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## Early to Rise — Singapore Revamps its Regulations to Capitalize on Asia's Growing Insurance Securitization Market

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Late in 2008, the Monetary Authority of Singapore issued regulations permitting the creation and oversight of Special Purpose Reinsurance Vehicles in connection with insurance securitization transactions.

The Insurance (General Provisions and Exemptions for Special Purpose Reinsurance Vehicles) Regulations 2008, which became effective Dec. 2, recognize the need for a streamlined regulatory process that will facilitate the accomplishment of securitizations. At the same time, the regulations are designed to protect the interests of the various parties to these transactions.

Although less comprehensive than rules now in place in other jurisdictions, including Ireland, South Carolina, Vermont and Delaware, the Singapore regulations provide a basic framework for insurance companies in Asia seeking to transfer insurance risks to the broader capital markets.

These regulations do not address all types of insurance securitizations. Some types of catastrophe securitizations, for instance, may need to be structured under the pre-existing Approved Special Purpose Vehicle Schemes.

Nevertheless, taken together, the rules for ASPVs and SPRVs should help make Singapore the domicile of choice for structuring securitization transactions on behalf of insurers throughout the Asia Pacific region.

### Program Renewal

The use of ASPV schemes in asset securitization transactions has been permitted in Singapore since 2004, although the authorization for ASPVs was due to expire at the end of 2008. In 2007, the MAS decided the ASPV scheme

**The News:** Singapore regulations provide a basic framework for insurance companies in Asia seeking to transfer insurance risks to broader capital markets.

**The Background:** The Monetary Authority of Singapore sees insurance securitization as a means to manage the risks of pandemics and natural catastrophes.

**The Upshot:** Interest is growing in securitizations that address catastrophe exposures in the Asia/Pacific region.

concept should be extended to 2013, and expanded to include the securitization of insurance-related risks. In a 2007 consultation paper, the MAS recognized the merits of insurance securitization, especially for managing risks related to pandemics and natural catastrophes.

More generally, the MAS noted the “potential demand for insurance-linked securities in Asia.” In May 2008, it issued a second consultation paper that contained draft regulations covering the formation and operation of SPRVs, and invited feedback on the draft.

The regulations set out basic requirements that will govern how insurance and insurance-related transactions are structured.

First, the regulations require SPRVs to be formed as reinsurers that engage in contracts of reinsurance with sponsoring insurers. In feedback received by the MAS it was noted that in many catastrophe bond transactions the securitization vehicle was not formed as a reinsurer—rather than indemnifying the sponsor for actual losses, payments from the vehicle have been based on various types of loss indexes, including parametric indexes.

The MAS declined to address such types of transactions in the SPRV regulations, but noted that transactions that are not structured as reinsurance may be open to structuring under the ASPV rules, and that the sponsoring insurer may still obtain regulatory relief.

Second, the regulations require each SPRV to “fully fund” its obligations under reinsurance contracts with sponsoring insurers.

This generally means that the SPRV must have assets “held on trust or otherwise” that are “at all times, not less than the potential liabilities of the SPRV under all reasonably foreseeable scenarios,” subject to an aggregate limit of liability if the SPRV’s reinsurance contract contains such limits.

In the feedback to the draft regulations it was noted that some life insurance securitization transactions structured in the United States have utilized a holding company to raise funds from the capital markets, and an SPRV to utilize those funds. The holding company has been permitted to hold funds outside of the SPRV until needed to fund the growth in actuarial reserves.

### **‘No Recognized Norms’**

Whether this is consistent with the MAS’s definition of “fully funded” — that the assets held in trust by the SPRV for the ceding insurer are not less than the potential liabilities of the SPRV under all reasonably foreseeable scenarios — seemingly would have to be addressed with the MAS on a case-by-case basis.

In its response to feedback on this aspect of the regulations, the MAS noted, “There are no internationally recognized norms on the level of sufficiency required of SPRVs. Thus, we expect the actuary to exercise professional judgment to ensure that he has considered all reasonably foreseeable scenarios in his assessment of the funding status of the SPRV.”

Also, the MAS states that the fully funded requirement is akin to a capital requirement and that bank letters of credit cannot be used as capital. In contrast, securitization rules in some other jurisdictions, such as Ireland, allow the use of letters of credit.

