

Insurance Update

November 2024



PRA proposes changes to ISPV framework

On 15 November 2024, the UK's Prudential Regulation Authority (the "PRA") published a consultation paper (CP15/24) in which it proposes making a number of reforms to the UK insurance special purpose vehicle ("UK ISPV") regulatory framework.

Background

Insurance special purpose vehicles are used in insurance linked securities ("ILS") structures, through which (re)insurers transfer risks from their balance sheets to capital market participants.

The UK ISPV regime came into force in December 2017, but has seen limited uptake since then, despite some intervening updates to the regime (the latest of which were made in 2022 – see the report in our Insurance Update newsletter). According to the PRA, market participants have suggested that the UK regime does not positively support the establishment of UK ISPVs.

The PRA is therefore proposing to make changes to its policy framework to allow the UK non-life insurance sector to play a bigger role in the global ILS market. The PRA considers that such changes will allow the UK ISPV regime to be more in line with global practice and make the regime more competitive. According to the PRA, the proposals should also facilitate more ILS deals through the UK, increasing diversification of available capital for PRA regulated (re)insurers and increasing capital availability for the (re)insurance market.

The PRA's proposals

The PRA is proposing to make a number of different changes to improve the existing UK ISPV regime.

Structural changes

- > Aggregate maximum risk exposure: The PRA proposes to clarify that UK ISPVs can count realised investment returns that are retained by the vehicle to cover its aggregate maximum risk exposure ("AMRE") and that the AMRE may increase over time commensurate with the realisation of investment returns that are retained in the vehicle.

This proposal addresses a concern that the current framework may limit the ability of firms to use UK ISPVs for multi-year risk transfer

arrangements due to the upfront investment required to ensure that they are fully funded at all times (“**FFAAT**”).

The PRA considers that its changes may potentially allow for a smaller upfront investment in the UK ISPV. This will also mean that investors may not need to inject further funds into the vehicle to cover an increase in the AMRE. The PRA believes that this will enhance the ability of firms to use UK ISPVs, making the regime more attractive to firms. The PRA’s proposal is subject to certain expectations, outlined in a proposed new [statement of policy](#) (the “**SoP**”).

- > Limited relaxation of PCC requirement: A UK ISPV that takes on more than one contract for risk transfer from one or more cedants is a UK multi arrangement insurance special purpose vehicle (a “**UK MISPV**”). PRA rules currently require all UK MISPVs to be formed as Protected Cell Companies (“**PCCs**”). This means that a standalone UK ISPV cannot undertake more than one contract.

However, the PRA recognises that there may be certain circumstances in which a standalone UK ISPV may want to undertake a risk transfer which needs to be structured through multiple risk transfer contracts. This could enable the tranching of risks, which allows a risk to be split in multiple layers in order to cater for the preferences and risk appetites of different sets of investors. Multiple risk transfer contracts also allow firms to renew contracts without setting up an entirely new vehicle.

The PRA therefore proposes to change its rules such that UK MISPVs which undertake more than one risk transformation transaction, but which fall within the definition of “contractual arrangement” in the PRA rules, are not required to be a PCC.

- > “Grace periods” will be permitted: The PRA describes a “grace period”, in the context of insurance special purpose vehicles, as a defined period of time during which the requirement for the insurance special purpose vehicle to be FFAAT is not applicable. This allows time to ascertain the extent of funds which can be “rolled over” from one risk transfer arrangement to another at renewal. The use of grace periods is not allowed in the current UK ISPV regime. Certain other jurisdictions permit the explicit use of grace periods.

The PRA says that it is aware that the requirement for UK ISPVs to be FFAAT can result in funding issues for renewals. The PRA considers that the allowance of grace periods would provide UK ISPVs and cedants with improved flexibility during rollover periods, as the use of a grace period allows time for any loss amount under the expiring contract to be determined and for investors to post the collateral needed, thereby avoiding over-collateralising, as would otherwise be needed during the grace period.

The PRA therefore proposes to modify its rulebook to explicitly allow for a 30 business day contractual “grace period” at the start of a risk transformation transaction, subject to certain criteria. During the grace

Linklaters

period the requirement for a UK ISPV or cell of a PCC to be FFAAT will not apply.

- > Limited recourse clauses: A limited recourse clause (“**LRC**”) has the effect of limiting an insurance special purpose vehicle’s AMRE to the value of its assets. The PRA proposes to clarify that it recognises that such clauses can be used to comply with the FFAAT requirement on an ongoing basis, subject to certain criteria being met. The PRA states in its proposed new SoP that an LRC should not be used as an alternative to a sound risk management framework and investment strategy.

