

## SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT

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### Section 1. Purpose

This Act provides for the creation of Special Purpose Reinsurance Vehicles (“SPRVs”) exclusively to facilitate the securitization of one or more ceding insurers’ risk as a means of accessing alternative sources of capital and achieving the benefits of securitization. Investors in fully funded insurance securitization transactions provide funds that are available to the SPRV to secure the aggregate limit under an SPRV contract that provides coverage against the occurrence of a triggering event. The creation of SPRVs is intended to achieve greater efficiencies in conducting insurance securitizations, to diversify and broaden insurers’ access to sources of risk bearing capital and to make insurance securitization generally available on reasonable terms to as many U.S. insurers as possible.

**Drafting Note:** Under the terms of the typical securities underlying an insurance securitization transaction, proceeds from the issuance of securities are repaid to the investor on a specified maturity date with interest or dividends unless a triggering event occurs. The insurance securitization proceeds are available to pay the SPRV’s obligations to the ceding insurer if a triggering event occurs, as well as being available to satisfy the SPRV’s obligation to repay the insurance securitization investors if a triggering event does not occur. Insurance securitization transactions have been performed by alien companies to utilize efficiencies available to alien companies that are not currently available to domestic companies. This Act allows more efficiency in conducting insurance securitizations, allows domestic ceding insurers easier access to alternative sources of risk bearing capital, and promotes the benefits of insurance securitization to U.S. insurers.

### Section 2. Exemption from Insurance Laws within Limitations

- A. An SPRV is subject to the following sections of [insert state’s insurance code]: [insert sections of code providing commissioner’s general powers, including power to investigate insurance law violations, subpoena and examine documents and witnesses, conduct hearings, institute other legal action to enforce laws or orders, issue cease and desist orders, impose fines, handle documents and records, suspend or revoke licenses or certificates of authority, impose fees and other charges; and reference state’s examination law for enforcement of the act].

**Drafting Note:** Insert the title of the chief insurance regulatory official wherever the term “commissioner” appears.

- B. No other provisions of this [insert state’s insurance code] shall be applicable to a SPRV organized under this Act, except as provided in this Act.

**Section 3. Definitions**

For purposes of this Act, the following terms have the indicated meanings:

- A. “Aggregate limit” means the maximum sum payable to the ceding insurer under an SPRV contract.
- B. “Ceding insurer” means one or more insurers or reinsurers under common control that enters into an SPRV contract with an SPRV.
- C. “Control” (including the terms “controlling,” “controlled by” and “under common control with”) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or non-management services, or otherwise, unless the power is the result of an official position with or corporate office held by the person. Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10%) or more of the voting securities of any other person. This presumption may be rebutted by a showing that control does not, in fact, exist. Notwithstanding the foregoing, for purposes of this Act, the fact that an SPRV exclusively provides reinsurance to a ceding insurer under an SPRV contract shall not by itself be sufficient grounds for a finding that the SPRV or the SPRV Organizer or owner is controlled by or under common control with the ceding insurer.
- D. “Fair value” means:
  - (1) As to cash, the amount thereof; and
  - (2) As to an asset other than cash:
    - (a) The amount at which that asset could be bought or sold in a current transaction between arms-length, willing parties;
    - (b) The quoted market price for the asset in active markets should be used if available; and
    - (c) If quoted market prices are not available, a value determined using the best information available considering values of like assets and other valuation methods, such as present value of future cash flows, historical value of the same or similar assets or comparison to values of other asset classes the value of which have been historically related to the subject asset.
- E. “Fully funded” means that, with respect to an SPRV contract, the fair value of the assets held in trust by or on behalf of the SPRV under the SPRV contract on the date on which the SPRV contract is effected, equals or exceeds the aggregate limit as defined in this Act.
- F. “Indemnity trigger” means a transaction term by which the SPRV’s obligation to pay the ceding insurer for losses covered by an SPRV contract is triggered by the ceding insurer incurring a specified level of losses.
- G. “Insolvency” or “insolvent” means that the SPRV is unable to pay its obligations when they are due, unless the obligations are the subject of a bona fide dispute.
- H. “Non-indemnity trigger” means a transaction term by which the SPRV’s obligation to pay the ceding insurer under an SPRV contract arises from the occurrence or existence of some event or condition other than the ceding insurer incurring a specified level of losses under its insurance or reinsurance contracts.
- I. “Permitted investments” means those investments that meet the qualifications set forth in Section 17 of this Act.

- J. “Qualified U.S. financial institution” means, for purposes of meeting the requirements of a trustee as specified in Section 6, a financial institution that is eligible to act as a fiduciary of a trust, and:
- (1) Is organized, or, in the case of a U.S. branch or agency office of a foreign banking organization, is licensed, under the laws of the United States or any state thereof, and
  - (2) Is regulated, supervised and examined by federal or state authorities having regulatory authority over banks and trust companies.

**Drafting Note:** Because assets held in a fiduciary capacity are not subject to the claims of the trustee’s creditors, and because the trust departments of all U.S. financial institutions (including U.S. branch or agency offices of foreign banking organizations having fiduciary powers in the U.S.) are regulated, supervised and examined by the institution’s primary U.S. bank regulatory authority (federal or state), there is no need to apply additional standards measuring the financial condition or standing of the institution.

- K. “Special Purpose Reinsurance Vehicle” or “SPRV” means an entity domiciled in and organized under the laws of this state, which has received a Limited Certificate of Authority from the commissioner under this Act exclusively for the limited purpose of entering into and effectuating SPRV insurance securitizations, SPRV contracts and other related transactions permitted by this Act.
- L. “SPRV contract” means a contract between the SPRV and the ceding insurer pursuant to which the SPRV agrees to pay the ceding insurer an agreed amount upon the occurrence of a triggering event.
- M. “SPRV insurance securitization” means a package of related risk transfer instruments and facilitating administrative agreements by which proceeds are obtained by an SPRV through the issuance of securities, which proceeds are held in trust pursuant to the requirements of this Act to secure the obligations of the SPRV under an SPRV contract with one or more ceding insurers, wherein the SPRV’s obligation to return the full initial investment to the holders of such securities, pursuant to the transaction terms, is contingent upon the funds not being used to pay the obligations of the SPRV to the ceding insurers under the SPRV contract.
- N. “SPRV organizer” means one or more persons that have organized or intend to organize an SPRV, under authority obtained as specified in this Act.
- O. “SPRV securities” means the securities issued by an SPRV.
- P. “Triggering event” means an event or condition that, if and when it occurs or exists, obligates the SPRV to make a payment to the ceding insurer under the provisions of an SPRV contract.

#### **Section 4. Limited Certificate of Authority Required**

- A. In order to securitize one or more ceding insurers’ risks, an SPRV shall obtain a limited certificate of authority from the commissioner according to the provisions of this section.
- B. An SPRV organizer seeking to obtain a limited certificate of authority for a SPRV shall file an application with the commissioner. A complete application shall include the following:
- (1) An affidavit verifying that each prospective SPRV organizer meets the requirements of this Act;
  - (2) A representation that the prospective SPRV organizer intends to form an SPRV that shall operate in accordance with the requirements set forth in this Act;
  - (3) The proposed name of the SPRV;
  - (4) Biographical affidavits of all SPRV organizers setting forth their legal names, any names under which they have or are conducting their affairs, and any affiliations with other persons as defined in [insert a citation to the state insurance holding company system act], together with such other biographical information as the commissioner may request;
  - (5) The source and form of the minimum capital to be contributed to the SPRV;

- (6) Any persons with which the SPRV is or upon formation will be affiliated as defined in [insert the state's insurance holding company system act];
  - (7) The names and biographical affidavits of the proposed members of the board of directors and principal officers of the SPRV, setting forth their legal names, any names under which they have or are conducting their affairs and any affiliations with other persons as defined in [insert the name of the state insurance holding company system act], together with such other biographical information as the commissioner may request;
  - (8) A plan of operation, consisting of a description of the contemplated insurance securitization, the SPRV contract and related transactions, which shall include:
    - (a) Draft documentation or, at the discretion of the commissioner, a written summary, of all material agreements that will be entered into to effectuate the insurance securitization and the related SPRV contract, to include the names of the ceding insurers, the nature of the risks being assumed, and the maximum amounts, purpose and nature and the interrelationships of the various transactions required to effectuate the insurance securitization;
    - (b) The investment strategy of the SPRV and a representation that the investment strategy complies with the investment requirements set forth in this Act and that the strategy will include investment practices or other provisions to preserve asset values, which will facilitate attainment of full funding during the term of the securitization with assets that can be monetized in response to a triggering event without a substantial loss in value; and
    - (c) A description of the method by which losses covered by the SPRV contract that may develop after the termination of the contract period are to be addressed under the provisions of the SPRV contract; and
    - (d) A representation that the trust agreement and the trusts holding assets that secure the obligations of the SPRV under the SPRV contract and the SPRV contract with the ceding insurers in connection with the contemplated insurance securitization will be structured in accordance with the requirements set forth in this act.
- C. The commissioner shall approve the application and issue a limited certificate of authority upon a finding that (1) the proposed plan of operation provides a reasonable expectation of a successful operation, (2) the terms of the SPRV contract and related transactions comply with this Act, (3) the proposed plan of operation is not hazardous to any ceding insurer or to policyholders and (4) the commissioner of the state of domicile of each ceding insurer has notified the commissioner in writing that it has not disapproved the transaction. In evaluating the expectation of a successful operation, the commissioner shall consider, among other factors, whether the proposed SPRV organizer, directors and officers are of known good character and not reasonably believed to be affiliated, directly or indirectly, through ownership, control, management, reinsurance transactions or other insurance or business relations, with any person known to have been involved in the improper manipulation of assets, accounts or reinsurance. If the commissioner denies the application, he or she shall grant the prospective SPRV organizer a hearing upon request.
- Drafting Note:** Each state should review its legislative authority to ensure that its commissioner has the necessary jurisdiction to review and approve or disapprove proposed SPRV transactions by its domestic ceding insurers to non-domestic SPRVs.
- D. Upon approval by the commissioner of the application and the issuance of a limited certificate of authority, the SPRV may be acquired or formed and, in accordance with the approved plan of operation, the SPRV may enter into contracts and conduct other activities within the scope of the filed plan of operation.
  - E. The limited certificate of authority shall state that the SPRV's authorization to be involved in the business of reinsurance shall be limited only to the reinsurance activities that the SPRV is allowed to conduct pursuant to this Act.

- F. The SPRV organizer shall provide a complete set of the documentation of the insurance securitization to the commissioner upon closing of the transactions, including an opinion of legal counsel with respect to compliance with this Act and any other applicable laws as of the effective date of the transaction. Any material change of the SPRV's plan of operation described in Subsection B of this section, including but not limited to the issuance of new securities to continue the securitization activities of the SPRV pursuant to this Act after expiration and full satisfaction of the initial securitization transactions, shall require prior approval of the commissioner, provided that a change in the counterparty to swap transactions for an existing securitization as allowed under this Act shall not be deemed a material change.

#### **Section 5. Limited Purpose of SPRV**

SPRVs authorized under this Act are created for the limited purpose of entering into insurance securitization transactions with investors and related agreements to pay one or more ceding insurers agreed upon amounts under a SPRV contract upon the occurrence of triggering events related to the insurance business of the ceding insurer. A SPRV may not issue a contract for assumption of risk or indemnification of loss other than a SPRV contract.

**Drafting Note:** States may consider either authorizing, either directly by statute, or by providing rule-making authority, specific lines of business that may be ceded to a SPRV or restricting specific lines of business from being ceded to a SPRV.

