
# BERMUDA MONETARY AUTHORITY

INFORMATION BULLETIN

SPECIAL PURPOSE INSURERS

5th October, 2009

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# 1. Introduction

## 1.1. Preface

1. The passage of the Insurance Amendment Act 2008 (the "Amendment Act") occurred on the 30th of July 2009. The Act introduced three new licensing classes, one of which was the class of Special Purpose Insurers ("SPIs")[1].

2. The purpose of the SPI amendment was to enhance the Bermuda Monetary Authority's (the "Authority's") regulatory framework so as to ensure the prudent development of sound business forms associated with side-cars, catastrophe bonds and other similar insurance-linked special purpose transactions.

3. Legislation enacted in March 1998[2] effectively facilitated the beginnings of the Authority's insurance-linked securities regime, introducing the concept of Designated Investment Contracts[3] which allowed for the transaction of indexed-based (or non-indemnity) event-linked covers. This new SPI legislation complements the 1998 legislation by introducing a platform for the establishment of full fledged (re)insurance entities, licensed to transact both indexed and non-indexed (indemnity) based event-linked structures.

4. This Information Bulletin (the "Bulletin") is comprised of a series of documents, exhibits and appendices which together provide a comprehensive overview of the Authority's licensing and ongoing supervisory activities associated with SPIs. A primary focus is to demonstrate the Authority's approach to the supervision of SPIs which involves, in the first instance, setting out prudent and robust fundamental requirements that these (re)insurers must meet in order to be licensed.

5. The Authority is of the view that once licensing for an SPI has been achieved, and in line with the risk characteristics of these (re)insurers, attention should be placed upon the original cedant/insured. This shift in focus, from the SPI to the ceding entity, is aligned with the fact that the SPI is by definition fully funded and therefore perpetually solvent. As such, the risks inherent to these structures are left with the ceding entity as the sole entity transferring risk to the SPI and the principal party concerned with the SPI's financial ability to satisfy its (re)insurance obligations. Moreover, the Authority expects that as the ceding entity benefits from capital relief associated with its risk-transfer to the SPI, it is

[1] The Insurance Amendment Act 2008 (the "Amendment Act") created three new classes of insurance licenses, Class 3A, Class 3B and Special Purpose Insurers.
[2] Designated Investment Contracts can be found in Section 57A of the Act (inserted by 1998:8 effective 23 March 1998; amended by 2001:27 effective 1 October 2001; by 2001:33 effective 1 January 2002; and by 2002:39 effective 30 December 2002)
[3] See Appendix IV (pg. 36)

expected to be adequately capitalised and technically equipped to manage all risk characteristics associated with the SPI cession.

6. The Authority recognises the need for clarity as to the scope and implementation of the provisions of the Insurance Act 1978 and related regulations ("the Act")[4] if the regulatory system is to command the confidence of both (re)insurers and contract/policyholders. The Authority therefore seeks to ensure that those operating in Bermuda have a sound understanding of the Authority's approach to implementing the Act in the context of SPIs.

7. While the Authority aims to provide clarity as to its approach, this bulletin cannot be exhaustive. The Authority will do its best, through this and other reports, to set out information about its regulatory approach and expectations regarding the activities associated with SPIs. Ultimately, it is the responsibility of the legal entity to ensure their compliance with the Act and all queries associated with this bulletin should be directed to the Authority.

8. The Authority's approach to SPIs as contained herein is of a general application and seeks to take into account the wide diversity of entities that may be licensed as SPIs under the Act. This said, and in line with the Authority's approach to effective regulation, it is our desire to maintain a sound working partnership with industry in the development and implementation of the SPI regime so as to ensure its effectiveness in relation to the conduct of SPI business.

9. To this end the Authority has established an SPI Advisory Group (the "Group") comprised of a broad cross-section of practitioners currently engaged in the design and execution of SPIs. The purpose of the Group has been both to assist in the finalisation of this Information Bulletin and to help develop related guidance[5] in the context of current market developments. Going forward, it is intended that the Group will review the SPI legislation and guidance for future amendments.

10. Although not obligatory, the Authority recognises that some issuers may wish to "exchange list" the securities underlying their SPI structures. The Authority is supportive of exchange listing activity, a sample of which is elaborated upon in Appendix V.

[4] The insurance legislation is comprised of the Insurance Act 1978 (as amended by the Insurance Amendment Acts, 1981, 1983, 1985, 1995, 1998, 2001, 2006 and 2008) and the regulations promulgated under that Act (the "Regulations"). The Regulations are the Insurance Accounts Regulations 1980 (as amended by The Insurance Accounts Amendment Regulations 1981, 1985, 1989 and 2008) and the Insurance Returns and Solvency Regulations 1980 (as amended by The Insurance Returns and Solvency Amendment Regulations 1981, 1985, 1989 and 2008). References herein to the "Act" are to the Insurance Act 1978 (as amended) and the Regulations.

[5] Appendix VII (pg. 44)

## 1.2. Standard Characteristics of SPIs[6]

11. In its basic form, an SPI is a special purpose, single transaction, or single customer (re)insurance company which assumes (re)insurance risks and which typically fully funds its exposure to such risks through the proceeds of a debt issuance or some other financing mechanism[7], where the repayment rights of the providers of such debt or other financing mechanism are subordinated to the (re)insurance obligations of the vehicle.

12. An SPI is usually established to enter in a single transaction or a single set of simultaneous transactions at the commencement of the company's business.

13. Covered event triggers for SPIs are varied[8]. In this context, it should be noted that although this new SPI framework has been designed to accommodate indexed based (non-indemnity) structures, the Act also allows for the transaction of indexed based structures through non-insurance companies licensed under Section 57A of the Act – "Designated Investment Contracts."[9]

14. As per Section 5 (2) of the Act, in considering whether to register a body as a Special Purpose Insurer, the Authority shall, in addition to the matters set out above, have regard to the following matters —

a) whether the (re)insurer is solely insuring or reinsuring one or more risks or group of risks with one or more policyholders; and

b) the sophistication[10] of the policyholders or the sophistication of the parties to a debt issuance or other funding mechanism.

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[6] An SPI is generally considered to be a special purpose exempted (re)insurance company, formed for a specified purpose for the benefit of sophisticated participants whereby the risks of the SPI are fully funded. Characteristics often common to SPIs include:

(a) The SPI's (re)insurance obligations are fully funded;
(b) An SPI is established for a specified or limited purpose typically for a limited duration.
(c) SPI transactions are carried out between a limited number of sophisticated participants
(d) Recoveries from the SPI are limited to its assets;

[7] The SPI's obligations are often fully funded either through cash, time deposits, or some other financial instrument such as a (re)insurance contract, guarantee or letter of credit, limited recourse notes, equity issue, and/or a derivative contract.

[8] See Appendix III (pg. 34)

[9] See Appendix IV (pg. 36)

[10] See Appendix VII – Guidance Note #20(12) (pg. 47).

# 2. Regulatory Approach to SPIs[11]

This section of the Bulletin sets out a broad framework of the Authority's regulatory approach to SPIs. Its primary audience is anticipated to be SPIs, sponsors, investors, and other key stakeholders of Bermuda domiciled SPIs and it has as its aim the provision of information about the application process, interpretation of the SPI classification, as well as to set out the Authority's policy on the prudential requirements for SPIs. It should be noted that this bulletin covers a range of non-life SPI structures and types including side-cars, catastrophe bonds, ILWs, and single and/or multiple programme business.

## 2.1 The Registration Process

15. Unlike most other (re)insurers an SPI will be fully funded to meet its (re)insurance obligations. It is, therefore, not exposed to insolvency risk to the same extent as other reinsurers and as such, under specified conditions, the Authority shall permit SPIs to be subject to a more streamlined application and ongoing supervisory process, commensurate with the assumed risk of the venture.

16. The SPI application process is intended to facilitate the fully funded, single transaction orientated nature of the SPI business environment, and is consistent with the Authority's risk-based approach to Registration.

17. In this context, and to the extent that SPI applications conform to the guidelines of the SPI Guidance Note[12], the Authority shall have policy to endeavour to provide the necessary resources to expedite approval of SPI structures when received. At a minimum, applications will be considered at the weekly Admissions and Licensing Committee (ALC) meeting.

## 2.2. SPI Application Form ("SAF")

18. The SPI application process will generally require that a SAF be completed and signed by the applicant before being submitted to the Authority. The SAF will include the following questions directed to the most pertinent details of the SPI transaction.

19. Details on the Relevant Participants[13] including confirmation that all (shall) fall within the "Sophisticated Participant" definition (See Appendix VI).

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[11] This bulletin is generally not intended to cover SPIs which are exclusively used for life, accident and health (re)insurance risks or credit, surety and financial guaranty risks. Those risks present issues distinct from those applicable to the non-life risks for which this bulletin is applicable. Where an SPI mixes non-life risks with other risks, concepts in this bulletin may or may not apply.

[12] Appendix VII

[13] In the context of this Bulletin, "Participant" or "Relevant Participant" means those sophisticated participants in the special purpose business who are fully knowledgeable of the transaction and able to attest to the accuracy of the SPI Application Form on behalf of the (re)insured group(s) and/or the

a) The Cedant/Insured
Details on the team/sponsor of the SPI

b) The Investors
Details on the Investors/Debt-holders of the SPI

20. Details on the Deal Terms including (but not limited to):

a) Confirmation of how and through what mechanism(s) the SPI will fully fund its liabilities and/or collateral requirements (as applicable), including detail on the timing or "ramping up" of such funding and/or collateral;

b) Details of the contract triggers and the aggregate limits of liability associated with the contract;

c) Details on the intended approach to capital and/or collateral release (as applicable);

d) Details on the intended approach to winding-up agreements (as applicable); this detail should include conditions under which the SPI will voluntarily wind-up, and the intended wind-up procedures to be implemented at that time;

e) Details with respect to underwriting, claims and claims handling.

21. Confirmation of disclosure of all pertinent risk factors associated with participation in the SPI transaction including (but not limited to) disclosed definitions of:

a) Investment Risks[14],

b) Other Operational Risks (e.g. the risk retention profile of the underwriting agent (ceding underwriter/cedant/insured) where this risk retention is specifically applicable to the business ceded to the SPI)).

22. Confirmation of full disclosure to the cedant/insured that the (re)insurance recoverables from the SPI are limited to its available assets[15].

23. Confirmation of full disclosure to the cedant/insured that insufficient assets may prove a risk factor in ceding business to an SPI.

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investor/debtor group(s). In the case of the investor/debtor group(s), a Relevant Participant might be the appropriately licensed securities broker responsible for placing the funding investments.

