

RESPONSE TO FEEDBACK RECEIVED - CONSULTATION PAPER ON THE PROPOSED REGULATORY FRAMEWORK GOVERNING SPECIAL PURPOSE REINSURANCE VEHICLES

1 INTRODUCTION

1.1 On 26 May 2008, MAS issued a consultation paper (“the CP”) inviting comments on the draft Insurance (Special Purpose Reinsurance Vehicles) Regulations 2008 (“the Regulations”) to govern Special Purpose Reinsurance Vehicles (“SPRVs”) set up in Singapore to enter into reinsurance contracts and issue insurance linked securities (“ILS”).

1.2 The consultation period closed on 26 June 2008. MAS would like to thank all respondents for their contributions. The list of respondents is in Appendix A. Comments that are of wider interest, together with MAS’ responses, are set out below.

1.3 After consideration of the comments received, MAS has finalised the regulatory framework governing SPRVs. The Insurance (General Provisions and Exemptions for Special Purpose Reinsurance Vehicles) Regulations 2008 comes into operation on 2 December 2008 and is available on the MAS website.

2 GENERAL COMMENTS ON THE FRAMEWORK

2.1 Reporting and certification costs

2.1.1 A respondent sought clarification as to what extent have local actuaries and auditors been consulted and wondered how much would the reporting and certification obligations cost both up front and on an ongoing basis be. The respondent opined that along with taxes, these costs would ultimately impact anyone who avails themselves of the statute.

MAS' Response

2.1.2 The public consultation paper was made available on the MAS website and all interested parties were welcome to provide comments, if any. In this regard, the Institute of Certified Public Accountants of Singapore ("ICPAS") had provided comments, some of which are set out in subsequent paragraphs. The number of statutory forms that have to be audited and submitted for an SPRV is significantly lesser than compared with other registered reinsurers. An SPRV is also exempted from having to submit quarterly unaudited returns.

2.1.2 We would like to clarify that the actuarial certification in respect of the adequacy of funds raised is required only at the point of application to set up an SPRV. On an ongoing basis, our supervisory focus will be on the registered insurer who has reinsured with the SPRV and has been granted regulatory credit for the risk transfer. We are prepared to consider actuarial certification from local or overseas actuaries, taking into consideration any prior experience the actuary may have in the valuation of insurance securitisation transactions.

2.2 Legal Structure of an SPRV

2.2.1 A respondent commented that there is no provision indicating where an SPRV might be domiciled or the kind of legal vehicle, which might be used. The concept of who is responsible for managing the SPRV is not clear. While a single Principal Officer is responsible for taking responsibility for the statutory returns, it is not clear who in practice is permitted to manage the SPRV, and who the auditors can rely on to produce the balance sheets that give a fair reflection of the financial position.

MAS' Response

2.2.2 The operations of an SPRV should be similar with other forms of special purpose vehicles ("SPV") established for securitisation purposes. The key difference from those is that an SPRV is carrying on reinsurance business and hence has to be registered under the Insurance Act ("the Act").

2.3 Actuarial Certification

2.3.1 One respondent wondered whether the actuarial certification that the fully funded requirement has been met will prove workable. The respondent added that it would depend on how the Authority applies this in practice as well as the accompanying form. The respondent would also like a safe harbour on how the actuary should view budgeted operating expenses as these are often funded through premium payments rather than investor capital.

MAS' Response

2.3.2 In certifying that an SPRV is fully-funded, the actuary is required to demonstrate that the assets of the SPRV will at all times be greater than its liabilities under all reasonably foreseeable scenarios. We expect the actuary to justify that the scenarios selected to project the cash flows of the SPRV are representative of the full range of all reasonably foreseeable scenarios and reliably demonstrate that the SPRV is fully funded, to the best of his knowledge and experience. These scenarios must include those at the boundary of the range. We expect any cash flow projection made to include all income and outgo which can affect the funding position of the SPRV, and these will include the premiums and operating expenses.

