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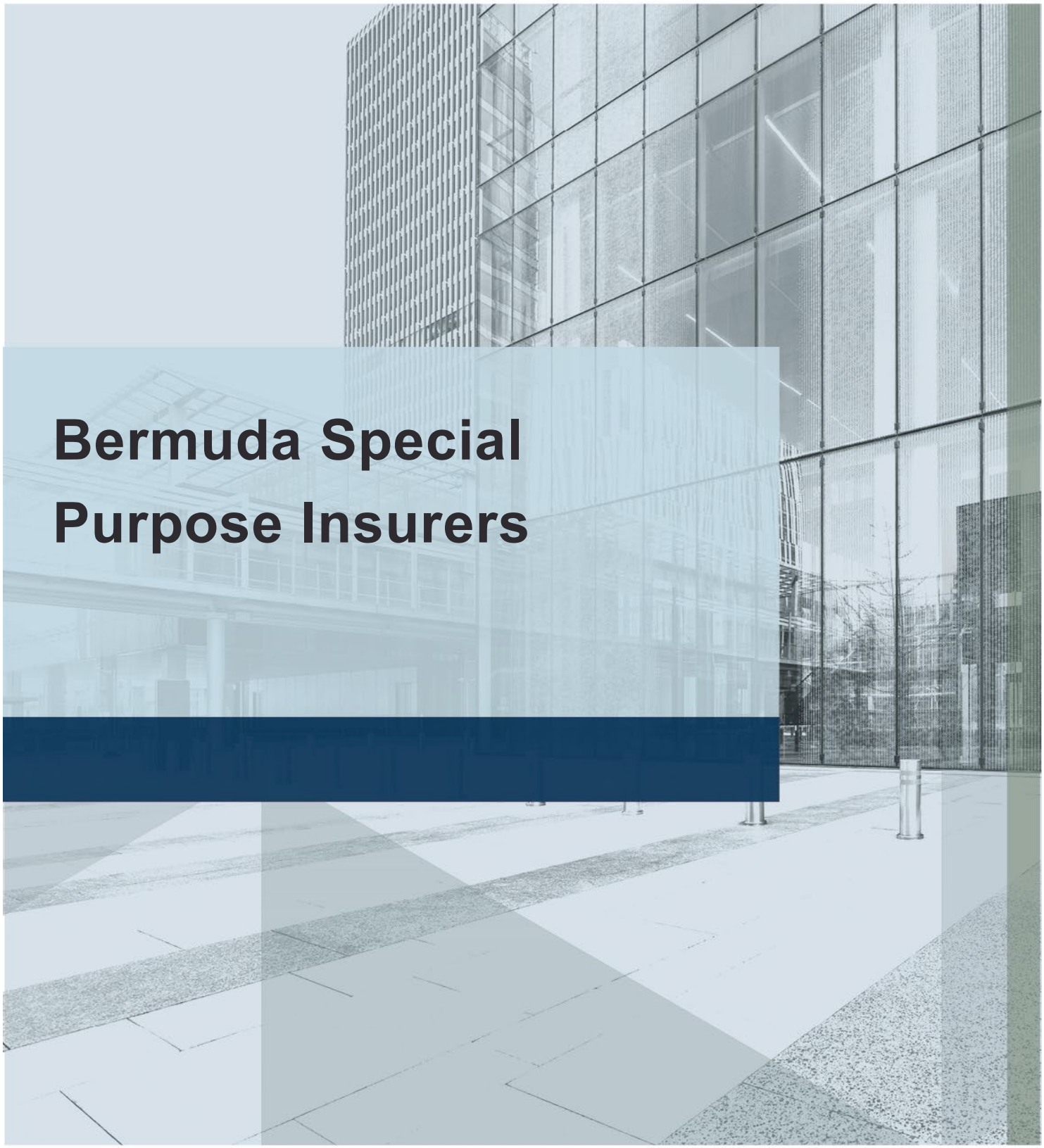

# Bermuda Special Purpose Insurers

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# Preface

This publication has been prepared for the assistance of those who are considering the formation of a "special purpose insurer" in Bermuda. It deals in broad terms with the requirements of Bermuda law for the establishment and operation of such companies under the Insurance Act 1978. It is not intended to be exhaustive but merely to provide brief details and information on the topic. We recommend that persons seek legal advice in Bermuda on any specific proposals they may have before taking steps to implement them. In addition, before proceeding with any such proposals, persons are advised to consult with their tax, legal and other professional advisers in their respective home jurisdictions.

