MFSA MALTA FINANCIAL SERVICES AUTHORITY

Feedback Document

Feedback Statement on the Consultation on the Amendments to the Companies Act (Cell Companies Carrying on Business of Insurance) Regulations and on a New Chapter 17 to the Insurance Rules entitled “Cell Companies carrying on Business of Insurance” and Amendments to Chapter 5 to the Insurance Rules

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Contents

1.0 Introduction....3

2.0 Main comments received on the proposed amendments to regulation 15 of the PCC Regulations....4

3.0 Main comments received on the proposed amendments to regulation 16 of the PCC Regulations....9

4.0 Main Comments Received on applying the proposed Regulations to Insurance Intermediaries.... 10

5.0 Main comments received on the proposed amendments to Chapter 5 of the Insurance Rules.... 11

6.0 Main Comments Received on the proposed New Chapter 17 of the Insurance Rules 13

7.0 Way Forward.... 16

8.0 Contacts.... 16

1.0 Introduction

On 13 September 2023, two Consultation Documents were issued. The first Consultation which was issued on the government portal was entitled Amendments to the Companies Act (Cell Companies Carrying on Business of Insurance) Regulations. The second Consultation Document, which was issued on the MFSA website was entitled New Chapter 17 to the Insurance Rules entitled "Cell Companies carrying on Business of Insurance" and amendments to Chapter 5 to the Insurance Rules.

The Consultation Documents issued, proposed:

- An amended Subsidiary Legislation 386.10 of the Companies Act (Cell Companies Carrying on Business of Insurance) Regulations; and
- A new Chapter 17 to the Insurance Rules entitled "Cell Companies carrying on Business of Insurance";
- An amendment to Chapter 5 to the Insurance Rules;

The purpose of the Consultation Documents was to highlight findings observed while conducting regulatory work, as well as other findings observed by the market and brought to the attention of the MFSA.

By means of the first Consultation Document, the MFSA introduced new provisions in relation to the transfer of cellular assets of a cell company and the liquidation of a cell in Subsidiary Legislation 386.10 Companies Act (Cell Companies Carrying on Business of Insurance) Regulations (hereinafter 'the PCC Regulations' or 'the Regulations') since it was aware that these procedures were not detailed. In this respect and in order to tackle the findings observed, the MFSA and the Malta Business Registry (hereinafter the 'MBR') have been liaising to discuss proposed amendments to be carried out to the said PCC Regulations in light of the fact that the Regulations are issued under the Companies Act which falls within the remit of the Malta Business Registry.

The second Consultation Document introduces a new Chapter 17 to the Insurance Rules to compliment the PCC Regulations. The aim behind this new Chapter is to include clear procedures in order to transfer a cell of a cell company as well as cease, service or run off the business of insurance of a cell and wind up a cell of a cell company.

The new Chapter aims to strike the right balance between creditor protection and effective procedures that eliminate time consuming and cumbersome processes. The said Consultation also proposes amendments to Chapter 5 to the Insurance Rules.

The Consultation period elapsed on 13 October 2023. Further to the said Consultation Document, the MFSA reviewed and discussed internally the comments raised by the market and is issuing a Feedback Statement on the comments received from the market in relation to the same.

2.0 Main Comments Received on the Proposed Amendments to Regulation 15 of the PCC Regulations

2.1 ***Industry Comment:*** *Numerous market participants suggested that the complete removal of Regulation 15 (Non-recourse provisions), especially in those circumstances where the Cell's capital is equal to or higher than the Statutory MCR (AMCR) would be allowing creditors of a Protected Cell Company to recover more than what would otherwise be legally possible for them to recover from any other insurance undertaking similarly regulated under the Solvency II Directive, thus inadvertently creating a more onerous capital requirement for Cell Companies, as opposed to all other European Insurance Undertakings. The said market participants believe that this could be tackled by Authority in a different manner, in that the Authority may prohibit the use of a non-recourse agreement when calculating the capital requirement of the Cell. Another proposal made by stakeholders was that of keeping the non-recourse provision in place in the law for pure captive and reinsurance cells that have cellular own funds exceeding the AMCR. The said market players argued that such a change in law will significantly alter the business landscape of some PCC structures due to the need to review and alter their appetite to host cells.*

Finally, another market participant argued that the amendments will create accounting consolidation issues to most PCC owners. In other PCC jurisdictions, the law unequivocally ring-fences both the cells and the Core from each other. In these jurisdictions therefore, one is able to demonstrate that the profits or losses of the cells are separate from the Core's activities and the economic interest is restricted only to the management of the Cell. This principle of ring-fencing and non-contamination between the cells and the Core, underpins the very purpose of a PCC.