3 KEY PROVISIONS IN THE INSURANCE (SPRV) REGULATIONS

3.1 Definition of Fully Funded

3.1.1 The issue of what would constitute fully funded draws a number of comments. One respondent would like a safe harbour of, for instance, 99th percentile of adverse reserve development and commented that the fully funded requirement should simply apply to assumed reinsurance obligations and not operating expenses, derivative obligations or return on investor securities. If it is mandatory to include operating expenses, then premium obligations should be allowed to offset operating expenses. Another

respondent commented that SPRVs that are exposed to a (contractually) not limited liability (e.g. life transactions) need a definition of what level of certainty is required (e.g. 99.5% - 1/200 years) or what tail risk may remain (e.g. 0.5%). The respondent was of the view that for these cases, a guideline (expressed in a figure) should be introduced into the Regulations.

3.1.2 A respondent also commented that in maintaining its fully funded status, an SPRV should be allowed to take into account appropriate hedging instruments. In general, SPRVs hedge themselves against interest rate risk associated with the variable part of the coupon by entering into an interest rate swap with a swap counterparty. If deemed appropriate, the suitability of a hedging instrument could be subject to the approval of the Authority.

3.1.3 Another respondent recommended that letters of credit issued by banks in Singapore be permitted for meeting the fully funded requirement.

MAS' Response

3.1.4 While we appreciate the rationale behind the respondents' request for certainty in the confidence level required for maintaining fully funded status, there are no internationally recognised norms on the level of sufficiency required of SPRVs. Thus we expect the actuary to exercise professional judgement to ensure that he has considered all reasonably foreseeable scenarios in his assessment of the funding status of the SPRV. We will rely on the actuary's justification of the assumptions used to evaluate the confidence in the actuarial findings. The actuary should state the level of confidence in the funding status of the SPRV in statistical terms if he uses a stochastic approach in his assessment.

3.1.5 We would like to reiterate that all relevant income and outgo is expected to be included in any cash flow projection conducted to test the funding of the SPRV. We would also take into consideration any mitigation from appropriate hedging instruments in assessing whether the fully funded requirement is satisfied. The fully funded requirement is akin to a capital requirement where it would be to support the activities of the SPRV and for

this purpose, MAS does not consider letter of credits from banks to be a form of capital. This is consistent with the definition of capital adopted for other insurance and reinsurance activities, as well as for the banking and securities sectors.

3.2 Definition of SPRV

3.2.1 A respondent suggested a little more clarity in the “SPRV” definition by clarifying that SPVs that cede insurance risks using non-indemnity contracts are exempt. On the other hand, another respondent highlighted that other forms of securitisation e.g. mortality risk securitisations in which the measurement of loss is based on an index, rather than the insurer’s or reinsurer’s own experience, are difficult to characterise as reinsurance, and yet such transactions can provide valuable protection for insurers and reinsurers. Hence, the second respondent suggested expanding the draft Regulations to cover contracts by which risk of loss is transferred from insurers or reinsurers to other forms of securitisation vehicles.

3.2.2 A third respondent welcomed that the draft Regulations stipulates that the SPRV is a legal entity separate from any third party involved in its establishment as compared with the requirement that the SPRV “must not be part of a corporate group” in the first consultation paper dated 13 June 2007. The respondent explained that in practice, it might be desirable to show the effects of a securitisation only on an individual financial accounts level, but not on a group level. Therefore it might be necessary that the SPRV is part of the group of the sponsor and the equity of the SPRV is held by a group company. In addition, the respondent was of the view that the original requirement in the 2007 consultation paper is not a prerequisite for bankruptcy remoteness since the claims of the creditors are in general not tied with the group as a whole but with a separate legal entity. Furthermore, in a non-synthetic value in force (“VIF”) securitisation, it is desirable that the interests in the SPRV’s equity are kept within the group so that the more riskier cash flows (i.e. the parts of the VIF that are not “sold” to investors) and the potential upside of the life portfolio would accrue to the group and not to a third party.