#### **Section 6. Approved Transactions and Operation of SPRVs**

- A. SPRVs authorized under this Act may at any given time enter into and effectuate SPRV contracts with one or more ceding insurers, provided that the SPRV contracts obligate the SPRV to indemnify the ceding insurer for losses and that contingent obligations of the SPRV under the SPRV contracts are securitized in full through a single SPRV insurance securitization and are fully funded and secured with assets held in trust in accordance with the requirements included herein pursuant to agreements contemplated by this Act and invested in a manner that meets the criteria set forth in Section 17.

**Drafting Note:** The requirement that a SPRV indemnify the ceding insurer against losses may be expanded to allow an SPRV to enter into non-indemnity transactions with ceding insurers pursuant to regulations issued by the commissioner addressing the treatment of the portion of the risk that is not indemnity based, accounting, disclosure, risk based capital treatment, and assessing risks associated with such SPRV contract governing credit for these transactions.

- B. An SPRV may enter into agreements with third parties and conduct business necessary to fulfill its obligations and administrative duties incident to the insurance securitization and the SPRV contract. The agreements may include entering into swap agreements or other transactions that have the objective of leveling timing differences in funding up-front or ongoing transaction expenses or managing credit or interest rate risk of the investments in trust to assure that the assets held in trust will be sufficient to satisfy payment or repayment of the securities issued pursuant to an insurance securitization transaction or the obligations of the SPRV under the SPRV contract. In fulfilling its function, the SPRV shall adhere to the following requirements and shall, to the extent of its powers, ensure that contracts obligating other parties to perform certain functions incident to its operations are substantively and materially consistent with the following requirements and guidelines:
- (1) An SPRV shall have a distinct name, which shall include the designation "SPRV." The name of the SPRV shall not be deceptively similar to, or likely to be confused with or mistaken for, any other existing business name registered in this state.
  - (2) Unless otherwise provided in the plan of operation, the principal place of business and office of any SPRV organized under this Act shall be located in this state.
  - (3) The assets of an SPRV shall be preserved and administered by or on behalf of the SPRV to satisfy the liabilities and obligations of the SPRV incident to the insurance securitization and other related agreements, including the SPRV contract.
  - (4) Assets of the SPRV that are pledged to secure obligations of the SPRV to a ceding insurer under an SPRV contract shall be held in trust and administered by a qualified U.S. financial institution. The qualified U.S. financial institution shall not control, be controlled by, or be under common control with, the SPRV or the ceding insurers.

- (5) The agreement governing any such trust shall create one or more trust accounts into which all pledged assets shall be deposited and held until distributed in accordance with the trust agreement. The pledged assets shall be held by the trustee at the trustee's office in the United States and may be held in certificated or electronic form.
- (6) The provisions for withdrawal by ceding insurers of assets from the trust shall be clean and unconditional, subject only to the following requirements:
  - (a) The ceding insurer shall have the right to withdraw assets from the trust account at any time, without notice to the SPRV, subject only to written notice to the trustee from the ceding insurer that funds in the amount requested are due and payable by the SPRV;
  - (b) No other statement or document need be presented in order to withdraw assets, except the ceding insurer may be required to acknowledge receipt of withdrawn assets;
  - (c) The trust agreement shall indicate that it is not subject to any conditions or qualifications outside of the trust agreement;
  - (d) The trust agreement shall not contain references to any other agreements or documents; and
  - (e) No reference shall be made to the fact that these funds may represent reinsurance premiums or that the funds have been deposited for any specific purpose.
- (7) The trust agreement shall be established for the sole use and benefit of the ceding insurer at least to the full extent of the SPRV's obligations to the ceding insurer under the SPRV contract. In the case of more than one ceding insurer, a separate trust agreement shall be entered into with each ceding insurer and a separate trust account shall be maintained for each ceding insurer.
- (8) The trust agreement shall provide for the trustee to:
  - (a) Receive assets and hold all assets in a safe place;
  - (b) Determine that all assets are in a form that the ceding insurer or the trustee, upon direction by the ceding insurer may, whenever necessary, negotiate the assets, without consent or signature from the SPRV or any other person or entity;
  - (c) Furnish to the SPRV, the commissioner and the ceding insurer a statement of all assets in the trust account reported at fair value upon its inception and at intervals no less frequent than the end of each calendar quarter;
  - (d) Notify the SPRV and the ceding insurer, within ten (10) days, of any deposits to or withdrawals from the trust account;
  - (e) Upon written demand of the ceding insurer, immediately take any and all steps necessary to transfer absolutely and unequivocally all right, title and interest in the assets held in the trust account to the ceding insurer and deliver physical custody of the assets to the ceding insurer; and
  - (f) Allow no substitutions or withdrawals of assets from the trust account, except on written instructions from the ceding insurer.
- (9) The trust agreement shall provide that at least thirty (30) days, but not more than forty-five (45) days, prior to termination of the trust account, written notification of termination shall be delivered by the trustee to the ceding insurer.
- (10) The trust agreement may be made subject to and governed by the laws of any state, in addition to the requirements for the trust as provided in this Act, provided that the state is disclosed in the plan of operation filed with and approved, or deemed approved, by the commissioner.

- (11) The trust agreement shall prohibit invasion of the trust corpus for the purpose of paying compensation to, or reimbursing the expenses of, the trustee.
- (12) The trust agreement shall provide that the trustee shall be liable for its own negligence, willful misconduct or lack of good faith.
  - (a) Notwithstanding the provisions of Subsection B(6)(c), (d) and (e) or B(14)(e) of this section, when a trust agreement is established in conjunction with an SPRV contract, then the trust agreement may provide that the ceding insurer shall undertake to use and apply any amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the SPRV, for the following purposes:
    - (i) To pay or reimburse the ceding insurer amounts due to the ceding insurer under the specific SPRV contract, including but not limited to unearned premiums due to the ceding insurer, if not otherwise paid by the SPRV in accordance with the terms of such agreement; or
    - (ii) Where the ceding insurer has received notification of termination of the trust account, and where the SPRV's entire "obligations" under the specific SPRV contract remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the obligations and deposit the amounts in a separate account, in the name of the ceding insurer, in any qualified U.S. financial institution, apart from its general assets, in trust for uses and purposes specified in Subparagraph (a) of this paragraph as may remain executory after the withdrawal and for any period after the termination date. "Obligations" within the meaning of this subparagraph may, without duplication, include:
      - (I) Losses and loss expenses paid by the ceding insurer, but not recovered from the SPRV;
      - (II) Reserves for losses reported and outstanding;
      - (III) Reserves for losses incurred but not reported;
      - (IV) Reserves for loss expenses;
      - (V) Reserves for unearned premiums;
      - (VI) Any other amounts that, together with Items (I) to (V) of this subparagraph, represent the aggregate limit remaining under the SPRV contract if the period of coverage or the agreed upon period of loss development has yet to expire.
  - (b) The provisions to be included in the trust agreement pursuant to this paragraph may instead be included in the underlying SPRV contract.
- (13) An SPRV contract shall contain provisions that:
  - (a) Require the SPRV to enter into a trust agreement and to establish a trust account for the benefit of the ceding insurer, and specifying what recoverables or reserves, or both, the agreement is to cover;
  - (b) Stipulate that assets deposited in the trust account shall be valued according to their current fair value, and shall consist only of permitted investments;

- (c) Require the SPRV, prior to depositing assets with the trustee, to execute assignments, endorsements in blank, or to transfer legal title to the trustee of all shares, obligations or any other assets requiring assignments, in order that the ceding insurer, or the trustee upon the direction of the ceding insurer, may whenever necessary negotiate any such assets without consent or signature from the SPRV or any other entity;
  - (d) Require that all settlements of account between the ceding insurer and the SPRV be made in cash or its equivalent; and
  - (e) Stipulate that the SPRV and the ceding insurer agree that the assets in the trust account, established pursuant to the provisions of the SPRV contract, may be withdrawn by the ceding insurer at any time, notwithstanding any other provisions in the SPRV contract, and shall be utilized and applied by the ceding insurer or any successor by operation of law of the ceding insurer, including (subject to the provisions of Section 16), but without further limitation, any liquidator, rehabilitator, receiver or conservator of the ceding insurer, without diminution because of insolvency on the part of the ceding insurer or the SPRV, only for the following purposes:
    - (i) To transfer all such assets into one or more trust accounts for the benefit of the ceding insurer pursuant to the terms of the SPRV contract and in compliance with this Act; and
    - (ii) To pay any other amounts that the ceding insurer claims are due under the SPRV contract.
- (14) The SPRV contract entered into by the SPRV may contain provisions that give the SPRV the right to seek approval from the ceding insurer to withdraw from the trust all or part of the assets contained in the trust and to transfer the assets to the SPRV, provided:
- (a) The SPRV shall, at the time of the withdrawal, replace the withdrawn assets with other qualified assets having a fair value equal to the fair value of the assets withdrawn and that meet the requirements of Section 17; and
  - (b) After the withdrawals and transfer, the fair value of the assets in trust securing the obligations of the SPRV under the SPRV contract is no less than an amount needed to satisfy the fully funded requirement of the SPRV contract. The ceding insurer shall be the sole judge as to the application of these provisions, but shall not unreasonably nor arbitrarily withhold its approval.
- (15) The contract shall provide that investors in the SPRV agree that any obligation to repay principal, interest or dividends on the securities issued by the SPRV shall be reduced upon the occurrence of a triggering event, to the extent that the assets of the SPRV held in trust for the benefit of the ceding insurer are remitted to the ceding insurer in fulfillment of the obligations of the SPRV under the SPRV contract.
- (16) Assets held by an SPRV in trust shall be valued at their fair value.
- (17) The proceeds from the sale of securities by the SPRV to investors shall be deposited with the trustee as contemplated by this Act, and shall be held or invested by the trustee in accordance with the requirements of Section 17.



- (18) An SPRV organized under this Act shall engage only in fully funded indemnity triggered SPRV contracts to support in full the ceding insurers' exposures assumed by the SPRV. However, an SPRV may engage in an SPRV contract that is non-indemnity triggered only after the commissioner, in accordance with the authority granted under Section 20 of this Act, adopts regulations addressing the treatment of the portion of the risk that is not indemnity based, to include accounting, disclosure, risk based capital treatment, and the manner in which risks associated with a non-indemnity based SPRV contract may be evaluated and managed. At no time may an SPRV enter into an SPRV contract that is not fully funded, whether indemnity triggered or non-indemnity triggered. Assets of the SPRV may be used to pay interest or other consideration on any outstanding debt or other obligation of the SPRV, and nothing in this paragraph shall be construed or interpreted to prevent an SPRV from entering into a swap agreement or other transaction that has the effect of guaranteeing interest or other consideration.
- (19) In the SPRV insurance securitization, the contracts or other relating documentation shall contain provisions identifying the SPRV that will enter into the special purpose reinsurance securitization and the contracts or other documentation shall clearly disclose that the assets of the SPRV, and only those assets, are available to pay the obligations of that SPRV. Notwithstanding the foregoing, and subject to the provisions of this Act and any other applicable law or regulation, the failure to include such language in the contracts or other documentation shall not be used as the sole basis by creditors, reinsurers or other claimants to circumvent the provisions of this Act.
- (20) Under no circumstances shall an SPRV be authorized to:
- (a) Issue or otherwise administer primary insurance policies;
  - (b) Have any obligation to the policyholders or reinsureds of the ceding insurer;
  - (c) Enter into an SPRV contract with a person that is not licensed or otherwise authorized to conduct the business of insurance or reinsurance in at least its state or country of domicile; or
  - (d) Assume or retain exposure to insurance or reinsurance losses for its own account that is not initially fully funded by proceeds from an SPRV securitization that meets the requirements of this Act.
- (21) At the cessation of business of an SPRV, the limited certificate of authority granted by the commissioner shall expire and the SPRV shall no longer be authorized to conduct activities pursuant to this Act unless and until a new certificate of authority is issued pursuant to a new filing in accordance with Section 4.
- (22) It shall be unlawful for an SPRV to loan or otherwise invest, or place in custody, trust or under management any of its assets with, or to borrow money or receive a loan from (other than by issuance of the securities pursuant to an insurance securitization), or advance from, anyone convicted of a felony, anyone who is untrustworthy or of known bad character or anyone convicted of a criminal offense involving the conversion or misappropriation of fiduciary funds or insurance accounts, theft, deceit, fraud, misrepresentation or corruption.