MFSA's Position: The MFSA would like to clarify that following feedback received by the market and internal discussions, it is proposing to retain the transitional period of ten years for any cells which were authorised prior to the coming into force of the new Regulations as proposed. Furthermore, the MFSA is introducing a new Regulation 15A which will allow cells which are pure captive insurance undertakings and pure captive re-insurance undertakings to continue making use of the non-recourse clause where such cells are capitalised as a indicated in the new regulation 15A.

2.2 ***Industry Comment:*** *A market participant stated that having non-recourse recognised at law, not just in contract, would protect the core and the wider PCC. Most cells have secondary recourse to the core, which fits the risk appetite. If a cell company has significant surplus capital, it may be comfortable with allowing certain cells to be in deficit, within the limits of our Risk Appetite Statement. As a result, one might also be comfortable allowing small pure captive and reinsurance cells with capital less than the AMCR to have recourse on the core. However, in cases where significant capitalisation is required within the cell, a cell company would not be comfortable having theoretical exposures on the core from cells with substantial volatility, event or tail exposures. The said market participant had proposed keeping the non-recourse provision in place in the law for pure captive and reinsurance cells that have cellular own funds exceeding the AMCR, and this would allow the PCC to provide increasing substance and cost-efficiency while retaining core protection in case of unprecedented remote cell losses not contemplated within Solvency II's 99.5% confidence. Non-recourse protection of the core (more so of smaller cores) becomes much more critical with cells with more significant exposures. In such cases, the cells would typically have their own funds exceeding their AMCR, meeting the new regulatory expectations. The said market participant also pointed out that the current PCC Regulations in Malta are already significantly more restrictive than those in all other domiciles, in so far as the application of nonrecourse agreements, since these arrangements are only permitted where the Cell carries on exclusively affiliated / captive business or reinsurance business*

MFSA's Position: The MFSA reviewed the comments of the market and took on board the suggestion proposed so that the new regulation 15 will allow the retention of the non-recourse clause for cells which are pure captive insurance undertakings and pure captive re-insurance undertakings which are capitalised in line with the new regulation 15A. With respect to the comparison carried out in relation to the constraints of the legislation to other domiciles, the MFSA would like to point out that the other jurisdictions which have legislation which regulates cells are not jurisdictions established in the EU. As a result, the PCC Regulations in Malta are required to ensure that legislative requirements are in line with the SII Directive.

2.3 ***Industry Comment****: A number of market participants claimed that Regulation 15 only applies to "business of affiliated insurance" where the risks being covered are first party risks, and therefore the shareholder of the cell is also the only beneficiary of the insurance policies issued by the cell, or to "reinsurance business". The said participants stated that cell shareholders enter into agreements in full and educated knowledge that any claims lodged against the cell as a policyholder will be limited to the assets or funds available in their own cell at any given point in time. Allowing an affiliated business to have recourse to Core capital in such instances would be allowing the Insured/Shareholder to make a profit by collecting monies that they are not entitled to under the intention of the arrangements.*

MFSA's Position: Following a review of the comments received from the market and upon internal discussion, the MFSA is of the view that the non-recourse clause will remain to be applicable for cells which carry on business of affiliated insurance as defined in the new regulation 15A as long as such cells are capitalised as much as specified in the same regulation 15A. Regulation 15 applies to business of affiliated insurance where the risks covered are first party risks and the shareholder of the cell is the only beneficiary of the insurance policy.

2.4 ***Industry Comment:*** *Market participants also noted that for Cell Companies writing exclusively affiliated insurance/reinsurance business, with particular reference to the concept of proportionality, the proposed amendments disregard the recent developments within the Solvency II review, whereby it has been officially recognised by both the EU Commission and the EU Parliament under Article 29, in two separate texts that captives are by default 'Low risk undertakings'.*

MFSA's Position: The MFSA would like to clarify that the amendments to the Directive on the taking up and pursuit of the business of insurance and reinsurance hereinafter '*the Solvency II Directive'* review have not yet been finalised and issued. Having said that, the MFSA would like to clarify further that the amendments to the Solvency II Directive as they currently stand would require the competent authority to approve whether a captive is a low risk profile undertaking or not.

