Guernsey International Insurance Association

Guidance on the formation and management of insurance & reinsurance special purpose vehicles (“SPV”) in Guernsey.

Background

Guernsey has a thriving sector for the use of licensed insurance vehicles (often formed as protected cell companies (“PCC”) or incorporated cell companies (“ICC”)) for the purposes of transforming risk. The flexibility of Guernsey’s legislation means that it has never been necessary to create specific legislation for SPVs, as the discretionary powers within current legislation allow them to be supervised with a different regulatory approach to that applied in the general insurance market.

Due to the growing frequency of enquiries, this guidance note has been prepared to explain the exercise by the GFSC of various discretions contained within the regulations and legislation in force in the Bailiwick of Guernsey. It also explains the application of these discretionary areas of the regulations to SPV insurers, in particular those conducting reinsurance, derivative swaps and ILS business or being utilised to transform capital market to insurance or reinsurance market risk or vice versa, whether long term or otherwise. This information is provided for general guidance purposes only, prospective promoters or controllers should liaise with a licensed insurance manager for advice and further information in each case. Further information on the general supervisory regime is available at www.gfsc.gg

We stress that despite these provisions, the managers and directors of licensed entities retain primary responsibility for exercising prudent management and oversight at all times.

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Licensing

It is an offence to conduct or hold oneself out as conducting insurance business in or from within the Bailiwick of Guernsey without a licence granted by the GFSC[1]. All SPV insurers must therefore hold a licence granted by the GFSC. In the case of PCC and ICC structures, each new IC is treated as a new licence application and each new protected cell requires authorisation under an umbrella licence which apples to the whole PCC. Both cell creation processes require applications.

Insurance business in Guernsey is categorised as either general or long term business. Long term business is generally life related, including contracts of insurance on human life, longevity based annuities, contracts to provide sums on marriage or birth, contracts linked to indices of property values, permanent health insurance, capital redemption contracts, pension fund management and credit life assurance. This is a general rather than exhaustive list. Generally, long term business will also include life indexed derivatives and reinsurance of those types of risk.

Long term business carries greater risks in terms of prudential management and therefore usually carries an enhanced accounting, actuarial and capital requirement than general business. These requirements are generally modified in the case of SPV business, on a case by case basis.

"Fit and Proper" Criteria

All controllers of licensed insurance companies in Guernsey must qualify under the fit and proper criteria set out in the law[2]. The GFSC will conduct an assessment of the integrity and skill of all applicants, to reach a conclusion as to whether the applicant or licensee is fit and proper (including probity, competence, experience, soundness of judgment, educational and professional qualifications, knowledge and understanding of the legal and professional obligations to be assumed or undertaken, procedures for vetting clients and previous conduct in business activities).

All applicants to become owners of licensed insurers or directors of licensees, must receive prior approval of the GFSC before their appointment and must submit a personal questionnaire form to the GFSC, which will be used as the basis for assessment. The provision of false information is an offence. The GFSC does conduct general searches on controllers, and expects that insurance managers will conduct similar due diligence to establish whether a prospective client will meet the relevant criteria. These criteria apply to the control or ownership of cells as well as ownership of whole company / PCC / ICC entities.

In the case of licensed insurers which are "orphaned" or controlled through a trust, the GFSC will consider the fit and proper criteria for the trustee as well as the ultimate promoter of the transaction / scheme. Generally the GFSC would expect any trustees of orphan SPV schemes to be regulated and resident in Guernsey to enable adequate oversight.

The GFSC will wish to identify the promoters of an SPV structure and may ask for additional information at the time of application.

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1 Section 1, Insurance Business (Bailiwick of Guernsey) Law, 2002, as amended
2 Schedule 7 of the Insurance Business (Bailiwick of Guernsey) Law, 2002, as amended

Applications

The majority of applications to the GFSC for licenses are handled by licensed insurance managers in Guernsey on behalf of applicants. All licensees must have sufficient substance or be managed and administered by an entity which holds a licence to act as insurance manager. The manager has certain legal responsibilities in connection with every licensee which are briefly described below. Prospective clients are likely to save considerable time by consulting with a licensed insurance manager before seeking to complete an application through the manager. An insurance manager will be familiar with the regulations and can give guidance as to the acceptability of certain types of scheme as well as practical guidance on the application and business plan process.

Guernsey is well known for the development and use of specialised structures, such as the PCC and the ICC. The GFSC will entertain discussions with prospective new business owners and will generally provide guidance and indicative terms for novel or unusual structures, on a non-binding basis. This approach enables promoters to establish the application of discretion (for example in connection with capital requirements) in novel circumstances prior to making a formal application. The GFSC may also grant "block" approval for new licensed cells subject to certain conditions, described below, in the interests of saving time and to provide commercial certainty to licensees.