MAS' Response

3.2.3 As insurance companies are increasingly exploring innovative risk transfer and capital management tools, the approach of prescribing what type of transactions/products would not tantamount to insurance contracts and hence not subject to insurance regulations can be ineffective and quickly outdated. Hence it may be better to rely on the assessment of the essence of each innovative transaction. If an SPV engages in a transaction which is not deemed as carrying on reinsurance business, it would not be required to be registered as a reinsurer under the Act. Interested parties may wish to refer to the guidelines on significant risk transfer in MAS Notices 208 and 316, which pertain to general and life financial reinsurance respectively.

3.2.4 If a form of risk mitigation transacted by a registered insurer fails the risk transfer test but nevertheless provides economic relief to the registered insurer, the latter may still be able to enjoy some regulatory relief, subject to approval, and the amount would likely be lower than the amount of credit applicable to a corresponding indemnity-type of reinsurance contract.

3.2.5 The underlying primary consideration in both consultation papers is that the SPRV should be structured as a bankruptcy remote entity. Should the SPRV be owned by the parent of the insurer ceding to the SPRV, we would be concerned if in the event of insolvency of the parent, its liquidator attempts to seize the assets of the SPRV, being one of the parent's subsidiaries. We would therefore be more comfortable if the SPRV is owned, for instance, by a charitable trust. As for the fear that the potential upside arising from the reinsured portfolio being accrued to a third party, we would suggest that the sponsor could consider providing for any potential upside to be accrued back to the cedant under the reinsurance contract arranged with the SPRV.

3.2.6 In light of the comments received during the two rounds of consultation conducted in 2007 and 2008, we have decided to remove the provision on the ownership structure of an SPRV from the Regulations. This will provide flexibility for interested parties to propose different structures that

could nevertheless ensure that the SPRV is bankruptcy remote. MAS will evaluate each case based on its individual merits.

3.3 Definition of Assets

3.3.1 A respondent queried whether the asset definition includes swaps, reinsurance and financial guarantees without any haircut. If not, the fully funded requirement could likely prove nearly unworkable for some structures.

MAS' Response

3.3.2 Assets of an SPRV will be valued in accordance with the Insurance (Valuation and Capital) Regulations 2004. The rules on the computation of financial resources under the said Regulations will not apply to the vehicle.

3.4 Permitted Activities of an SPRV

3.4.1 A respondent sought clarification that an SPRV can both cede and assume risk via reinsurance and can cede insurance risk in derivative form. For example, an SPRV ceding a motor quota share to investors via ILS might cede net catastrophic risk to a reinsurer in a reinsurance treaty incurring to the benefit of the motor quota share.

MAS' Response

3.4.2 As provided in regulation 3 of the draft Regulations, an SPRV may enter into arrangements, and carry on any business, as may be necessary, to fulfil its obligations and administrative duties related or incidental to insurance securitisation and the reinsurance contracts. In assessing an application, we would review whether the proposed activities of the SPRV fall within the scope of the said regulation and would not adversely affect the fully funded status of the SPRV.

3.5 Authority for Corrective Action

3.5.1 A respondent noted that both the fully funded requirement in regulation 4 and the fund solvency requirement and capital adequacy requirement in regulation 7 provide MAS with certain authority to require corrective action in the event of inability of the SPRV to comply with these requirements. The respondent acknowledged that the provision is, of course, designed to give MAS a reasonable degree of regulatory control. At the same time it is important to realise that once a transaction is completed, many parties have expectations that the transaction will proceed according to its terms. As a general matter, parties to a securitisation favour predictability.