2.5 ***Industry Comment:*** *A market participant queried that in order for the Authority not to introduce an uncompetitive measure within the local PCC market, all Cell Companies (PCC Owners) should be allowed to apply the provisions of Regulation 15 throughout the Transitional Period for both existing and new cells. However there should be a grand fathering period when this non-recourse is also being used for the purposes of calculating the SCR of the Cell. The view is that this grandfathering period should cover what is a traditional ORSA planning period of 3 years, as this would give sufficient time for the Cell to be adequately capitalised to the AMCR as though the cell were a stand-alone insurance / reinsurance undertaking.*

MFSA's Position: The MFSA discussed the proposal further internally and remains of the view that cells which already make use of the non-recourse agreement will continue to make use of the said agreements until ten (10) years from the day upon which the PCC Regulations enter into force. With respect to cells which are pure captives and pure reinsurance captives, these entities will be required to capitalise the cell as if the cell was a stand alone company and in such a case, the new regulation 15A will allow such to continue making use of the non-recourse clause. For clarification purposes, the MFSA will be retaining the current transitional clause and introducing a new clause which allows such entities to make use of the non-recourse clause where the cell is adequately capitalised and in line with the definition in the Solvency II Directive.

2.6 ***Industry Comment:*** *A market participant commented that the definition in Regulation 15(2) of the PCC Regulations should be applicable only to transitional entities. The same market participant queried that it would be best to create a new definition which transposes the SII Directive to be applicable as a way forward. The same market participant also claimed that the definition in Regulation 15(2) of the PCC Regulations should be limited to only pure captives insurance and pure captives reinsurance, and that such cells should be fully capitalised in line with the provision of the non-recourse and should be capitalised as a stand alone company meaning that the MCR would not apply to the cell if instead the non-recourse is applied.*

MFSA's Position: The MFSA would like to clarify that the definition in the current regulation 15(2) of the PCC Regulations will remain the same and applicable to entities which were authorised and entered into an agreement prior to the publication of the Amending Regulations, due to the ten year transitional clause. Nevertheless, a new definition will be introduced in the new regulation 15A which will contain a definition of "business of affiliated insurance" and will capture paragraph (a) and (b) only of the current regulation 15(2). This will ensure that the definition of "business of affiliated insurance" is aligned with the definition in the SII Directive.

2.7 ***Industry Comment:*** *Clarification is sought as to whether the cells availing themselves of the 10 year Transition Period and also any "risk mitigation clauses and/or techniques in relation to the obligation to pay a claim where a reinsurance undertaking defaults" to reduce capital, will be permitted to maintain their current capital levels unchanged throughout the transitional period. Clarification is also sought as to whether the proviso to Regulation 15(4) which allows a ten-year transitional provisions to apply to specific written agreements which contain non-recourse provisions may also continue applying the pay as paid clause and cell limitation clauses. Clarification is sought on the fact that the transitional period for existing cells referenced in Regulation 15 will equally apply to the treatment of those cells in relation to the proposed changes to Chapter 5, and therefore those existing cells which have been approved and licensed using risk mitigation clauses and/or techniques for the purposes of calculating the Solvency Capital Requirement (in compliance with existing rules and regulations) shall continue to benefit from such treatment for the duration of the 10 year period.*

MFSA's Position: The MFSA would like to clarify that cells availing themselves of the 10 year transitional period would be permitted to maintain their current capital levels unchanged throughout the transition period, and continue making use of the clauses in their existing agreements. This has been also clarified in the Regulations. Following the said transitional period, the said cells will need to commence complying with the same obligations as new cells authorised following the coming into force of these Regulations. Following comments received by the market, the MFSA has amended Chapter 5 of the Insurance Rules to clarify its applicability by introducing a new proviso, and has also

amended the Regulations to clarify that Chapter 5 of the Insurance Rules will not apply during the transitional period.

