PROJECT HISTORY - 2001

SPECIAL PURPOSE REINSURANCE VEHICLE MODEL ACT (#789)

1. Project Description

This model provides a basis for the creation of Special Purpose Reinsurance Vehicles ("SPRVs") exclusively to facilitate the securitization of one or more ceding insurers' risk. At present, insurers have been using offshore SPRVs to effectuate securitizations, often using Bermuda or Cayman Island domiciles. Domestic insurers cede reinsurance to the offshore SPRV, which then securitizes the risk and thereby retains none of it. These SPRVs are sometimes referred to as 'transformers' because they transform a reinsurance transaction into a capital markets transaction. The purpose of the SPRV model is to enable those transactions to take place onshore.

2. Group Responsible for Drafting the Act

The project was assigned to the Insurance Securitization Working Group of the Financial Condition (E) Committee. The members of the working group were: Arnie Dutcher (IL), Chair, Greg Serio (NY), Vice-Chair, Woody Girion (CA), Al Franz (DE), Kevin McCarty (FL), Don Roof (GA), Craig Gardner (LA), Alessandro Iuppa (ME), Steve Johnson (PA), Joe Torti (RI), Ernst Csiszar (SC), and Jose Montemayor (TX).

3. Charge Authorizing the Project

Extract: "The Insurance Securitization Working Group will investigate whether there needs to be a regulatory response to continuing developments in insurance securitization, including the use of non-U.S. special purpose vehicles…". This charge was first given to the group in 1998. The response decided upon at the October 22, 1998, meeting by the group was to facilitate onshore as opposed to offshore SPRVs.

4. General Description of the Drafting Process and Due Process

Interested parties performed much of the original drafting of the act, with representatives of USAA, a current user of offshore SPRVs, providing much input. The act was extensively modified in a series of meetings spanning from October 1999 through July 2001.

The first significant discussion of a SPRV model was at the Atlanta National Meeting on October 4, 1999, where the first industry interested parties' draft of a model was presented to the group. The model was extensively discussed and revised on November 10, 1999, and a new draft was received by the working group and discussed further on December 6, 1999. There was then a significant amount of discussion regarding the public policy issues surrounding SPRVs at a two-day public hearing in May 2000 with position papers presented by industry interested parties in support of and opposed to SPRVs. Subsequent to this, an academic paper was presented to the working group in June 2000 and considered in more detail at an interim meeting on August 30, 2000, where a new draft of the model act was also presented. The academic paper was then modified in March 2001 by its authors. The draft act was modified again and discussed at an interim meeting on November 15, 2000, and a further draft was prepared for a full day interim meeting on February 6, 2001, at which regulators found compromise solutions for numerous areas, and voted 11-0 to adopt the act. Changes were discussed at a conference call on March 16, 2001, to consider the final drafting from the February meeting, but none were agreed upon. Some minor changes were agreed at its March 24, 2001, meeting and all twelve working group members voted unanimously to adopt the model.

Following the adoption of the model by the Insurance Securitization Working Group on March 24, 2001, the Financial Condition (E) Committee requested additional comment from regulators and interested parties for discussion during a June 9, 2001, public hearing in New Orleans. At the June 9, 2001, hearing, oral and written comments were considered, and the draft act was modified and released once again for public comment. The Committee considered comments received during a July 26, 2001, conference call and agreed to additional revisions. Finally, the Committee voted 10-2 to adopt the act.

5. Discussion of Key Issues

Tax: Although the income statement of an SPRV would be a wash, its viability does depend critically on being able to deduct the interest payments to securitization investors as interest. There is some concern that there could be reclassification of the interest to dividends under some IRS interpretations, and hence the proponents of onshore SPRVs would intend to ask Congress to provide the same certainty that pass-through tax treatment would be allowed as Congress has done with mortgage securitizations. This would of course require an act in Congress. The Reinsurance Association of America (RAA) is very opposed to such potential legislation claiming that it provides a tax advantage and that it is inherently unfair. The proponents' viewpoint is that it provides no advantage, merely guarantees against a disadvantage. In fact, they say that were a domestic reinsurer to do exactly what an SPRV is expected to do, the reinsurer would already receive the tax treatment that the SPRVs want to receive. The academic paper regarding onshore SPRVs concluded, inter alia, 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" and that the authors did "not believe that proposed tax treatment of onshore SPRV transactions would have a detrimental impact on other forms of and vehicles for risk transfer."

Competition: Major industry associations of direct and primary insurers are firmly supportive of the act, while the RAA is opposed, presumably mostly from a competitive standpoint. Together with the tax issue mentioned above, the RAA would prefer that SPRVs be limited to catastrophic risk only and that any multiple cedent situation only apply to small companies. The RAA's position is that the SPRV program creates incentives that promote on-shore securitizations while doing nothing to promote utilization of on-shore reinsurance.

