Malta: Licensing of Reinsurance SPVs

MFSA
MALTA FINANCIAL SERVICES AUTHORITY

Introduction

The use of Special Purpose Vehicles [SPVs] is an established feature of the insurance industry globally. SPVs are used as vehicles for the transfer of risk from the insurance industry to capital markets and other investors. These vehicles provide additional reinsurance capacity when cover through traditional channels, such as insurance of exposure to catastrophic risks, is limited.

(a) Regulatory framework

Malta has an established track record in the financial services sector and as an EU Member State offers the opportunity for investors to set up in an onshore location whose regulatory legislation conforms with EU standards. The Regulations covering the authorisation and supervision of Reinsurance SPVs [RSPVs] were published in 2013 [Legal Notice 452 of 2013]. These Regulations are consistent with the provisions of the Reinsurance Directive (Directive 2005/68/EC) and anticipate the requirements of the Solvency II Directive (Directive 2009/138/EC) in the area of insurance SPVs. The Regulations are also aligned with the EIOPA's draft Solvency II advice on Level II Implementing Measures for entry into securitisation transactions.

> "an established track record in the financial services sector"

The Regulations provide that Maltese RSPVs must be set up as limited liability companies formed or constituted in Malta and require that RSPVs only assume risks from a single ceding reinsurance undertaking or from multiple ceding reinsurance undertakings belonging to the same group of companies. This needs to take place through reinsurance contracts or similar arrangements. Therefore an RSPV must fully fund its exposure to these risks through the proceeds of a debt issuance or any other financing mechanism where the repayment right of the providers of the debt or financing mechanism are subordinated to the RSPV's reinsurance obligations.

The providers of debt/financing to the RSPV have no right of recourse to the assets of the ceding undertaking and no rights to apply for the winding up of the RSPV.

The Regulations also lay down a number of statutory requirements in respect of RSPVs:

(i) an RSPV's objects must be restricted to operating as an RSPV;

(ii) the RSPV must assume risk from a ceding undertaking through reinsurance contracts or assume insurance risks through similar undertakings;

(iii) the persons who direct or manage the RSPV must satisfy the applicable conditions laid down in the Regulations;

(iv) the identity of shareholders/members having a qualifying shareholding in the RSPV must be the disclosed to the MFSA and such persons must satisfy the applicable fit and proper criteria;

(v) the RSPV must have an effective system of governance;

(vi) the RSPV must satisfy the statutory conditions relative to supervisory reporting, solvency requirements and application of the prudent person principle in the investment of the RSPV's assets.

(vii) the RSPVs may be managed by a licensed insurance manager located in Malta.

(b) Issuance of Financial Instruments

The RSPVs may issue financial instruments in order to fund their exposure under the risk transfer contract only to professional clients as defined in Annex II of the European Markets in Financial Instruments Directive (“MiFID”) (Directive 2004/39/EC). Malta offers the possibility of listing such instruments on the European Wholesale Securities Market (EWSM), an EU regulated market for wholesale debt securities.

(c) Taxation framework

The Malta tax regime provides the possibility of tax neutrality for RSPVs. RSPVs are considered to be securitisation vehicles for tax purposes and benefit from the Securitisation Transactions (Deductions) Rules (Legal Notice 324 of 2011) – “the Securitisation Rules”.

In the case of securitisation vehicles and RSPVs, apart from the normal deductions established in the Income Tax Act, the Securitisation Rules provide for the following additional deductions:

(i) sums payable by the company to the originator or assignor for the transfer of the securitisation assets and risks assumed risk;

(ii) premiums, interest or discounts relative to financial instruments issued or funds borrowed by the company to finance the acquisition of securitisation assets or the assumption of risk;

(iii) expenditure on the day-to-day administration of the company (including fees of third party service providers to whom the day-to-day administration is delegated), e.g. expenditure relating to statutory requirements, assets and risks, as well as that relating to collection of claims.

The Securitisation Rules also grant the securitisation vehicle/ RSPV the option of claiming an additional deduction (“the Optional Deduction”) equivalent to any chargeable income remaining after claiming all other deductions.

Claiming this optional deduction effectively means that the securitisation vehicle/RSPV’s income is reduced to zero, and this is subject to the condition that the originator or assignor must have given his irrevocable, written consent for the exercise of such an option.

The amount of deductions claimed by the securitisation vehicle/ RSPV in respect of the cost of acquisition of the securitisation assets, the cost of the assumption of risk and the Optional Deduction constitute trading income for the particular ceding undertaking. This income is not considered to arise in Malta if the control and management of the ceding undertaking is not exercised in Malta. No Maltese tax would be imposed on income earned by foreign companies, where the control and management of the business is not exercised in Malta.

No withholding tax is imposed on distributions of profits by Maltese companies to non-Maltese-resident shareholders. Furthermore, where applicable, shareholders may, on distribution of dividends thereto, be entitled to recover refunds of tax paid on the profits out of which the distributions were made under Malta’s imputation system of taxation.

Interest paid to non-resident lenders is exempt from tax in terms of Maltese domestic law, subject to satisfying a few straightforward conditions. Therefore payments of interest by Maltese RSPVs to non-resident lenders can qualify for exemption from Maltese tax irrespective of the country of residence of the lender and of whether or not a double taxation treaty exists between Malta and the lender’s country of residence. Also Maltese law provides for the issue by the Commissioner for Revenue of a stamp duty exemption determination applicable to transfers of marketable securities made or issued by companies satisfying certain qualifying conditions, for example if the particular company’s business or business interests are situated as to more than 90% outside Malta.