

Policy Statement | PS26/17

# Authorisation and supervision of insurance special purpose vehicles

November 2017



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY









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## 1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback to responses to Consultation Paper (CP) 42/16 'Authorisation and supervision of insurance special purpose vehicles'<sup>1</sup> and sets out the PRA's final approach and expectations in relation to the authorisation and supervision of insurance special purpose vehicles (ISPVs) subject to paragraph 1.5.

1.2 This PS is relevant to all parties who wish to apply to the PRA 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.<sup>2</sup>

1.3 In accordance with Article 2 of the Implementing Regulation,<sup>3</sup> an ISPV that takes on more than one contract for risk transfer from one or more cedants<sup>4</sup> is referred to as a multi-arrangement insurance special purpose vehicle (MISPV). All references made to ISPVs in this SS are equally applicable to MISPVs, unless otherwise specified.

1.4 This PS includes the following materials (which are all subject to paragraph 1.5 below):

- Supervisory Statement (SS) 8/17 'Authorisation and supervision of insurance special purpose vehicles' (Appendix 1);
- amendments to the Insurance Special Purpose Vehicles Part of the PRA Rulebook (Appendix 2);
- an application form in relation to the authorisation and supervision of ISPVs (Appendix 3); and
- two sets of notification forms for MISPVs (Appendices 4 and 5).

1.5 The rules will be made and the SS and forms will be formally adopted once the Risk Transformation Regulations 2017 (SI 2017/1212) (RTR) have passed through Parliament. If this does not happen, the rules will not be made and the SS and forms will not be formally adopted by the PRA. The PRA does not expect there to be changes to the rules, SS and forms between now and formal adoption. If changes were to occur, the PRA will notify firms through issuing an addendum to this PS to explain any such changes.

**Update 8 December 2017: The RTR were made on 5 December 2017 and commenced on 8 December 2017.**

1.6 In this PS, reference to 'the regulators' means the PRA and the Financial Conduct Authority (FCA).

### Background

1.7 In November 2016, HM Treasury published a consultation on a new regulatory and tax framework for insurance-linked securities in the United Kingdom, which included a draft of the RTR. In that month, the regulators also published the CP on their proposed approach to the authorisation and supervision of ISPVs.

1 Available at (see page 2): [www.bankofengland.co.uk/prudential-regulation/publication/2016/authorisation-and-supervision-of-insurance-special-purpose-vehicles](http://www.bankofengland.co.uk/prudential-regulation/publication/2016/authorisation-and-supervision-of-insurance-special-purpose-vehicles).

2 Directive (2009/138/EC) (Solvency II Directive).

3 Commission Implementing Regulation (EU) 2015/462 (Implementing Regulation).

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

1.8 The CP set out the regulators' proposed approach and expectations in relation to the authorisation and supervision of ISPVs. It included a draft SS that set out the PRA's proposed expectations on such matters as the application process, fit and proper requirements and the requirement on ISPVs to be fully funded at all times. Furthermore it proposed amendments to the Insurance Special Purpose Vehicles Part of the PRA Rulebook, which included a new requirement for ISPVs to give prior notification before establishing a new cell.

1.9 On 20 July 2017, HM Treasury published a response to its consultation with an updated draft version of the RTR.<sup>1</sup> The final version of the RTR was laid before Parliament on 12 October 2017.

### **Changes to the draft rules and Supervisory Statement**

1.10 Where the proposed final rules differ from the draft in the CP in a way which is, in the opinion of the PRA, significant, the Financial Services and Markets Act 2000 (FSMA)<sup>2</sup> requires the PRA to publish:

- (i) details of the difference (and the PRA's response to representations made to it regarding those changes) together with a cost benefit analysis (CBA); and
- (ii) a statement setting out in the PRA's opinion whether or not the impact of the final rule on mutuals is significantly different to the impact that the draft rule would have had on mutuals, or the impact that the final rule will have on other PRA-authorized firms.

1.11 Following consideration of responses to the CP and the revised RTR, the PRA has made updates to the proposed SS largely to add clarity, and to the proposed rules.

1.12 Changes made to the SS resulting from responses include additional guidance on the:

- fully funded requirement;
- Senior Insurance Managers Regime (SIMR), those individuals 'effectively running' the ISPV (Article 322 of the Delegated Regulation);<sup>3</sup>
- fit and proper assessment of shareholders with a qualifying holding (Article 323 of the Delegated Regulation); and
- circumstances in which ISPVs may be authorised prior to receiving funding.