Copies of the Insurance Act 1978 together with the regulations promulgated thereunder are available on request.

**Conyers Dill & Pearman**

# TABLE OF CONTENTS

## 1. INTRODUCTION

Bermuda has long been an important global insurance and reinsurance centre, and is regarded as one of the most sophisticated markets in the world. With a reputation for innovation and speed to market, the island's industry began with the development of the captive insurer concept in the 1960s, quickly followed by the growth of the now well established commercial market. Bermuda has also led the development of sophisticated insurance-linked security ("**ILS**") products such as cat-bonds, sidecars, transformers and other fully-funded insurance and reinsurance vehicles.

In 2008, having recognised the sophistication of the ILS market, the Bermuda Monetary Authority ("**BMA**") established the class of "Special Purpose Insurer" ("**SPI**"), specifically to write sophisticated, fully-collateralized insurance and reinsurance transactions. Since then, there has been an extraordinary growth in both the number of companies and diversity of transactions availing themselves of the SPI licence. Cat bonds and sidecars are two of the more common uses, both as one-off transactions and with multiple tranches and series. SPIs have also been formed to act as transformer vehicles, to provide reinsurance to Lloyd's corporate members, and to write embedded value life and "triple-X" securitisation transactions. They are commonly used to write collateralised retrocession business, in certain circumstances for multiple cedants, and in that capacity have also been used as a key component of ILS-specialised investment funds. In short, their inherent flexibility and efficiency make them an ideal vehicle for a broad array of transactions, and they have proven to be extremely popular.

In 2020, in recognition of the ever growing uses of the SPI class, the BMA introduced amendments to distinguish those SPIs which carry on restricted special purpose business, being business with only specific insureds approved by the BMA ("**Restricted SPIs**") and those which carry out unrestricted special purpose business, being business with any insured, if the insured is rated A- or higher by AM Best or an equivalent rating from a rating agency recognised by the BMA ("**Unrestricted SPIs**"). In doing so, the BMA sought to create a more streamlined regulatory regime and licensing process for those SPIs with a more simple risk profile, like a standard cat bond, versus those which are more complex.

## 2. KEY CRITERIA FOR REGISTRATION AS AN SPI

In order to be deemed to be writing "special purpose business", and therefore to be registered as an SPI, the applicant will be required to evidence two key criteria, namely that:

(i) the business it intends to write will be fully-collateralized; and

(ii) the parties to the proposed transaction are sufficiently sophisticated.

The question of what is meant by "fully-collateralized" and "sufficiently sophisticated" has been intentionally left to the discretion of the BMA, in order to allow maximum structural flexibility. The BMA has developed a Guidance Note outlining its interpretation of these principles and the regulation of SPIs generally, a copy of which is appended hereto. A summary of the concepts, and the practical application of them, follows.

### 2.1. Fully-collateralized

Under the Insurance Act 1978, special purpose business may be fully-collateralized, in short, by any "*…financing mechanism approved by the [BMA]*". This might be (and often is) in the form of cash collateral or subordinated debt, but can also be achieved by any number of other financing mechanisms, including contingent assets such as letters of credit, reinsurance, derivatives, etc.

The reinsurance agreement(s) must contain a limited recourse clause stating that the maximum reinsurance recoverable from the SPI is limited to the lower of (i) the explicitly stated, fixed or formulaic, aggregate limit, or (ii) the available assets provided as collateral. Collateral "top-up" mechanisms may also be permitted in certain circumstances.