**Section 7. Powers**

- A. An SPRV authorized under this Act shall have the necessary powers to enter into contracts and to conduct other commercial activities necessary to fulfill the purposes of this Act. These activities may include, but are not limited to, entering into SPRV contracts, issuing securities of the SPRV and complying with the terms thereof, entering into trust, swap and other agreements necessary to effectuate an insurance securitization in compliance with the limitations and pursuant to the authorities granted to the SPRV under this Act or the plan of operation approved or deemed approved by the commissioner.

- B. An SPRV organized or doing business under this Act shall be capable of suing or being sued, and may make or enforce contracts in relation to the business of the SPRV; may have and use a common seal, and in the name of the SPRV or by a trustee chosen by the board of directors, shall be capable of taking, purchasing, holding and disposing of real and personal property for carrying into effect the purposes of its organization; and may by its board of directors, trustees, officers or managers, make bylaws and amendments thereto not inconsistent with the laws or the constitution of this state or of the United States. The bylaws shall define the manner of electing directors, trustees or managers and officers of the SPRV, together with their qualifications and duties and fixing the term of office.

**Section 8. Affiliation**

Notwithstanding the provisions of the [insert citation to insurance holding company system act] the SPRV, the SPRV organizer, or subsequent debt or equity investors in SPRV securities shall not be deemed affiliates of the ceding insurer by virtue of the SPRV contract between the ceding insurer and the SPRV, the securities of the SPRV or related agreements necessary to implement the SPRV insurance securitization. The SPRV may not be controlled by, may not control, or may not be under common control with, any ceding insurer that is a party to an SPRV contract.

**Section 9. Capitalization**

An SPRV shall have minimum initial capital of not less than \$5,000. All of the initial capital shall be received by the SPRV in cash. The minimum initial capital required and all other funds of the SPRV in excess of its minimum initial capital, including funds held in trust to secure the obligations of the SPRV pursuant to its obligations under the SPRV contracts, shall be invested as provided in Section 17.

**Section 10. Dividends**

The SPRV may not declare or pay dividends in any form to its owners unless the dividends do not decrease the capital of the SPRV below \$5,000 and, after giving effect to the dividends, the assets of the SPRV, including assets held in trust pursuant to the terms of the insurance securitization, shall be sufficient to meet its obligations. The dividends may be declared by the board of directors of the SPRV if the dividends would not violate the provisions of this Act or jeopardize the fulfillment of the obligations of the SPRV or the trustee pursuant to the SPRV insurance securitization, the SPRV contract or any related transaction. The provisions of [insert reference to the insurance holding company system act of the state of the SPRV's domicile] pertaining to dividends do not apply to such dividends.

**Section 11. Records and Financial Reports**

- A. The records of the SPRV shall be maintained in this state and shall be available for examination by the commissioner at any time. No later than five (5) months after the fiscal year end of the SPRV, the SPRV shall file with the commissioner an audit by a certified public accounting firm of the financial statements of the SPRV and the trust accounts.
- B. Each SPRV organized under this Act shall file with the commissioner not later than March 1 a statement of operations, to include a statement of income, a balance sheet and a detailed listing of invested assets, including identification of assets held in trust to secure the SPRV's obligations under the SPRV contract, for the year ending the prior December 31. The statements shall be prepared in accordance with [insert reference to applicable statutory accounting guidance for reinsurers adopted by this state] on forms required by the commissioner.
- C. The SPRV shall keep its books and records in such manner that its financial condition, affairs and operations can be ascertained and so that its financial statements filed with the commissioner can be readily verified and its compliance with the provisions of this Act determined. The books or records may be photographed, reproduced on film or stored and reproduced electronically.
- D. All books, records, documents, accounts and vouchers shall be preserved and kept available in this state for the purpose of examination and until authority to destroy or otherwise dispose of the records is secured from the commissioner. The original records may, however, be kept and maintained outside this state if, according to a plan adopted by the SPRV's board of directors and approved by the commissioner, it maintains suitable records in lieu thereof.

## **Section 12. Officers and Directors**

The directors of an SPRV shall elect officers that they deem necessary to carry out the purposes of the SPRV pursuant to this Act. The provisions of [insert the insurance code or relevant business corporation act, limited liability corporation act, limited partnership act, etc.] relating to the indemnification of officers and directors apply to and govern SPRVs organized under this Act.

- A. Each SPRV authorized to do business in this state shall notify the commissioner within thirty (30) days of the appointment or election of any new officers or directors.
- B. In cases where the commissioner deems that an officer or director does not meet the standards set forth in this section, he shall, after notice and hearing afforded to the officer or director, and after a finding that the officer or director is incompetent or untrustworthy or of known bad character, order the removal of the person. If the SPRV does not comply with a removal order within thirty (30) days, the commissioner may suspend that SPRV's limited certificate of authority until such time as the order is complied with.
- C. The SPRV shall make no loans to any SPRV organizer, owner, director, officer, manager or affiliate of the SPRV.

## **Section 13. Fees and Taxes**

The commissioner may charge fees to reimburse the commissioner for expenses and costs incurred by the department of insurance incident to the examination of financial statements, review of the plan of operation and to reimburse other such activities of the commissioner related to the formation and ongoing operation of the SPRV. The SPRV shall not be subject to state premium or other taxes incidental to the operation of its business as long as the business remains within the limitations of this Act.

## **Section 14. Dissolution**

An SPRV operating under this Act may be dissolved at any time by a vote of its board of directors, and after the action has been approved by the commissioner. No voluntary dissolution shall be effected or allowed until and unless all of the obligations of the SPRV pursuant to the insurance securitization have been fully and finally satisfied pursuant to their terms. In the case of voluntary dissolution, the disposition of the affairs of the SPRV (including the settlement of all outstanding obligations), shall be made by the officers or directors of the SPRV and when the liquidation has been completed and a final statement, in acceptable form, filed with and approved, or deemed approved, by the commissioner, the provisions for voluntary dissolution under the [insert reference to section of the state's insurance code or general business law that provides for and governs dissolution of insurers or other entities as appropriate] shall be followed to dissolve the SPRV.

## **Section 15. Conservation, Rehabilitation or Liquidation**

- A. The provisions of [insert reference to the conservation, rehabilitation and liquidation statute] apply to an SPRV, except to the extent modified below.
- B. (1) Notwithstanding the provisions of [insert reference to the state's conservation, rehabilitation and liquidation act that is consistent with Section 16 of the NAIC Insurers Rehabilitation and Liquidation Model Act], the commissioner may apply by petition to the [insert reference to appropriate court of jurisdiction] for an order authorizing the commissioner to conserve, rehabilitate or liquidate an SPRV domiciled in this state solely on one or more of the following grounds:
  - (a) There has been embezzlement, wrongful sequestration, dissipation, or diversion of the assets of the SPRV intended to be used to pay amounts owed to the ceding insurer or the holders of SPRV securities; or
  - (b) The SPRV is insolvent and the holders of a majority in outstanding principal amount of each class of SPRV securities request or consent to conservation, rehabilitation or liquidation under this Act.

- (2) The court shall not grant relief under Paragraph (1)(a) of this subsection unless, after notice and a hearing, the commissioner, who shall have the burden of proof, establishes by clear and convincing evidence that relief should be granted.
- C. Notwithstanding any contrary provision in the insurance code of this state, the regulations promulgated under the insurance code of this state, or any other applicable law or regulation, upon any order of conservation, rehabilitation or liquidation of the SPRV, the receiver shall be bound to deal with the SPRV's assets and liabilities, in accordance with the requirements set forth in this Act.
- D. With respect to amounts recoverable under an SPRV contract, the amount recoverable by the receiver shall not be reduced or diminished as a result of the entry of an order of conservation, rehabilitation or liquidation with respect to the ceding insurer, notwithstanding any provisions to the contrary in the contracts or other documentation governing the SPRV insurance securitization.
  - (1) Notwithstanding the provisions of [insert reference to the conservation, rehabilitation and liquidation act consistent with Section 5 of the NAIC Rehabilitation and Liquidation Model Act] or any other Section of the [insert reference to the conservation, rehabilitation and liquidation act], an application or petition under Section [insert conservation, rehabilitation and liquidation act provisions consistent with Sections 10, 11, 17, 20, 55, 58 or 59 of the NAIC Insurers Rehabilitation and Liquidation Model Act], or any temporary restraining order or injunction issued under any such section, with respect to a ceding insurer shall not prohibit the transaction of any business by an SPRV, including any payment by an SPRV made pursuant to an SPRV security, or any action or proceeding against an SPRV or its assets.
  - (2) Notwithstanding the provisions of [insert reference to the section of the conservation, rehabilitation and liquidation act that is consistent with Section 10 of the NAIC Insurers Rehabilitation and Liquidation Model Act], the commencement of a summary proceeding or other interim proceeding commenced prior to a formal delinquency proceeding with respect to an SPRV, and any order issued by the court thereunder, shall not prohibit the payment by an SPRV made pursuant to an SPRV security or SPRV contract or the SPRV from taking any action required to make the payment.
- E. Notwithstanding any other provision of [insert reference to the state's conservation, rehabilitation and liquidation act] or other state law:
  - (1) A receiver of a ceding insurer may not avoid a non-fraudulent transfer by a ceding insurer to an SPRV of money or other property made pursuant to an SPRV contract; and
  - (2) A receiver of an SPRV may not void a non-fraudulent transfer by the SPRV of money or other property made to a ceding insurer pursuant to an SPRV contract or made to or for the benefit of any holder of an SPRV security on account of the SPRV security.
- F. With the exception of the fulfillment of the obligations under an SPRV contract, and notwithstanding any other provisions of this Act or other law of this state to the contrary, the assets of an SPRV, including assets held in trust, shall not be consolidated with or included in the estate of a ceding insurer in any delinquency proceeding against the ceding insurer under this Act for any purpose, including, without limitation, distribution to creditors of the ceding insurer.
- G. Notwithstanding any other provision of this Act:
  - (1) The domiciliary receiver of an SPRV domiciled in another state shall be vested by operation of law with the title to all of the assets, property, contracts and rights of action, and all of the books, accounts and other records of the SPRV located in this state. The domiciliary receiver shall have the immediate right to recover all such vested property, assets, and causes of action of the SPRV located in this state.
  - (2) No ancillary proceeding may be commenced or prosecuted in this state against an SPRV domiciled in another state.

**Drafting Note:** The state should amend its conservation, rehabilitation and liquidation law to include an SPRV as a “person covered” as defined in the Section 2 of the NAIC Insurers Rehabilitation and Liquidation Model Act].

**Drafting Note:** A number of states require a liquidator to cancel policies within a pre-specified time period in the event of a liquidation. While reviewing the Plan of Operation, commissioners should consider the termination provisions, if any, of the securitization instruments in the event of the cancellation of all of the insurance policies underlying the securitization in order to assess whether any portion of the risk premium relating to those underlying policies should equitably be returned to the ceding insurer.

