part of the PRA Rulebook. Effectively running is described in paragraph 2.32 of SS35/15 'Strengthening individual accountability in insurance'¹⁰ and in Solvency II European Insurance and Occupational Pensions Authority's guidelines.¹¹ It is expected to include all the members of the governing body, as well as the senior management of the ISPV (or any related insurance group) who are responsible for key decision making and for implementing the strategies and policies approved by the governing body. These individuals can be both Senior Management Function (SMF) roles and non-SMF roles.

3.2 The PRA requires applicants to nominate fit and proper individuals for approval by the PRA to occupy the following SMF roles for each ISPV.¹²

- Chief Executive (SMF1);
- Chief Finance (SMF2); and
- Chair of the Board (SMF9).

⁹ As defined in Article 1(44) of the Delegated Regulation.

¹⁰ February 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-insurance-ss>.

¹¹ EIOPA Guidelines of system of governance (EIOPA-BoS-14/253 EN), paragraph 1.21.

¹² Pursuant to Insurance – Senior Management Functions 2, and Insurance – Fitness and Propriety 2.

3.3 The PRA considers that each of these roles is important for the ongoing safety and soundness of the ISPV but, depending on its assessment of the particular case, an individual with the relevant skills and experience may be able to perform more than one of these roles. It is also acknowledged that provided there are no conflicts of interest, a SMF role or individual deemed to be effectively running the ISPV could be held by a suitably senior employee or director of a third party such as an outsourced service provider.

3.4 The ISPV must complete the relevant application form (see Insurance – Senior Managers Regime – Applications and Notifications Part) for each of the individuals nominated for PRA approval to perform a SMF role at the ISPV. Once the ISPV is approved, if at any time an individual is appointed as a NED or key function holder,¹³ and this individual is not already a SMF holder, then following their appointment the ISPV must submit Form M (see Key Function Holder – Notifications Part) to the PRA.

3.5 The individuals who are effectively running the ISPV are expected to be responsible for providing oversight of the activities and key functions of the ISPV, including outsourced service providers, and for ensuring that the ISPV meets its regulatory requirements.

Fit and proper requirements for shareholders or members with a qualifying holding

3.6 Article 323 of the Delegated Regulation requires a fit and proper assessment of shareholders or members with a qualifying holding in the ISPV. The term qualifying holding is defined in Article 13(21) of the Solvency II Directive as a direct or indirect holding in an undertaking which represents 10% or more of the capital, or 10% or more of the voting rights, or which makes it possible to exercise a significant influence over the management of the undertaking.

3.7 The PRA's approach when assessing compliance against this requirement will be proportionate to the nature and level of influence any shareholder or member with a qualifying holding is expected to have on the ISPV, including any voting rights, or ability to exercise influence, and the extent of their financial commitments to the ISPV.

3.8 For both MISPVs and single-arrangement ISPVs, the PRA will carry out a fit and proper assessment of shareholders or members who have a qualifying holding on the basis that they hold 10% or more of the voting rights in the ISPV, or have significant influence over the management of the ISPV. The PRA expects that a significant influence over the management of the ISPV is likely to arise where there is a holding representing 10% or more of the capital of the ISPV, and either: (i) at least some of those holdings include voting rights; or (ii) the arrangements of the ISPV are such that the shareholder or member may have a significant influence over the management of the ISPV. The PRA considers that these shareholders or members can control the ISPV, and for that reason they will form part of the ISPV's SOP, meaning that a change in these shareholders or members would require a VOP (and the PRA would consider the proposed change in accordance with the criteria in Article 323(1)(a) to (d) of the Delegated Regulation).