Broadly speaking, the nature of the assets being used to fund the liabilities of the SPI can take whatever form the parties may agree, provided that the details are adequately disclosed both prior to and during the life of the transaction in question (and provided that the parties are able to evidence sufficient sophistication – see below). Likewise, there is no restriction on the nature of investments that an SPI may make, again provided adequate disclosure of such investments is made to participants. It is the expectation of the BMA that an SPI will generally carry minimal investment risk with respect to the collateral in the collateral account. In transactions where a collateral top-up may be required, the manner in which the top-up mechanism is to operate and the credit-worthiness of the party providing the additional collateral should also be disclosed to all relevant parties. Provided that such disclosure can be made, it will generally be left to the parties to determine the collateral tolerances within which they are willing to operate.

In practice, the necessary disclosure is readily achieved. The offering circular in a cat bond transaction or the private placement memorandum in a sidecar arrangement will often serve this purpose, and where there is no such general disclosure document, simply evidencing the key terms of the transaction documents will generally suffice.

### 2.2. Sophisticated Participant

As described above, the SPI concept was developed with sophisticated transactions in mind, it being recognised that in such transactions the need for regulation differs from that of traditional insurance or reinsurance business. In short, in order to be satisfied that the SPI's lighter regulatory regime is appropriate to a particular transaction, the BMA must first be satisfied that the participants in the transaction are sufficiently sophisticated to be able to appreciate the nature of the risks involved (see the disclosure requirements described above in the "fully-collateralized" context). If they are able to evidence that sophistication (and that the liabilities will be fully-collateralized), the company will be able to avail itself of the SPI regulation.

In its Guidance Note, the BMA sets out specific criteria for determining the appropriate level of sophistication of both individuals and entities. These criteria are broadly based on high net worth/income and/or experience in sophisticated financial matters. In keeping with the theme of flexibility, however, the BMA also retains broad discretion to authorize other persons/entities as being suitably sophisticated for the purposes of the SPI requirements.

## 3. ADVANTAGES

Where an applicant satisfies the above criteria and is registered as an SPI, it will be subject to a lighter regulatory regime than that of "traditional" general or long term business insurers and reinsurers[1]. Notably:

(i) the minimum issued share capital of an SPI is $1, and the margin of solvency for an SPI (i.e. amount by which the SPI's assets must exceed its liabilities) is also simply $1;

(ii) no regulatory restrictions on or approvals required in connection with a return of capital;

(iii) for Restricted SPIs, there is no requirement to file audited financial statements with the BMA and for Unrestricted SPIs in many circumstances it may be possible to waive the requirement to prepare audited financial statements and statutory financial return, and instead file unaudited management accounts (prepared in accordance with GAAP, IFRS or other appropriate accounting standard) in lieu;

(iv) there is no requirement for a loss reserve opinion;

(v) there are no investment restrictions (subject to adequate disclosure and an expectation that the investment strategy will be prudent with minimal risk based on the sophistication of the parties); and

(vi) low annual registration fee.

In addition, many of the enhancements to Bermuda's insurance/reinsurance regulatory regime introduced as part of the island's quest for Solvency II equivalence are not applicable to SPIs. SPIs, along with captive insurers, are included within the broader "limited purpose insurer" concept, with the effect that the more detailed BSCR and enhanced capital requirements, among other things, are not applicable.

## 4. APPLICATION PROCESS

### 4.1. Restricted SPIs – Catastrophe and Mortgage Bonds

In 2021, the BMA introduced a streamlined and expedited registration process for those Restricted SPIs whose business model is to issue catastrophe or mortgage bonds, allowing them to be registered in three business days. The application package is submitted electronically before 5pm on any business day and must include at a minimum:

(i) Cover Letter;

(ii) SPI Licensing and Registration Checklist – Notably, there is no requirement to file a business plan. Instead, the company must complete an SPI Licensing and Registration Checklist which highlights fundamental aspects of the company and its proposed transaction;

[1] For a detailed discussion of the regulatory regime applicable to long term and general business insurers, including information on the classes of each such category of business, please refer to our general publication titled "Bermuda Insurance Companies".