1.13 Changes to the draft rules and SS to reflect the revised RTR include:

- amendments in line with Regulation 60 of the RTR, which now requires MISPVs to provide post-transaction notification to the PRA of the assumption of new risks;
- additional material on the PRA's approach to limiting the activities of an ISPV, pursuant to Regulation 7 of the RTR, and referenced in the SS as the Scope of Permission (SOP)<sup>4</sup>. This

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1 Available at: [www.gov.uk/government/consultations/regulations-implementing-a-new-regulatory-and-tax-framework-for-insurance-linked-securities](http://www.gov.uk/government/consultations/regulations-implementing-a-new-regulatory-and-tax-framework-for-insurance-linked-securities).

2 Sections 138J(5) and 138K(4).

3 Commission Delegated Regulation (EU) 2015/35 (Delegated Regulation).

4 The SOP will define the boundaries within which the ISPV may carry on the regulated activity of insurance risk transformation.

approach replaces the Regulatory Business Plan (RBP) which was included in the draft SS; and

- details on the approach to inter-cell arrangements and the notification process, in line with Chapter 6 of the RTR.

**Update 8 December 2017: The final rules have also been updated to insert the statutory reference to the Risk Transformation Regulations 2017, the commencement date, to consolidate the definition of ISPV, and to make minor administrative corrections. They are included as Appendix 6.**

1.14 Details of the changes and feedback to responses are set out in Chapter 2. Consideration of the CBA and the PRA's other statutory obligations in relation to the above changes is set out in Chapter 3.

## 2 Feedback to responses

2.1 Before making any proposed rules or establishing its general policies and practices, the PRA is required by FSMA<sup>1</sup> to have regard to any representations made to it, and to publish an account, in general terms, of those representations and its response to them.

2.2 The PRA received sixteen responses to the CP. The sections below summarise the responses, and provide the PRA's feedback and proposed final approach in light of the version of the RTR as laid before Parliament.

### MISPV notification

2.3 The CP proposed that an MISPV must notify the PRA of a proposal to establish any new cell at least ten working days before the proposal takes effect. Eleven respondents expressed concerns with the commercial viability of a pre-transaction notification regime for the establishment of new cells.

2.4 In light of the feedback, the PRA has decided that post-transaction notification of a new assumption of risk is acceptable provided that this is within the SOP of the MISPV. HM Treasury has amended the RTR<sup>2</sup> so that where a Protected Cell Company (PCC) assumes a risk from an undertaking, the PCC must notify the PRA within five working days beginning with the day the PCC assumed the risk. This change to the MISPV notification process has been reflected in paragraph 2.27 of the SS and Chapter 4 of the Insurance Special Purpose Vehicles Part.

### Application review timeline

2.5 Ten respondents commented that the PRA's proposed application review time of 6-8 weeks for non-complex applications was not commercially viable.

2.6 Solvency II specifies that the supervisory authority must decide on an application within six months of receipt.<sup>3</sup> Having considered the responses, the PRA remains of the view that it may be able to arrive at a decision within 6-8 weeks for relatively straightforward, high quality applications, and possibly more quickly in some circumstances. The PRA may revisit these estimated timelines in the future.

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1 Sections 138J(3) to (5) and section 2N.

2 See Regulation 60 of the RTR.

3 Article 4(1) of the Implementing Regulation.

2.7 More complex applications are more likely to require an extended review time, particularly where MISPVs wish to include a range of options for how they may structure arrangements in future cells. However, given the changes described in paragraph 2.4, an MISPV will not need further approval to assume new risks once it has been authorised, as long as it is operating within its SOP. Rather, the MISPV will be required to notify the PRA within five working days of the risk being assumed.

2.8 To support the application process and ensure that the regulators can complete their reviews in as timely a manner as possible, the PRA strongly encourages applicants to engage the regulators in the pre-application process as set out in paragraphs 2.5 and 2.6 in the SS.

### **Documentation requirements**

2.9 Four respondents requested clarification of the PRA's expectations regarding the documentation to be submitted as part of an ISPV application.

2.10 The PRA has set up a webpage<sup>1</sup> for ISPVs that gives an overview of the regime and references the relevant ISPV documentation, including links to the relevant HM Treasury and FCA materials. The ISPV application form sets out the information the PRA will need when assessing an application.

2.11 Three respondents requested clarity on the PRA's proposal to accept draft documentation on certain conditions as part of the ISPV application. Further guidance on the PRA's expectations regarding draft and final documents within applications has been provided in paragraphs 2.9 to 2.11 of the SS.