[14] Investment Risks include, but are not limited to, General Investment Risks, Loss of Principal and Interest, Market Risks and Counterparty Reinvestment Risks.

[15] In the context of this Bulletin, all references to "assets" and "asset value" include "contingent assets" and the "contingent asset value" as applicable and unless otherwise indicated.

24. Confirmation of disclosures indicating whether a top-up provision (in the event of asset deterioration) will or will not form a part of the contract language. To the extent that a top-up provision exists, this documentation should include (but not be limited to):

a) The conditions under which a top-up will be required;

b) Supporting financial information on the named party responsible for the top-up;

c) The time-frame within which the top-up must be carried out after the said asset deterioration.

25. Confirmation of disclosure that under the terms of any applicable debt it issues or other financing mechanism used to fund the SPI, the rights of providers of that debt or other financing will or will not be fully subordinated to the claims of creditors under its contracts of (re)insurance.[16]

26. Confirmation of disclosure that, to the extent that more than one (re)insurance contract will be in place within the SPI, that each of the (re)insurance contracts will or will not be individually structured so that the SPI meets the fully funded requirements individually for each contract.[17]

27. Confirmation of disclosure of the investment guidelines of the SPI. This documentation is expected to disclose detail including the types of acceptable instruments, issuers and credit ratings of permissible investments.

28. Where an SPI is funded through a balance of "contingent assets" (e.g. (re)insurance, LOCs or other financial mechanisms such as swaps, contracts for differences etc.) this documentation will be expected to demonstrate whether or not the issuer of these contingent assets:

a) Is a regulated financial institution subject to regulation by the Authority or equivalent regulation by another regulatory body; and

b) Has achieved a financial rating (counterparty, credit or financial strength as applicable) of at least A- as of the date of application and as determined by a recognised rating agency; or

[16] To the extent that all claims are not subordinated to the claims of creditors under the SPI's contracts of (re)insurance, the applicant will be expected to demonstrate full disclosure of this fact to the cedant(s)/insured(s).

[17] To the extent that there is no clearly defined asset segregation by contract, the applicant will be expected to clearly disclose the contract intent and provide the Authority with assurance that there is clarity of contract obligations via specific contract language.

c) Is of a sound financial quality in circumstances of unrated issuers or issuances.

29. Confirmation of disclosures attesting to the fact that the SPI agrees to make available to the cedant/insured and relevant counterparties, the following data, (as applicable): 1) the total composition of the assets of the SPI, 2) latest available market value of the assets, and/or 3) the latest available net asset value of such assets: (A) within a maximum of 10 Business Days after the end of each calendar month, and (B) within 2 Business Days of the request of any relevant participant where such data are not aged by more than 30 days unless agreed upon by the relevant parties.

30. Confirmation of procedures to fully disclose the existence of all contingent assets and similar funding vehicles within monthly investment management accounts of the SPI.

31. Confirmation of the existence of procedures established to satisfy the SPI that any concentration risks underwritten by the issuer(s) of these contingent assets (as reflected in any similar investment or underwriting instruments of the issuer(s) (e.g. (re)insurance linked securities, (re)insurance exposures etc.)), are within the risk appetite of the SPI. Such procedures should, at a minimum, demonstrate a standard comparable to a typical (re)insurance security check.

32. Confirmation of an acknowledgement from the Principal Representative, that to the extent that the value of the SPI available assets falls below the value of the expected (re)insurance recoveries or aggregate liabilities by a specified margin, then the Principal Representative has the duty to forthwith inform the Authority. The quantification of this margin of deterioration will be left to the discretion of the relevant participants but must be fully disclosed to the Authority at the time of making the SPI application.

33. Confirmation of a commitment to provide to the Authority, within 60 days of the commencement of business, the names and contact details of the designated lead relevant (re)insurance regulators, as submitted by all named cedant/insured groups to the transaction. “Designated lead relevant (re)insurance regulators” in this context includes the regulators to be the point of regulatory contact for the Authority.

34. Confirmation of a commitment to provide to the Authority, within 30 days of the commencement of business, all closing documentation agreed upon at the time of licensing.

35. Confirmation of a commitment to maintain at the premises of the SPI pertinent documentation for review by the relevant authorities. This detail should include all licensing documentation, details of the debt issuance or other financing mechanism by which the SPI's (re)insurance liabilities are funded, details on the

SPI's key management and control functions, and details of the Principal Representative, claims handling, and any material outsourcing agreements.

36. Confirmation of a commitment to make available regular financial accounts to the relevant participants for their review. The nature and frequency of such accounts will be left to the discretion of the relevant participants but should be disclosed at the time of making the SPI application.

a) Confirmation of a commitment to provide a copy of these accounts to the Authority as soon as practicable after such financial accounts have been issued to participants and at a minimum within four months of the end of each financial year.

37. Confirmation of whether the company will request a Section 56 waiver of annual statutory financial returns.

38. Confirmation of whether the company will request a Section 56 waiver of external audits of its financial statements, and if not, the details of the intended auditor.

39. Clear indication on whether the SPI will be used for programme[18] business or a one-off transaction.

40. Details on the Board of Directors ("the Board") which is to be comprised of at least two persons, one of whom may be the Principal Representative.
Personal Details to include:

a) Name;

b) Nationality;

c) Occupation (preceding five years to present);

d) Years of Experience in Investment and/or Insurance Business;

e) Relationship to Participants (as applicable).

41. Details on the Service Providers

a) Details on the Insurance Manager[19] - Confirmation from the Manager that it is aware of the potential complex issues associated with SPIs and supporting

[18] An SPI Programme can be defined as a multi-deal special purpose transaction which is run through the same SPI usually over more than one underwriting period.
[19] Where any component of the (re)insurance management function of the SPI is conducted by an entity which has no substantial economic interest in the SPI, then this entity must be a regulated Insurance Manager.

evidence that the Manager has the skills and competencies necessary to proficiently manage the operations of the SPI;

b) Details on the Principal Representative - Confirmation from the Principal Representative that he/she is aware of the potential complex issues associated with SPIs and supporting evidence that the Principal Representative has the skills and competencies necessary to proficiently oversee the operations of the SPI.

42. Any additional information that the Authority shall require in support of the SPI Application.

## 2.3. Characteristics of Fully Funded Structures

43. The Authority recognises the numerous interpretations of the term "full funding" in evaluating the financial position and contractual arrangements inherent to SPI vehicles.

44. For the purposes of interpreting the provisions in the Act in the context of the SPI's fully funded position, the policy of the Authority is that the following conditions shall apply to the SPI's available assets and liabilities and its contractual arrangements. To be fully funded, an SPI will generally be expected to:

a) confirm full disclosure to the cedant/insured of the fact that the maximum recovery under the (re)insurance contract is limited to the lower of the stated contract limit and the available assets of the SPI; [20]

b) ensure that, under the terms of any debt issues 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 creditors under its contracts of (re)insurance;[21]

[20] Notwithstanding this expectation, to the extent that an SPI (re)insurance agreement does not include this limited recourse language, the SPI may be required to validate that it has in place adequate financial arrangements for the purpose of funding cedant/insured claims exceeding its available assets. In these circumstances the SPI may be required to demonstrate that any issuing counterparty:

1. Is a regulated financial institution subject to regulation by the Authority or a regulatory body considered by the Authority to have an equivalent international standing; and
2. Has achieved a financial rating (counterparty, credit or financial strength as applicable) of at least A- as of the date of application and as determined by a recognised rating agency, or
3. Is of a sound financial quality, in circumstances of unrated issuers or issuances.

[21] To the extent that all claims are not subordinated to the claims of creditors under the SPI's contracts of (re)insurance, the applicant will be expected to demonstrate full disclosure of this fact to the cedant(s)/insured(s).

c) enter into contracts or otherwise assume obligations which are solely necessary for it to give effect to the (re)insurance special purpose for which it has been established; and

d) ensure that, to the extent that more than one (re)insurance contract is in place within the SPI, each of the (re)insurance contracts is structured so that the SPI meets the fully funded requirements individually for each contract.[22]

## 2.4. Sophisticated Participant[23]

45. Underpinning the SPI regulation and guidance is the Authority's risk-based approach to (re)insurance supervision. It follows that in line with the minimal capital and solvency margins and other registration requirements for SPIs, Section 5(2) of the Act stipulates that the Authority will evaluate an SPI application based upon the Authority's evaluation of "the sophistication of the policyholders or the sophistication of the parties to a debt issuance or other funding mechanism."

46. This stipulation is intended to make clear that the participants in the SPI process will be expected to be sufficiently sophisticated to engage in this highly specialised form of business, and as such, where its participants fall within the Sophisticated Participant definition, the Authority shall expedite the approval of a completed SPI application.

47. Notwithstanding the above, this stipulation is not intended to suggest that the Authority shall prohibit otherwise suitable investors (which fall within the principle of the meaning of the definition of sophisticated investor) from being acceptable for licensing approval and as such, on a case by case basis, the Authority may approve other persons as suitable investors in addition to the list of persons set out in Appendix VII.

## 2.5. Asset Quality Disclosures

48. The Authority is aware of the significance of full disclosure of investment guidelines and asset values in the context of SPIs. As such, and in line with the level of sophistication of SPI participants, the Authority shall have a policy of expecting high levels of transparency and disclosure, enforcing this through a principals-based philosophy without prescribing the means and/or frequency of this transparency and disclosure, but rather leaving this to the professional discretion of participants who must fully disclose these details to the Authority at the time of making the SPI application.

[22] To the extent that there is no clearly defined asset segregation by contract, the applicant will be expected to clearly disclose the contract intent and provide the Authority with assurance that there is clarity of contract obligations via specific contract language.

[23] See Appendix VII – Guidance Note #20(12)(pg. 47)

49. In this context of full transparency and disclosure, the Authority expects that the company shall make available appropriate documentation to the cedant/insured(s) and investor/debt-holder(s) setting out the investment guidelines governing the SPI structure. This documentation is expected to disclose detail such as the types of acceptable instruments, (including contingent assets as applicable) issuers and credit ratings of permissible investments.

50. To the extent that, as a result of a deterioration in the value of assets (whether or not contingent assets), the SPI available assets falls below the value of the expected (re)insurance recoveries or aggregate liabilities by a specified margin, then the Principal Representative has the duty to forthwith inform the Authority. The quantification of this margin of deterioration will be left to the discretion of the relevant participants but must be fully disclosed at the time of making the SPI application.