(iii) Certificate of Incorporation and Memorandum of Association;

(iv) Completed Form 1B;

(v) Draft Transaction Documents – Drafts of the term sheet, offering circular or subscription agreement(s), reinsurance agreement (s), reinsurance trust agreement(s), and indenture must be included in the application;

(vi) Five Year Pro-Forma Financial Statements;

(vii) Information on Directors – If not already known the BMA, appropriate due diligence and a resume highlighting insurance expertise will need to be provided; and

(viii) Service Provider Acceptance Letter(s).

Upon receipt, the BMA will process and issue the certificate of registration before the end of three business days.

### 4.2. Unrestricted SPIs and other Restricted SPIs

The application process for registration of Unrestricted SPIs and Restricted SPIs that do not issue catastrophe or mortgage bonds follows the same track as for "traditional" insurers and reinsurers. Initially, an "in principle" application is filed with the BMA by close of business on any given Monday for review on the Friday of that same week. The application package will be comprised of the following documents:

(i) Cover Letter;

(ii) Business Plan – This is generally no more than six pages and should describe the fundamental elements of the transaction in question, including details of: investors, cedant(s)/sponsor and directors/senior management, and service providers (to evidence sophistication); nature of funding mechanism (to evidence fully-collateralized); any other pertinent details such as a segregated account structure or other unique elements;

(iii) Draft Form 1B;

(iv) Drafts of relevant transaction documents – This may include any term sheet, offering circular or subscription agreement(s), contribution agreement(s), reinsurance agreement(s), reinsurance trust agreement(s), indenture or other key documents;

(v) Five Year Pro Forma Financial Statements;

(vi) Information on Directors – If not already known the BMA, appropriate due diligence and a resume highlighting insurance expertise will need to be provided;

(vii) Service provider acceptance letter(s); and

(viii) Other relevant documents/information (as appropriate).

The nature of SPI transactions is such that the BMA will, in most cases, be in a position to grant its approval in principle to the application at its initial Friday review. Following that approval, the company may then formally apply to obtain its certificate of registration as an SPI.

## 5. SINGLE SPI – MULTIPLE TRANSACTIONS

In many cases, an SPI will be used to write a single contract or series of contracts. However, it is possible for an SPI to write multiple contracts, even for multiple cedants, provided that each such contract is "separately structured". What this means in essence is that the collateral or other funding supporting the liabilities of a particular contract may be used only to pay claims under that contract and not any others.

In practice, this separate structuring can be and often is achieved contractually (e.g. through the use of separate reinsurance trusts or security arrangements for each contract written). It is also possible to register the SPI as a "segregated account company" pursuant to the Segregated Accounts Companies Act 2000, and have each contract written, and the related collateral held, through a distinct segregated account. In either case, it is important that the mechanism to be used is clearly described in the application, such that the BMA is satisfied that each contract to be written by the SPI will be "separately structured".

## APPENDIX A - BMA GUIDANCE NOTE – SPECIAL PURPOSE INSURERS

BERMUDA MONETARY AUTHORITY

# GUIDANCE NOTE

## SPECIAL PURPOSE INSURERS

1 July 2020

## TABLE OF CONTENTS

## I. INTRODUCTION

1. The Special Purpose Insurer (SPI) class was introduced by the passage of the Insurance Amendment Act 2008 on 30 July 2008.

2. This Guidance Note (Note) is a revision to the Guidance Note issued in October 2009 and sets out updated guidance in relation to the Bermuda Monetary Authority's (Authority) regulatory regime for SPIs.

3. A primary focus of this Note is to outline the Authority's approach to the licensing and ongoing supervision of SPIs. This involves setting out robust prudential requirements that SPIs must meet in order to comply with the Insurance Act 1978 (the Act) and its related rules, codes and guidance.[1]

4. If Bermuda's regulatory system is to command the confidence of (re)insurers, cedants/policyholders, regulators, investors and other key stakeholders, the Authority recognises the need for clarity as to the scope and implementation of the provisions of the Act. The Authority therefore seeks to ensure that relevant stakeholders have a sound understanding of the Authority's approach to implementing the Act in the context of SPIs.