Process changes

- > “Accelerated pathway” for certain UK ISPVs: At present, the PRA’s authorisation commitment for UK ISPVs is 4 to 6 weeks for standard applications. The PRA has received feedback that this timeframe is slow in comparison to other jurisdictions. It therefore proposes introducing an “accelerated pathway” for vehicles with defined criteria, whereby the PRA would consider applications and, where satisfied, issue approvals within 10 working days of a completed application being submitted to the PRA.
- > Simplified authorisation process for other standard UK ISPVs: The PRA proposes to make a number of changes which it hopes will allow for a faster and smoother application process for standard applications.

Updates to PRA expectations of (re)insurers ceding to insurance special purpose vehicles

- > New supervisory statement: The PRA proposes to introduce a new **supervisory statement** (the “**SS**”) setting out the PRA’s expectations in respect of the use of insurance special purpose vehicles (authorised in any jurisdiction) by UK cedants. The new SS is intended to provide UK cedants with clarity on the PRA’s expectations for how firms transferring risks to insurance special purpose vehicles should manage risks in relation to LRCs and grace periods. It also builds on certain existing PRA requirements and expectations.
- > Restriction on the transfer of annuities and similar risks: The PRA is proposing to set an expectation that UK firms should not use insurance special purpose vehicles to transfer risks from annuity or similar business.

Changes to the Senior Managers and Certification Regime

- > The PRA proposes to change the definition of the Chief Executive function (SMF1) for UK ISPVs and introduce rules and expectations that will define the particular SMF1 responsibilities in UK ISPVs. At present, UK ISPVs require at least three designated Senior Management Function (“**SMF**”) roles. Under the PRA’s proposal these three SMFs would no longer be needed. Instead, just a CEO for UK ISPVs (SMF1) would be sufficient for all UK ISPVs. The PRA considers that requiring only one SMF for these entities reflects the limited nature of the transactions undertaken by UK ISPVs and will make applications quicker and easier. The PRA recognises that in the case of certain complex

Linklaters

structures there may be a need for more than one person to hold the UK ISPV SMF1 role.

Consequential changes

- > The PRA proposes to make other minor or consequential changes including to improve clarity and to reflect feedback received from CP5/24 that was beyond the scope of that consultation (as noted in Chapter 11 of PS15/24).

Effect on existing materials

Changes to the PRA's materials as a result of its proposals would include:

- > **Changes** to the Insurance Special Purpose Vehicles Part of the PRA Rulebook.
- > Deletion of supervisory statement SS8/17 and the introduction of the new SoP. This proposed new SoP includes material from SS8/17 plus amendments to reflect the proposals on which the PRA is currently consulting.
- > The introduction of the proposed new SS to reflect the PRA's proposals that update its expectations of (re)insurers ceding to insurance special purpose vehicles.
- > **Changes** to the Solvency II – Insurance – Senior Management Functions Part of the PRA Rulebook.

Next steps

Feedback on the PRA's proposals is requested by 14 February 2025. The PRA currently intends to implement any changes in mid-2025.

The PRA notes that some of the changes that it has previously discussed with stakeholders require legislative changes that are outside its remit. The PRA is working with HM Treasury to assess and enable reform in those areas, if deemed appropriate.



Duncan Barber

Partner, UK

Tel: (+44) 207456 3356

Mob: (+44) 7979537346

duncan.barber@linklaters.com



Tim Brown

Senior Associate, UK

Tel: (+44) 207456 5025

Mob: (+44) 7980846658

tim.brown@linklaters.com

For general enquiries please contact

Linklaters LLP, One Silk Street, London EC2Y 8HQ

Tel: +44 20 7456 2000

Fax: +44 20 7456 2222

Linklaters

Delivering legal certainty in a changing world.

Author: Tim Brown

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please feel free to contact us.

© Linklaters LLP. All Rights reserved 2024

Linklaters LLP is a limited liability partnership registered in England and Wales with registered number OC326345. It is a law firm authorised and regulated by the Solicitors Regulation Authority. The term partner in relation to Linklaters LLP is used to refer to a member of Linklaters LLP or an employee or consultant of Linklaters LLP or any of its affiliated firms or entities with equivalent standing and qualifications. A list of the names of the members of Linklaters LLP together with a list of those non-members who are designated as partners and their professional qualifications is open to inspection at its registered office, One Silk Street, London EC2Y 8HQ or on www.linklaters.com and such persons are either solicitors or registered foreign lawyers. This document contains confidential and proprietary information. It is provided on condition that its contents are kept confidential and are not disclosed to any third party without the prior written consent of Linklaters. Please refer to www.linklaters.com/regulation for important information on our regulatory position.

We process your data in line with our Global Privacy Notice. You can view this at www.linklaters.com/en/legal-notices/privacy-notice.

To opt-out of receiving any marketing emails from us, or to manage your email preferences and the personal details we hold for you, please contact: marketing.database@linklaters.com.