**Section 16. Not Subject to Guaranty Funds, Residual Market or Similar Arrangements**

- A. The SPRV or the activities, assets and obligations relating to the SPRV are not subject to the provisions of [insert reference to sections of the insurance code addressing life and health and property and casualty guaranty or insolvency funds], and an SPRV shall not be assessed by or otherwise be required to contribute to any guaranty fund or guaranty association in this state with respect to the activities, assets or obligations of an SPRV or the ceding insurer.
- B. The SPRV shall not be required to participate in residual market, FAIR plan or other similar plans to provide insurance coverage, take out policies, assume risks, make capital contributions, pay or be otherwise obligated for assessments, surcharges or fees, or otherwise support or participate in such plans or arrangements.

**Section 17. Asset and Investment Limitations**

- A. Assets of the SPRV held in trust to secure obligations under the SPRV contract shall at all times be held in:
  - (1) Cash; and cash equivalents;
  - (2) Securities listed by the Securities Valuation Office of the NAIC and qualifying as admitted assets under statutory accounting convention in its state of domicile; or
  - (3) Any other form of security acceptable to the commissioner.
- B. In addition, the SPRV may enter into swap agreements or other transactions that have the objective of leveling timing differences in funding of up-front or ongoing transaction expenses or managing credit or interest rate risk of the investments in the trust to ensure that the investments are sufficient to assure payment or repayment of the securities (and related interest or principal payments) issued pursuant to an SPRV insurance securitization transaction or the SPRV’s obligations under the SPRV contract.

**Section 18. Credit for Reinsurance for the SPRV Contract**

An SPRV contract meeting the requirements under this Act shall be granted credit for reinsurance treatment or shall otherwise qualify as an asset or a reduction from liability for reinsurance ceded by a domestic insurer to an assuming insurer under the (insert reference to the state’s equivalent of Section 3 of the NAIC Credit for Reinsurance Model Act) for the benefit of the ceding insurer, provided and only to the extent that:

- A. The fair value of the assets held in trust for the benefit of the ceding insurer equal or exceed the obligations due and payable to the ceding insurer by the SPRV under the SPRV contract;
- B. The assets are held in trust in accordance with the requirements set forth in this Act;
- C. The assets are administered in the manner and pursuant to arrangements as set forth in this Act; and
- D. The assets are held or invested in one or more of the forms allowed in Section 17.

**Section 19. No Transaction of an Insurance Business by Investors in Securities**

The securities issued by the SPRV pursuant to an SPRV insurance securitization shall not be deemed to be insurance or reinsurance contracts. An investor in such securities issued pursuant to an SPRV insurance securitization or any holder of such securities shall not, by sole means of this investment or holding, be deemed to be transacting an insurance business in this state. The underwriters or selling agents (and their partners, directors, officers, members, managers, employees, agents, representatives and advisors) involved in an SPRV insurance securitization shall not be deemed to be conducting an insurance or reinsurance agency, brokerage, intermediary, advisory or consulting business by virtue of their activities in connection therewith.

**Section 20. Authority to Adopt Regulations**

The commissioner may adopt regulations necessary to effectuate the purposes of this Act. Any regulations so adopted will not affect a SPRV insurance securitization in effect at the time of adoption.

**Section 21. Effective Date**

This Act shall become effective on [insert date].

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*Chronological Summary of Actions (all references are to the Proceedings of the NAIC).*

*2001 Proc. 3<sup>rd</sup> Quarter (adopted).*

## SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT

**This chart is intended to provide readers with additional information to more easily access state statutes, regulations, bulletins or administrative rulings related to the NAIC model. Such guidance provides readers with a starting point from which they may review how each state has addressed the model and the topic being covered. The NAIC Legal Division has reviewed each state's activity in this area and has determined whether the citation most appropriately fits in the Model Adoption column or Related State Activity column based on the definitions listed below. The NAIC's interpretation may or may not be shared by the individual states or by interested readers.**

**This chart does not constitute a formal legal opinion by the NAIC staff on the provisions of state law and should not be relied upon as such. Nor does this state page reflect a determination as to whether a state meets any applicable accreditation standards. Every effort has been made to provide correct and accurate summaries to assist readers in locating useful information. Readers should consult state law for further details and for the most current information.**

**SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT**

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**SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT**

**KEY:**

**MODEL ADOPTION:** States that have citations identified in this column adopted the most recent version of the NAIC model in a **substantially similar manner**. This requires states to adopt the model in its entirety but does allow for variations in style and format. States that have adopted portions of the current NAIC model will be included in this column with an explanatory note.

**RELATED STATE ACTIVITY:** Examples of Related State Activity include but are not limited to: older versions of the NAIC model, statutes or regulations addressing the same subject matter, or other administrative guidance such as bulletins and notices. States that have citations identified in this column **only** (and nothing listed in the Model Adoption column) have **not** adopted the most recent version of the NAIC model in a **substantially similar manner**.

**NO CURRENT ACTIVITY:** No state activity on the topic as of the date of the most recent update. This includes states that have repealed legislation as well as states that have never adopted legislation.

NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Alabama	NO CURRENT ACTIVITY	
Alaska	NO CURRENT ACTIVITY	
American Samoa	NO CURRENT ACTIVITY	
Arizona	NO CURRENT ACTIVITY	
Arkansas	NO CURRENT ACTIVITY	
California	NO CURRENT ACTIVITY	
Colorado	NO CURRENT ACTIVITY	
Connecticut	NO CURRENT ACTIVITY	
Delaware	NO CURRENT ACTIVITY	
District of Columbia	NO CURRENT ACTIVITY	
Florida	NO CURRENT ACTIVITY	
Georgia	NO CURRENT ACTIVITY	
Guam	NO CURRENT ACTIVITY	
Hawaii	NO CURRENT ACTIVITY	
Idaho	NO CURRENT ACTIVITY	

**SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT**

<b>NAIC MEMBER</b>	<b>MODEL ADOPTION</b>	<b>RELATED STATE ACTIVITY</b>
Illinois	215 ILL. COMP. STAT. §§ 5/179E-1 to 5/179E-100 (2001).	
Indiana	NO CURRENT ACTIVITY	
Iowa	NO CURRENT ACTIVITY	
Kansas	NO CURRENT ACTIVITY	
Kentucky	NO CURRENT ACTIVITY	
Louisiana		LA. REV. STAT. ANN. § 22:1727 (2011).
Maine	ME. REV. STAT. ANN. tit. 24-A, §§ 781 to 798 (2003/2007).	
Maryland	NO CURRENT ACTIVITY	
Massachusetts	NO CURRENT ACTIVITY	
Michigan	NO CURRENT ACTIVITY	
Minnesota	NO CURRENT ACTIVITY	
Mississippi	NO CURRENT ACTIVITY	
Missouri	NO CURRENT ACTIVITY	
Montana	NO CURRENT ACTIVITY	
Nebraska	NO CURRENT ACTIVITY	
Nevada	NO CURRENT ACTIVITY	
New Hampshire	NO CURRENT ACTIVITY	
New Jersey	NO CURRENT ACTIVITY	
New Mexico	NO CURRENT ACTIVITY	
New York	NO CURRENT ACTIVITY	

**SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT**

<b>NAIC MEMBER</b>	<b>MODEL ADOPTION</b>	<b>RELATED STATE ACTIVITY</b>
North Carolina	NO CURRENT ACTIVITY	
North Dakota	NO CURRENT ACTIVITY	
Northern Marianas	NO CURRENT ACTIVITY	
Ohio	NO CURRENT ACTIVITY	
Oklahoma	NO CURRENT ACTIVITY	
Oregon	NO CURRENT ACTIVITY	
Pennsylvania	NO CURRENT ACTIVITY	
Puerto Rico	NO CURRENT ACTIVITY	
Rhode Island	NO CURRENT ACTIVITY	
South Carolina	S.C. CODE ANN. §§ 38-14-10 to 38-14-200 (2002).	
South Dakota	NO CURRENT ACTIVITY	
Tennessee	NO CURRENT ACTIVITY	
Texas	NO CURRENT ACTIVITY	
Utah	NO CURRENT ACTIVITY	
Vermont	NO CURRENT ACTIVITY	
Virgin Islands	NO CURRENT ACTIVITY	
Virginia	NO CURRENT ACTIVITY	
Washington	NO CURRENT ACTIVITY	
West Virginia	NO CURRENT ACTIVITY	
Wisconsin	NO CURRENT ACTIVITY	
Wyoming	NO CURRENT ACTIVITY	

**SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT**

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## SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 1. Purpose

In the fall of 1998, a new charge was proposed to investigate whether there needed to be a regulatory response to continuing developments in insurance securitization, including the use of non-U.S. special purpose vehicles and whether educational material should be provided to regulators. The assignment was to consider a number of areas: (a) the degree to which various forms of insurance securitizations might constitute the business of insurance; (b) risk transfer and correlation of risk; (c) counterparty and credit risk; (d) collateral requirements; (e) accounting issues and rules, including risk-based capital; (f) any impediments to the use of a domestic insurer as the issuer of the security; and (g) any other relevant issues. **1998 Proc. 3<sup>rd</sup> Quarter 253.**

The chair of the working group assigned the new charge stated that his state was very concerned with insurance securitization. The state's domestic companies had significant catastrophe exposure and might need the added capacity that insurance securitization could bring. He noted that predictions regarding earthquake, hurricane and other risks in the United States include scenarios with insured losses in excess of \$100 billion, which would cause significant insolvencies within the U.S. insurance industry. While traditional insurers could utilize loss prevention, deductibles and reinsurance to help mitigate their losses, there was now the possibility of including insurance securitization as a further mitigation strategy. He noted that the total exposures insured by most property and casualty companies were considerably in excess of net surplus. **1998 Proc. 4<sup>th</sup> Quarter 275.**

A regulator stated that it was his state's position that, while there needed to be a regulatory response to the continuing developments in insurance securitization, this response should be one that facilitated a more fluid transfer of insurance risk to the capital markets. He stressed that the working group should strive not to impose impediments to securitizing insurance risks that were not present currently. He pointed out that there were already a fair number of successful insurance securitization deals and, furthermore, these deals took place in a "soft" market. He noted that there were various precedents in the securitization of other risks, such as interest rate risk in mortgages and credit risk in receivables, that indicate securitization of risk was a sound economic concept that could provide additional liquidity to a market. He said that the amount of resources that were being dedicated to the development of insurance securitization by investment banks, commercial brokers, insurers and reinsurers indicated that the market should evolve and could play a material role in the distribution of insurance risk. **1998 Proc. 4<sup>th</sup> Quarter 275.**

The chair noted that the first part of the working group's charge was to "investigate whether there needed to be a regulatory response to continuing developments in insurance securitization." The working group agreed that such a response was needed. The second part of the charge included consideration of the use of non-U.S. special purpose vehicles. A regulator asked if there was anything that the regulators could do to help bring special purpose vehicles on shore. One of the possibilities was the use of separate accounts by property/casualty insurers, but noted that this proposal would be feasible only with a separate account that would be bankruptcy protected. Nonetheless, he noted that if these problems could be solved, the transaction cost for securitizations would be reduced. Another concern was the tax treatment of special purpose vehicles by the Internal Revenue Service. **1998 Proc. 4<sup>th</sup> Quarter 276.**

A commissioner asked whether the tax issue could be solved by a regulation by the IRS or whether it would require legislative action in Congress. The chair replied that it might be possible to create a favorable structure without necessarily involving the IRS or Congress. He also noted that another working group was discussing prefunding of catastrophe reserves and had been examining similar problems with tax treatment and the IRS. **1998 Proc. 4<sup>th</sup> Quarter 276.**

An interested party warned that the group should be careful regarding making recommendations that required interpretation or change in the tax code. He also noted that lobbying for such changes might open up many issues that had previously been regarded as resolved. **1998 Proc. 4<sup>th</sup> Quarter 276.**