5. SPIs typically facilitate the transfer of specific insurance risks to the capital markets through the issuance of Insurance-Linked Securities. The Authority may register an SPI as restricted or unrestricted. A restricted SPI may conduct special purpose business with specific insureds approved by the Authority. Whilst unrestricted SPIs may transact with any insured, if the insured is rated A- or higher, in terms of its financial strength, by AM Best or an equivalent rating from a rating agency recognised by the Authority (see 21 below). Otherwise, the Authority's approval is required. The (re)insurance arrangement must be fully collateralized, which generally reduces exposure to counter-party default.

6. Clear contractual arrangements must be established to govern the operations of the SPI such as a (re)insurance contract, arrangement for safekeeping of collateral and funding documentation. The Authority considers SPI arrangements appropriate for sophisticated cedants and investors only.

7. Whilst the Authority aims to provide clarity as to its approach, this Note cannot be exhaustive. The Authority endeavours, through this Note, to set out information regarding its regulatory and supervisory approach and expectations of the activities associated with SPIs. Ultimately, it is the responsibility of the Board of Directors of the SPI to ensure the SPI complies with the Act.

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[1] The rules refer to the Insurance (Special Purpose Insurers) (Statements,Returns and Solvency Requirement) Rules 2020.The codes include the Insurance Code of Conduct, July 2015.

## II. APPLICATION AND REGISTRATION PROCESS

8. An SPI is subject to an application, registration and ongoing supervisory review process commensurate with its risk profile. SPI applications are expected to include all relevant documentation required of (re)insurance applications.[2]

9. The Authority endeavours to process approval of a vetted, compliant and complete SPI application within one week. To make the process more efficient, applicants are encouraged to discuss their proposals with the Authority prior to formal application.

10. Once approved, the applicant should make further application to the Authority to be registered as a licensed SPI. Provided the registration documentation is thoroughly completed, a licence is generally issued within three business days.

## III. FULLY COLLATERALIZED STRUCTURE AND CONTRACT CERTAINTY

11. The Authority recognises there may be numerous interpretations of the term "fully collateralized" in evaluating the financial position and contractual arrangements inherent to SPI vehicles. For the purposes of interpreting the provisions in the Act in the context of an SPI's fully collateralized position, the following conditions shall apply to an SPI's available assets and liabilities and its contractual arrangements:
    a) To be fully collateralized in accordance with the Act, an SPI will be expected to:
        i. Provide collateral to its insured(s) to cover the full aggregate limit(s) of potential claims that could arise from its (re)insurance contract(s);
        ii. Establish the effective date of the associated (re)insurance contract(s) concurrently or subsequent to the required collateral being fully paid-in to the associated SPI account.[3] Generally, the Authority expects collateral shall be provided on or before the effective date of the (re)insurance contract. However, the (re)insurance contract may expressly allow collateral to be provided within a specified grace period, not exceeding 30 business days, after the later of:
            - The execution date of the (re)insurance contract by the SPI;[4] and
            - The effective date of the (re)insurance contract.

            Where the grace period is relied upon, the (re)insurance contract must clearly define, using explicit contractual language, how the SPI will settle any claim occurring during the grace period. For example, including clear contractual provisions in a funding agreement, which is legally binding on its investors, stating that the funding agreement will be automatically

[2] Where final transaction details and documentation are not available at the time of application, draft transaction documentation, utilising estimates of final agreed terms, are deemed acceptable.
[3] Effective Date means the first date the (re)insurance contract becomes operational or takes effect.
[4] Execution Date means the date on which the (re)insurance contract is signed by the SPI.

drawn down or enforced by the SPI to settle any claim occurring during the grace period.

b) Collateral may include any net premiums receivable from the cedant provided the (re)insurance contract has appropriate contractual provisions that permits the SPI to offset the losses payable by the SPI against the net premiums due under the (re)insurance contract. The net premiums shall be the gross premium written, less any applicable expenses such as brokerage, tax, etc. Similarly, funds withheld by a cedant may cover the collateral requirements provided this is clearly stated in the (re)insurance contract.