The GFSC will generally provide consent within 28 days for a new licensee although in practice this can be achieved more quickly, and particularly for repeat business. Timing can be improved by submitting an initial plan whilst final details are agreed, for later clarification.

Independent Directors

All Guernsey licensees are generally required to appoint an independent director who is not an associated party or owner of the administrator or shareholder. This requirement is generally maintained but the GFSC has the discretionary power to waive it in certain circumstances[3]. The issues which the GFSC may take into consideration are not limited but may include the following:

a) Whether the business is in run-off / fully collateralised

b) The complexity of the proposals

c) The risk to third parties (such as multiple investors)

d) The general requirement for good governance by independent oversight of activities, processes or decision making

e) Perceived risks to the reputation of the Bailiwick as a finance centre.

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[3] Schedule 7, section 5(2) of the Insurance Business (Bailiwick of Guernsey) Law, 2002

Business Plans

All licensees, including SPVs are required to submit and maintain business plans which explain the rationale for the business and explain its detailed financial structure (liability, capital, risk gap, premiums, reliance on reinsurance). Business plans must also be completed in connection with individual cells of a PCC or ICC. Any change in business written by a licensee must be notified and approved by the GFSC[4].

General representatives - responsibilities

All licensees, unless they are self-managed with appropriate levels of resource, must appoint a general representative which is an authorised insurance manager. This places a number of legal obligations on the manager to –

a) Generally act on behalf of the insurer and accept service of documents on its behalf;

b) Make any return, deposit accounts, reports and other documents with the GFSC;

c) Furnish any information which the insurer is required or requested to make to the GFSC

Anti-Money Laundering

All entities and individuals resident in Guernsey are under an obligation to report suspicious activity representing potential money laundering to the police. General insurers, because they must be administered by licensed insurance managers, who are in turn subject to the full provisions of the anti-money laundering legislation, are not separately required to maintain a full AML policy manual and procedures. In practice, AML processes and customer checks and due diligence will therefore be conducted by the insurance manager.

Listing on the CISE

There have been a number of examples of licensed insurers or SPVs listing their shares or notes on the CISE and other exchanges. The listing of securities does not require separate consent of the GFSC but would be notified in the business plan of the insurer. The CISE is a recognised exchange for UK and US purposes and securities may therefore count as qualifying investments with a wider range of capital providers (for example pension funds) than would be the case for private, unlisted notes. Each applicant for listing must have a sponsor which is a member of the exchange.

[4] Section 11, Insurance Business (Bailiwick of Guernsey) Law, 2002.

Overlaps Between Investment and Insurance Regulations

The GFSC recognises that insurance SPVs usually involve bespoke peer-to-peer transactions which have little or no spread of underlying risk, single investors and therefore usually have no potential to be construed as collective investment schemes under the applicable investment regulations. SPVs are also often structured as platforms sitting below an ILS fund or capital feeder structure. Much however depends on the nature of the SPV and promoter, and the marketing and the scope of circulation of marketing materials. The circulation of marketing materials for restricted investments (such as a shares and notes) is a regulated activity if carried out in or from within Guernsey to the public. In certain circumstances it is possible for an insurance SPV to fall within the remit of both insurance and investment regulations.

It is common, wherever there is a potential investment regulation overlap with an SPV which is licensed as an insurer, to discuss any potential difficulties with both investment and insurance regulatory departments to ensure all concerns are properly addressed. The main risk concern from a regulatory perspective is to ensure no marketing (or potential for any secondary market) of complex high-risk financial instruments to members of the public, and promoters should bear this in mind and be prepared to explain the processes in place to mitigate against such risks, if applicable.

Despite these concerns, structuring continues to evolve towards hybrids of investment funds and insurers / reinsurers. The GFSC is always open and willing to discuss the regulatory approach to new or novel structures.

Application of AIFMD & Solvency II

Guernsey is outside the EU and is therefore not required to implement AIFMD, Solvency II or other directives. However, Guernsey's complex financial infrastructure is cross border in nature and it has therefore implemented an AIFMD equivalent regime which allows a choice between application of AIFMD equivalence or not for alternative investment structures, which can include certain types of ILS instrument or platform. Guernsey has decided not to apply a Solvency II equivalent capital and solvency regime as its insurance and reinsurance market does not include any systemically material general insurers with European-centric operations. Guernsey is therefore able to offer the benefits of the choice of AIFMD equivalence whilst retaining significant capital and solvency flexibility. This is particularly important for certain types of insurance SPV, such as collateralised reinsurance platforms structured as PCCs or ICCs.

Part 2 – Exercise of Discretions

Consents & Initial Formation

Once a completed business plan and application is submitted, the GFSC will aim to provide outline consent within 28 working days. Once outline consent is provided, the final licence is issued upon evidence of the capitalisation of the relevant licensee (usually by physical evidence such as a bank statement). In cases where there is a capital waiver (such as fully collateralised structures), no further approval is required.