3.9 A qualifying holding may arise where a holding represents 10% or more of capital, even where the shareholder or member does not have voting rights or a significant influence over the management of the ISPV. In the case of single-arrangement ISPVs, the PRA expects them to have a framework in place for assessing these shareholders or members, which should consider all of the criteria in Article 323(1)(a) to (d) of the Delegated Regulation, including any financial commitments to the ISPV. The ISPV's assessment under Article 323(1)(a) to (d) of the Delegated Regulation can be proportionate to the fact that these shareholders or members will be expected to have little or no

¹³ Individuals who perform key functions pursuant to the Key Function Holder – Notifications part of the PRA Rulebook.

influence over the management of the ISPV. The PRA will assess this framework at authorisation, and will expect the ISPV to demonstrate to the PRA that these shareholders or members will not have (or acquire) a significant influence over the management of the ISPV (otherwise, the PRA will consider these shareholders or members in line with the process described above).

3.10 The assessment required under Article 323 of the Delegated Regulation also applies in respect of shareholders or members having a qualifying holding in the MISPV. Accordingly, the PRA expects that the assessment described in paragraph 3.8 will include holdings issued on behalf of the core of an MISPV, on the basis that these shareholders or members will exercise a significant influence over the management of the MISPV. As regards shareholders or members in the cells of a Protected Cell Company (PCC), the RTR specifies that only a holding issued on behalf the core of a PCC is to be treated as a holding in the PCC. Therefore one of the effects of the RTR is that the assessment under Article 323 of the Delegated Regulation should not include holdings issued on behalf of a cell of a PCC. Furthermore, the PRA would not expect the governance arrangements of the PCC to enable holdings in cells to exercise significant influence over the MISPV.

3.11 The PRA expects all ISPVs to explain their proposed ownership structure in the application for authorisation, identifying, to the extent possible, any proposed shareholders or members that will have a qualifying holding (highlighting those for the PRA's assessment under Article 323 of the Delegated Regulation as described in paragraph 3.8 above). The application for authorisation should contain sufficient information to enable the PRA to perform its assessment of qualifying holding shareholders' or members' fitness and propriety (as described above), and (in the case of a single-arrangement ISPV) details of the proposed framework for the ISPV's assessment of other shareholders or members with a qualifying holding.

3.11A Where the ISPV is consolidated into a group the applicant must provide an assessment of the applicable accounting consolidation requirements of the ISPV into the group, in accordance with Annex I of the Implementing Regulation. The PRA will assess the specific circumstances for consolidation against the relevant requirements.

The requirement for ISPVs to be fully funded

3.12 Solvency II requires all ISPVs to be fully funded. Article 326 of the Delegated Regulation sets out the requirements that must be satisfied in order for an ISPV to be considered fully funded.

3.13 Article 326(1)(a) of the Delegated Regulation requires that the assets of the ISPV be valued in accordance with Article 75 of the Solvency II Directive. For this purpose, the PRA expects the ISPV to recognise and value its assets in accordance with Article 8 of the Delegated Regulation. This means that, unless provided otherwise, assets must be recognised in conformity with the international accounting standards adopted by the European Commission in accordance with Regulation (EC) No 1606/2002. This will determine the extent to which assets may be recognised and taken into account for the purposes of satisfying the fully funded requirement.

3.14 Article 326(1)(c) of the Delegated Regulation requires that the proceeds of the ISPV's debt issuance or other funding mechanism are fully paid-in. The PRA considers that to be fully paid-in an ISPV should have received the proceeds of the debt issuance or other mechanism by which it is financed. Therefore on the basis of Article 326(1)(a) and (c) of the Delegated Regulation, the PRA expects ISPVs not to include contingent assets for the purposes of satisfying the fully funded requirement. Accordingly, ISPVs should not count legally binding commitments that could be treated as ancillary own funds by insurance or reinsurance undertakings under Article 89 of the Solvency II Directive, as assets for the purposes of satisfying the fully funded requirement.

3.15 The PRA expects ISPVs to recognise payments expected to be received from the cedant (e.g. funds withheld) as an asset only if all the requirements in Article 326(4) of the Delegated Regulation are met.

