Dubai Financial Services Authority

CONSULTATION PAPER NO 47

20 MAY 2007

PROPOSALS RELATING TO INSURANCE SECURITISATION

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Why are we issuing this paper?

1. This Consultation Paper seeks public comments on the DFSA's proposals to introduce a framework for insurance securitisation. The proposals deal with the establishment of Insurance Special Purpose Vehicles (ISPVs) within the DIFC, and also the treatment of securitisations by DIFC authorised insurers. They involve amendments to the Prudential – Insurance Business (PIN), General (GEN), Conduct of Business (COB), and Glossary (GLO) Modules of the DFSA Rulebook, and the introduction of a new form (AUT- ISPV) in the AFN Sourcebook.

Who should read this paper?

2. The proposals in this paper would be of primary interest to Persons considering arranging or undertaking insurance securitisation transactions in or from the DIFC.

How is this paper structured?

3. In this paper, we set out:

   (a) definitions – paragraph 6;

   (b) proposals relating to Authorised Insurance Special Purpose Vehicles – paragraphs 7 – 17; and

   (c) proposals relating to the treatment of insurance securitisations by Insurers – paragraph 18.

How to provide comments?

4. All comments should be forwarded to the person specified below. You may, if relevant, identify the organisation you represent in providing your comments. The DFSA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making comments.

What happens next?

5. The deadline for providing comments on these proposals is **20 June 2007**. Once we receive your comments, we will consider if any further refinements are required to these proposals. We will then proceed to enact the changes to the DFSA's Rulebook. You should not act on these proposals until the relevant changes to the DFSA Rulebook are made. We will issue a notice on our website telling you when this happens.

Comments to be addressed to:
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Definitions

6. In this paper, generally, capitalised terms are defined in the GLO Module of the DFSA Rulebook. For convenience, the following terms have the meaning set out below:

   (a) "Insurance Special Purpose Vehicle" means an insurer which:

      (i) assumes risks by way of reinsurance; and

      (ii) fully funds its exposures to such risks through the proceeds of a debt issuance or some other financing mechanism where the repayment rights of the providers of such debt or other financing mechanism are subordinated to the insurer's reinsurance obligations;

   (b) "ISPV" means an Insurance Special Purpose Vehicle; and

   (c) "Authorised ISPV" means an ISPV who holds a Licence.

Proposals relating to ISPVs

7. An insurance securitisation is a transaction intended to transfer insurance risk to the capital markets. Although various structures are possible, almost all involve the use of a Special Purpose Vehicle (SPV). In a typical insurance securitisation, the SPV is a normal company, or in some jurisdictions a cell of a protected cell company or similar structure. It assumes risk from an insurer through a reinsurance contract, with an associated premium. It transfers this risk to the capital markets, normally through the issue of bonds whose coupon, and sometimes principal, are at risk depending on the claims made against the reinsurance contract.

8. Regulators commonly require that the SPV in an insurance transaction be fully-funded. This means that its possible liabilities under the reinsurance contract should be capped, and it should always have assets which exceed those liabilities. This requirement is included within our definition of an Insurance Special Purpose Vehicle (ISPV).

9. Because of the reinsurance contract, an ISPV would be regarded as conducting insurance business in most jurisdictions, and would thus fall to be regulated under the normal insurance regime. There is, however, a general consensus among regulators that this would be disproportionate to the risks. The European Reinsurance Directive makes specific provision for countries to introduce a much simplified regime for ISPVs.

10. Amongst other jurisdictions some, for example the UK, have decided to adopt explicit provisions for ISPVs in their rules. Others, for example Jersey, deal with proposals on a case by case basis using powers to waive or modify their regimes. We have taken the former approach, since we believe the industry will welcome the legal certainty it offers, especially in our position as a new jurisdiction, but we welcome comment on this point.

11. Our proposals are set out in Annexes A-E. Readers are reminded that only underlined amendments are relevant for the purposes of this proposal. Text which is not underlined is unchanged and currently in force. No comments are required in relation to text which is not underlined, as it is provided solely to show the legislative amendments in context.

12. Annex A covers our proposals to amend PIN. In essence, the capital adequacy and reporting regimes of PIN are replaced for an Authorised ISPV, by provisions which require, in substance, that:

- the ISPV's assets exceed its liabilities at all times;
- these assets be held by or on behalf of the ISPV or the ceding insurer;
- its liabilities are capped to no more than its assets;
- the rights of those who finance the ISPV are fully subordinated to its reinsurance obligations;
- its activities are confined to the ISPV activities for which it was established; and
- it maintains a proper risk management system.

These provisions apply to a Cell of a Protected Cell Company as though it were an Insurer.

13. Annex B contains amendments to the GEN Module which cut back somewhat the systems and controls requirements of Chapter 5, and also provide for an ISPV to be subject to a similar fees regime to that for a captive insurer. (Note that Chapter 8 is not amended, and an ISPV will therefore still need to submit audited annual accounts.)

14. Annex C amends the COB Module to disapply entirely Part 4, which contains the conduct of business provisions for insurance business.

15. Annex D sets out new definitions to be included in GLO.

16. In considering which parts of the DFSA Rulebook should continue to apply, we have recognised that it would be normal for an ISPV to outsource all or most of its management functions. We have assumed that this would be to a professional firm, which if located in the DIFC, would be required to be licensed as an Insurance Manager, and that for such a firm it would not be onerous to comply with other provisions of the Rulebook, so far as they are relevant to the limited activities of an ISPV. However, we welcome comment on the overall weight and shape of the regime, as well as its details.

17. Annex E contains the proposed new authorisation form AUT-ISPV. Although we are not required to consult on new forms, we are doing so in this case to give an indication of the approach we propose to take to the authorisation of ISPVs. We envisage that ISPVs would have to submit only AUT-ISPV, plus forms in respect of each individual for whom Authorised Individual status is sought. The form provides for independent legal certification of the arrangements surrounding the ISPV. Apart from this, our main considerations at authorisation will be the effective capping of its liabilities, the adequacy of its assets to meet those liabilities, and the fitness and propriety of those associated with it. On this basis we expect to operate a very streamlined authorisation process.

Proposals relating to the capital treatment of insurance securitisations

18. It is possible that an Insurer operating in the DIFC will wish to transfer risk through an insurance securitisation. Annex A also contains our proposals to deal with such transactions within our capital adequacy regime. In essence, we have followed the approach proposed by the UK FSA, that we shall deal with any securitisations on a case by case basis, using our waiver/modification powers. This will enable us to consider in each case the effectiveness of the risk transfer and the legal arrangements surrounding the SPV, wherever it is located.