The working group assigned a number of projects to help understand the issues facing the group, including tax issues. An interested party reported that the main impediments were the basic taxation of the special purpose reinsurance vehicle (SPRV) or protected cell, the taxation of investors and the deductibility for income tax purposes of reinsurance paid. He noted that offshore SPRVs were generally pass-through entities formed in jurisdictions where they are not taxed, whereas U.S. insurers were taxable entities under the Internal Revenue Code. **1998 Proc. 4<sup>th</sup> Quarter 249.**

## SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 1 (cont.)

An interested party referred the group to a package of materials describing the tax issues. He reported that the major tax questions for SPRVs at this stage were whether debt instruments would be treated as equity for tax purposes and whether the SPRV could be treated as a pass-through entity for tax purposes. The conclusion of the industry group was that it was possible, but not likely, that bonds issued by an SPRV would be treated as debt, and more likely that they would be treated as equity. However, each case would require a private letter ruling from the Internal Revenue Service (IRS) unless some form of legislation clarified the issue. The group felt that it would be better to try to obtain pass-through entity treatment by way of federal legislation. **1999 Proc. 1<sup>st</sup> Quarter 195, 201–206.**

The chair of the group that drafted the Protected Cell Model Act noted that one advantage of the protected cell concept was the lower cost of the transaction. He explained that currently all but one insurance securitization has been conducted through an offshore single purpose entity, which was essentially an insurance company formed solely for a single transaction to take on a specific risk exposure. Since minimum capitalization requirements were relatively high in the United States, these transactions all occurred offshore. The protected cell concept allowed an insurance company to isolate assets and a specific risk exposure in a protected cell with only a marginal risk-based capital requirement. **1999 Proc. 3<sup>rd</sup> Quarter 330.**

A regulator questioned whether existing transactions by offshore single purpose entities provided any greater security than onshore protected cells with respect to the adequacy of assets issue. The working group chair replied that there was essentially no difference because offshore single purpose entities were only marginally capitalized and this capital was immaterial compared to the risk transferred to the entity. **1999 Proc. 3<sup>rd</sup> Quarter 332.**

When presenting the Protected Cell Model Act for consideration by the Executive Committee, the chair of the parent committee noted that the working group that drafted the model had the charge to examine any impediments to having a domestic insurer as an issuer of insurance linked securities. Issuance of insurance linked securities had taken place largely offshore through special purpose vehicles due to a number of statutory accounting and tax reasons. **1999 Proc. 3<sup>rd</sup> Quarter 24.**

The chair reported that the working group had an extensive discussion regarding a possible Special Purpose Reinsurance Vehicle Model Act. The initial debate included concerns over public policy considerations as to whether such entities should be allowed to exist on-shore. In particular, questions were raised as to whether an untaxed unregulated entity should be allowed to compete with taxed and regulated domestic reinsurers. The industry interested parties agreed to produce an issue paper for the next meeting that would address these concerns. **1999 Proc. 4<sup>th</sup> Quarter I 364-365.**

A representative from a reinsurance company questioned the public policy justification for the work of the working group on these issues. He stated that a recent study claimed that the insurance industry was over-capitalized on a risk-adjusted return on capital basis. He stated that insurance securitizations brought in naïve capital, which then had the effect of reducing the price that reinsurers were able to charge for their risk-taking activities and that this was disadvantageous to the current reinsurance industry. He therefore questioned why the group was considering these forms of securitization in the first place. The chair replied that the public policy considerations had already been taken into account by the working group in prior meetings and the long-term effect of securitizations from a public policy point of view were not part of the charge before the group. **1999 Proc. 4<sup>th</sup> Quarter I 411.**

A regulator asked why a ceding insurer would use a special purpose reinsurance vehicle as opposed to just a protected cell. An interested party replied that investors have preferences. Some may be comfortable with protected cells but others might be more comfortable with something more isolated from an insurance company such as a SPRV. The endeavor was to try to create at least two options to facilitate on-shore securitizations, and many investors were comfortable with various forms of special purpose vehicle. Another interested party pointed out that it was possible that protected cells might not need a change in the tax law to operate efficiently but that it seemed clear that an SPRV would need a change in tax legislation to have certainty that it could operate efficiently. **1999 Proc. 4<sup>th</sup> Quarter I 411.**

## SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 1 (cont.)

A spokesperson for a group of interested parties said some were questioning the public policy issue of even allowing a special purpose reinsurance vehicle on shore. He stated that it was prudent to expand the number of possible sources of capital to cover catastrophe risk and that the more tools and sources that could be brought to bear on these problems, the better. A representative from a reinsurance association stated that his association's position was that there was already an on-shore domestic solution to securitizations in the form of the NAIC Protected Cell Model Act, which had already been adopted. His association did not believe that a non-regulated, non-taxed entity should be allowed to compete for insurance risks with a taxed and regulated reinsurer. He believed that the securitization market was developing well, but that no purpose was served by allowing inequitable competition. Another interested party stated that one needed to recognize that a securitization differed from regular reinsurance. In a securitization, the entity has had to post the entire aggregate limits and fully fund these amounts. This was not competing with traditional reinsurance, which did not fully fund risks in advance. **1999 Proc. 4<sup>th</sup> Quarter I 398.**

A regulator noted that, even if the working group were to adopt this model act in the future, it would require a change in federal tax law to enable the concept to work economically. An interested party asked if there was any point, given that the overall concept was already enabled through the NAIC Protected Cell Model Act. A reinsurer representative stated that, although securitizations could be done off shore with special purpose reinsurance vehicles, there were frictional costs involved. Allowing special purpose reinsurance vehicles on shore would remove the frictional costs and thereby enable those vehicles to compete on an unlevel playing field with traditional reinsurers. **1999 Proc. 4<sup>th</sup> Quarter I 398.**

There was much discussion regarding the tax issue. A reinsurance association representative stated that allowing a pass-through tax treatment for SPRVs would disadvantage traditional reinsurers, and another interested party noted that comparisons with offshore SPRVs usually overlooked the federal excise tax that is payable on offshore cessions. An interested party favoring SPRVs countered that the differential taxation of debt and equity was a feature of the U.S. tax system, and that it was not fair to compare equity financing of a reinsurer with the debt equity financing of an insurance securitization, noting that debt and equity investors have different needs. **2000 Proc. 2<sup>nd</sup> Quarter 528.**

A regulator suggested that there were two problems before the working group and the market as a whole: Should regulators enable SPRVs on shore and secondly, if they did enable them, should regulators encourage them to exist or simply set up a neutral framework? He noted that the tax issue was not an issue over which insurance regulators had control. An interested party responded that the securitization market was flourishing and there was no tax inequity offshore at present. Another stated that the issue related to the differences under the U.S. taxation system between tax on debt and equity. He suggested that providing pass through tax treatment for SPRVs would in fact remove a disincentive for investors to play on a level playing field with reinsurers. A third interested party stated that he had some difficulty understanding the level field argument applied to SPRVs. He noted that SPRVs fully fund the entire exposure and this in and of itself was an uneven playing field relative to traditional reinsurers. He therefore questioned why traditional reinsurers should regard a different tax treatment for SPRVs as inequitable. Another agreed, stating that SPRVs merited a lax regulatory regime entirely due to the fact that they would fully fund their exposure. Nonetheless he was concerned about the apparent tax disadvantage to traditional reinsurers. **2000 Proc. 3<sup>rd</sup> Quarter 519.**

At a meeting early in 2001, the chair returned to a discussion of the tax issues. An interested party stated that transactions to date had to include many provisions in order to ensure that the issued securities would be regarded as debt as opposed to equity. He stated that the wish of the proponents of federal tax legislation was simply to gain certainty from Congress regarding this, as these current methodologies only added extra cost to the transactions. A reinsurance representative stated that this could lead to an inequity and the actions of Congress should not advantage bondholders over regular reinsurers. **2001 Proc. 1<sup>st</sup> Quarter 398.**

A commissioner asked how the tax issue affected an insurance commissioner, noting that such issues were outside a commissioner's jurisdiction. He stated that his role was to protect consumers and to provide them with as many cost-effective options as possible to insure their risks. He felt strongly that it was not the role of an insurance commissioner to decide or take position on the federal tax implications of any one methodology of transferring risk over another. An interested party stated that in his view the possibility of requesting pass through tax treatment for SPRVs from Congress should be seen as removing a barrier and not granting a benefit. **2001 Proc. 1<sup>st</sup> Quarter 398.**

## SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 1 (cont.)

A regulator suggested that, if one allowed that there may be a tax advantage for an SPRV with pass through tax treatment, then that advantage already existed in the offshore deals that were currently being done. He then suggested that it would be in regulators' best interest to bring onshore the transactions that were currently being done offshore, thereby bringing them under control of U.S. regulators. In addition he took issue with the concept that SPRVs had some form of unlevel playing field relative to regular reinsurers noting that the transactions were different and, in the case of an SPRV, the exposure was fully funded, which was never the case with a regular reinsurance contract. **2001 Proc. 1<sup>st</sup> Quarter 398.**

The chair picked up on an argument suggesting that Congress would endeavor to equalize the amount of tax paid by the insurance industry as a whole and asked why, if Congress thought there would be a tax loss with SPRV, direct writers wouldn't be concerned with a potential increase in tax. An interested party countered that part of the problem may be that SPRVs might replace existing primary and reinsurance capacity in the United States, not just the current offshore transactions. The commissioner noted that it would surely be better to have these transactions onshore than offshore from the U.S. regulators' viewpoint. A regulator agreed and said that one could not look at the tax issue in isolation and should look at the aggregate picture, noting that there may be much interaction between primary and reinsurance markets and SPRVs. An interested party stated that a majority of the primary insurance industry supported the model act and did not see SPRVs as particularly tax advantaged. They regarded them instead as an additional tool in the risk management techniques available to primary insurers. In addition, he felt that it was possible that the assumptions regarding calculation of tax bases, etc. may well have changed since the last election. **2001 Proc. 1<sup>st</sup> Quarter 398.**

The chair referred the group to the two possible wordings for a resolution on the tax issue. A regulator noted that it was unusual for NAIC working groups to include a resolution with a model. He suggested that the wording of any resolution may not be able to achieve complete neutrality. He noted that the original intention and charge to the working group was to facilitate on-shore securitizations and he questioned why one needed a resolution. He opined that any resolution might be used inappropriately by lobbyists for and against the Special Purpose Reinsurance Vehicle Model Act. Another regulator said the resolution was part of the compromise package put together at an earlier meeting. He said that the SPRV model probably would not work without tax legislation, but noted that without a resolution some may interrupt the adoption of the act as NAIC's support for federal tax legislation. Another regulator agreed that silence was the least neutral position, but a third thought that the most neutral was not to say anything about tax legislation. An interested party stated that the minutes themselves are part of the public record and consequently the discussion regarding tax issues and the fact that the working group had come to no position either supporting or proposing federal tax legislation would therefore be clear. **2001 Proc. 1<sup>st</sup> Quarter 375.**

Interested parties prepared a paper on the various public policy issues surrounding insurance securitization. The chair indicated that he expected to have a panel discussion and debate at the Summer National Meeting and a two-day interim meeting to discuss the interested parties' document. **2000 Proc. 1<sup>st</sup> Quarter 642.**

The paper outlined positions in support of special purpose reinsurance vehicles and counterpoint. It noted that various approaches to insurance securitizations have been tried and that off-shore special purpose reinsurance vehicles were most common. The paper contained supportive public policy discussion and reasons why the development of onshore reinsurance vehicles was not appropriate. Public policy questions were discussed. **2000 Proc. 2<sup>nd</sup> Quarter 552-575.**

One of the key issues was whether the tax treatment of SPRVs would create an inequitable situation vis-à-vis traditional reinsurers. The chair said that SPRVs were potentially very good for funding catastrophe losses, but expressed concern about the potential for abuses if SPRVs were allowed to operate in other areas. Another regulator said that potential abuses might be controlled through the Plan of Operation for an SPRV that would be filed with commissioners. The chair made the point that investors in a securitization might well invest for different reasons, depending on the type of securitization. Catastrophe securitization investors were likely to be different from non-catastrophe investors, and would be investing to diversify their portfolios with a zero beta investment. On the other hand, investors in working layer securitizations would presumably be looking for underwriting risk, and would therefore be like the traditional Lloyd's Names. The second regulator countered that the securitizations under consideration would be 100% funded, and questioned whether insurance regulators should seek to regulate who should and should not be allowed to risk their 100% investment. **2000 Proc. 2<sup>nd</sup> Quarter 528.**



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#### Section 1 (cont.)