Fast Track Consent and pre-consents for SPVs

The GFSC recognises the need for speed and commercial certainty in the approvals process to enable fast completions, particularly at pinch points during the underwriting year and in certain CAT markets. The GFSC considers and grants applications from licensees for self-certification of news cells for their creation and to underwrite business where such business broadly follows the business plan submitted for previous cells of the cell user and the shareholder is the same. Thus far this self-certification approval has only been extended for use with PCCs but there is no reason in principle why the Commission would not consider extension to ICCs. The GFSC expects that the manager will submit applications of this sort where the business plans for each cell are broadly similar in nature and structure (generally speaking collateralised reinsurance / retrocession). This self-certification process requires the manager and board of the relevant licensee to self-certify the nature of the transactions contemplated and they carry the responsibility for updating the GFSC within 7 days of deals being completed.

Capital and Solvency Waivers

The minimum capital requirements for general insurance and long term business are £100,000 and £250,000 respectively. The GFSC has the power to modify these requirements according to the type of underwriting activity undertaken. We recognise that there is considerable scope for the reduction / waiver of capital requirements for many types of insurance SPV which have a risk profile which is significantly different from general insurance underwriting.

Although we consider each application on a case-by-case basis, generally speaking any structure with 100% collateralisation where the collateral is subject to a trust or other security arrangement will not be required to hold the minimum capital specified in the law and will usually be rated at zero. In many cases we apply a reduced capital requirement for a PCC platform or ICC but no capital requirement for cellular transactions within that structure.

For the same reasons, Guernsey's fixed minimum solvency requirements for SPVs (based on percentage of premiums or claims) are inappropriate and usually waived, the characteristics of SPV business usually being single-premium, single trigger / event with full collateral and no requirement to maintain any specific level of liquidity.

Guernsey applies a subjective own solvency and capital assessment regime in addition to the fixed minimum calculations, known as an "OSCA". For the same reasons as noted above, these calculations are largely irrelevant to many types of SPV transaction and the requirement to provide such assessments for SPV platforms, companies and cells is usually waived.

Banking Arrangements

The GFSC does not require that collateral held in connection with insurance SPVs be kept in Guernsey, it is very typical for SPVs to use a range of US and international banks, usually at the commercial option of the reinsured. The GFSC expects such banking institutions to have an appropriately high level of credit rating to mitigate against counterparty risk. It is also desirable, in our view, for collateralised funds to be held in accounts which are treated for legal purposes as "client" money (or in trust) and repayable to clients in preference to general creditors in the event of insolvency.

Accounting – Reporting Frameworks

Guernsey companies do not have to issue audited accounts to any public registry. Accounts of all licensees do have to be submitted annually to the GFSC to ensure prudential oversight. The phasing out of "old" UK GAAP means that a general transition towards IFRS and associated additional reporting is underway. "New" UK GAAP (FRS 100, 101, 102 & 103) has been strongly influenced by IFRS in its construction. However, certain of the notes required under "new" UK GAAP, in particular disclosure required by FRS 103, are considered to be irrelevant to many types of parent owned insurance and reinsurance companies (captives) and also to ILS SPVs. With this in mind, and given the additional cost of compliance with notes to FRS accounts which are of little meaningful benefit, the GFSC has exercised its powers to waive the requirement for accounts to comply fully with UK FRS. This enables considerable potential cost and reporting savings for SPVs. The option for adopting IFRS as the reporting framework also exists.

Actuaries & Long Term Business

Actuaries are required to be appointed in connection with all licensees conducting long term business and licensees must follow certain rules associated with separation of assets of such business. The GFSC has an absolute discretion to permit a long term insurer not to appoint an actuary. This discretion has applicability to certain types of long term SPV where there is securitisation or reinsurance of long term or longevity related risks but where the risk is unlikely to alter significantly following inception of the structure (for example runoff situations or the reinsurance of pension scheme longevity risk). This can assist in significantly reducing the long term costs of certain types of SPV.

Waivers Matrix

Type	Capital Waiver	Solvency Waiver	Self-Certification
Fully collateralised reinsurance / retrocessions with independent trustee	Yes	Yes	Yes within defined limits
Reinsurance transactions with risk-gap	Case by case basis	Case by case basis	Yes within pre-defined limits
Longevity based reinsurance transactions (fully collateralised)	Yes	Case by case	Yes within pre-defined limits
Longevity based reinsurance transactions (partly collateralised)	Case by case	Case by case	Yes within pre-defined limits
Derivative / transformer transactions	Yes	Yes	Yes within pre-defined limits
Reinsurance company CAT bond issuance	Yes	Yes	Yes within predefined limits