

Bermuda continues to be innovative – growth in “special purpose insurers”

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Bermuda has developed an excellent international reputation in the global insurance market by providing a comprehensive yet flexible regulatory framework supervised by the Bermuda Monetary Authority (BMA) that takes into consideration the type of risks being underwritten and enables those entities with sound business plans to incorporate in a relatively efficient timeframe with a regulatory environment that is guided by the principle of “proportionality”.

The enhancements to Bermuda’s insurance regulatory regime introduced as part of Bermuda’s Solvency II equivalence bid, will not apply to captives, non-commercial insurers or special purpose insurers (SPI). The insurance regulatory approach used for captives, non-commercial insurers or SPI in Bermuda is distinctly different from the risk-based regulatory framework that applies to commercial insurers or reinsurers.

In the tradition of innovation, Bermuda passed The Insurance Amendment Act 2008¹ which introduced a new class of insurer; namely the special purpose insurer for sophisticated participants whether writing general or long term risks involving a fast-track application process with flexible and proportionate regulatory requirements that recognises the lower level of risks involved. For instance, there are minimal capital requirements for an SPI and the audit may be waived. Such a flexible regulatory system has resulted in reducing the overall costs of establishing a Bermuda insurer provided the risks are fully funded and the participants involved are ‘sophisticated’ participants.

SPIs have significantly increased in numbers since the 2008 Act came into effect in late 2009. A total of 23 new SPIs were licensed in 2011 (up from eight in 2010).

In essence, the SPI is a flexible insurance mechanism available to the insurance and reinsurance market which can be utilised for a variety of purposes provided the risks are fully-

funded and the participants involved are sophisticated persons or entities. Since the introduction of the SPI concept in Bermuda, there has been significant growth in the number of such entities and the diversity of the transactions placed through an SPI. An SPI may be used to write a single insurance or reinsurance contract or series of such contracts. SPIs have been predominantly used for Cat Bond transactions but are now being used for other insurance-linked security purposes.

A typical SPI would fund its exposure to risks through the proceeds of a debt issuance or some other financing mechanism. The repayment rights of the providers of such debt or other financing mechanism are subordinated to the reinsurance obligations of the SPI. If there are multiple insurance or reinsurance agreements within the SPI, each such agreement is fully-funded.

Incorporation application

The incorporation application for an SPI is more streamlined than other classes of insurers in Bermuda and is more cost effective. Since SPIs are fully-funded, the BMA applies a proportionate level of supervision. The BMA will review the Business Plan, pro forma financials and transaction documentation of the SPI and evaluate its proposed business on a case-by-case basis taking into consideration the quality of the sophisticated participants in the structure and whether the business the SPI intends to write will be fully-funded. The typical SPI application will take approximately one week for approval. Recently, the BMA announced that it had halved the registration fees for special purpose insurers.² This move was seen as a boost to Bermuda’s competitiveness in the global insurance-linked securities (ILS) market which has flourished over the past two years in Bermuda that utilised the SPI concept.³ The value of ILS listed on the Bermuda Stock Exchange has gone from zero to USD3.5 billion⁴.

Fully-funded requirement

The question as to the definition of “fully-funded” is intentionally left to the discretion of

the BMA in order to provide the market with a significant degree of flexibility. In essence, ‘fully-funded’ has been interpreted to mean that the transaction must be supported by cash collateral or any other BMA approved security or asset; and the nature of the security or asset being used to fund the liabilities of the SPI can take a broad variety of forms.

Also, the BMA may require “limited recourse” language to be used in the transaction documentation so that it is fully disclosed to all participants that the liability of the SPI will be limited to the value of the assets held as collateral.

Sophisticated participants

The SPI concept was introduced to meet sophisticated insurance transactions involving sophisticated participants who understand and appreciate the nature of the risks being underwritten. The BMA gives guidance on who is considered to be ‘sophisticated’.

Regulatory framework

Since the liabilities of the SPI must be fully-funded, there is no minimum capital required for an SPI. In addition, a loss reserve opinion would not be required for an SPI and the annual audit of a Bermuda insurer may be waived with the permission of the BMA.

Every insurer in Bermuda is required to maintain a principal office in Bermuda and appoint and maintain a Principal Representative. A Principal Representative is either a registered insurance manager in Bermuda or a person (resident in Bermuda) approved by the Minister as that insurer’s Principal Representative.

In addition to the insurance regime, an SPI may also be registered as a “segregated account” company pursuant to the Segregated Accounts Companies Act 2000 and has the ability to legally segregate each contract and related collateral or securities in a separate account (the relevant segregated account) thereby ensuring that neither the general account of the SPI or other segregated accounts have any recourse to the assets or securities in the relevant segregated account.

Conclusion

Bermuda has once again demonstrated that it can increase its competitiveness in the insurance/reinsurance market by adapting its regulatory regime to meet the special needs and requirements of the sophisticated or specialty insurance market. As the ILS business evolves, Bermuda stands ready to become the lead jurisdiction for such specialty insurance products.

END NOTES:

1. The 2008 Act came into effect on 30 July 2009.
2. Effective 1 April 2012 SPIs will pay USD6,000 for annual registration fees as announced by the BMA.
3. Published in the Royal Gazette (Jonathan Kent) 26 March 2012.
4. Published in the Royal Gazette (Jonathan Kent) 26 March 2012.