A university professor prepared a research paper for the working group. This paper evaluated proposed regulatory and implied tax policies for onshore special purpose reinsurance vehicles. **2000 Proc. 2<sup>nd</sup> Quarter 492-527.**

In March 2001, the working group received a letter from the professor amending some of the conclusions in the paper, “Regulating On-shore Special Purpose Reinsurance Vehicles” which had been presented to the group at the 2000 Fall National Meeting. The chair noted that the professor now believed that the NAIC’s adoption of the SPRV Model Act would be a positive step and its enactment and implementation by the various states would promote the interests of insurance consumers and the general public. Furthermore, he now concluded that the issues involved with the proposed federal tax treatment of onshore SPRVs should not be used to impede the development and use of these vehicles. **2001 Proc. 1<sup>st</sup> Quarter 376, 387-389.**

A revised version of the paper was included with the minutes of the June 2001 meeting. **2001 Proc. 2<sup>nd</sup> Quarter 435-451.**

A reinsurance representative said that in his view SPRVs may create greater price shocks due to a lack of permanent capital. He thought that the net effect of the model act might be to deregulate part of the insurance industry. Another interested party favoring SPRVs stated that capital can already flow in and out of the insurance industry easily and that there has always been cyclicity and presumably there will still be cyclicity in the future. However he suggested that having SPRVs as an additional source of capacity would tend to reduce or moderate that cyclicity. He noted that corporate entities are already going directly to the capital markets and the insurance industry had a choice of either participating or not in these new capital market risk transfer mechanisms. By passing the SPRV Model Act, the insurance industry would have an opportunity to play in the game. He noted that many serious thinkers were not worried about a \$30 billion event, they were worried more about the possibility of a \$100 billion event that would effect everyone in the insurance industry. He also noted a public policy concern about the increasing use of higher deductibles and therefore the trend towards avoiding risk in the insurance industry. He suggested that utilizing the capital markets might be a way of reversing this trend. **2001 Proc. 1<sup>st</sup> Quarter 398-399.**

The chair reported that the model provided a regulatory framework for a limited certificate of authority to a special purpose reinsurance vehicle for the purpose of transforming insurance risk into a security, which would then offered for sale in the U.S. securities market. The SPRV would be required to fully fund the aggregate amount of exposure ceded to it. The assets of the SPRV were required to be held in a trust administered by a qualified U.S. financial institution. The trustee must obtain the approval of the U.S. cedent before transferring any trust assets. He reminded the committee that the most important safeguard within the model was that the cedent maintained control over the trust assets. **2001 Proc. 2<sup>nd</sup> Quarter 430.**

A regulator pointed out that opponents of the model argued that it created an unlevel playing field between SPRVs and reinsurers for two reasons: 1) it creates a relaxed regulatory regime for SPRVs; and 2) it created a tax disadvantage for existing reinsurers. He said that a relaxed regulatory regime was intentional, based on the fact the entire amount of coverage was fully funded, which eliminated credit risk and included marginal market risk. He further explained that the working group took no position on the issue of taxation and recognized that federal tax legislation might be necessary to make SPRV transactions viable. **2001 Proc. 2<sup>nd</sup> Quarter 430.**

Just prior to the model’s adoption, a representative from a reinsurance association again expressed opposition to the model. He reminded the committee that his association had opposed the model throughout the project for three primary reasons: First, the association believed the model created a tax and regulatory advantaged reinsurer. The objective of the model was to duplicate current securitization transactions that occurred offshore. To do this, there must be an identical cost structure in the United States; otherwise, the onshore SPRV would not be an attractive alternative to offshore securitization transactions. This would require a federal tax law change that would create a tax loophole, thereby creating a tax-advantaged reinsurer. The representative suggested that the proponents of the model supported it because it promoted efficiency that, in his opinion, arose from a tax advantage to the SPRV. He noted that SPRV transactions could be done onshore without a change in federal tax legislation. However, such SRPV transactions would be much more expensive and, therefore, less attractive. Second, the association believed the model created a general-purpose reinsurer, rather than a special-purpose reinsurer, with no limits on the type of business that could be written or the number of cedents from which the SPRV could assume business. Third, the association believed the model created potential unintended consequences that might not be in the best interest of regulators. **2001 Proc. 2<sup>nd</sup> Quarter 431.**

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#### Section 1 (cont.)

Another reinsurer representative stated that the model represented an incentive program for SPRVs that would undercut the business sent to U.S. reinsurers because of the tax and regulatory advantages. He urged regulators to take a regulatory interest in marketplace equity and to seek similar incentives for U.S. reinsurers to allow them to compete with SPRVs. He also urged the committee to limit the model to catastrophe risk at this point to further experiment with other lines of business. **2001 Proc. 2<sup>nd</sup> Quarter 431.**

#### Section 2. Exemption from Insurance Laws within Limitations

A. An interested party noted that a subgroup of interested parties was looking at more than the original tax issue to include other matters arising from the concept of bringing special purpose vehicles on-shore and most important was whether a special purpose vehicle would be regarded as an insurer for regulatory purposes. A representative from a reinsurer stated that current offshore special purpose vehicles were structured as special purpose reinsurers. Their contract with the ceding company was reinsurance, and the special purpose vehicle issued securitizations on the other side of the reinsurance transaction. **1999 Proc. 1<sup>st</sup> Quarter 196.**

B. An interested party presented a memorandum that discussed the degree to which various forms of insurance securitizations might constitute the business of insurance and explained that the central issue was whether the investors in an SPRV or counterparty to an insurance securitization transaction were engaged in the business of insurance and therefore subject to insurance regulation in the states. He noted that many states have taken the position that investors in insurance-linked securities are not in the business of insurance and that a few states have concluded that index-linked swaps or options also were not considered the business of insurance by the counterparty. He opined that it would be beneficial to the states, insurers and investors evaluating these financial instruments if the NAIC could take a definitive position on whether investment in these securities constitute the business of insurance. **1998 Proc. 4<sup>th</sup> Quarter 250–259.**

An interested party proposed changes to the draft, which included changing the name of a special purpose vehicle to a special purpose reinsurance vehicle (SPRV). The interested parties felt that the change of name would not change the fact that the insurance securitization contracts were not the business of insurance. **1999 Proc. 4<sup>th</sup> Quarter I 411.**

#### Section 3. Definitions

B. The chair asked whether, based on the definition of a ceding insurer, an SPRV could only assume business from an affiliated group. An interested party replied that, based on the wording of Section 6, an SPRV could enter into a transaction with one or more ceding insurers; thereby enabling a group of insurers to get together and create a securitization through an SPRV. The chair noted that this could possibly lead to the formation of what might be regarded as an entrepreneurial group SPRV. The interested party responded that one would still need a Plan of Operation that was approved by the commissioner and hence a group securitization might not be too risky. However he noted that the reason for this provision was that the various trades had asked for the ability for their smaller members to participate in securitizations. The chair asked whether all ceding insurers would need to be identified and the interested party replied that they would based on Section 4(8)(a), which required that the plan name all ceding insurers. In addition the interested party noted that an SPRV could effectuate only one securitization at any one time although this would not prevent the securitization having multiple tranches with separate trusts for each tranche. **2000 Proc. 4<sup>th</sup> Quarter 459-460.**

D. The working group discussed the definition of “fair value” in Section 3D. A regulator asked why the definition of fair value allowed for good faith valuation where no generally recognized sources of quotations existed, noting that his understanding was that the investments would be quoted market instruments. An interested party suggested that the fair value wording from SSAP No. 33 be substituted. **1999 Proc. 4<sup>th</sup> Quarter I 411.**

F. As contemplated in the first draft, initially the special purpose vehicle contract could be only an indemnity contract, but as the NAIC developed standards and accounting for non-indemnity contracts, it could be a qualifying non-indemnity contract as well. **1999 Proc. 3<sup>rd</sup> Quarter I 298.**

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#### Section 3 (cont.)

K. The chair noted that nowhere in the model act was a special purpose reinsurance vehicle (SPRV) defined as an insurance company and asked whether this was deliberate. An interested party replied that it was, although he noted that the definition required that the entity receive a certificate of authority from the commissioner. However, there were tax problems with defining the entity as an insurer; if the SPRV was an insurer, investors might be exposed to taxation as an insurance entity and the investor group might be in the business of insurance. **1999 Proc. 3<sup>rd</sup> Quarter I 241.**

The chair replied that he was concerned that, if a SPRV was not defined as an insurance entity, it might cause other problems with the treatment of SPRVs. For example, a contract between an insurer and an SPRV might not be a reinsurance contract if an SPRV were not an insurer, given that a ceding insurer may not be able to cede reinsurance to a non-insurance entity. The SPRV contract might not be subject to the reinsurance articles of the insurance code. The interested party replied the intent was that at the ceding company level the transaction should be treated as reinsurance but agreed that this needed more review. The chair also noted that Section 15 would apply some of the state rehabilitation and liquidation statutes to the SPRV and that relief from the federal bankruptcy code would generally require the entity to be an insurer. Another interested party suggested that stating that the SPRV was governed by the state's rehabilitation act should address that problem. A state would need to amend its receivership act to include an SPRV within the definition of insurers and this was noted in a footnote to the model act. The chair replied that the federal bankruptcy code did not refer to an SPRV but did refer to the word insurer. **1999 Proc. 3<sup>rd</sup> Quarter I 241-242.**

#### Section 4. Limited Certificate of Authority Required

The chair asked about the application of the McCarran-Ferguson Act to an SPRV. An interested party replied that he assumed that the SPRV would be treated as an insurer as it was basically in the business of insurance. The chair, however, noted that the model act had specified that an SPRV was not an insurer and the interested party agreed that the group would need to revisit this issue and stressed the reason why the interested parties had not specified the SPRV as an insurer was to try to obtain the best tax treatment. A regulator asked how a commissioner could issue a certificate of authority if the entity were not an insurer. The interested party replied the certificate of authority was only for the purpose of the model act and might need a different name. He noted that the SPRV was an entity that had a very limited purpose and the certificate of authority would therefore also need to be limited. Another regulator said that there needed to be some guidelines for the commissioner regarding the issuance of the certificate of authority. **1999 Proc. 3<sup>rd</sup> Quarter I 242.**

B. A commissioner questioned the exposure to market risk and how this risk would be managed by the SPRV. The chair responded that the SPRV would be required to submit business plans as part of the license application, which would state the SPRV's plan to maintain its fully funded status and its ability to manage market risk. **2001 Proc. 2<sup>nd</sup> Quarter 430.**

C. An interested party suggested that, in order to address the potential problem of forum shopping, the host commissioner should be empowered to approve cessions to SPRVs. The chair thought that this should probably be placed in the reinsurance authorization statute as opposed to the model act. However, a reinsurance representative stated that for financial reinsurance transactions it is often required that the transaction be reviewed and not disapproved by the commissioner and he suggested that perhaps a similar approach might be used in this case. The chair then suggested an amendment to Section 4 requiring that the domiciliary commissioner of the SPRV receive notice of non-disapproval from the regulator of the domicile of the ceding entity. He suggested that this be done by way of a drafting note for states to consider any change in their law to enable the commissioner to approve or disapprove the transaction. **2001 Proc. 1<sup>st</sup> Quarter 399-400.**

Shortly before adoption of the model, the committee considered an amendment to Subsection C that incorporated standards for the approval or disapproval of the SPRV's certificate of authority. **2001 Proc. 2<sup>nd</sup> Quarter 430, 433.**

A regulator pointed out the need to communicate the drafting note following Section 4C to all states, because, while not all states would consider the model for presentation to their legislatures, all states should have ensured that the commissioner had the necessary jurisdiction to review and approve or disapprove SPRV transactions. **2001 Proc. 3<sup>rd</sup> Quarter 321.**

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#### Section 4 (cont.)