c) The aggregate limit may be a fixed amount or an amount calculated at any point in time by reference to a specific formula, adjustment(s), model or otherwise, provided:
   i. The aggregate limit is clearly defined in the (re)insurance contract; and
   ii. The contractual provisions clearly specify when the aggregate limit may change and the mechanics of how full collateralization to the aggregate limit will be maintained throughout the life of the contract.

d) The (re)insurance contract must contain a limited recourse clause stating that the maximum (re)insurance recoverable from the SPI is limited to the lower of:
   i. The explicitly stated, fixed or formulaic, aggregate limit; or
   ii. The available assets provided as collateral.

e) The limited recourse clause should be employed in the context of sound contractual arrangements governing the SPI structure. More specifically, limited recourse cannot substitute the need to have, amongst other things:
   i. Clear and effective contractual language within the (re)insurance agreement specifying the aggregate limit transferred to the SPI, and confirming this amount to be equal to or less than the collateral;
   ii. A prudent investment strategy; and
   iii. Adequate governance and risk management controls that are consistent with the risk profile of the SPI.

f) The SPI shall ensure that, to the extent it has entered into more than one (re)insurance contract, notwithstanding any other requirements:
   i. Each (re)insurance contract and associated collateral is structured so that the SPI at all times meets the full collateralization requirements individually for each (re)insurance contract; and
   ii. Each (re)insurance contract has a single cedant and/or multiple cedants under common ownership.

g) The SPI shall ensure that, under the terms of any debt issuance or other financing mechanism used to fund its (re)insurance liabilities, the rights of providers of that debt or other financing are fully subordinated to the claims of policyholders under its contracts of (re)insurance.

12. It is the Authority's expectation that:
    a) The SPI shall enter into contracts or otherwise assume obligations, which are solely necessary for it to give effect to the special purpose (re)insurance for which it has been established.

    b) All documents governing the SPI, including the terms and conditions of ancillary contracts shall be clearly aligned, consistent and not contradictory.

    c) If the SPI executes a (re)insurance contract which stipulates collateral will be provided within a grace period (not exceeding 30 business days), the SPI shall have entered into a corresponding funding agreement, which is enforceable by the SPI and legally binding on its investors, prior to executing that (re)insurance contract.

## IV. ROLLOVER/ROLLFORWARD

13. Where all or part of the collateral supporting a (re)insurance contract is used to support a subsequent collateralized (re)insurance contract, for example in the case of renewing a (re)insurance contract, the contractual documentation must clearly state to what extent the collateral supports each (re)insurance contract and the corresponding effect on the aggregate limit of each of the (re)insurance contracts. The Authority expects the aggregate limit(s) of the contract(s) from which the collateral is transferred to be simultaneously and commensurately reduced with the associated release of collateral. Similarly, the aggregate limit of the contract to which the collateral is transferred shall not contractually come in-force until after the associated collateral is fully paid-in to the collateral account.

## V. COLLATERAL RELEASE AND CLAWBACK

14. The Authority expects that the release of collateral by the cedant shall reduce the aggregate limit of a (re)insurance contract commensurately. Further, on full release of collateral by the cedant, the cedant shall discharge the SPI of all past, present and future liabilities arising from the (re)insurance contract. The collateral release arrangement should be governed by clear contractual provisions, for example, a commutation clause in the (re)insurance contract.

15. Given the requirement that an SPI must fully collateralize all of its obligations under a (re)insurance contract and that the liability of an SPI under a (re)insurance contract must ultimately be limited to the assets provided as collateral supporting the (re)insurance contract, an SPI may not as part of a (re)insurance contract (or contract ancillary thereto) include an obligation to return collateral released by the cedant as that would potentially leave the SPI with an unfunded liability.

## VI. TOP-UP PROVISIONS TO MANAGE ASSET IMPAIRMENT

16. The Authority neither requires nor prohibits the use of contractual top-up provisions to mitigate and manage the risk of loss of value of assets backing the collateral. The following conditions apply if top-up provisions are included in the (re)insurance contract:
    a) The (re)insurance contract must clarify that the top-up provision is to specifically manage the impairment risk of assets supporting the collateral. As a result, this provision cannot be relied upon to:
        i. Clawback or facilitate the return of collateral previously released by the cedant (refer to paragraph 15 above);
        ii. Undermine the need for the SPI to be fully collateralized in accordance with the Act (refer to paragraph 12 (a) above); or
        iii. Justify an inappropriate investment strategy that is not in accordance with this Note (refer to paragraph 22 below).

    b) The (re)insurance contract must clearly define, using explicit contractual language, specific mechanisms and arrangements demonstrating how the top-up provision will be executed in the event it is triggered. Such arrangements could, for example, be in the form of off-balance sheet support or funding agreement and other hedging arrangements.