2.8 ***Industry Comment:*** *Clarification is sought as to whether existing cells approved prior to the date of coming into force of the new legislation can continue to evolve in line with changes to their business and still benefit from grandfathering, for instance should a new class of business be approved post the coming into force of the new legislation, particularly if it is incidental to the original business plan.*

MFSA's Position: The MFSA would like to clarify that the transitional 10 year period applies to agreements entered into before the coming into force of the new regulations which amend the current Companies Act (Cell Companies Carrying on Business of Insurance) Regulations. Therefore, business in classes which have already been approved will continue to operate for the next ten years, but the said cells will not be allowed to apply for new classes of business after the coming into force of the law, even if these are incidental to the original business plan.

2.9 ***Industry Comment****: A market participant stated that the same cell company may have cells that have been approved prior to the date of coming into force of the new regulations, and cells that have been approved after the coming into force of the new regulations. Clarification is sought as to whether the said cell companies can operate during the transitional period under a dual regime which differentiates between cells licensed both prior to and post the implementation of the new regulations.*

MFSA's Position*:* The MFSA would like to clarify that a cell company is allowed to continue operating with cells which have been approved prior to the coming into force of the regulations and cells which have been approved after the coming into force of the regulations, thus operating in a dual regime.

2.10 ***Industry Comment:*** *Clarification is sought as to whether cells availing themselves of the 10 year Transition Period would be able to transfer of a Cell from one Cell Company to another whilst retaining the conditions on licensing.*

MFSA's Position: The MFSA would like to clarify that cells availing themselves of the ten year transitional clause may be transferred to other cell companies and retain the non-recourse clause and conditions which they obtained at authorisation stage even post transfer.

2.11 ***Industry Comment****: A market participant argued that in order for the MFSA not to introduce an uncompetitive measure within the local PCC market, all Cell Companies (PCC Owners) should be allowed to apply the provisions of Regulation 15 throughout the transitional period for both existing and new cells.*

MFSA's Position: The MFSA would like to clarify that the aim of the transitional period is that of allowing cells sufficient time to align themselves with the new legislation. It is however to be noted that whilst the Consultation issued proposed the complete removal of the non-recourse clause for new cells, following feedback received from the market, and internal discussions, it was agreed that where new cells which are pure captive insurance undertakings or pure captive reinsurance companies and are captialised in the manner indicated in the new regulation 15A, the said cells may continue making use of the non-recourse clause.

*2.12 **Industry Comment**: A market participant claimed that beyond the agreements that protect the core, with most other insurance management companies capital requirement calculations can actually adapt to not recognize non-recourse protection within a much shorter timeframe. The said market participant claimed that the transitional period should cover what is a traditional ORSA planning period of 3 years, as in our view, this should give sufficient time for the Cell to be adequately capitalised to the AMCR as though the cell were a stand-alone insurance / reinsurance undertaking.*

MFSA's Position: The MFSA took note of the feedback received by the market, and after internal discussions, it was agreed to retain that the transitional clause will be retained at 10 years and will not be reduced.

3.0 Main Comments Received on the Proposed Amendments to Regulation 16 of the PCC Regulations

3.1.1 ***Industry Comment:*** *An industry participant stated that in addition to introducing the possibility of transferring a Cell to another cell company authorised under Article 7 of the Insurance Business Act, an authorised insurance undertaking or a European insurance undertaking as defined in the Insurance Business Act or a third country insurance undertaking as defined in the Insurance Business Act, the MFSA should it is possible to transfer the cell to the core of a cell company and/or a cell of another cell company.*

MFSA's Position: The MFSA would like to clarify that following feedback received from the market, it has amended the Regulations and Chapter 17 of the Insurance Rules to allow the possibility of a cell to transfer to another cell of the same cell company in the cases where such cells do not make use of the non-recourse clause and whenever the shareholders of the cells are the same shareholders.

3.1.2 ***Industry Comment:*** *Clarification is sought on the process with which a cell can be converted to an insurance undertaking (stand-alone) in its own right, as often a cell is used as an incubator until critical mass is achieved.*

MFSA's Position: The MFSA would like to clarify that where a cell intends to convert itself to an insurance undertaking, this can be done by creating an insurance undertaking and then use the applicable laws to transfer the portfolio from a cell to an insurance undertaking. It is to be noted that the requirements to authorise a cell are different from the requirements of an insurance undertaking, and therefore the process which has to be the followed is the creation of a new company.