51. In addition, the Authority expects that the company shall make available to the cedant/insured and relevant counterparties the following data, (as applicable): 1) the total composition of the assets of the SPI, 2) latest available market value of the assets, and/or 3) the latest available net asset value of such assets: (A) within a maximum of 10 Business Days after the end of each calendar month, and (B) within 2 Business Days of the request of any relevant participant where such data are not aged by more than 30 days unless agreed upon by the relevant parties..

### 2.6. (Re)insurance, Letters of Credit (LOCs) and other Contingent Assets as Forms of Collateral

52. The Authority shall recognise (re)insurance, LOCs and other "contingent assets" from appropriately risk managed and regulated institutions as acceptable instruments for inclusion in the funding structures of SPIs.

53. The Authority recognises that there are numerous approaches to fully fund SPIs. Notwithstanding the perceived security of many of the instruments put forth, the Authority shall request a heightened level of disclosure where "contingent assets" are being proposed as a source of an SPI's collateral base.

54. The Authority defines a "contingent asset" as an asset in which, at the time of its purchase, the possibility of an economic benefit from the asset depends solely upon future events, where these events are fortuitous and therefore cannot be controlled by the company. Due to the uncertainty of the future events, these assets may or may not be placed on the company's balance sheet. These assets, are however, likely to be found in the company's financial statement notes.

55. Where an SPI is funded through a balance of "contingent assets" (e.g. (re)insurance, LOCs or other financial mechanisms such as swaps, contracts for differences etc.) the SPI will be expected to demonstrate that the said issuer of these contingent assets:

a) Is a regulated financial institution subject to regulation by the Authority or equivalent regulation by another regulatory body; and

b) Has achieved a financial rating (counterparty, credit or financial strength as applicable) of at least A- as of the date of application and as determined by a recognised rating agency; or

c) Is of a sound financial quality (in circumstances of unrated issuers or issuances.)

56. The Authority expects full disclosure within the notes to the annual accounts of the SPI, including clarification on the existence of all contingent assets and similar funding vehicles. It is expected that the SPI will be positioned to reveal how the issuer(s) of the said contingent assets have satisfied the SPI that any concentration risks underwritten by the issuer(s) are within the risk appetite of the SPI.

## 2.7. Prudent Investment Guidelines, Reporting and Disclosure Requirements

57. In line with the Asset Quality disclosures, and in accordance with the prudent investment guidelines set out in the Authority's Investments Guidance Note #15, the Board of Directors of the SPI (the "Board") and the approved Principal Representative are expected to exercise sound and thorough judgment in monitoring, fully disclosing and reporting upon the funding position and processes, and the investment management activities associated with the SPI.

58. As such, it is the expectation of the Authority that the Board and the Principal Representative shall ensure that the overall processes and procedures for the funding and investment management of the SPI assets are in place, are prudently approached, are appropriate to the nature, scale and complexity of the SPI contract and are operating effectively so as to maximise the likelihood that the expected outcomes of the counterparties are met.

## 2.8. Post-Closing Document Completion

59. The Authority is cognisant of a number of circumstances which are likely to dictate the inability to make available all required documentation at the time of making an application for an SPI license. As such, and within the discretion of the Authority, approvals may be subject to a document completion process within 30 days of closing.

60. Post-closing documentation requested by the Authority may include, but are not limited to; finalised closing details of items specified in 2.2 above.

61. In addition, and in accordance with Section 29A and B of the Act, the Authority reserves its right to gain access to the SPI documentation for the purpose of audit and/or review in relation to any SPI transaction during the life of the SPI.

62. Finally, and in accordance with sound regulatory practice the Authority shall expect that a licensed SPI has specified documentation readily available for review by the appropriate regulatory bodies.

a) In addition to all licensing documentation, the SPI should have available details of the debt issuance or other financing mechanism by which the SPI's (re)insurance liabilities are funded;

b) The Authority will also expect that the SPI will have available written information about the SPI's key management and control functions, including details of the Principal Representative, arrangements for claims handling, and any material outsourcing agreements.

## 2.9. Multiple Cedant/Insured and/or Investor/debt-holder groups

63. It will be the Authority's position to review SPI structures on a case by case basis, with a policy of generally only authorising structures established by one or more entities within the same group and not by a number of unrelated entities from different groups.

64. Under conditions where it is anticipated that multiple cedants/insureds will utilise the SPI, the Authority may require either special reporting responsibilities or separately incorporated SPI cells for each unrelated transaction.

65. Notwithstanding the aforementioned position, the Authority shall generally have a policy of only authorising SPIs in such circumstance where the SPI can ensure that, to the extent that more than one (re)insurance agreement is in place within the SPI, each of the (re)insurance contracts is individually structured so that the SPI meets the fully funded requirements individually for each contract.[24]

66. Finally it should be clarified that transformer (re)insurers established with the intent to execute an unlimited number of fully funded transactions on behalf of a number of unrelated cedants\insureds and/or investors/debt-holders, are not eligible to be licensed within the SPI framework.[25]

[24] This provision should not necessarily be deemed to require asset segregation by SPI contract, but rather that the Authority will at a minimum expect to be provided with assurance that there is clarity of contract obligations via specific contract language.

[25] It is the Authority's view that transformers are better suited to be licensed under one of its Class 3 or Class 4 licensing categories.

## 2.10. Programme Business and Re-Use of an SPI

67. Any potential reuse of an SPI should be clearly specified at initial authorisation when the SPI is first being established. In such circumstances a ceding entity should explain whether the SPI is a one-off transaction or part of a programme.

68. Any anticipated reuse of an SPI needs prior approval from the Authority, either at the time of initial application or upon reapplication, where the re-approval process should take into account any actual or anticipated changes to the original contractual terms.

## 2.11. Material Change in Business

69. If during its lifetime the SPI intends to: 1) have any additional risks reinsured into it that were not contemplated in the initial transaction, or 2) have any material changes made to the contracts involved, or 3) make any modifications to the material disclosures included in the original application, 4) have further capital raised from investors and/or debt-holders after authorisation, or 5) make any other changes pertinent to its business where these changes would be deemed by a reasonable and knowledgeable person to be material, then these changes are subject to prior supervisory approval.

70. The approval process for any material change of an SPI's business characteristics shall take into account the nature, scale and complexity of those changes and may not require a full authorisation process as would be needed at the original establishment of the SPI.

71. In quantifying the materiality component of this provision, the Authority shall leave this measure to the discretion of the participants, expecting a standard commensurate with that of a "prudent person", knowledgeable in the business of SPIs.

72. In its deliberations, the Authority shall consider whether these 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.

## 2.12. Exemption from Prior Approval for Capital Release

73. 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 the regulation of SPIs and the Sophisticated Participant requirements associated with these entities.

74. In this context, it is the expectation of the Authority that, at the time of making an SPI application, the intended approach to capital and/or collateral release and winding-up procedures shall be addressed (see 20.(c) above).

75. Finally, any change in intent, during the course of the SPI's life, with respect to the company's capital release disclosures included in the application should be considered to be a "material change" required to be reported to the Authority for prior approval as per 70 - 73 above.

### 2.13. Application Fee

76. The Authority will assess a $525 registration fee to process an SPI application.

### 2.14. Annual Business Fee

77. The Authority will assess an annual business fee of $10,000 for each registered SPI.[26]

### 2.15. Filing Requirements and Audits for SPIs

78. The Authority recognises the mitigated risks associated with SPIs due in large part to the level of sophistication of the Participants, the general short term nature of the (re)insurance agreements and the typically fully funded position of SPIs.

79. As such the Authority shall, on a case by case basis, exercise its powers under section 56 to modify the annual accounting provisions in respect of an SPI, subjecting it to more streamlined filing requirements.

a) Therefore, given consent through a section 56 directive in this regard, the statutory filing requirement under the Act will be waived for the purpose of the SPI's annual filings.

80. In this same context, the Act exempts SPIs from the need to file Annual Loss Reserve Specialist Opinions. This said, the Authority is cognisant of the value of actuarial input in evaluating ultimate losses for certain SPI structures and leaves to the discretion of the participants the extent to which such loss reserve analyses should be conducted.

81. The Authority shall, on a case by case basis, exercise its powers under Section 56 to waive the requirement of annual financial audits of the accounts of SPIs. It is the view of the Authority that the Sophisticated Participant requirement is intended to render all key stakeholders sufficiently equipped to utilise their professional judgment in this regard and the decision to engage audits of the SPI,

[26] Regarding circumstances where there is a "stub" financial period, the Authority has held discussions to review a policy of prorating the annual fee given that the SPI has had a life of at least twelve months. Applicants should consult the Authority for further clarification if such a fee modification is desired.

under the appropriate Authority directive, will be left to the discretion of the relevant parties but must be fully disclosed to the Authority at the time of making the SPI application.

82. For the purposes of an SPI's registration and ongoing reporting, and where the appropriate Section 56 request has been granted, the Authority will accept unaudited management accounts from the SPI prepared in accordance with any one of the following standards or principles—

a) International Financial Reporting Standards ('IFRS');

b) generally accepted accounting principles ('GAAP') that apply in Bermuda, Canada, the United Kingdom or the United States of America; or

c) such other accounting standard as the Authority may recognise.

83. Where management accounts are deemed to be acceptable to the Authority, the SPI is required to provide to the Authority a copy of those accounts as soon as practicable after such management accounts have been submitted to participants and at a minimum within four months of the end of each financial year.

84. Notwithstanding the above, financial statements will be due in accordance with the requirements under the Act.[27]

85. It shall remain the responsibility of the Principal Representative under Section 8A of the Act to report immediately any condition which would jeopardise the ability of the SPI to remain in compliance.

[27] However, upon the completion of a stub period, and the appropriate Section 56 directive, no annual accounts will be required. A "stub period," is a one- time incomplete accounting period that covers the time frame from the beginning of the last fiscal year to the time at which business activities are considered to effectively cease.

# 3. Regulatory Approach to Entities Ceding to SPIs[28]

This section of the Bulletin is addressed to Bermuda registered cedants/insureds, where these regulated entities purchase (re)insurance cover from fully funded Special Purpose Insurers (SPIs) (or vehicles) whether or not these (re)insurers are domiciled in Bermuda. This section of the bulletin is intended to serve as a supplement to our BSCR guidance and focuses upon the Authority's expectations of Bermuda cedants/insureds intending to gain regulatory capital relief from SPI (re)insurance purchases.