MAS' Response

3.5.2 The original provisions for corrective action in the draft Regulations are meant to be invoked only in the event that the Authority deems that it is necessary and possible for the SPRV to take corrective actions to comply with the requirements prescribed in regulations 4 and 7. In light that the Authority has the power under Section 41 of the Act to issue directions where the Authority is satisfied that the affairs of any insurer are being conducted in a manner likely to be detrimental to the public interest or the interests of the policy owners or prejudicial to the interests of the insurer, we are agreeable to omit the said provisions in regulations 4 (3) and 7 (4).

3.6 Financial Accounting and Reporting

3.6.1 Regulation 14 requires an SPRV to lodge returns in Singapore dollars (as in the case of all other registered insurers). One respondent expressed concerns that the presentation in Singapore dollars may potentially result in huge translation reserves, as these SPRVs are likely to have functional currencies other than Singapore dollars. This could result in a difficulty in the interpretation of regulations 7 (1) and 7 (2) (fund solvency and capital adequacy requirements). Given that Singapore FRS allows presentation in currencies other than Singapore dollars for a more meaningful presentation of financial statements, the respondent recommended that MAS

should consider allowing presentation in currencies other than Singapore dollars for these returns.

3.6.2 However the respondent noted that it would not pose a difficulty if all the assets and liabilities of an SPRV are translated from the functional currency into Singapore dollars at the exchange rate at the end of the financial year, and any exchange translation reserves arising are recorded in an exchange translation account as part of the surplus of each fund or as part of owners' equity.

MAS' Response

3.6.3 All insurance returns submitted by registered insurers have to be presented in Singapore dollars to facilitate compilation of industry statistics. We would amend the draft Regulations to deduct the exchange translation reserves resulting from the translation of the financial statements from a non-Singapore dollar denominated functional currency to the presentation currency in Singapore dollars from the value of liabilities in regulations 7 (1) and 7 (2).

3.7 Audit and Auditor's Report

3.7.1 One respondent commented that regulation 17 (2) appears to impose a wide responsibility on the auditors and the terms in the said regulation appear vague and onerous on the auditors. In addition, the expectation of the Authority with regards to the frequency and timing of this requirement is not clear. Bearing in mind that the audit will likely to be conducted once a year, further clarification is needed from MAS. The respondent noted that it is currently not in the scope of the audit of MAS returns of other registered insurers to cover the requirement spelt out in regulation 17. Regulation 17 (3) also appears to be a new regulation not imposed by the Act or any legislation affecting any other type of financial institution. The respondent was of the view that a separate engagement with the SPRV will need to be arranged to carry out specific procedures to meet the said requirements upon further clarification from MAS.

MAS' Response

3.7.2 We would like to clarify that under Section 36 (11) of the Act, an auditor is required, in the course of the performance of his duties as an auditor of a registered insurer, to report in writing to the Authority immediately if it is satisfied that, amongst various things, there has been a serious contravention of any provision of the Act, or any transaction or dispute has taken place which will have a material effect on the solvency of any insurance fund established by the insurer under the Act. Further, the auditor is required currently to comment under the auditor's supplementary report, areas of material weakness in the operations of the registered insurer based on its audit. Hence we are of the view that the proposed regulation 17 (2) which requires the auditor to notify the Authority immediately if it is aware of circumstances or material defects stated in the said regulation is not imposing wider responsibility on the auditors.

3.7.3 Regulation 17 (3) is reiterating the provision under Section 36 (9a) of the Act whereby the Authority may impose a duty on the auditor to submit such additional information in relation to his audit as the Authority considers necessary. Nevertheless, the Authority is agreeable to omit regulation 17 (2) and 17 (3) from the draft Regulations and engage the ICPAS and insurance industry associations in a dialogue on incorporating similar requirements in the Insurance (Accounts and Statements) Regulations 2004 in the next review.

Appendix A

List of Respondents to the Consultation Paper on the Proposed Regulatory Framework governing Special Purpose Reinsurance Vehicles

1. Dewey & LeBoeuf LLP
2. Institute of Certified Public Accountants of Singapore
3. Munich Re
4. Swiss Re