3.16 Article 326(1)(b) of the Delegated Regulation requires that the ISPV must at all times have assets the value of which is equal to or exceeds its AMRE and that it is able to pay the amounts it is liable for as they fall due. The AMRE is defined in Article 1(44) of the Delegated Regulation as the sum of the maximum payments including expenses that the ISPV may incur, although expenses that satisfy Article 1(44)(a) to (c) of the Delegated Regulation can be excluded. The PRA considers that the AMRE must be an amount that is determinable at any given point in time, so that ISPVs and the PRA are able to assess whether the fully funded requirement is being met at that point in time. Consequently, the PRA expects the risk exposure taken on by the ISPV to either be a fixed amount that is specified in the contract, or to be an amount determinable in accordance with the terms of the contract with the cedant, eg the contractual limit is recalculated on a periodic basis with reference to the amount generated by a model as long as it is explicitly reflected in the contractual limit and the updated AMRE. In either case, consistent with Article 320 of the Delegated Regulation, the PRA expects an ISPV to ensure that the risk transfer (and the contractual provisions regarding any changes thereto) is clearly defined so that an ISPV's AMRE can be determined clearly at any point in time.

3.17 For a single-arrangement ISPV, there will be one AMRE that applies in respect of the entire risk exposure of the ISPV. For MISPVs, for the purposes of Article 7(3) of the Implementing Regulation, the AMRE should be determined and fully funded at the level of each individual cell, except that, in the case of a group of cells,¹⁴ the AMRE will apply at the level of the group of cells in accordance with Insurance Special Purpose Vehicles 2.2. For the purposes of this rule, the PRA expects the MISPV to demonstrate how the group of cells will satisfy the fully funded requirement, and also to consider any risks arising from the inter-cell arrangements in their system of governance.

3.18 While the AMRE should be fully funded at all times, the AMRE can change over the life of the arrangement. At the outset, the AMRE might consist only of initial expense costs. At the point risk is transferred to the ISPV the AMRE will increase in parallel to the amount of the risk transfer. Any claims paid may result in the AMRE decreasing in parallel to the amount paid out, and thereafter the AMRE will reflect any remaining risk exposure. Where the contractual arrangements envisage changes to the risk transferred and/or to the funding of the ISPV (for example, reinstatements, stepped increases or decreases to the risk transfer, deferral of premium payments, funding top-ups, delayed risk period inception, or mechanisms that allow the 'roll-over' of funding between two consecutive risk transfer arrangements) the PRA expects an ISPV to ensure that the contractual provisions clearly set out how and when the risk transfer and funding, and consequently the AMRE, may change.

3.19 Given that Solvency II does not envisage a gap between risks being transferred to and funding being received by the ISPV, the PRA expects an ISPV to ensure that the contractual provisions should be such that any increase in the AMRE during the life of the arrangement is only effective if and when the corresponding funds are paid-in. The PRA expects ISPVs to ensure that this is made clear in the contractual provisions. Where arrangements contain contractual features that could result in the AMRE decreasing, the conditions governing return of capital to investors should be such that the fully funded requirement is maintained. In general, the PRA expects that, unless clearly provided for in the terms of the contract with the cedant, injections or repayments of funds to match these kinds

¹⁴ A group of cells comprise the cells which form part of an arrangement between cells, referred to as an 'inter-cell arrangement'.

of contractual changes in the AMRE (as described above and in paragraph 3.16) should not take credit for increases in the value of assets already invested.

3.19A In light of paragraphs 3.18 and 3.19, where parties may wish to 'roll-over' funding from one risk transfer arrangement to the other, the same funds should not be used to meet the AMRE of two consecutive risk transfer arrangements at the same time. This means that the funds being held to meet the AMRE of an existing risk transfer arrangement should not, simultaneously, be counted to meet the AMRE of a new risk transfer arrangement. However, once the AMRE of the existing risk transfer is reduced and the funds equal to the value of such reduction are released, some or all of such funds can then be re-invested in the new risk transfer arrangement and be counted to meet the AMRE of the new risk transfer arrangement.