17. The principal representative of the SPI shall forthwith notify the Authority on reaching the view or on coming to the knowledge that an impairment of assets backing the collateral has occurred and the SPI is liable to top-up the collateral account(s) in accordance with explicit provisions of its (re)insurance contract(s). The principal representative shall furnish the Authority with a report in writing outlining all the relevant particulars including how the top-up has been or shall be satisfied.

## VII. GOVERNANCE, BOARD COMPOSITION AND RISK MANAGEMENT

18. In accordance with the Insurance Code of Conduct, an SPI must establish sound and effective governance and risk management frameworks that are proportional to its risk profile. The frameworks should facilitate effective and efficient operations and address the organisational structure of the SPI, including the segregation of duties and the management of conflicts of interest.

19. In particular, unrestricted SPIs should organise their governance arrangements and board composition in a manner that mitigates conflict of interest including by eliminating situations whereby:
    a) All of the board positions are filled by one service provider;
    b) One service provider is satisfying a majority of key roles such as the insurance manager, principal representative and a majority of board positions.

## VIII. SOPHISTICATED PARTICIPANTS

20. The Authority expects that only sufficiently fit and proper sophisticated participants will engage in this highly specialised form of business, which in the context of this Note means a knowledgeable person who satisfies one or more of the below criteria:

a) Investors

i. High-income private investors;
ii. High-net-worth private investors;
iii. Sophisticated private investors;[5]
iv. Eligible investment funds approved by the Authority;
v. Bodies corporate, each of which has total assets of not less than $5 million, where such assets are held solely by the body corporate or held partly by the body corporate and partly by one or more members of a group of which it is a member;
vi. Unincorporated associations, partnerships or trusts, each of which has total assets of not less than $5 million, where such assets are held solely by such association, partnership or trust or held partly by it and partly by one or more members of a group of which it is a member;
vii. Bodies corporate, all of whose shareholders fall within one or more of the subparagraphs of this paragraph, except subparagraph (iv);
viii. Partnerships, all of whose members fall within one or more of the subparagraphs of this paragraph, except subparagraph (iv);
ix. Trusts, all of whose beneficiaries fall within one or more of the subparagraphs of this paragraph, except subparagraph (iv);
x. Any company quoted on a recognised stock exchange;
xi. 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; and
xii. Other persons approved by the Authority as suitable investors on a case-by-case basis.

b) Cedants:

i. Restricted SPI - specified licensed (re)insurance entity(ies) typically listed in the SPI's certificate of registration;
ii. Unrestricted SPI - licensed (re)insurance entity(ies) rated A- or higher by AM Best or equivalent rating by Fitch, Standard & Poor's, Moody's, Demotech, Inc., Dominion Bond Rating Service, Egan Jones Rating Company, Japan Credit Rating Agency, Kroll Bond Rating Agency, Morningstar Credit Ratings or other recognised rating agencies as approved by the Authority;
iii. Entities in possession of a legislative mandate (e.g. government insurance pools) to provide insurance coverage; and

[5]Private investor means an individual who has such knowledge of, and experience in, financial and business matters as would enable him/her to properly evaluate the merits and risks of a prospective purchase of investments.

iv. Entities with the demonstrated ability, necessary risk management capabilities and infrastructure to engage as a party to SPI business as determined by the Authority.

c) Insurance Managers:
   i. Insurance managers licensed by the Authority who are deemed fit and proper to manage SPI vehicles.