### 3.1. Capital Relief Resultant from SPI Activities

86. In line with the prudential reporting requirements contained within the Act, the Authority will allow a Bermuda (re)insurer to treat amounts recoverable from an SPI as:

a) a recoverable asset,

b) (re)insurance for the purposes of calculating its technical reserves; and/or

c) (re)insurance having the effect of reducing its Enhanced Capital Requirement (for companies subject to the Bermuda Solvency Capital Requirement ("the BSCR") or companies with internal models approved for regulatory capital purposes);

however only to the extent that the ceding (re)insurer can demonstrate its ability to adequately manage all key risks associated with the SPI transaction, including investment, basis and credit risks[29], showing its understanding of the effects of the SPI (re)insurance protection upon its aggregate modeled losses and its net loss reserves.

87. For the purposes of authorising capital relief to a ceding entity for an SPI cession, and in order to exercise proper due diligence in this regard, the ceding entity must clearly disclose its approach to probabilistically reflecting SPI asset impairment within its BSCR (and/or approved internal model) returns.

a) Entities regulated by the Authority, who purchase (re)insurance protection from SPIs, are expected to ensure that they have in place (or have access to) the appropriate systems required to manage the risk exposures inherent to their SPI (re)insurance cessions.

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[28] In this section all references to SPIs (unless otherwise stated) include Bermuda domiciled SPIs, SPVs, ISPVs and all other insurance-linked fully funded vehicles, whether or not domiciled in Bermuda.

[29] Investment Risks include, but are not limited to, General Investment Risks, Loss of Principal and Interest, Market Risks and Counterparty Reinvestment Risks. Basis Risks include, but are not limited to, Trigger Risk, Timing Risk, Currency Risk, Model Risk, Data Risk, Operational Risk and Liquidity Risk.

88. Any ceding entity regulated by the Authority is expected to disclose, within its Bermuda Statutory Financial Returns (SFR), any financial interests it has in SPI related "investments". In this context, a regulated entity should be positioned to discuss how it has satisfied itself, through modeling techniques or otherwise, that it has appropriately managed any existing concentration risk that might arise in light of the combined effect of its SPI investments and its direct (re)insurance writings, clearly showing that all perceived risk concentrations are within the ceding entity's risk appetite.

89. SPI cedants/insureds regulated by the Authority are expected to ensure that they have in place adequate systems of communication with the SPI so as to be regularly apprised of the net asset value and/or collateral position of the SPI at suitable intervals. The Authority deems these communications necessary so to ensure that the regulated entity has access to the net asset value of current and/or future recoverables.

90. To the extent that the value of the SPI available assets falls below the value of the expected (re)insurance recoveries or aggregate liabilities by a specified margin, the Principal Representative of Authority regulated SPIs has the duty to forthwith inform the Authority. The quantification of this margin of deterioration will be left to the discretion of the relevant participants but must be fully disclosed at the time of making the SPI application.

a) In this same context, to the extent that the value of an SPI's available assets falls below the value of the expected (re)insurance recoveries or aggregate liabilities by a specified margin, the cedant/insured is expected to inform the Authority forthwith. The quantification of this margin of deterioration will be left to the discretion of the relevant participants but will be expected to be disclosed to the Authority within the cedant's/insured's SFR. Notwithstanding this discretionary privilege, and in the interest of full disclosure, it should be noted that it is the expectation of the Authority to be forthwith notified if there is any risk that such asset deterioration could lead to a ceding entity's statutory capital and surplus falling below the Target Capital Level (TCL). [30]

91. Upon the request of the Authority, details should be made available evidencing that all residual risks associated with the SPI arrangement (including but not limited to basis, credit, market, liquidity and operational risks) are considered in the ceding entity's financial results whether modeled or not. Where an SPI is funded through a balance of "contingent assets" the cedant/insured will be expected to demonstrate that the said issuer of these contingent assets:

[30] A (re)insurer's Target Capital Level represents 120% of its Enhanced Capital Requirement (ECR) where the ECR shall be calculated by reference to either the Bermuda Solvency Capital Requirement (BSCR) model or an approved internal capital model, provided that the ECR shall at all times be an amount equal to, or exceeding, the margin of solvency (within the meaning of section 6 of the Act).

a) Is a regulated financial institution subject to regulation by the Authority or equivalent regulation by another regulatory body; and

b) Has achieved a financial rating (counterparty, credit or financial strength as applicable) of at least A- as of the date of application and as determined by a recognised rating agency; or

c) Is of a sound financial quality (in circumstances of unrated issuers or issuances).

92. Furthermore, any entity regulated by the Authority which cedes business to an SPI is expected to disclose within its annual returns how it has satisfied itself that it has appropriately evaluated the financial position of the issuer(s) of any existing contingent assets which support the SPI. The ceding entity is expected to: 1) discuss how it has subjected these issuers to standard credit security tests; 2) demonstrate that is has appropriately reflected in its analysis all known probable credit risk attributable to the said issuer(s); and 3) show how the said issuer's credit risk falls within the ceding entity's risk appetite.

93. Any anticipated reuse by a ceding entity of an Authority regulated SPI needs prior approval from the Authority. Re-entering the approval process with the Authority is necessary for any regulatory capital relief to be taken by a ceding entity for an SPI arrangement. The SPIs re-approval process shall take into account any changes to the contractual terms since the original authorisation.

### 3.2. Intra-group (Re)insurance

94. An important mandatory consideration for authorising an SPI for intragroup (re)insurance is that a ceding entity cannot use an internally funded SPI to achieve a regulatory capital reduction at group level in the absence of any financing external to the group.

95. Regulatory capital requirements of a group are only permitted to be reduced therefore if, and to the extent to which, funding is provided externally to back the (re)insurance provided by an SPI to an entity within the group.

# 4. Information to Regulators of Entities Ceding to Bermuda SPIs[31]

This section of the Bulletin is addressed to regulators of non-Bermuda domiciled cedants/insureds which rely on (re)insurance recoveries from SPIs regulated by the Authority.

### 4.1. Contractual Limits of Liability

96. Most SPI structures will contain contractual language obliging the SPI to pay the reinsured an amount up to a stated value at the time of the occurrence of a covered event. These SPI contractual payouts may include but are not limited to language limiting the SPI contract to a specified fixed dollar aggregate, Probable Maximum Loss (PML), Loss Ratio Cap, Tail Value at Risk (TVar) or other prescribed amount(s).

97. Notwithstanding the aforementioned contract language and event triggers signifying SPI loss payouts, the Authority views it imperative that all key stakeholder, including regulators of key stakeholders, be fully cognisant of the risk that there can be no guarantee than an SPI will be immune from asset deterioration. As such, there can be no guarantee that, at the time of an event trigger, the available assets of an SPI will equal or exceed the expected loss payout for the covered event.

98. To the extent that the value of the SPI available assets falls below the value of the expected (re)insurance recoveries or aggregate liabilities by a specified margin, then the Principal Representative of the SPI has the duty to forthwith inform the Authority. The quantification of this margin of deterioration will be left to the discretion of the relevant participants but must be fully disclosed to the Authority at the time of making the SPI application.

99. In the interest of full disclosure, and to assist in the mitigation of unexpected occurrences of material asset deterioration, the Authority expects that the SPI shall make available to the cedant/insured and relevant counterparties the following data, (as applicable): 1) the total composition of the assets of the SPI, 2) latest available market value of the assets, and/or 3) the latest available net asset value of such assets: (A) within 10 Business Days after the end of each calendar month, and (B) within 2 Business Days of the request of any relevant participant where such data may not aged by more than 30 days unless agreed upon by the relevant parties.

100. Where there is some deterioration in asset value, some SPI structures will require that a named entity "top-up" the assets of the SPI at the time of such deterioration. In order to establish some degree of transparency in these

[31] In this section, all references to SPIs refer to Bermuda SPIs unless otherwise indicated.

circumstances, the Authority requires that these "top-up" provisions form part of the contract language and be clearly disclosed at the time of application. These disclosures should include (but are not limited to):

a) The conditions under which a top-up will be required;

b) Supporting financial information on the named party responsible for the top-up;

c) The time-frame within which the top-up must be carried out after the said asset deterioration.

101. The Authority deems it prudent to further require its regulated ceding entities to disclose within their annual returns any additional perceived risks attendant to their purchase of (re)insurance from an SPI (whether or not Bermuda domiciled) where the SPI is partially funded through contingent assets. Under such circumstance, the Bermuda regulated ceding entity is expected to discuss how it has satisfied itself that: 1) it has appropriately evaluated the financial position of the issuer(s) of these contingent assets, passing them through standard credit security tests, and 2) any existing credit risk attributable to the said issuer has been appropriately reviewed and falls within the ceding entity's risk appetite.

a) In this context the Authority views it to be prudent that regulators ensure that ceding entities monitor asset values on a relatively frequent basis.

### 4.2. Limited Recourse

102. Many SPI structures will include "limited recourse" language. This language generally is intended to limit the maximum recovery under the SPI (re)insurance agreement to the lower of the stated contract limit and the available assets of the SPI.[32] Most specifically, this language generally includes terms that secure the bankruptcy remoteness of the SPI, and ensures that the maximum recovery from the SPI is capped at a level that is no greater than the SPI's available assets. It is generally the view of the Authority that this is a necessary condition of the SPI being fully funded.

[32] Notwithstanding this expectation, to the extent that the SPI (re)insurance agreement does not include this limited recourse language, the SPI may be required to validate that it has in place adequate financial arrangements for the purpose of funding cedant/insured claims exceeding the SPI's available assets. In these circumstances the SPI may be required to confirm that any issuing counterparty:

1. Is a regulated financial institution subject to regulation by the Authority or a regulatory body considered by the Authority to have an equivalent international standing; and
2. Has achieved a financial rating (counterparty, credit or financial strength as applicable) of at least A- as of the date of application and as determined by a recognised rating agency, or
3. Is of a sound financial quality in circumstances of unrated issuers or issuances.

103. Notwithstanding the latter, the Authority recognises that there are numerous approaches to ensuring that an SPI is bankruptcy remote. As such, applications which do not include "limited recourse language" will be expected to satisfy the Authority, during the applications process, that under the binding conditions of the (re)insurance and/or other related financial arrangements, the SPI should not find that its available assets are insufficient to meet its (re)insurance liabilities.

### 4.3. Capital Relief

104. In cases where regulated insurance companies utilise SPIs to transfer risk, it is the Authority's recommendation that the principal focus of regulatory attention should be on a prudent assessment of the extent of capital relief afforded to the ceding regulated insurer. At a minimum, it is the view of the Authority that regulators could ensure that a ceding entity appropriately quantifies the probability of asset impairment in its modeled loss results, particularly in cases where contingent or other potentially vulnerable asset classes form some component of the SPI asset portfolio.