3.20 The PRA neither requires nor prohibits the use of limited recourse clauses that cap an ISPV's AMRE to a level no greater than its assets. The PRA does not expect limited recourse clauses to be relied upon by the ISPV as an alternative to having assets to at least the value of the AMRE as set out in Article 326(1) of the Delegated Regulation, or having a sound risk management framework (in accordance with Article 324 of the Delegated Regulation) and investment strategy (in accordance with Article 327 of the Delegated Regulation). Nor should a limited recourse clause undermine the requirement that the risk transferred to the ISPV is effective at all times and incontrovertible. However, provided that, in line with Article 324 of the Delegated Regulation, the ISPV has a sound risk management framework which includes policies to mitigate and manage the risk that the limited recourse clause is called upon, as well as an adequate investment strategy, the PRA considers that limited recourse clauses may be used as a means of mitigating the risk from a contractual perspective that the ISPV ceases to comply with the fully funded requirement on an ongoing basis.

3.21 In assessing the suitability of limited recourse clauses the PRA will expect an ISPV to demonstrate that its risk management framework is sound and its investment strategy is consistent with its risk profile.

3.22 The presence of other off-balance sheet support arrangements such as contingent assets (including guarantees, or other market or credit risk mitigation) could also be relevant to the effectiveness of risk transfer and ensuring the ISPV is fully funded on an ongoing basis. However, as outlined in paragraph 3.14 such arrangements should not be considered as a substitute for paid in funds or justification to underfund the risk transfer.

3.23 It is the responsibility of the applicant to demonstrate that the ISPV will be fully funded at all times, consistent with Articles 318(h), 326 and 327 of the Delegated Regulation. Consequently, the PRA expects that an ISPV should make clear in its application how the components referred to in (ii) and (iii) of the Appendix of this SS, work together to ensure the ISPV will remain fully funded and maintain effective risk transfer throughout its existence.

Inter-cell arrangements

3.24 The RTR includes provisions for PCCs to make arrangements between cells within strictly confined parameters. HM Treasury has stated that, unless proposed arrangements between cells are included within the scope of the Part 4A permission granted by the PRA, inter-cell arrangements will not be available to a PCC. Accordingly the PRA, pursuant to the requirement imposed on the PRA under Regulation 7 of the RTR, will exercise its discretion to impose a limitation on the MISPV's

permission with reference to the inter-cell arrangements specified in an MISPV's application for Part 4A permission.¹⁵

3.25 Therefore, if an MISPV proposes to use inter-cell arrangements, the PRA expects the MISPV to include a clear proposal for their use in its application, with the specific details of the arrangements, so that the PRA can assess the arrangements for inclusion within the MISPV's SOP (as outlined in paragraphs 2.13 to 2.18) at the time of authorisation. The PRA will expect the MISPV to describe clearly the approach to any proposed inter-cell arrangements, including how assets and AMRE will be allocated amongst the group of cells, the circumstances under which assets would move back to cell A (where cell A is the cedant-facing cell), details of how the group of cells will be fully funded at all times, and the investment strategy of the cells. This should also include the approach to any amendments or cancellations of inter-cell arrangements, and details of how the group of cells continue to meet their AMRE, or evidence that the obligations of the group of cells have been fully discharged.

3.26 The PRA expects MISPVs to ensure that arrangements between cells are used with care and are consistent with Solvency II requirements.¹⁶ Accordingly, the PRA will consider the MISPV's explanation of how the proposed arrangements comply with Solvency II, to ensure, for example, that the proposed arrangements will not undermine the Solvency II requirement that each contractual arrangement for risk transfer satisfies the fully funded requirement, that the claims of the investors are at all times subordinated to the reinsurance obligations of the ISPV, and that its solvency cannot be affected by the insolvency of any cedant.

3.27 If an MISPV does not propose to use inter-cell arrangements, the SOP shall preclude the use of inter-cell arrangements. Should an MISPV subsequently propose the use of inter-cell arrangements for the first time, or the use of inter-cell arrangements in a manner not specified within the MISPV's SOP, a subsequent application for a VOP should be submitted to the PRA in the manner described in paragraph 2.18.