4.0 Main Comments Received on Applying the Proposed Regulations to Insurance Intermediaries

4.1.1 ***Industry Comment:*** *A market participant commented on behalf of Insurance intermediaries (both managers and brokers) who are also licensed as protected cell companies. The said market participant noted that the proposed amendments only address scenarios involving re/insurance undertakings, and thus excluding scenarios where the transfer of cellular assets of a cell company relates to insurance managers and/or insurance brokers. Clarification was sought as to whether the suggested amendments in the consultation paper should also be replicated within the local Insurance Distribution Rules. Confirmation was also sought as to whether a separate Consultation Document will also be sent to the market to cover intermediaries also licensed as PCCs or whether this current consultation document be amended to include intermediaries.*

MFSA's Position: The MFSA has taken note of the comments raised by the market and following internal discussions has amended the regulation and chapter 17 of the Insurance Rules. In this respect, cells of a cell company which is an insurance manager or an insurance broker will be able to transfer the cell to another cell company which is an insurance manager or a broker or to an insurance manager or an insurance manager which is not a PCC.

4.1.2 ***Industry Comment:*** *A market participant noted that the MFSA is proposing to amend the PCC Regulations to extend to ceasing, run-off or servicing and winding up process. Clarification is sought as to whether the same process will also apply to insurance managers and insurance brokers set-up as a PCC. Excluding insurance managers and/or insurance brokers formed or constituted as cell companies from access to these new procedures will create an unlevel playing field between the local PCC market players, deny insurance managers and/or insurance brokers formed or constituted as PCCs access to a structured procedure for ceasing, run-off or servicing and winding up, all of which will negatively impact the attractiveness of insurance managers and/or insurance brokers formed or constituted as cell companies.*

MFSA's Position: Following the comments raised by the market and further internal discussions, the MFSA has amended the applicability of Chapter 17 of the Insurance Rules so that the ceasing, run-off or servicing and winding up of the said cells will apply to insurance intermediaries in the same manner. The MFSA has also reviewed the requirements in Chapter 17 and made excluded any paragraphs which could not be made applicable to cells of an insurance manager or an insurance broker set up as a PCC.

5.0 Main Comments Received on the Proposed Amendments to Chapter 5 of the Insurance Rules

5.1.1 ***Industry Comment:*** *Reference was made to the proposed new paragraph 5.5.95 of Chapter 5 of the Insurance Rules. A market participant claimed that the wording of the above proposed provision is not clear at all. The said market participant claimed that the provision starts by referring to an authorised insurance undertaking that would use reinsurance as a risk mitigation technique. It is to be noted that reinsurance is a standard risk mitigation technique used by insurance undertakings to reduce risk exposure. The risk mitigation technique however generates a counterparty default risk which depends on the credit rating of the reinsurer. It is not clear why the proposed wording states that the mitigation technique affects the obligation to pay a claim, as the insurer remains liable in the event of default of the reinsurer. The provision continues to state that the default of the reinsurer reduces the counterparty default risk on the exposure of the reinsurance undertaking. It is therefore unclear as to whether this clause is referring to the SCR calculation of a reinsurance undertaking or that of the ceding insurance undertaking. Furthermore, in the case of a ceding insurance undertaking, default of the reinsurer obviously reflects the manifestation of the counterparty default risk rather than "disproportionately reduces it". The said market participant argued that the clause also ignores the timing of SCR calculations and reinsurer default. Clarification in this respect is being sought.*

MFSA's Position: The MFSA took note of the comments of the market, and upon further internal discussions, has revisited the proposed wording in Chapter 5 of the Insurance Rules to state the following: *"Undertakings shall not take into account risk mitigation clauses and, or techniques in relation to the obligation to pay a claim where a reinsurance undertaking defaults. For the purposes of calculating the Solvency Capital requirement, undertakings shall not take into account risk mitigation clauses and, or techniques which disproportionately reduce the counterparty default risk on the exposure of the reinsurance undertaking.".*

5.1.2 ***Industry Comment:*** *A market participant claimed that the amendment proposed to be carried out to Chapter 5 of the Insurance Rules appears to solely reference the solvency capital requirement. However, the rationale described in 3.2 of the consultation document might suggest that an insurance claim would need to be settled by the undertaking*

regardless of whether the re-insurer defaults, even if there are clauses in the insurance contract that limit such claims. Clarification is being sought in this respect.