### **Third party opinions**

2.12 Four respondents asked for clarity on the scope of third party opinions for an ISPV application.

2.13 The PRA does not require the submission of third party opinions as part of an ISPV application, and acknowledges their use may be limited in assessing compliance of certain requirements. However, applicants are encouraged to consider providing them where they may aid the PRA's review of an application. Further detail on the use of third party opinions has been added to paragraph 2.12 of the SS.

### **Qualifying holding**

2.14 Five respondents requested clarification of the types of investors that would have a qualifying holding<sup>2</sup> (as defined in the Solvency II Directive) requiring an assessment under Article 323 of the Delegated Regulation, and guidance on what the PRA expects of ISPVs in relation to the fit and proper assessment of shareholders with a qualifying holding. Respondents also asked for clarity on how this would be applied to MISPVs.

2.15 The PRA will carry out fit and proper assessments of all shareholders in the core of an MISPV; these individuals will have a qualifying holding on the basis that they may exercise a significant influence over the management of the MISPV. The effect of the RTR is to prevent shares in cells from being treated as shares in the MISPV, and for this reason the RTR means

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1 [www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles](http://www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles).

2 Article 13(21) of the Solvency II Directive: 'qualifying holding' means a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking.

that shares in cells cannot amount to a qualifying holding requiring an assessment under Article 323 of the Delegated Regulation.

2.16 For single-arrangement ISPVs the PRA will carry out fit and proper assessments of those shareholders with 10% or more of the voting rights or who may have significant influence over the ISPV. The fit and proper assessment of the remaining passive, non-voting shareholders in an ISPV, who meet the qualifying holding threshold by way of holding 10% or more of the share capital in the vehicle, will be carried out by the ISPV itself and the PRA will assess the ISPV's framework for doing so. The SS includes further details on these points in paragraphs 3.6 to 3.11.

### **SIMR requirements**

2.17 Three respondents questioned the necessity and relevance of the three mandatory Senior Insurance Manager Function (SIMF) roles required for ISPVs under the SIMR. Five respondents also queried whether these SIMF roles must be occupied by employees of the ISPV, given the lack of employees typically found in the ISPV structure.

2.18 The requirement for three mandatory SIMF roles was set when the SIMR was established (and the PRA did not propose to change this in the CP). The PRA continues to believe that the three mandatory roles are appropriate and proportionate for an ISPV. In paragraph 3.3 of the SS, the PRA has clarified that one person may be able to perform more than one of these roles and that a SIMF role need not be held by an employee of the ISPV.

### **Individuals 'effectively running' the ISPV**

2.19 Four respondents asked for further clarity on those individuals deemed to be 'effectively running' the ISPV. Paragraphs 3.1 and 3.5 of the SS set this out with reference to Solvency II EIOPA guidelines<sup>1</sup> and SS35/15 'Strengthening individual accountability in insurance'<sup>2</sup>.

### **ISPV Manager**

2.20 Four respondents proposed a new regulated activity be created within FSMA for outsourced service providers that have management responsibilities over the ISPV. The PRA considers that this would require legislative change and therefore it is a matter of policy for HM Treasury. HM Treasury has responded to the proposal in its feedback statement.<sup>3</sup>

### **Considerations of the cedant<sup>4</sup>**

2.21 Four respondents commented that once an ISPV is authorised, the regulatory focus should shift to the cedant of the ISPV. The PRA is required to assess an ISPV's compliance with the Solvency II requirements at authorisation and on an ongoing basis. The supervisory authority of the cedant may also assess the cedant's treatment of the arrangement with the ISPV in light of the prevailing regulatory regime.

### **The requirement for ISPVs to be fully funded**

Limited recourse clauses

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1 EIOPA Guidelines of system of governance (EIOPA-BoS-14/253 EN), paragraph 1.21.  
 2 May 2017: [www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-insurance-ss](http://www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-insurance-ss).  
 3 Paragraphs 3.26 and 3.27 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/regulations-implementing-a-new-regulatory-and-tax-framework-for-insurance-linked-securities](http://www.gov.uk/government/consultations/regulations-implementing-a-new-regulatory-and-tax-framework-for-insurance-linked-securities).  
 4 See footnote 4 of page 5.

2.22 Eight respondents suggested that limited recourse clauses be mandatory for ISPVs, or suggested that the existence of a limited recourse clause might be relied upon by ISPVs as sufficient to demonstrate that the fully funded requirement was met.

2.23 Solvency II requires that an ISPV is fully funded at all times and defines what this means in Article 326 of the Delegated Regulation: the ISPV must have 'assets the value of which is equal to or exceeds the ISPV's aggregate maximum risk exposure' and the ISPV 'is able to pay the amounts it is liable for as they fall due'. An ISPV cannot rely on a limited recourse clause as an alternative to holding assets the value of which is equal to or in excess of its aggregate maximum risk exposure (AMRE), or be relied on in a way which undermines the effectiveness of risk transfer. The impact of a limited recourse clause on the effectiveness of risk transfer, and how it contributes to the ISPV's ability to meet the fully funded requirement in combination with its risk management and investment strategies, must therefore be assessed case by case. Paragraph 3.20 of the SS has been amended to provide further clarity.