Notification process

3.28 Where an MISPV makes use of an inter-cell arrangement in line with the approved approach in its SOP, the MISPV is required to notify the PRA within five working days of the arrangement being entered into, pursuant to Regulation 69(2)(a) of the RTR. This includes notification of any amendments or cancellations to a group of cells pursuant to Regulation 70(3) of the RTR. As set out in Insurance Special Purpose Vehicles 4.4, the MISPV must notify the PRA by submitting the Group of Cells Notification Form.¹⁷

Risk transfer requirements

3.29 A stand-alone ISPV may only take on a single contract for risk transfer from a single cedant. This follows from Article 2 of the Implementing Regulation, which defines an MISPV. It may not take on a contract for risk transfer from multiple cedants, nor can it take on more than one contract for risk transfer from one cedant. Similarly, in line with Regulation 43(5) of the RTR, a single cell of a PCC may only take on a single contract for risk transfer from a single cedant.

3.30 The PRA recognises that ISPVs may assume risks through reinsurance contracts or assume insurance risks through 'similar arrangements' consistent with Article 318(a) of the Delegated

¹⁵ Paragraphs 3.19 and 3.21 of HM Treasury's response document, 'Regulations implementing a new regulatory and tax framework for Insurance Linked Securities: response to the consultation' July 2017: www.gov.uk/government/consultations/insurance-linked-securities-consultation.

¹⁶ Paragraphs 3.18 of HM Treasury's response document.

¹⁷ See Insurance Special Purpose Vehicles 6.2.

Regulation. Regardless of the form of the risk transfer, the PRA expects applicants to demonstrate that their activity complies with Regulation 13A of the RAO and Article 318(a) of the Delegated Regulation, and that Article 320 of the Delegated Regulation is met, including that the risk is effectively transferred from the cedant to the ISPV and from the ISPV to the providers of debt or other financing mechanism.

3.31 The PRA expects an applicant to describe clearly, in its application form, the details of the proposed risk transfer and demonstrate how the risk transfer complies with these requirements.

3.32 In the case of risk transfers that include non-indemnity triggers, the PRA expects applicants to include specific details of the structure of the trigger, eg any pay-out factors, geographic weightings, exposures vectors, relative experience ratios, or regular portfolio resets. In line with Annex 1 of the Implementing Regulation, where basis risk exists, applicants must submit a basis risk analysis as part of their application.

4 Ongoing supervision of ISPVs

4.1 ISPVs will be subject to ongoing supervision by the regulators, and will need to comply with the relevant Threshold Conditions and the relevant Solvency II requirements on an ongoing basis. The PRA's ongoing assessment will be proportionate and risk-based, in line with the risks that the ISPV poses to the PRA objectives and in accordance with applicable requirements.

4.2 In order to comply with the supervisory reporting requirements in Articles 325 and 326 of the Delegated Regulation, the PRA expects applicants to explain their procedures for how the ISPV intends to monitor the assets of the vehicle on an ongoing basis, including ensuring the ISPV at all times has assets the value of which is equal to or exceeds the AMRE.

4.3 Also, consistent with Articles 325 and 326 of the Delegated Regulation and Articles 13 to 18 of the Implementing Regulation, ISPVs are required to provide both a qualitative and a quantitative report annually to the PRA, the latter of which requires completing the templates that are designed specifically for Special Purpose Vehicle reporting and are set out in Annexes II and III of the Implementing Regulation.

4.4 Consistent with Article 325(5) of the Delegated Regulation, the PRA expects ISPVs to notify the regulators immediately in the event of any changes which could affect its compliance with any applicable requirements, including any breach of the fully funded requirement. As explained in paragraph 2.18, any changes that would affect any components of the SOP require the ISPV to apply for a VOP before such changes can take effect.