MFSA's Position: Following internal discussions and comments received, the MFSA has revised the wording of paragraph 5.5.95 and clarified the wording of Chapter 5 to state the following: "Undertakings shall not take into account risk mitigation clauses and, or techniques in relation to the obligation to pay a claim where a reinsurance undertaking defaults. For the purposes of calculating the Solvency Capital requirement, undertakings shall not take into account risk mitigation clauses and, or techniques which disproportionately reduce the counterparty default risk on the exposure of the reinsurance undertaking.". The MFSA would like to clarify that whilst the introduction of the clause was mainly to avoid the disproportionate amount in the capital, the consequence is also that a valid claim will need to be honored by the undertaking irrespective of whether the re-insurer is in default.

5.1.3 ***Industry Comment:*** *A market participant argued that the proposed paragraph 5.5.95 to Chapter 5 of the Insurance Rules should at the very least be without prejudice to the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014, Article 192, and 208 to 213. Article 208 of the Solvency II Directive clearly allows for risk mitigation. It is also crucial that cut-through clauses continue to benefit capital calculations, consistent with the current recognition under Solvency II. Finally, the said market participant claimed that no risk mitigation technique related to the obligation to pay a claim when a reinsurer defaults, can cause the Solvency Capital Requirement of an authorised insurance undertaking and/or a Cell within a Cell Company to fall below the Statutory MCR (AMCR).*

MFSA's Position: Primarily, the MFSA would like to note that any new provisions introduced by the MFSA is without prejudice to any provisions in the Solvency II Directive and the Commission Delegated Regulation. However, the MFSA would also like to clarify that risk mitigation clauses cannot be used in a way which disproportionately reduce the counterparty default risk on the exposure of the reinsurance undertaking. Finally, in order to clarify the requirement better, the MFSA has revised the wording of Chapter 5 to the following: "Undertakings shall not take into account risk mitigation clauses and, or techniques in relation to the obligation to pay a claim where a reinsurance undertaking defaults. For the purposes of calculating the Solvency Capital requirement, undertakings shall not take into account risk mitigation clauses and, or techniques which disproportionately reduce the counterparty default risk on the exposure of the reinsurance undertaking.".

6.0 Main Comments Received on the Proposed New Chapter 17 of the Insurance Rules

6.1.1 ***Industry Comment:*** *A market participant stated that the proposed regulation expects the cell that intends to cease to carry on the business of insurance to notify the MFSA six months before ceasing. Whilst this is considered reasonable for those cells carrying out compulsory or third-party business, such requirement is disproportionate to a cell that writes exclusively captive insurance or reinsurance business as the decision as to whether a cell will be used or not is generally taken close to insurance renewal period. The said market participant requested the Authority to consider introducing a potential waiver of the 3 month notification period where the business written by a cell falls within the definition of affiliated insurance business since the general public has no interest in the affairs of the Cell.*

MFSA's Position: The MFA would like to note that the provisions included in the proposed regulations mirror the requirements of an insurance undertaking under Article 39 of the Insurance Business Act. The Insurance Business (Captive Insurance Undertakings and Captive Reinsurance Undertakings) Regulations 2003 do not disapply this requirement when it comes to the ceasing of a captive insurance undertaking or a captive reinsurance undertaking. As a result, following internal discussions, the MFSA has agreed that the ceasing of a cell which is a pure captive insurance undertaking or a pure captive reinsurance undertaking should apply as proposed in the Consultation Document.

6.1.2 ***Industry Comment:*** *A market participant referred to the requirement identified in paragraph 17.7.2(e)(ii) of Chapter 17 of the Insurance Rules as proposed in the Consultation Document. Clarification is sought as to whether despite the application of Regulation 15 and the Transition Period, in the event of the ceasing of a cell whose liabilities exceed its assets at the time of it ceasing, the non-cellular assets would become exposed to any liabilities that remain outstanding after erosion of the cellular assets.*

MFSA's Position: When drafting paragraph 17.7.2(e)(ii), of Chapter 17 of the Insurance Rules as proposed in the Consultation Document, the MFSA was taking into consideration the possibility of a cell which has become insolvent even when although there is recourse to the core, the assets of the core would not be enough to satisfy the liabilities of the cell. In such a case, the MFSA would consider such a cell to be insolvent and the provisions identified in section 17.10 would apply.