D. The working group discussed deemer language in Section 4 regarding a limited certificate of authority. The chair questioned whether deemer language would actually satisfy the capital markets in the sense of giving them sufficient confidence to issue an SPRV securitization when the only certificate of authority had been issued due to action of a deemer. An interested party stated that sponsors would tend not to go to the market until they had specific written approval of a limited certificate of authority. Regarding the timing issue inherent in the reason for the deemer language, he thought that the only problem that might occur would be for the seasonal coverages, e.g. hurricane, where the ceding company may wish to get rapid approval of the SPRV. **2001 Proc. 1<sup>st</sup> Quarter 398.**

One state regulator said he would be prepared to support the act if all deemers were removed from the current draft, and another added that if the industry wanted the additional latitude of multiple cedents then regulators needed a chance to review applications properly. A long discussion followed regarding the use of the deemer clause. The chair noted that the deemer provision relating to the certificate of authority would not take effect until after the receipt of a notice of non-disapproval by the ceding insurers' domiciliary commissioners. An industry representative stated that that was an oversight in the drafting and asked the group to reconsider including this within the deemer period. The chair disagreed, noting that the way the clause was written constituted a powerful protection. All wanted the current language that would not allow the deemer to take effect until after the receipt of the notices. **2001 Proc. 1<sup>st</sup> Quarter 397.**

Shortly before adoption of the model, a state expressed concern with the "deemer provision" for the approval of the SPRV certificate of authority and proposed that the deemer provisions be eliminated. The state also proposed that a regulation or implementation guidance be drafted to provide guidance to the reviewers of SPRV transactions. **2001 Proc. 2<sup>nd</sup> Quarter 325.**

The amendments incorporated in the next draft included: 1) a limitation on the use of SPRVs to property catastrophe lines of business only; 2) the deletion of the 30-day deemer provision on the approval of the SPRV; and 3) additional criteria for the approval of the limited certificate of authority for a SPRV. **2001 Proc. 3<sup>rd</sup> Quarter 321.**

A representative from an association stated the association's support for the thirty-day deemer provision and a regulator responded that investors in the SPRV transaction would most likely not want to invest in a transaction that had not received explicit regulatory approval. Another interested party agreed that the deemer provision brought uncertainty to the approval of the SPRV. Another regulator raised concern that the states might not have the expertise or resources to review the SPRV transaction within the thirty-day time frame of the deemer provision. A commissioner suggested that additional experience with SPRV transactions was necessary before a deemer provision was used. The draft adopted did not include the deemer provision. **2001 Proc. 3<sup>rd</sup> Quarter 321.**

E. The chair recommended that the wording in Section 4 regarding the limited certificate of authority be revised to eliminate the language deeming the SPRV business to be the business of reinsurance and stating that it was the business of reinsurance but limited by this act. **1999 Proc. 4<sup>th</sup> Quarter I 411.**

F. A regulator said his state was willing to explore creative and innovative ways to manage catastrophe risk. However, there were concerns with the tremendous responsibility of the regulator in reviewing SPRV transactions, in that the regulator needed to be certain that the SPRV transaction was adequate. Additionally, he said that there may need to be a limited number of players in such transactions with a specific level of skill and sophistication. Additional consideration and revisions might be necessary to gain a comfort level with and support of the model. Another regulator stated that the model allowed a significant amount of discretion among the states, which might not provide for the consistent application of the model among the states. His state was concerned about the level of expertise necessary to review and approve SPRV transactions and recommended that some additional time be taken by the committee to review and further consider the model. The chair of the drafting group reminded the committee that SPRV transactions were already occurring in the marketplace and that state regulators currently had no authority to review such transactions. The model was simply incorporating a U.S.-based unauthorized reinsurer, which would be subject to the rules and regulations of the states. **2001 Proc. 2<sup>nd</sup> Quarter 432.**

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#### Section 5. Limited Purpose of SPRV

The chair asked whether the model should allow SPRVs to be used for other than catastrophic risks noting that this was a suggestion in the scholarly paper received by the working group. A regulator stated that he believed the working group should take baby steps and that it should therefore focus on catastrophic risk only to begin with. He did not feel comfortable voting for a model that allowed unlimited types of SPRVs. He also noted that tail risk and the issue of multiple cedents were also major problems that needed to be solved. A commissioner stated that it would be a mistake to focus solely on catastrophic risks. He noted that the earliest securitization deal was a life insurance securitization as has been the case with some of the more recent securitizations. Insurance regulators were playing catch up with the overall capital markets. While he agreed that baby steps were more cautious, he said that insurance regulators would face the same debate in the future and one may as well bring closure now and vote on the model as is. Another regulator stated that his state had a problem limiting the act to only catastrophic risks especially given that the commissioner had to approve all deals and would therefore be able to deal appropriately with any newer proposals for other forms of insurance securitizations. **2001 Proc. 1<sup>st</sup> Quarter 399.**

The chair called for a vote on whether to limit the model to catastrophic risk or other lines of business or to craft the model with no limits. Seven voted to have no limits in the model act per se, while five voted to limit the act, possibly to catastrophic risk only. In consequence the working group supported no limits as lines of business. **2001 Proc. 1<sup>st</sup> Quarter 399.**

A regulator suggested that as a compromise the model could be modified to state that availability was limited to such lines of business as the commissioner allowed by rule. After discussion the chair recommended that a drafting note be added to Section 5 stating that states may consider either authorizing specific lines of business that may be ceded to an SPRV or restricting specific lines of business from being ceded to an SPRV. Without objection the working group unanimously adopted this approach. **2001 Proc. 1<sup>st</sup> Quarter 399.**

In May 2001 the parent committee received a letter from a life insurance trade association requesting that the model be adopted in such a form that SPRVs could be used with life insurance products. The organization recognized that significant actuarial and accounting work would need to be completed to satisfy regulatory interest in the life application and to make SPRVs workable for life insurance products. However, they requested that regulators leave open the opportunity to apply the model to life insurance products in the future. **2001 Proc. 2<sup>nd</sup> Quarter 452.**

Just prior to adoption of the model by the parent committee, a representative from a life insurance trade association again requested that a placeholder be maintained in the model for the use of SPRVs with life insurance products. The chair reminded the committee that the model did not limit the use of SPRVs to any specific lines of business. A regulator expressed concern with how the SPRV structure would work for other lines of business and suggested that there be more development of the model prior to its application to lines of business other than catastrophe risk. **2001 Proc. 2<sup>nd</sup> Quarter 430.**

The committee moved the property catastrophe limitation from the definitions section to Section 5 of the model to make it clearer. **2001 Proc. 3<sup>rd</sup> Quarter 321.**

#### Section 6. Approved Transactions and Operation of SPRVs

When development of the model began, a member of the drafting group identified a number of issues for the group to review, such as credit risk, accounting treatment, correlation for index-based products, and the different tax treatments between on-shore and off-shore securitization vehicles. He opined that these issues should be addressed in a manner that gave regulators comfort that solvency concerns were being mitigated. He cautioned that the group need not identify every potential problem because the market was an evolving one whose problems could be addressed over time. **1998 Proc. 4<sup>th</sup> Quarter 275.**

Another regulator spoke in agreement with that approach and suggested that the approach would help foster the growth of the market and hopefully also keep a lid on escalating premium costs. He noted that the issue of credit risk was particularly important for his state. **1998 Proc. 4<sup>th</sup> Quarter 275.**

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#### Section 6 (cont.)

A regulator noted that a number of issuers had utilized swap agreements and other forms of derivative transactions to securitize insurance risk, which brought in the element of credit risk in that there was a question as to whether the counterparty would be able to pay the issuer after a triggering event. In addition, there was the issue as to what would trigger the derivative—an insurer's actual loss experience or an index. The chair also mentioned various forms of equity and contingent equity issuance as forms of securitization. **1998 Proc. 4<sup>th</sup> Quarter 275.**

A. As contemplated in the first draft, initially the special purpose vehicle contract could be only an indemnity contract, but as the NAIC developed standards and accounting for non-indemnity contracts, it could be a qualifying non-indemnity contract as well. **1999 Proc. 3<sup>rd</sup> Quarter I 298.**

Regulators discussed whether the act was intended to allow retrocession. An interested party said that it was intended that the SPRV could reinsure a reinsurer. Additionally, there was no total prohibition on the SPRV retroceding business but it was suggested that this should only be allowed for basis risk. Another interested party noted that a securitization must still be fully funded with respect to the ceding insurer even if there was a retrocession and another interested party agreed and said that there was no intention that the SPRV should become or be allowed to become a fronting arrangement. **1999 Proc. 4<sup>th</sup> Quarter I 411.**

B. The special purpose vehicle trust would be formed and operated in a manner and under a regulatory regime that met criteria set forth in the act. The requirements were based on an existing state law used commonly for offshore securitization transactions. **1999 Proc. 3<sup>rd</sup> Quarter I 298.**

The working group discussed the possibility of SPRVs being used in a multi-cedent transaction. After discussion the working group agreed that it could compromise by ensuring that there were separate trusts and separate agreements for each cedent, with each trust complying with the single cedent rules. The group unanimously adopted a change to Section 6B(7) to state that "In the case of more than one ceding insurer, a separate trust agreement shall be entered into with each ceding insurer and a separate trust account shall be maintained for each ceding insurer." **2001 Proc. 1<sup>st</sup> Quarter 400.**

The working group discussed deleting the "willful misconduct" language in Paragraph (12) and substituting simply "misconduct." **1999 Proc. 4<sup>th</sup> Quarter I 411.**

NAIC staff noted that a normal reinsurance trust tended to be continuous unlike a securitization, which had a definitive termination date or maturity date of the underlying instruments absent a trigger. He asked how the tail of liability would be handled in Section 6B(12) where a trigger event had occurred, but where it might not have penetrated completely the securitization layer. It was suggested that Section 6B(12)(a)(ii)(VI) should enable the ceding insurer to retain the assets of the SPRV trust in order to fund its exposure during the period of loss development. **1999 Proc. 4<sup>th</sup> Quarter I 411.**

During the drafting, an interested party noted that interested parties wanted to prevent fronting but had not yet agreed on wording to achieve this end. The agreed upon wording became part of Paragraph (21). **1999 Proc. 4<sup>th</sup> Quarter I 412.**

The working group discussed the wording of Paragraph (22). The chair suggested the language be changed to "void the certificate of authority at the end of the securitization" so as to enable future securitizations with that SPRV as opposed to requiring that it immediately be wound up. **1999 Proc. 4<sup>th</sup> Quarter I 412.**

An interested party also suggested broadening Paragraph (23) to try to prevent funds from a securitization getting into the hands of an inappropriate investment manager or others. **1999 Proc. 4<sup>th</sup> Quarter I 412.**

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#### Section 6 (cont.)