Appendix: Selected information likely to be relevant for defining the SOP

SOP component
i) Key contractual provisions (excluding fully funded, see (iii) below) – contract wording relied upon for the ISPV to meet the Solvency II requirements, eg subordination clauses and insolvency clauses.
ii) Fully funded approach - the ISPV's approach to meeting the fully funded requirement, including:
<ul style="list-style-type: none"> • Specific contractual provisions or mechanisms relied upon for the ISPV to satisfy and continue to satisfy the fully funded requirement (eg capital release/distribution clauses, and limited recourse clauses). • The ISPV's approach to the triggering, timing and determination or calculation of any changes to the amount of risk transfer and the AMRE throughout the life of the contract, including any contractual provisions that will be relied upon to meet the fully funded requirements (eg the approach, terms and conditions for ramp-ups). • Details of all expense arrangements, both those included within the AMRE and those eligible for exclusion from the AMRE (and details of how they will be satisfied). • Details of any contingency actions to avoid a breach of the fully funded requirement (eg contingent assets, top-ups, and limited recourse clauses). • A clear description of the approach to risk transfer(s), and how they remain effective (ie do not revert back to the cedant) in all circumstances. • Details of any connected transaction that may undermine the fully funded or effectiveness of the risk transfer requirements.
iii) Investment policy – a policy which outlines how the ISPV will satisfy all the requirements in the subparagraphs of Article 327 of the Delegated Regulation.
iv) Trigger mechanisms – the ISPV's approach to any loss event triggers (eg parametric, and index-linked trigger).
v) Type of business – details of the type of arrangements and nature and class of the underlying insurance risk proposed to be transferred.
vi) Qualifying holdings – the identity of any shareholders who meet the criteria of the qualifying holding definition as described in paragraphs 3.6 to 3.11.
vii) Sponsor of the ISPV – identity of the sponsor of the ISPV where this is not the cedant.
viii) Outsourced service provider of the ISPV – identity of any outsourced service provider where the outsourcing arrangement is considered critical, eg a management company carrying out the day-to-day management duties of the ISPV.
ix) Inter-cell arrangements (only applicable for MISPVs) – details of any proposed inter-cell arrangements, specifically: <ul style="list-style-type: none"> • the approach to allocating assets between the group of cells; • the approach to allocating AMRE between the group of cells; • the circumstances under which assets would move back to cell A, where cell A is the cedant-facing cell; • details of how the group of cells will be fully funded at all times; • the investment strategy of the cells; and • the approach to any amendments or cancellations of the arrangements.

Annex: SS8/17 updates

This annex details the changes that have been made to this SS following its initial publication in December 2017.

Updates

May 2020

This SS has been updated alongside the publication of Policy Statement (PS) 13/20 'Insurance special purpose vehicles: Updates to authorisation and supervision'.¹⁸ Details of the PRA's feedback to the response are available in Chapter 2 of the PS.

The PRA amended the following sections of the SS:

- the 'documentation requirements' section to expand on (i) the PRA's expectations regarding the documentation to be submitted at the point of application; (ii) the PRA's expectations where outstanding commercial terms may only be finalised post-approval; and (iii) the PRA's expectations regarding independent-third party opinions (in particular legal opinions);
- the 'funding arrangements' section to elaborate on the PRA's expectations where there may be changes to the risk and/or funding of the ISPV (in particular 'roll-over' mechanisms);
- the 'risk transfer requirements' section which sets out its expectations on risk transfer requirements (in particular where a 'similar arrangement' is being contemplated); and
- other sections to improve readability and provide further detail, including: how the SOP may be used in practice; how the PRA will treat similar 'repeat' transactions; and a reminder to firms that the PRA may require an assessment of the accounting consolidation if an ISPV is consolidated into a group.

The PRA has also corrected references in paragraph 3.30 and corrected typographical errors.

December 2017

The SS was updated to insert the statutory reference to the Risk Transformation Regulations 2017, and include a reference to the FCA Statement.

¹⁸ May 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2019/ispsv-updates-to-authorisation-and-supervision>.