105. To avoid a situation in which a cedant/insured could be subject to an inappropriately low capital requirement or technical provision by using an SPI, where there is no contractual top-up clause, it can be effective, from a regulatory perspective, if the amount of capital relief afforded a ceding entity under these conditions is based upon the regulators' perceived risk of full recovery in the event of a covered loss. Under such conditions, the regulator might choose to quantify any proposed 'hair-cut' of capital relief based upon the ceding entity's modeled losses, where these modeled losses are presented as aggregate net loss outcomes with and without probabilistic asset impairment assumptions.

106. Finally it is the Authority's view that it would be prudent for regulators of SPI cedants/insureds to adopt an approach whereby (in cases of asset impairment, where there is no top-up provision in place, and where such impairment impacts potential loss recoveries from the SPI) the maximum allowable (re)insurance credit taken by a ceding entity for an SPI arrangement is capped at an amount equal to the lower of the maximum liability transferred and the aggregate value of anticipated recovery from the SPI transaction.

### 4.4. (Re)Insurance Regulator to Regulator Dialogue

107. The Authority is committed, in accordance with its policy of regulatory cooperation, to engage in all necessary and prudent "regulator-to-regulator" dialogue so as to ensure that all valid documentation, as requested from the appropriate authorities, is made available for review and audit for the purpose of validating the efficacy of assets available to settle (re)insurance recoveries due from an SPI licensed under the Authority.

108. In line with this commitment to regulator–to-regulator cooperation, one component of our SPI applications process requires a confirmation from the SPI of a commitment to provide to the Authority, within 60 days of the commencement of business, the names and contact details of designated lead relevant (re)insurance regulators, as submitted by all named cedant/insured groups to the transaction. "Designated lead relevant (re)insurance regulators" in this context includes the regulators designated by all relevant cedant/insured groups to be the point of regulatory contact for the Authority.

a) With this information, the Authority shall produce a database of "Designated lead relevant (re)insurance regulators" solely for the purpose of reference in relation to SPI issues.

# Appendix I

## Examples of SPI Transactions[33]

### 1.1. Typical Insurance-Linked Securitisation Transactions

1. In these transactions an SPI is established for the purpose of entering into a single (re)insurance contract. In order to fund its obligations under that contract, the SPI will issue notes (the "Notes") to investor and/or debt-holders in an amount equal to its maximum liability under the (re)insurance contract.

2. The Notes will be limited recourse notes and provide that the SPI's obligation to pay interest and principal to the note holders diminishes by an amount equal to the amount the SPI pays under the (re)insurance contract.

3. The (re)insurance company (SPI) does not enter into any other business, save for ancillary agreements such as interest rate swaps on guaranteed investment contracts that ensure the interest can be paid on debt and other obligations.

### 1.2. Catastrophic Risk (CAT) Bonds (Exhibits - Figure 1)

4. Catastrophe bonds are thought to have been mirrored after asset-backed-security transactions executed for a wide variety of financial assets including mortgage loans, automobile loans, aircraft leases, and student loans. Catastrophe bonds are part of a broader class of assets known as risk-linked bonds, in which investors face the risk of default and where there is a pay off to the cedant/insurer on the occurrence of a specified event or events. Most risk-linked bonds issued to date have been linked to catastrophes such as hurricanes and earthquakes, although bonds also have been issued that respond to mortality events.

5. In these transactions an SPI may be established to allow the sponsoring cedant to access the capital markets for (re)insurance capacity.

### 1.3. Sidecars (Exhibits - Figure 2)

6. Sidecars are SPIs typically formed by a single (re)insurance company to avail itself of additional capacity to write (re)insurance, usually for property catastrophes and marine risks. Sidecars typically serve to accept property catastrophe quota share or excess of loss retrocessions exclusively from a single (re)insurer (sponsor) and sidecars generally have limited lifetimes.

7. Most sidecars are capitalised by private investor and/or debt-holders such as hedge funds, but (re)insurers also participate in this financing device. Sidecars receive premiums for the (re)insurance underwritten from the (re)insurance

[33] Cummins, David J.

company sponsor and are liable to pay claims under the terms of the (re)insurance contracts.

8. In addition to providing capacity, sidecars also enable the sponsoring (re)insurer to move some of its risks off-balance sheet, thus improving leverage.

### 1.4. Dual Trigger Industry Loss Warranties (Exhibits - Figure 3)

9. Dual Trigger ILWs are (re)insurance contracts which have a (re)insurance retention trigger based on:

a) the incurred losses of the (re)insurer buying the contract as well as
a warranty trigger based on an industry-wide loss index

10. As such the contracts pay off on the dual event that a specified industry-wide loss exceeds a particular threshold at the same time that the issuing (re)insurer's losses from the event equal or exceed a specified amount.

11. Both triggers have to be hit in order for the buyer of the contract to receive a payoff. The issuing (re)insurer thus is covered in states of the world when its own losses are high and the (re)insurance market is likely to enter a hard-market phase.

12. ILWs cover events from specified catastrophe perils in a defined geographical region. For example, an ILW might cover losses from hurricanes in the South Eastern U.S.

13. The term of the contract is typically one year.

14. ILWs may have binary triggers, where the full amount of the contract pays off once the two triggers are satisfied or pro rata triggers where the payoff depends upon how much the loss exceeds the warranty.

15. The principal advantages of ILWs are that they are treated as (re)insurance for regulatory purposes and that they can be used to plug gaps in (re)insurance programs. They also represent an efficient use of funds in that they pay off in states of the world where both the (re)insurer's losses and industry-wide losses are high.

16. Capital market participants provide the majority of risk capital in the ILW market, just as they do in the Catastrophe bond market. In addition, ILWs can be packaged and securitised, broadening the investor and/or debt-holder base.

# Appendix II

## Some Risks Inherent to SPI Activities[34]

### 2.1. Basis Risk

1. Basis Risk is the risk that a hedge or financial protection procured ("the hedge transaction") is insufficient to meet the obligations assumed ("the assuming transaction"), as a result of differences between the terms or structure of the assuming and hedge transactions.

2. Types of Basis Risk include:

a) Trigger Risk – This risk addresses the possibility that the modeled recovery is less than the modeled portfolio loss when the contract is written typically with a non-indemnity trigger (see Appendix III).

b) Timing Risk - This risk addresses the likelihood that the delay between the event date and the date of indemnification is longer than is likely in a traditional (re)insurance transaction

c) Currency Risk – This risk addresses exchange rate movement from the date the transaction is entered into until the date the contract is completed and funds are disseminated.

d) Model Risk – This risk captures the probability that the catastrophe model misestimates the impact of one or more catastrophic events. Parameter estimates which may be inaccurate include the event frequency, severity, location, and damage factor assumptions in catastrophe models.

e) Data Risk – These risks arise when portfolio data submitted for modelling analysis is incomplete or inaccurate.

f) Operational Risk – This risk arises due to errors and omissions in the operations of key counterparties. Risks might include law suits and contract cancellation in cases where eg.: 1) data quality leads to a claim of misrepresentation by investor/debt-holders or 2) if funds are not prudently invested by investment managers.

g) Liquidity Risk – This risk arises when assets are not suitably matched with liabilities.

[34] Ratings Direct

### 2.2. Tail Risk

3. Tail Risk is the risk that actual losses exceed expected modeled losses in the tail of the assumed loss distribution utilised to model events assumed in the contract terms.

4. Tail risk is typically associated with a reinsured's PML or TVaR and reflects the risk that actual losses exceed the estimated PML and/or TVaR.

### 2.3. Market Risk

5. Market Risk addresses movement in financial market indicators from the date the transaction is entered into until the date the contract is completed and funds are disseminated. Sources of market risk include movements in equity prices, bond prices and interest rates.

### 2.4. Counterparty Credit Risk

6. Counterparty Credit Risk addresses the risk that a counterparty will be unable or unwilling to fulfil its financial obligations in a contract.

# Appendix III

## Some Examples of SPI Trigger Types[35]

### 3.1. Indemnity Triggers

1. Indemnity contract triggers mirror the actual losses of the reinsured and can be likened to a non proportional contract often with a commutation at the end of an extension period artificially imposed to allow the contract to have a legal final maturity.

2. Risks arise within these contracts if the ultimate loss exceeds the loss estimated at the time of commutation.

### 3.2. Non-Indemnity Triggers

3. Non-Indemnity triggers are contract triggers which are not designed to mirror the actual losses of the reinsured. Examples of non-indemnity triggers include:

a) Modelled Loss

Modelled loss triggers are evaluated according to whether modeled losses fall above a certain threshold.

The modeled losses are calculated from an exposure portfolio designed to reflect as closely as possible the actual underlying portfolio and which is compatible with a specified catastrophe modelling software. When an event occurs, the event parameters are run against the exposure database in the catastrophe model to determine whether the contract is triggered.

Risk within these contracts is a function of how accurately the notional portfolio matches that of the actual business written. Risks also arise due to the quality of the calibration of the modelling software.

b) Parametric

Parametric triggers are a type of non-indemnity trigger where loss payment is determined by a mathematical formula related to the quantifying characteristics of an event (e.g. earthquake magnitude and depth, or maximum wind speed).

Risk within these contracts depends upon the granularity and appropriateness of the weights in the parametric index and the accuracy and availability of

[35] Ratings Direct, September 12, 2008 (Also see Exhibits - Figure 3 - (Source: Swiss Re))

related sources (e.g. wind stations) which measure the event compared to the reinsured's modeled exposure.

c) Industry Loss Warranty

Industry Loss Triggers (a.k.a. ILWs) are a non indemnity trigger activated when the (re)insurance industry loss reaches a certain threshold.

Unless the reinsured is a well diversified national writer, covering major lines of business, there is significant risk that the payout from the SPI contract will not match the losses incurred.

# Appendix IV

## Designated Investment Contracts - Section 57A [36]

**4.1. Section 57 A (1) For the purposes of this section—**

1. 'contract' includes investment or security, and any reference to ""parties"" in relation to an investment or security shall be taken to be a reference to its issuers and investor and/or debt-holders; and 'designated investment contract' means—

a) any contract (including, but not limited to, any option contract, futures contract, which is to secure a profit or avoid a loss—

- by reference to fluctuations in the value or price of property of any description, or in an index, or other factor, specified for that purpose in the contract, or

- based on the happening of a particular event specified for that purpose in the contract; and

b) in relation to which the Authority has given a direction under subsection (2)

2. The Authority may direct in writing that a contract falling within paragraph (a) of the definition of designated investment contract in subsection (1), which was submitted to him in draft together with—

a) the fee of $1000, or such other fee as may be prescribed under the Bermuda Monetary Authority Act 1969, and

b) such other documents as the Authority may require, is a designated investment contract for the purposes of this section.