## IX. ASSET QUALITY AND DISCLOSURES

21. It is the expectation of the Authority that the SPI will generally carry minimal investment risk with respect to the collateral in the collateral account. The SPI should provide full disclosure of the investment guidelines governing the collateral to the cedant and its investor/debtholder(s). The associated documentation is expected to disclose detail such as the types, issuers and target credit ratings of permissible investments.

22. In addition, it is the expectation of the Authority that the SPI provide full disclosure to the cedant and investor/debtholder(s) and agree to make available to the relevant counterparties the following data, (as applicable):
    a) The total composition of the assets of the collateral; and

    b) The latest available market value of the assets and/or the latest available net asset value of such assets:
       i. As soon as commercially practicable after the end of each calendar month or such other times as agreed between the parties; and
       ii. As soon as commercially practicable after the request of any relevant participant where such data may not be aged by more than 30 days unless agreed upon by the relevant parties.

## X. LETTERS OF CREDIT AND OUTWARDS REINSURANCE

23. The Authority recognises letters of credit as acceptable instruments for inclusion in the collateral structure of SPIs. The SPI must demonstrate that the issuer of the letter of credit:
    a) Is a regulated financial institution subject to regulation by the Authority or equivalent regulation by another regulatory body; and

    b) Either:
       i. Has achieved a financial rating (counterparty, credit or financial strength as applicable) of at least A- (or equivalent) as of the date of application and as determined by a recognised rating agency; or
       ii. Is of a sound financial quality (in the circumstance of unrated issuers or issuances) as deemed by the Authority.

24. The Authority does not generally recognise outwards reinsurance as a form of funding acceptable to collateralize the aggregate limit (re)insured by an SPI under a (re)insurance contract. However, the Authority may approve the use of suitable reinsurance arrangements by an SPI, for example where the reinsured limit is fully collateralized with high-quality assets.

## XI. MATERIAL CHANGE IN BUSINESS

25. If during the lifetime of the SPI it intends to:
    a) (Re)insure any additional risks that were not contemplated in the initial transaction and/or business plan;

    b) Make any material changes to any of the ancillary contracts to the (re)insurance contract;

    c) Make any modifications to the material disclosures included in the original application;

    d) Raise additional capital from investors and/or debtholders not identified or contemplated in the original documentation approved by the Authority;

    e) Make any other changes pertinent to its business where these changes would be deemed by a reasonable and knowledgeable person to be material; and/or

    f) Make any material change as outlined in Section 30JA of the Act,

    then these changes are subject to prior supervisory approval as required by Section 30JB of the Act.

26. The approval process for any material change in an SPI's business shall take into account the nature, scale and complexity of those changes as determined by the Authority.

27. In its deliberations, the Authority shall consider whether the changes constitute a change in the objectives of the SPI, and to the extent that they do, the Authority may require a more exhaustive authorisation process.

## XII. EXEMPTION FROM PRIOR APPROVAL OF CAPITAL RELEASE

28. Section 31C of the Act – "Restrictions as to reduction of capital" is not applicable to SPIs. This is consistent with the Authority's risk-based approach to regulation, and the Sophisticated Participant requirements associated with these entities

## XIII. FILING REQUIREMENTS FOR SPIs

29. Statutory Financial Returns shall be prepared and filed in accordance with the requirements of the Special Purpose Insurer's Accounts, Returns and Solvency Rules 2019 (the Rules). The Rules require each SPI to submit a Statutory Financial Return (SFR) populated from the corresponding values in its Generally Accepted Accounting Principles (GAAP) financial statements.

30. SPI's are required to have their GAAP financial statements audited unless they write only restricted special purpose business (as defined in the Act) or have been granted an audit exemption by the Authority (see paragraph 32 below). Where an SPI is not required by the Authority to have its GAAP financial statements audited, but it does so for any other purpose, it shall submit those audited financial statements to the Authority.

31. The Authority shall, on a case-by-case basis, consider applications to modify the GAAP external audit requirement, where appropriate. An SPI must be in good standing with the Authority for its application to be considered by the Authority. Additionally, audit waivers shall be considered on an annual basis and shall relate to the relevant financial period.

## XIV. IMPLEMENTATION

32. This Note came into effect on 1 July 2020.