2.24 Eight respondents were unsure as to how the PRA would view limited recourse clauses in their assessment of an applicant ISPV's arrangements to ensure the fully funded requirement will be met.

2.25 The PRA's view is that limited recourse clauses should not be used to justify 'underfunding' of an ISPV on the assumption that off-balance sheet support may be available, or to deal with the risk of receipt of funds being delayed until after contractually agreed changes in the AMRE have become effective. The SS has been amended to provide further clarity; in particular the PRA would not expect any risk transfer to the ISPV to become effective until the corresponding funds have been received by the ISPV.

#### Other questions and suggestions

2.26 Five respondents were keen to understand the PRA's views on how the fully funded requirement might be met in the context of features such as renewals, rollovers and top-ups. Provided that the contractual provisions make clear that such arrangements do not result in the risk transfer becoming effective before the corresponding funds are received and that the same funds are not being used to cover more than one contractual arrangement at a time, the PRA considers that, in principle, these types of arrangements can be accommodated by the UK's ISPV regime. Further text has been added to paragraphs 3.18 and 3.19 of the SS to explain the PRA's views in these areas.

2.27 Three respondents sought reassurance that arrangements that do not contain monetary risk limits but use a model to establish the AMRE would be possible in the UK's regime. The PRA considers that, while there should be a clear limit, it is possible for parties to determine the limit of risk transfer in a number of ways. Calculating the risk transfer on a periodic basis with reference to the amount generated by a model can be one of these ways as long as it is explicitly reflected in the contractual limit and accordingly in the AMRE as updated periodically. This is discussed in paragraph 3.16 of the SS.

2.28 Eleven respondents queried if contingent assets could count towards an assessment of whether an ISPV is fully funded, either explicitly or rather by having the PRA accept that together with limited recourse clauses they can compensate for a lack of paid-in funds. 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 and Article 326(1)(c) of the Delegated Regulation requires the proceeds of the financing mechanism to be paid in. The SS makes clear in paragraphs 3.14 and 3.22 that on the basis of both of these requirements, contingent assets cannot form part of an assessment of whether an ISPV is fully funded but that they can be

considered when assessing the effectiveness of risk transfer in combination with the risk management and investment strategies.

### **Authorisation timing**

2.29 In the CP, the PRA asked firms for their view on timing of authorisation in terms of the funding of the vehicle and the risk being transferred to the ISPV. Eight respondents raised practical timing issues around authorisation, explaining that requiring the vehicle to already have the funds in place in order to be authorised would create difficulties due to the sequencing and time delays between authorisation, finalising a transaction and receipt of funds.

2.30 The PRA has considered feedback and accepts that there are legitimate issues which might arise for ISPVs in sequencing the timing of authorisation with the likely timing of receipt of funds. It is prepared to discuss with applicants on a case-by-case basis how such issues might best be dealt with. The PRA may in some cases be prepared to authorise an ISPV before funding is received, and has added new text in paragraph 2.26 of the SS to explain its views on this issue. As stated above, the PRA's view is that risk transfer to the ISPV should not become effective unless, and until, the corresponding funding is received.

### **Communication of decision**

2.31 One respondent commented that obtaining an application decision from a single regulator rather than both regulators would be more streamlined. As set out in paragraph 2.3 of the SS, the PRA will lead on the assessment of the application for authorisation. However, the FCA will also assess the applicant against its own objectives before giving consent to the approval or rejection of the application.

### **Scope of Permission (SOP)**

2.32 Nine respondents fed back that the areas in which the PRA was proposing to restrict MISPVs within its RBP were unnecessary and overly prescriptive. Three respondents also questioned what would be considered a material change to the RBP that would require approval by the PRA.

2.33 The RBP has now been replaced with a formal SOP which outlines the arrangements, structures, and mechanisms to which the ISPV is limited with reference to the relevant detail in the application documents. This is outlined in paragraphs 2.13 to 2.18 of the SS, including details of the requirement to apply for a Variation of Permission (VOP) where the ISPV is considering an amendment to its SOP.

### **PRA intervention powers**

2.34 Four respondents requested further clarity on how the PRA would exercise its powers where an ISPV became non-compliant, specifically in the case of MISPVs, and whether supervisory action would be taken at cellular or entity level.