3. A direction under this section—

a) may be made with retroactive effect;

b) may be subject to conditions which may be varied at any time, provided—

- that the variation has been applied for, or is consented to by the parties to the contract in question; and

- that those parties undertake to notify such other persons as the Authority considers may be affected by the variation;

[36] **The Bermuda Insurance Act - Section 57A**

c) is not a statutory instrument having legislative effect.

4. Being a party to a designated investment contract shall not constitute carrying on (re)insurance business, and a designated investment contract shall not constitute a contract of (re)insurance, for any purposes.

5. For the avoidance of doubt, a designated investment contract shall not constitute a bet for the purposes of the Betting Act 1975.

6. The Minister may by order amend the definition of designated investment contract in subsection (1), if, after consulting the Authority, he considers it necessary to do so; and any such order shall be subject to the negative resolution procedure.

[Section 57A inserted by 1998:8 effective 23 March 1998; amended by 2001:27 effective 1 October 2001; by 2001:33 effective 1 January 2002; and by 2002:39 effective 30 December 2002]

# Appendix V

## Insurance-Linked Securities -Benefits of Exchange Listing[37]

**5.1. The following have been cited as benefits to listing insurance-linked securities on a "recognised stock exchange":**

1. Exchange listing can provide regulators and investors with a greater degree of comfort in that the listed vehicle would be subject to international regulatory standards, including transparency and public dissemination of relevant information.

2. Increased standards of transparency ensure that existing and potential investors are given sufficient and timely information to enable them to make properly informed assessments in relation to the value and merits of the exchange listed vehicles.

3. Some investment in exchange listed instruments is often mandatory for larger investment structures, such as pension plans, which typically have fiduciary responsibilities to their ultimate investors. Many such plans limit their investment allocations in unlisted securities to ensure the efficacy of asset quality.

4. Trading through a recognised stock exchange provides access to increased liquidity for listed vehicles. This provides investors with a greater degree of flexibility to manage their investments in insurance-linked products either by increasing or decreasing their stakes as desired.

In support of Bermuda's indigenous (re)insurance industry, the Bermuda Stock Exchange (BSX) has created regulations to support the listing of (re)insurance related products and operates and publishes the RG/BSX Bermuda Insurance Index which is a bell weather indicator of the market performance of those publicly listed (re)insurance companies with mind and management in Bermuda

[37] Contributed by the Bermuda Stock Exchange (BSX); www.bsx.com. The BSX was established in 1971, and operates as an internationally recognised stock exchange and settlement platform in Bermuda with listings numbering over 650.

The BSX Official List is comprised of equity, debt, collective investment vehicles (including hedge funds), equity derivative warrants and specialised debt products such as catastrophe bonds.

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# Appendix VI

## SPIs -Frequently Asked Questions

### 6.1. What are the advantages to incorporating an SPI?

1. Ceding entities obtain access to tailored, fully funded, (re)insurance capacity in a very cost effective structure.

2. Investor and/or debt-holders enjoy, amongst other things, the ability to invest in (re)insurance markets quickly, with readily available access to underwriting expertise, with expected high returns and with no need to set up infrastructure.

### 6.2. How much will it cost to apply?

3. There will be a one-off $525 fee to process an application.

### 6.3. Will there be any restrictions upon the realisation of Capital Relief Resultant from SPI Activities?

4. In line with the prudential reporting requirements contained within the Act, the Authority will allow a Bermuda (re)insurer to treat amounts recoverable from an SPI as:

a) a relevant asset, or

b) (re)insurance for the purposes of calculating its technical reserves, or

c) as (re)insurance reducing its Enhanced Capital Requirement for companies subject to the Bermuda Solvency Capital Requirement ("the BSCR") or companies with approved internal models for regulatory capital purposes,

however only to the extent that the ceding re(insurer) can demonstrate its ability to manage the impact of the SPI (re)insurance protection upon its modeled losses and its net loss reserves respectively.

Upon the request of the Authority, details should be made available evidencing that all residual risks associated with the SPI arrangement (including but not limited to basis, credit, market, liquidity and operational risks) are considered in modeled results.

### 6.4. What is the significance of the "Sophisticated Participant" requirement for SPIs?

5. Underpinning the SPI regime is the Authority's risk-based approach to regulation. In line with the minimal capital and solvency and other contractual requirements for SPIs, the parties engaged in the process will be expected to be adequately qualified to engage in this highly specialised and sophisticated business.

6. With the Sophisticated Participant stipulation and the requirement to fully fund the SPI, the Authority will be inclined to grant a Section 56 request, requiring less information from an SPI during both the application and ongoing filing processes than conventional (re)insurers.

### 6.5. What are the minimum capital requirements for SPIs?

7. The Act stipulates that the minimum capital and surplus requirements for Special Purpose Insurers is $1.

### 6.6. What are the fully funded requirements?

8. This Bulletin includes guidance on the requirements for an SPI to be 'fully funded'. It includes general expectations applying to the SPI's assets and liabilities and its contractual arrangements which ensure the SPI remains fully funded.

9. To be fully funded, an SPI will be expected to:

a) confirm full disclosure to the cedant/insured that the available assets of the SPI will at all times exceed its aggregate recoveries;

b) ensure that, under terms of any debt issues or other financing arrangement used to fund its (re)insurance liabilities, the rights of providers of that debt or other financing are fully subordinated to the claims of creditors under its contracts of (re)insurance;

c) enter only into contracts or otherwise assume obligations which are necessary for it to give effect to the (re)insurance special purpose for which it has been established; and

d) ensure that, to the extent that more than one (re)insurance contract is in place within an SPI, each of the (re)insurance contracts is individually structured to meet the fully funded requirements for the SPI.

### 6.7. Can (Re)insurance and other Contingent Assets be used for Collateral?

10. The Authority recognises the numerous forms of proposed vehicles available to fully fund SPIs. Notwithstanding the perceived security of many of these instruments, it will be the policy of the Authority to request a heightened level of disclosure where "contingent assets" are being proposed as a source of an SPI's funding.

11. The Authority defines a "contingent asset" as an asset in which the possibility of an economic benefit from the asset depends solely upon future events where these events are fortuitous and therefore cannot be controlled by the company. Due to the uncertainty of the future events, these assets may or may not be placed on the company's balance sheet. These assets, such as outwards (re)insurance, may sometimes be found in the company's financial statement notes.

12. This Bulletin stipulates that where an SPI's (re)insurance liabilities are funded through a balance of "contingent assets" (i.e. (re)insurance, LOCs or other financial mechanisms such as swaps, contracts for differences or other debt mechanisms) the authority will expect the SPI to demonstrate that the said issuer of these assets 1) is a regulated financial institution subject to regulation by the Authority or equivalent regulation by another regulatory body; and 2) has achieved a financial rating (counterparty, credit or financial strength as applicable) of at least A- as of the date of application and as determined by a recognised rating agency, or 3) is of a sound financial quality (in circumstances of unrated issuers or issuances.)

13. In addition, the applicant must confirm full disclosure of procedures established to satisfy the SPI that any concentration risks underwritten by the issuer(s) of contingent assets (as reflected in any similar investment or underwriting instruments of the issuer(s) (e.g. (re)insurance linked securities, (re)insurance exposures etc.)), are within the risk appetite of the issuer, and the SPI.

14. This means that the Authority recognises (re)insurance and/or LOCs from appropriately regulated and financially sound institutions as acceptable instruments for inclusion in the collateral structures of SPIs.

### 6.8. How does the Authority ensure that the funds held by the SPI will be solely available to pay losses of the reinsured and that no unrelated participant will be indemnified from the SPI fund?

15. The Act stipulates that one measure of the efficacy of a SPI is whether the (re)insurer is "solely" insuring or reinsuring one or more risks or group of risks with one or more policyholders.

16. This provision is intended to address the "risk sharing" characteristics of SPI structures utilising language which assures that there is no opportunity for unintended co-mingling of assets amongst unrelated (re)insured parties.

17. This clause is established to ensure no ambiguity in the extent of the fully funded requirement of an SPI and no question as to the availability of the entirety of the "fund" to the appropriate eligible policyholder or related policyholder group.

### 6.9. How will the Authority ensure that the SPI remains solvent?

18. The approved Principal Representative of the SPI will be required to ensure that at all times the available assets (including contingent assets) of the SPI are equal to or greater than its liabilities where these liabilities are valued according to Generally Accepted Accounting Principles (GAAP) or another approved internationally recognised accounting standard. Moreover to the extent that there is a material deterioration in the value of the SPI assets the Principal Representative has the duty to forthwith inform the Authority.

19. In addition monthly investment management accounts will be expected to be made available to participants.

20. Finally the Authority expects, at the time of application, that the SPI shall agree to make available to the cedant/insured and relevant counterparties, the following data, (as applicable): 1) the total composition of the assets of the SPI, 2) latest available market value of the assets, and/or 3) the latest available net asset value of such assets: (A) within a maximum of 10 Business Days after the end of each calendar month, and (B) within 2 Business Days of 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.

### 6.10. What will be the filing requirements for SPIs?

21. Where the appropriate Section 56 request has been granted to an applicant, Bermuda Statutory filing requirements will not be required for the purpose of the annual filings for an SPI. In such instances, the Authority may accept unaudited management accounts prepared in accordance with any one of the following standards or principles—

a) International Financial Reporting Standards ('IFRS');

b) generally accepted accounting principles ('GAAP') that apply in Bermuda, Canada, the United Kingdom or the United States of America; or

c) such other financial accounts as the Authority may recognise.

22. Notwithstanding the above, financial statements will be due in accordance with the requirements under the Act.

### 6.11. What are the requirements for companies already involved in SPI related activities?

23. Existing companies established with "fully funded" (re)insurance contracts or companies already engaged in SPI related activity will not be required to re-register as SPIs.

24. Should any entity wish to avail itself of this new category of registration, the company should make application to the Authority for a change of class through the standard registration procedures.

25. All existing regulatory approvals related to existing "fully funded" (re)insurance entities, including but not limited to section 56 directions, relevant asset approvals and other fixed capital approvals shall remain in force.

26. As ongoing policy demands, the Authority shall review prior approvals to ensure that said approvals remain appropriate. Should the Authority deem any previously granted approval to fall outside of the Authority's policy, the Authority shall consult with the applicant prior to amending or voiding said approval.