The regulations also address operations of SPRVs, paid-up capital, fund solvency and capital adequacy requirements, accounts and statements and exemptions from other aspects of the Insurance Act.

They afford the SPRV broad authority to enter into transactions and contractual arrangements necessary to carry out a securitization. The regulations provide that SPRVs may “enter into arrangements and carry on any business ... related or incidental to insurance securitization and the contracts of reinsurance ... including entering into management and administrative service agreements, swap agreements and other forms of asset management agreements.”

### **‘Solvent at All Times’**

The regulations further provide for protection against bankruptcy by requiring that holders of its debt securities not initiate or participate in “winding-up” (bankruptcy) proceedings against the SPRV until the debt securities are discharged. The MAS said that “the underlying primary consideration ... is that the SPRV should be structured as a bankruptcy-remote entity.” The concern is that the SPRV might be consolidated in the insolvency of the sponsoring insurer.

To address this concern, the MAS stated in its response to feedback, “we would be more comfortable if the SPRV is owned, for instance, by a charitable trust.”

The use of charitable ownership structures to avoid bankruptcy consolidation is used in securitization structures in Ireland and other jurisdictions. The MAS chose not to include any such requirement in the regulations, in order to provide flexibility in structuring transactions.

Instead, the MAS will decide on a case-by-case basis whether the structure of a particular SPRV will qualify for bankruptcy-remoteness. As part of the application for approval of an SPRV, the MAS requires the sponsor to submit an opinion of independent external legal counsel qualified to practice Singapore law as to the bankruptcy-remoteness of the SPRV, and the compliance of the securitization structure with other requirements of the regulations. The opinion of counsel “should also include a description of any other measures to enable the SPRV to remain solvent at all times, and thus could not be petitioned for bankruptcy.”

The regulations exempt SPRVs from most requirements of the Insurance Act. An SPRV must have paid-in share capital of not less than S\$20,000, as opposed to the general requirement that reinsurers have paid-in share capital of not less than S\$25 million.

In addition, for insurance fund solvency and capital adequacy purposes, assets may not be less than relevant liabilities, but without the amounts required of other insurers under the Insurance Act and the Insurance (Valuation and Capital) Regulation of 2004. The SPRV regulations provide that assets and liabilities be valued in accordance with the Valuation and Capital Regulation.

Amounts referred to in any document submitted to MAS must be in Singapore dollars, but the SPRV is not required to include exchange translation reserves when translating financial statements from the functional currency of the SPRV to Singapore dollars for purposes of computing fund solvency and capital adequacy.

### **Required Filing**

The regulations require the filing of annual audited and unaudited returns. SPRVs and ASPVs are also eligible to apply for tax incentives under the ASPV scheme. These incentives, which are in effect for transactions entered into through the end of 2013, include income tax exemption for the ASPV or SPRV, and exemption from withholding tax for payments under certain over-the-counter derivative contracts made to persons who are neither residents nor have a permanent establishment in Singapore.

Although the financial crisis has made the market for insurance securitization transactions difficult, interest is growing in securitizations that address catastrophe exposures in the Asia Pacific region.

A Guy Carpenter report in February 2009 said that “in contrast to other credit risk-related asset classes — such as auction rate securities and residential mortgage securities, which have effectively been slowed substantially by the ongoing credit crisis — catastrophe bond issuance activity will continue, and the asset class should actually emerge with improved utility for both sponsors and investors.”

Indeed, at least seven catastrophe bond transactions and one life insurance securitization have closed by May of 2009. Various governmental agencies and organizations are devoting resources to studying various mechanisms, including securitization, for addressing catastrophe risk in Asia.

For example, the Asian Development Bank and the Japanese Ministry of Finance recently sponsored a program entitled “Natural Catastrophe Risk Insurance Mechanisms for Asia and the Pacific.”

In a 2008 circular, the MAS stated that implementing the SPRV scheme is intended to “promote Singapore as an alternative risk transfer centre in Asia.” Singapore seems primed to assume a leading position as the domicile for Asian insurance companies looking for opportunities to transfer risks to the capital markets.