There was discussion regarding the appropriate wording of the trusts for an SPRV. With a reinsurance trust there is an unconditional right for the ceding company to withdraw funds from the trust although in such a case the liabilities have already arisen. However, in the case of a fully funded SPRV, some of the assets in the trust were being held on an exposure basis and, prior to the triggering event, did not secure liabilities of the ceding company. The working group decided to tighten up the language to enable an unconditional right of withdrawal subject only to notice to the trustee that the triggering event has occurred. This would be very similar to a documentary letter of credit. **2000 Proc. 4<sup>th</sup> Quarter 460.**

#### Section 7. Powers

#### Section 8. Affiliation

The chair asked who would in general own a special purpose reinsurance vehicle (SPRV). An interested party replied that the offshore SPRVs had typically been owned by a charitable trust organization but the interested parties who drafted the model act had deliberately left that issue vague. The chair also noted that the model act contemplated only one securitization within the SPRV but asked whether the SPRV could accept business from more than one ceding insurer. The interested party replied that it could and indeed this would enable small companies to band together to undertake cost effective securitizations. **1999 Proc. 3<sup>rd</sup> Quarter I 242.**

A regulator asked why the SPRVs were defined as being owned by persons not affiliated with the ceding company. An interested party replied that the industry representatives who prepared the draft felt there should be distance between the ceding insurer and the SPRV because of liquidation and tax laws. Another regulator asked what tools might be available to the commissioner in the event of a failure of the SPRV to pay the ceding insurer's losses after a triggering event. The interested party responded that this was somewhat unlikely as the assets in the SPRV would be placed in trust for the ceding insurer, although it was possible that there could be market value diminution. **1999 Proc. 3<sup>rd</sup> Quarter I 241.**

A regulator noted that the SPRV securitization needed to be fully funded at the time of the securitization but asked whether there was any onus on the owner to try to maintain the value of the portfolio over the period of the securitization. An interested party replied that the credit for reinsurance for the ceding insurer would be keyed off the market value of assets. He noted that securitizations usually used very secure short-term assets with minimal volatility, stating that both the ceding insurer and the investors tend to have similar security and liquidity requirements. **1999 Proc. 3<sup>rd</sup> Quarter I 242.**

When reviewing a revised draft several months later, a regulator asked why the new draft had limited the securitization under an SPRV to only one ceding insurer, noting that the prior draft had allowed small companies to group together to use an SPRV. An interested party stated that there was a tax issue with a multiple company scenario as the pass through tax status of an SPRV would provide a substantial advantage to the SPRV over other reinsurers. The regulator asked whether a situation involving two contracts of reinsurance from a ceding insurer would require two SPRVs. It was agreed that the current draft would require multiple SPRVs but one interested party suggested that it might be possible to use a consolidator reinsurer ahead of multiple company risks such that the consolidator reinsurer issued a single contract of reinsurance to the SPRV. The chair asked whether any offshore SPRVs to date had had more than one cedent and the interested party stated that he believed they had not. **1999 Proc. 4<sup>th</sup> Quarter I 411.**

#### Section 9. Capitalization

The chair said that he was concerned with the problem of transient capital. Securitizations tended to be funded with debt instruments that had a specified or limited time period, unlike equity investments which tended to need regulatory approval to be repaid. In some states primary insurers could instantly get out of particular lines of business and if a company were to hedge such business with securitizations and debt capital, then once the debt matured it might not be possible to reinstate the equivalent of the reinsurance cover. In addition he stated that there was the possibility of damage to traditional insurance capital if it is unable to compete with new capital being provided by securitizations. A college professor responded that he was skeptical of barriers to capital mobility and suggested that one needed to ask what situation would prevent the renewal of

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#### Section 9 (cont.)

debt securities. He suggested that the same situation would also result in the withdrawal of reinsurance capacity. He admitted that there was a possibility of a temporary dislocation due to the frictional costs of set-up and shut-down of SPRVs and agreed that there could also be problems if there were misrepresentations to the investment community regarding the riskiness of a securitization investment. In his personal view, the professor could not think that working layer risk would make a lot of sense for SPRVs. Another regulator asked whether states should prohibit working layer risk in SPRVs or simply allow the market to make such transactions irrelevant or alternatively whether regulators should prohibit certain parts of working layer securitizations. The professor responded that regulators perhaps would need skepticism regarding the Plan of Operation on working layer risk. Ideally, he suggested regulators wanted carriers to take a long-term view and if carriers used short-term capital that may not be available in the long term to help finance their risks, then there is clearly an additional financial risk to the primary insurer. He suggested that this was akin to an asset liability matching issue. **2000 Proc. 3<sup>rd</sup> Quarter 518.**

The working group discussed whether capital provided for a securitization could be removed before time. An interested party suggested that the SPRV model as drafted was modeled after the collateral requirements of unauthorized reinsurance. He suggested that all capital was effectively transient and that there was nothing in the current regulatory structure to require traditional reinsurers to renew policies. **2000 Proc. 3<sup>rd</sup> Quarter 518.**

Then followed a discussion of the credit for reinsurance issues and the ability of ceding insurers to draw down all assets in an SPRV trust. An interested party noted that the ceding insurer was indeed able to draw down all assets in an SPRV trust even if ultimately that may not be adjudicated as legal. Nonetheless he noted that this was modeled exactly on the credit for reinsurance trusts for unauthorized reinsurers. Another interested party suggested that the traditional reinsurance market provided committed capital to ceding insurers whereas securitizations would provide transient capital. He noted that one of the key differences potentially between the two was in the area of tail risk and suggested that there would be an inequity to reinsurers in the current market if on-shore SPRVs were allowed to go forward with tax advantages. He also suggested that creating an incentive for risk transfer mechanisms to move to transient capital might have unintended consequences. In particular he asked where the public policy issue was relating to any possible capacity shortfall, suggesting that there was no capacity shortfall except potentially in the area of very high catastrophic risk. **2000 Proc. 3<sup>rd</sup> Quarter 518–519.**

The chair asked whether the capital required in Section 9 needed to be in the form of common stock but an interested party responsible for drafting said it was deliberately left unspecified. **2000 Proc. 4<sup>th</sup> Quarter 460.**

#### Section 10. Dividends

#### Section 11. Records and Financial Reports

An interested party opined that the statutory reporting requirements for insurance companies might be excessive and burdensome for a special purpose reinsurance vehicle (SPRV) that was formed for a very specific purpose. He also noted that many of the general insurance regulatory requirements such as licensing and capitalization requirements, risk-based capital (RBC), investment limitations, holding company act provisions and others were similarly burdensome for these types of entities. He recommended in particular that SPRVs should not be subject to assessment or participation in state guaranty funds and that in addition they should be subject to an expedited winding up process after the special purpose for which they were created was completed. **1998 Proc. 4<sup>th</sup> Quarter 249.**

A. A regulator requested that the wording in Section 11 stating that an audit “may” be requested should be changed to require audits. An interested party pointed out that to date the audits of SPRVs tended to be Generally Accepted Accounting Principles (GAAP) audits as opposed to Statutory Accounting Practices (SAP) audits. **1999 Proc. 4<sup>th</sup> Quarter I 412.**



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#### Section 11 (cont.)

There was considerable discussion regarding Section 11, which seems to imply that the fiscal year-end of the SPRV might be other than year-end. The chair asked whether the filed financial statements would link with the statements needed for regulatory purposes. An interested party suggested that it would increase transactional costs if there were a requirement for different audited regulatory statements and audited financial statements of the SPRV. He noted that Paragraph (8) required the bank holding the trust assets to report on the assets in the trust and wondered whether this would be sufficient. A regulator agreed that there was a difference between a one-time seasonal securitization and a going concern, but suggested that the hurdles may be too high and the frictional costs too high to allow anything other than annual year-end audits. The chair pointed out that all regulatory reporting is based on a Dec. 31 year-end, and it would be very difficult to change this. **1999 Proc. 4<sup>th</sup> Quarter I 398.**

#### Section 12. Officers and Directors

#### Section 13. Fees and Taxes

An interested party presented a memorandum that considered the taxation of both protected cells and special purpose vehicles. Another interested party opined that for special purpose vehicles to be effectively utilized on-shore there may need to be a change in both federal tax law and possibly also state tax laws as they related to premium taxes. However, he noted that federal legislation had been enacted to enable mortgage securitization transactions to be brought on-shore and it may be possible to do the same for insurance securitization transactions. If a special purpose vehicle was not held to be in the business of insurance for tax purposes, then it might be possible to obtain pass-through accounting. In the alternative there would need to be the ability to obtain an offset of interest costs of the insurance securities and the investment income on the cash received from the bondholders. **1999 Proc. 1<sup>st</sup> Quarter 211.**

#### Section 14. Dissolution

An interested party opined that the statutory reporting requirements for insurance companies might be excessive and burdensome for a special purpose reinsurance vehicle (SPRV) that was formed for a very specific purpose. He recommended in particular that SPRVs should be subject to an expedited winding up process after the special purpose for which they were created was completed. **1998 Proc. 4<sup>th</sup> Quarter 249.**

#### Section 15. Conservation, Rehabilitation or Liquidation

A. While discussing the definition of special purpose reinsurance vehicle (SPRV), the chair said he was concerned that, if a SPRV was not defined as an insurance entity, it might cause other problems with the treatment of SPRVs. Section 15 would apply some of the state rehabilitation and liquidation statutes to the SPRV and relief from the federal bankruptcy code would generally require the entity to be an insurer. An interested party suggested that stating that the SPRV was governed by the state's rehabilitation act should address that problem. A state would need to amend its receivership act to include an SPRV within the definition of insurers and that this was noted in a footnote to the model act. The chair replied that the federal bankruptcy code did not refer to an SPRV but did refer to an insurer. **1999 Proc. 3<sup>rd</sup> Quarter I 241-242.**

G. The working group agreed to bring the same language in the drafting note to Section 7 of the Protected Cell Company Model Act to Section 15 of this model to cover the situation where a liquidator is required to cancel policies of insurance and therefore the SPRV may not be on risk. **2001 Proc. 1<sup>st</sup> Quarter 400.**

#### Section 16. Not Subject to Guaranty Funds, Residual Market or Similar Arrangements

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#### Section 17. Asset and Investment Limitations

A. The obligation of the special purpose vehicle to the ceding insurer under the special purpose vehicle contract would be fully funded and secured with permitted investments. This would be implemented by the proceeds from the sale of securities and other monies received by the SPRV being placed in a special purpose vehicle trust to secure the obligations of the special purpose vehicle to the ceding insurer. **1999 Proc. 3<sup>rd</sup> Quarter I 298.**

B. The working group discussed investment limitations, in particular regarding the possibility of the SPRV and the trust entering into swap arrangements. It was agreed that these would probably only be entered into for the purpose of swapping out basis risk so as to enable investors to invest in what would effectively be an index-based securitization. **1999 Proc. 4<sup>th</sup> Quarter I 412.**

#### Section 18. Credit for Reinsurance for SPRV Contract

As contemplated in the first draft, the ceding insurer would receive credit for reinsurance for the special purpose vehicle contract only to the extent of the market value of the permitted assets held in trust and securing the obligations of the special purpose vehicle under the special purpose vehicle contract with the ceding insurer per the requirements of the Act. **1999 Proc. 3<sup>rd</sup> Quarter I 298.**

#### Section 19. No Transaction of an Insurance Business by Investors in Securities

The chair noted that a commissioner had expressed concern as to whether securitization instruments might be sold to unsophisticated investors and noted that there were surely some problems with the suitability of such sales. An interested party stated that in general securitization instruments could only be placed with sophisticated investors and that consequently they should not turn up in the portfolios of unsophisticated investors. **2000 Proc. 4<sup>th</sup> Quarter 458.**

#### Section 20. Authority to Adopt Regulations

#### Section 21. Effective Date

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*Chronological Summary of Actions*

*October 2001: Model adopted.*