

Insurance Law Committee response to the PRA and the FCA's consultation on the authorisation and supervision of insurance special purpose vehicles

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The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response in respect of the PRA and the FCA's consultation paper PRA CP42/16 and FCA CP16-34 (the “**Consultation Paper**”) on the authorisation and supervision of insurance special purpose vehicles has been prepared by the CLLS Insurance Law Committee (the “**Committee**”).

The Consultation Paper was published alongside HM Treasury's consultation on regulations to implement the insurance linked securities regime, to which the Committee responded on 18 January 2017. The Committee's responses to the Consultation Paper are set out below. All references to paragraphs are to paragraphs of the draft PRA supervisory statement “*Authorisation and supervision of insurance special purpose vehicles*” which is contained in Appendix 1 to the Consultation Paper.

SIMR requirements (paragraphs 2.8 to 2.10)

Paragraph 2.10 states that the PRA expects the Chairman and the Chief Executive to be separate individuals. The Committee is unsure why it would be necessary for an ISPV to have separate individuals performing these roles, and for there to be a separate Chief Finance Officer. The Committee considers that, in order for the UK's proposed insurance linked securities regime to compete effectively with the

insurance linked securities regimes of other jurisdictions, the UK's regime should be no more onerous than Solvency II requires.

Documentation requirements (paragraphs 2.11 and 2.12)

Paragraph 2.12 refers to legal opinions helping to demonstrate that the key contractual features of the transaction documents comply with the regulatory requirements. The Committee is unsure how a legal opinion on compliance with the regulatory business plan could be provided or, if one were provided, whether it would be useful, given that it would most likely be heavily qualified.

The requirement to be fully-funded (paragraphs 2.15 to 2.21)

The Committee considers that the PRA should clarify the treatment of contingent assets and the extent to which they can be taken into account to meet the liquidity requirement, as paragraph 2.18 does not make the position completely clear. It seems to the Committee that it would be appropriate for contingent assets to be used to satisfy Article 326(2) of the Solvency II Level 2 Delegated Regulation, even though they cannot be taken into account for the purposes of Article 326(1)(b).

Paragraph 2.20 refers to off-balance sheet support. Where an ISPV has off-balance sheet support, would the PRA permit the ISPV to calculate its maximum exposure on a net basis?

While the Committee accepts that, as stated in paragraph 2.21, limited recourse clauses would not be relevant to the initial assessment of whether an ISPV is fully-funded, the Committee assumes that a limited recourse clause which takes effect in future is acceptable and would be recognised by the PRA. If not, this would undermine the purpose of limited recourse clauses, which have a legitimate and desirable role to play in segregated account/cell companies.

Timelines for review of applications (paragraphs 2.23 to 2.27)

The Committee expects that some investors will seek to establish an ISPV before recruiting investors for an ISPV's cell(s) and before having full (or potentially any) details of the transactions into which the cell(s) will enter. It should be clarified, either in the Risk Transformation Regulations 2017 or in the PRA Handbook, whether an application for authorisation of ISPV could be made at this stage, with 10 working days' notice being given of the establishment of each cell once transactions for each cell have been identified, or whether full details of the first cell's first transaction will be required before the ISPV can be authorised (and, accordingly, that the establishment of an ISPV's first cell will be subject to the proposed 6 to 8 week authorisation process):

- i. If it will be possible to establish an ISPV before its cells are established, the approach which the Committee favours, steps should be taken to ensure that

the PRA will not decline to review an application for authorisation on the grounds of insufficient information where there are valid reasons for the lack of information (i.e. that the transactions have not yet been determined) – authorisation should be granted where there is sufficient disclosure of the proposed business and documentation.

- ii. If the establishment of the first cell will be subject to the authorisation process, rather than the non-objection period, the authorisation process must be shorter than the suggested 6 to 8 weeks in order to give the UK's regime a commercial advantage over (or at least parity with) the regimes of other jurisdictions. The Consultation Paper refers to the PRA making a decision within the 6 to 8 week period where there has been "*good engagement at pre-application stage*". While it is accepted that the PRA would need to be provided with sufficient information to enable it to make a decision, this should be balanced against the ability for investors to set up ISPVs at relatively short notice, without the risk that the pre-application stage would stretch to several months. The Committee considers that the PRA would have to commit to examining applications for authorisation in a more timely manner, and to ensure that sufficient resources would be allocated to reviewing applications for authorisation, as waiting 6 to 8 weeks (potentially longer, depending on the length of the pre-application stage) for approval of a cell would almost certainly deter investors from utilising the UK's regime.

MISPV authorisation (paragraphs 3.6 to 3.13)

The Committee considers that the PRA's expectations regarding the regulatory business plan for an MISPV seem overly-future looking and prescriptive, and potentially quite challenging to comply with in practice. When first applying for authorisation of an MISPV, it would not be unreasonable for the applicants not to know whether future cells would undertake the same type of business as the first cell(s), or even more basic details such as the total number of cells that the MISPV would ultimately have.

Supervision of ISPVs (paragraph 4)

It is unclear what the regulatory consequences would be for an MISPV if one cell failed to meet its regulatory requirements. On the basis that the core would be responsible for the failure to comply, would authorisation to write new business be withdrawn for the entire MISPV, or would only the cell in question be prevented from writing any new business until it had rectified the non-compliance? The Committee considers that, where one cell fails to comply with its regulatory requirements, (a) the cell in question should not be prevented from continuing to perform an existing contract, (b) the other cells of the MISPV should not retrospectively lose their ability to continue their existing business or to write new business, and (c) the core should be permitted to establish new cells.

Similarly, where the core fails to meet its regulatory requirements, existing business should be unaffected: the consequence of the core's non-compliance should be that new business cannot be undertaken until the core has rectified the non-compliance.

23 February 2017
HFWLDN\38730461-3

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