2.35 Any breach of the Solvency II requirements will be considered on a case-by-case basis, and supervisory action (whether taken at the cellular or entity level) will be proportionate to the specific nature and circumstances of the breach.

## **3 The PRA's statutory obligations**

### **Cost benefit analysis**

3.1 The PRA considers that the changes made to the rules and SS to reflect the changes to the RTR do not change the CBA set out in the CP. The change from pre to post-transaction notification upon an MISPV assuming a new risk does not affect the associated compliance

costs since it only involves a change in the timing of the submission of the notification form to the PRA of the appropriate information. If anything, the move to post-notification should increase MISPV's ability to effect deals more quickly and therefore increase the benefits.

### **Compatibility with the PRA's objectives and regulatory principles**

3.2 The PRA considers the changes to its rules and the SS to be compatible with the PRA's statutory objectives under FSMA:

- to promote the safety and soundness of PRA-authorised firms;
- in the context of insurance, to contribute to policyholder protection; and
- as a secondary objective to facilitate effective competition in the markets for services provided by PRA-authorised persons in carrying out regulated activities.

3.3 The changes to the PRA's rules and the expectations on ISPVs given in the SS (in light of the updated RTR) are consistent with the requirements of Solvency II. As such, the PRA considers them to be compatible with the requirements on the PRA to act in a way that advances its objectives. As described in the CP, the PRA has had regard to the regulatory principles. The changes made to the proposals in the CP do not affect that analysis.

### **Impact on mutuals**

3.4 The PRA considers that the impact of the new rules and SS on mutuals will be no different from the impact on other PRA-authorised firms.

### **HM Treasury recommendation letter**

3.5 On 8 March 2017, HM Treasury made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the objectives of the PRA and apply the regulatory principles as set out in FSMA.<sup>1</sup>

3.6 The PRA considers that three of these aspects are of particular relevance to the final rules and SS:

(i) *Competitiveness*: The PRA is mindful of the international nature of financial services. In developing the framework for authorisation and supervision of ISPVs the PRA has given consideration to the commercial considerations necessary for the establishment of ISPVs in the UK. The changes to the approach set out in the CP were made in response to industry feedback and should enhance the competitiveness of the UK ISPV regime.

(ii) *Growth*: The PRA acknowledges the importance of the financial services sector contributing to sustainable economic growth. Having regard to competitiveness of the UK ISPV regime should encourage trade in the type of financial services ISPVs provide and growth in the sector.

(iii) *Innovation*: The PRA considers that the final framework allows enough flexibility for the UK ISPV market to mature and innovate.

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<sup>1</sup> Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at [www.bankofengland.co.uk/about/Pages/people/prapeople.aspx](http://www.bankofengland.co.uk/about/Pages/people/prapeople.aspx).



## Appendices

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- 1** **Supervisory Statement 8/17 'Authorisation and supervision of insurance special purpose vehicles', available at:**  
[www.bankofengland.co.uk/prudential-regulation/publication/2017/authorisation-and-supervision-of-insurance-special-purpose-vehicles-ss](http://www.bankofengland.co.uk/prudential-regulation/publication/2017/authorisation-and-supervision-of-insurance-special-purpose-vehicles-ss)

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- 2** **PRA RULEBOOK: SOLVENCY II FIRMS: NON SOLVENCY II FIRMS: TRANSFORMER VEHICLES INSTRUMENT 2017 DRAFT, available at:**  
[www.bankofengland.co.uk/prudential-regulation/publication/2016/authorisation-and-supervision-of-insurance-special-purpose-vehicles](http://www.bankofengland.co.uk/prudential-regulation/publication/2016/authorisation-and-supervision-of-insurance-special-purpose-vehicles)

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- 3** **Application form for insurance special purpose vehicles (ISPVs), available at:**  
[www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles](http://www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles)

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- 4** **MISPV New Risk Assumption Notification Form, available at:**  
[www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles](http://www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles)

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- 5** **MISPV Group of Cells Notification Form, available at:**  
[www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles](http://www.bankofengland.co.uk/prudential-regulation/authorisations/insurance-special-purpose-vehicles)

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- 6** **PRA RULEBOOK: SOLVENCY II FIRMS: NON SOLVENCY II FIRMS: TRANSFORMER VEHICLES INSTRUMENT 2017 FINAL, available at:**  
[www.bankofengland.co.uk/prudential-regulation/publication/2016/authorisation-and-supervision-of-insurance-special-purpose-vehicles](http://www.bankofengland.co.uk/prudential-regulation/publication/2016/authorisation-and-supervision-of-insurance-special-purpose-vehicles)