### 6.12. How much will it cost to register?

27. An annual fee of $10,000 will be assessed[38]

### 6.13. When does the application process for SPIs begin?

28. With the passage of the Amendment Act on 30th July, 2009, applications for SPIs are currently being accepted.

[38] .The Authority is currently in discussions related to reviewing a policy of prorating the annual fee for a "stub" financial period given that the SPI has had a life of at least twelve months. Applicants should consult the Authority for further clarification if such a fee modification is desired.

**Appendix VII**

# BERMUDA MONETARY AUTHORITY

GUIDANCE NOTE #20

SPECIAL PURPOSE INSURERS

5th October, 2009

## GUIDANCE NOTE: SPECIAL PURPOSE INSURERS

### 1. Introduction

1. The class of Special Purpose Insurers ("SPIs") was introduced by the passage of the Insurance Amendment Act 2008 on 30th July 2009 (IA(1)).

2. This note (the "Note") sets out guidance in relation to the Authority's licensing and supervisory regime in relation to SPIs. A primary focus of the Note is to demonstrate the Authority's approach to the supervision of SPIs which involves setting out prudent and robust fundamental requirements that SPIs must meet in order to be licensed under Bermuda law.

3. The Authority is of the view that once licensing for an SPI has been achieved, regulatory attention should be placed upon the original cedant/insured. This is aligned with the fact that the SPI is by definition fully funded and therefore perpetually solvent. In this regard, the Authority expects that as the ceding entity benefits from capital relief associated with its risk-transfer to the SPI, it shall be adequately capitalised and technically equipped to manage all risk characteristics associated with the SPI cession.

4. The Authority recognises the need for clarity as to the scope and implementation of the provisions of the Insurance Act 1978 and related regulations ("the Act")[39] if the regulatory system is to command the confidence of both (re)insurers and contract/policyholders. The Authority therefore seeks to ensure that those operating in Bermuda have a sound understanding of the Authority's approach to implementing the Act in the context of SPIs.

5. While the Authority aims to provide clarity as to its approach, this Note cannot be exhaustive. The Authority will do its best, through this and other guidance notes, to set out information about its regulatory approach and expectations regarding the activities associated with SPIs. Ultimately, it is the responsibility of the legal entity to ensure their compliance with the Act and all queries associated with this guidance should be directed to the Authority.

6. There is likely to be a need for some modification in the SPI guidance over time as new scenarios emerge. In this context, it is generally the approach of the Authority to pass material changes in process through industry consultation before being published, usually through the issuance of revised versions.

[39] "The Act" means the Insurance Act 1978 and its related regulations. The insurance legislation is comprised of the Insurance Act 1978 (as amended by the Insurance Amendment Acts, 1981, 1983, 1985, 1995, 1998, 2001, 2006 and 2008) (IA) and the regulations promulgated under that Act (the "Regulations"). The Regulations are the Insurance Accounts Regulations 1980 (as amended by The Insurance Accounts Amendment Regulations 1981, 1985, 1989 and 2008) and the Insurance Returns and Solvency Regulations 1980 (as amended by The Insurance Returns and Solvency Amendment Regulations 1981, 1985, 1989 and 2008).

## 2. The Registration Process

7. SPIs will be subject to a streamlined application and ongoing supervisory process, commensurate with the assumed risk of the venture.

8. The SPI application process will generally require that an SPI application form ("SAF") be completed and signed by the applicant before being submitted to the Authority. The SAF will include a series of questions directed to the most pertinent details of the SPI transaction.

9. The Authority shall expedite approval of SPI applications when received. At a minimum, applications will be considered at the weekly Admissions and Licensing Committee (ALC) meeting.

## 3. Characteristics of Fully Funded Structures

10. The Authority recognises the numerous interpretations of the term "full funding" in evaluating the financial position and contractual arrangements inherent to SPI vehicles.

11. For the purposes of interpreting the provisions in the Act in the context of the SPI's fully funded position, the following conditions shall apply to the SPI's available assets and liabilities and its contractual arrangements. To be fully funded, an SPI will generally be expected to:

a) confirm full disclosure to the cedant or insured of the fact that the maximum reinsurance recovery from the SPI is limited to the lower of the stated contract limit and the available assets of the SPI; [40]

b) ensure that, under the terms of any debt issues 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 creditors under its contracts of (re)insurance;

[40] Notwithstanding this expectation, to the extent that an SPI reinsurance agreement does not include limited recourse language, the SPI may be required to validate that it has in place adequate financial arrangements for the purpose of funding cedant/insured claims exceeding its available assets. In these circumstances the SPI may be required to demonstrate that any issuing counterparty:

1. Is a regulated financial institution subject to regulation by the Authority or equivalent regulation by another regulatory body; and
2. Has achieved a financial rating (counterparty, credit or financial strength as applicable) of at least A- as of the date of application and as determined by a recognised rating agency or,
3. Is of a sound financial quality (in the circumstance of unrated issuers or issuances,)

c) enter into contracts or otherwise assume obligations which are solely necessary for it to give effect to the (re)insurance special purpose for which it has been established; and

d) ensure that, to the extent that more than one (re)insurance contract is in place within the SPI, each of the (re)insurance contracts is structured so that the SPI meets the fully funded requirements individually for each contract.[41]

## 4. Sophisticated Participant

12. The Authority expects that only sufficiently Sophisticated Participants will engage in this highly specialised form of business, which in the context of this Note means a person who satisfies one or more of the criterion below:

a) high income private investors;[42]

b) high net worth private investors;[43]

c) sophisticated private investors; [44]

d) investment funds approved by the Authority under the Investment Funds Act (IFA)

e) bodies corporate, each of which has total assets of not less than five million dollars, 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;

f) unincorporated associations, partnerships or trusts, each of which has total assets of not less than five million dollars, 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;

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[41] This provision should not necessarily be deemed to require asset segregation by contract, but rather that that the Authority will at a minimum expect to be provided with assurance that there is clarity of contract obligations via specific contract language.

[42] Means an individual who has had a personal income in excess of $200,000 in each of the two years preceding the current year or has had a joint income with that person's spouse in excess of $300,000 in each of those years, and has a reasonable expectation of reaching the same income level in the current year - "current year" means the year in which he purchases an investment;

[43] Means an individual whose net worth or joint net worth with that person's spouse in the year in which he purchases an investment exceeds $1,000,000 - "net worth" means the excess of total assets at fair market value over total liabilities;

[44] Means an individual: 1) who has such knowledge of, and experience in, financial and business matters as would enable him to properly evaluate the merits and risks of a prospective purchase of investments; and 2) who, in respect of each investment transaction, deals in amounts of not less than $100,000.

g) bodies corporate, all of whose shareholders fall within one or more of the subparagraphs of this paragraph, except subparagraph (d);

h) partnerships, all of whose members fall within one or more of the subparagraphs of this paragraph, except subparagraph (d);

i) trusts, all of whose beneficiaries fall within one or more of the subparagraphs of this paragraph, except subparagraph (d);

j) any company quoted on a recognised stock exchange; and

k) 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.

13. On a case by case basis, the Authority may approve other persons as suitable investors (in addition to the list of persons set out in 12 above).

## 5. Asset Quality and Disclosures

14. It is the expectation of the Authority that the SPI provide full disclosure to the cedant/insured(s) and investor/debt-holder(s) and makes available documentation setting out the investment guidelines governing the SPI structure. This documentation is expected to disclose detail such as the types of acceptable instruments (including contingent assets as applicable), issuers and credit ratings of permissible investments.

15. In addition, it is the expectation of the Authority that the SPI provide full disclosure to the cedant/insured(s) and investor/debt-holder(s) and agrees to make available to the relevant counterparties the following data, (as applicable): 1) the total composition of the assets of the SPI, 2) latest available market value of the assets, and/or 3) the latest available net asset value of such assets: (A) within a maximum of 10 business days after the end of each calendar month, and (B) within 2 business days of 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.

## 6. Contingent Assets[45] as Forms of Collateral

16. The Authority recognises contingent assets such as reinsurance and/or LOCs from appropriately risk managed and regulated institutions as acceptable instruments for inclusion in the funding structures of SPIs.

[45] The Authority defines a "contingent asset" as an asset in which, at the time of its purchase, the possibility of an economic benefit from the asset depends solely upon future events, where these events are fortuitous and therefore cannot be controlled by the company. (e.g. reinsurance, LOCs or other financial mechanisms such as swaps, contracts for differences etc.)

17. In this context, where an SPI is funded through a balance of contingent assets the SPI must demonstrate that any issuer of these contingent assets:

a) is a regulated financial institution subject to regulation by the Authority or equivalent regulation by another regulatory body; and

b) has achieved a financial rating (counterparty, credit or financial strength as applicable) of at least A- as of the date of application and as determined by a recognised rating agency, or

c) is of a sound financial quality (in the circumstance of unrated issuers or issuances,)

18. To the extent that, as a result of deterioration in the value of contingent assets, the value of the SPI available assets falls below the value of the expected reinsurance recoveries or aggregate liabilities by a specified margin, then the Principal Representative shall forthwith inform the Authority. The quantification of this margin of deterioration will be left to the discretion of the relevant participants but must be fully disclosed at the time of making the SPI application.

19. The SPI must fully disclose, within the notes to its accounts, the existence of all contingent assets and similar funding vehicles. The SPI must be prepared to demonstrate, through documentation or otherwise, how the issuer(s) of the said contingent assets has satisfied the SPI that any concentration risks underwritten by the issuer(s) are within the risk appetite of the SPI. This evaluation, at a minimum, should involve standard credit risk analyses.

## 7. Multiple Cedant/Insured and/or Investor/debt-holder groups

20. The Authority shall review SPI structures on a case by case basis, generally only authorising structures established by one or more entities within the same group and not by a number of unrelated entities from different groups.

21. Where the SPI anticipates that multiple cedants/insureds will utilise the SPI, the Authority may require either special reporting responsibilities or separately incorporated SPI cells for each unrelated transaction.

22. On a case by case basis, the Authority may register SPIs where the SPI discloses that more than one (re)insurance agreement is in place, however it is the expectation of the Authority that, a) each of the (re)insurance contracts is individually structured; and b) that the SPI can individually meet the fully funded requirements for each contract.[46]

[46] This provision should not necessarily be deemed to require asset segregation by contract, but rather that that the Authority will, at a minimum, expect to be provided with assurance that there is clarity of contract obligations via specific contract language.

## 8. Programme Business and Prior Approval for Re-Use of an SPI

23. Any reuse of an SPI needs prior approval from the Authority, either at the time of initial application or upon reapplication, where, at the time of (re)approval, the Authority shall take into account any actual or anticipated changes to the original contractual terms.

## 9. Material Change in Business

24. If during the lifetime of the SPI it: 1) has any additional risks reinsured into it that were not contemplated in the initial transaction, or 2) has any material changes made to the contracts involved, or 3) makes any modifications to the material disclosures included in the original application, or 4) has further capital raised from investors and/or debt-holders after authorisation, or 5) makes any other changes pertinent to its business where these changes would be deemed by a reasonable and knowledgeable person to be material, then these changes are subject to prior supervisory approval.

25. 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 through consultation with the applicant and may not require a full authorisation process as would be needed at the original establishment of the SPI.

26. 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.

## 10. Exemption from Prior Approval for Capital Release

27. 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.

## 11. Filing and External Audit Requirements for SPIs

28. The Authority shall, on a case by case basis, exercise its powers under section 56 to modify the annual accounting provisions in respect of an SPI, subjecting it to more streamlined filing requirements.

29. In this context, and for the purposes of an SPI's registration process and ongoing reporting, and where the appropriate Section 56 request has been granted, the Authority will accept unaudited management accounts from the SPI prepared in accordance with any one of the following standards or principles-

a) International Financial Reporting Standards ('IFRS');

b) generally accepted accounting principles ('GAAP') that apply in Bermuda, Canada, the United Kingdom or the United States of America; or

c) such other accounting standard as the Authority may recognise.

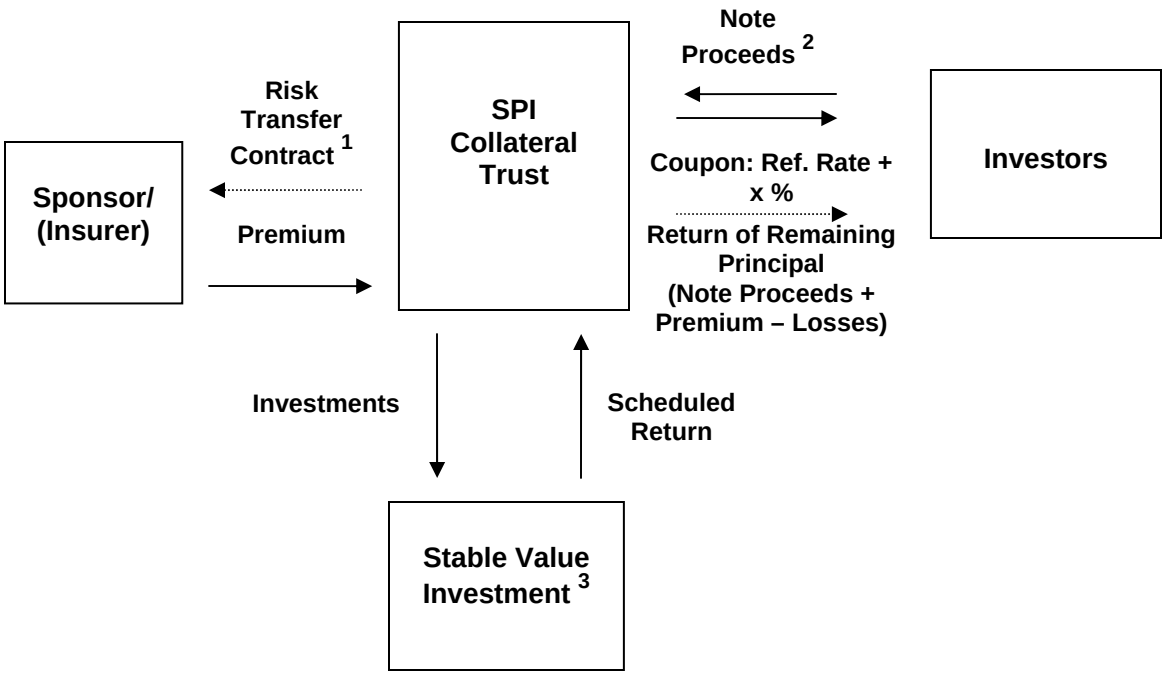
30. Where management accounts are deemed to be acceptable to the Authority for the purposes of regulatory reporting, the SPI is required to provide to the Authority a copy of those accounts as soon as practicable after such management accounts have been submitted to participants and at a minimum within four months of the end of each financial year.

31. Notwithstanding the above, financial statements will be due in accordance with the requirements under the Act.[47]

[47] However, upon the completion of a stub period, and the appropriate Section 56 directive, no annual accounts will be required. A "stub period," is a one- time incomplete accounting period that covers the time frame from the beginning of the last fiscal year to the time at which business activities are considered to effectively cease.

Figure 1

# Basic Catastrophe Bond

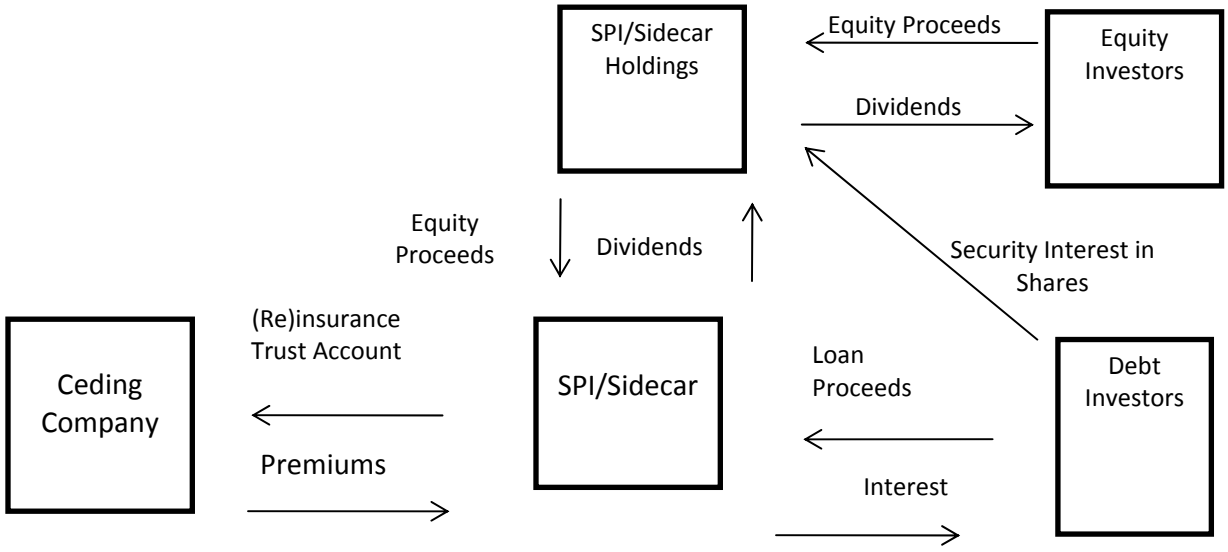



1. The Reinsured enters into a risk transfer contract with a Special Purpose Insurer (SPI).
2. The SPI hedges the contract by issuing notes to investors in the capital markets.
3. Proceeds from the notes along with the (re)insurance premium received from the reinsured are invested in assets to maintain stable value and generate a floating return (the reference rate).

**Source: Swiss Re**

Figure 2

# Typical Sidecar Structure




**Source: Horseshoe Group**

# Figure 3
# Overview of Natural Catastrophe Trigger Types

1. An **Indemnity** transaction is based on the actual losses of the sponsor (reinsurer).

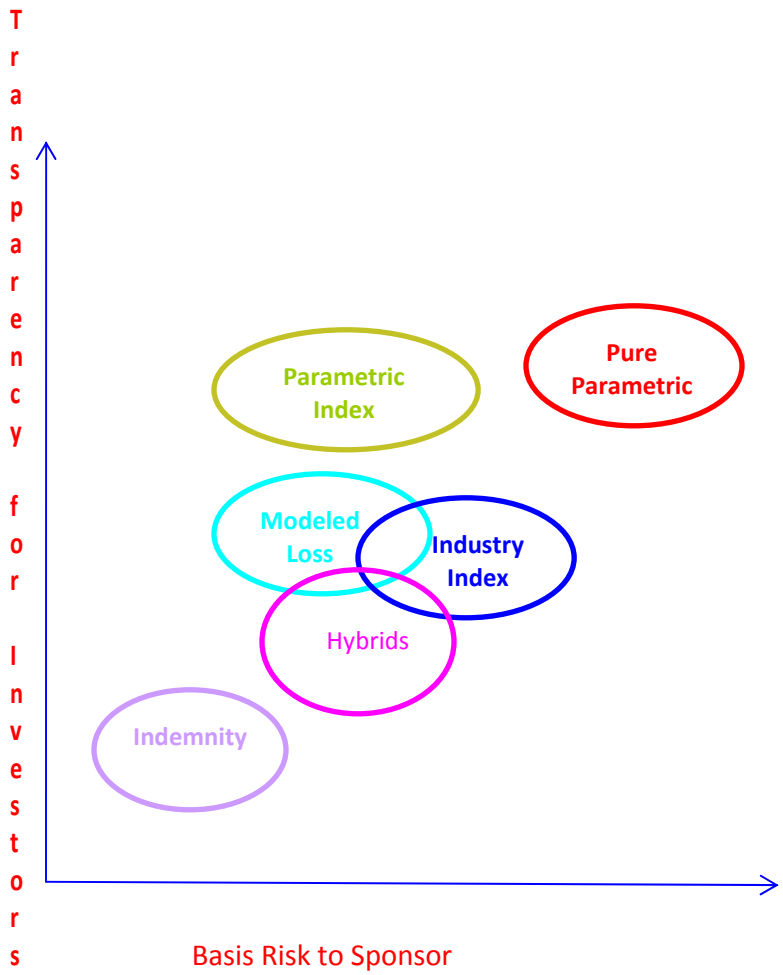
2. An **Industry Index** transaction is based on an industry-wide index of losses (e.g. Property Claims Service or "PCS" in the United States)

3. A **Pure Parametric** trigger is based on the actual reported physical event (i.e. magnitude of earthquake or wind speed of hurricane)

4. A **Parametric Index** is a more refined version of a pure parametric trigger using more complicated formulas and more detailed measuring locations

5. In a **Modeled Loss** transaction, losses are determined by inputting actual physical parameters into an escrow model which then calculates the loss.

6. **Hybrids** (Dual Triggers) include the **Modeled Industry Trigger Transaction ("MITT")** trigger and **Long-Term Aggregate Zonal (Re)insurance ("LAZR")** trigger. The triggers combine modeled loss and PCS triggers.




Source: Swiss Re - with patent pending