6.1.3 ***Industry Comment:*** *A market participant referred to the requirement identified in paragraph 17.7.2 (a) of Chapter 17 of the Insurance Rules as proposed in the Consultation Document on the publication of run-off of specific books of business, especially where the PCC will continue its operations. Furthermore, the said market participant is of the view that the paragraph should not apply to a pure captive and reinsurance business.*

MFSA's Position: The MFSA took note of the comments raised by the market and also noted that the Insurance Business (Captive Insurance Undertakings and Captive Reinsurance Undertakings) Regulations 2003, states that Article 39(2)(a)(i) of the Act does not apply to a captive insurance undertaking or a captive reinsurance undertaking. As a result, the MFSA has carried out necessary amendments to clarify that the publication of run-off of specific books of business does not apply in the case of a captive insurance undertaking or a captive reinsurance undertaking.

6.1.4 ***Industry Comment:*** *An industry participant referred to paragraph 17.7.2 (d) of Chapter 17 of the Insurance Rules as proposed in the Consultation Document and claimed that it did not see the need for a board resolution for a cell to enter run-off. The said market participant claimed that the matter may be handled by a cell committee which would inform the board in due course.*

MFSA's Position: The MFSA understands that the cell is managed by the cell committee, however, it is to be noted that a cell does not have legal personality and that it is the cell company that enters into any agreements on behalf of the cell. As a result, the MFSA remains of the view that a board resolution from the Board of Directors of the PCC is necessary before the cell informs the Authority that it will be ceasing to conduct business. The MFSA would like to clarify that as a PCC, it should always the Board of Directors of the PCC which is responsible for significant decisions to be taken by the cell company. Since the Board of Directors are involved when a cell is being set up, in fact it is the Board which accepts that a cell may be set up, the Board of Directors should also be involved when there are proposals to remove the said cell. With respect to the Board of Director's determination of whether the assets of a cell satisfy the liabilities, this shouldn't be a concern, as long as the directors can affirm that there are ample non-cellular assets to cover any excess cell liabilities at the time of notification.

6.1.5 ***Industry Comment:*** *A market participant referred to paragraph 17.7.3 of Chapter 17 of the Insurance Rules as proposed in the Consultation Document on the ceasing of a cell and queried whether there is the need to authorise a cell to enter into run-off and likewise why does a person need to be authorised to carry out the run-off of the PCC especially where the Core remains operational.*

MFSA's Position: The MFSA would like to clarify that the provisions indicated in Chapter 17 of the Insurance Rules are the same provisions found in the Insurance Business Act when it comes to ceasing. It is to be noted that paragraph 17.7.3 (now 17.8.3) of Chapter 17 is an obligation on the MFSA. For the MFSA to be in a position to issue the permit to cease, it is required to authorise the ceasing of such cell and authorise a person to carry out the service or run-off of the said business. This will depend on information the cell company provides the MFSA. With respect to the query as to why a person needs to be authorised, it is to be

noted that a person may also be a legal person, so an entity, and the MFSA is required to ensure that whoever will be carrying on the servicing or run off is a knowledgeable person.

6.1.6 ***Industry Comment:*** *Reference is made to paragraph 17.10 as proposed in the Consultation Document on the winding up of a solvent cell. A market participant claimed that it is imperative that the Board of Directors retains control over the entire cell company even in the event of the winding up of a solvent cell. The proposal that restricts directors of a solvent cell company from exercising management power over a cell in winding up, without the consent of the cell's administrator or liquidator, is concerning. The said market participant argued that such a restriction could compromise the non-cellular core and hinder the board's ability to uphold its responsibilities as mandated by EU directives and principles of good corporate governance. The said market participant claimed that there is no point in stipulating that the directors cannot exercise management power on risks that will also impact noncellular core assets including its creditors, especially when the liabilities of an insolvent cell would be picked up by the core. It is essential that the board retains control over the entire PCC.*

MFSA's Position: Primarily the MFSA would like to note that paragraph 17.10.3 (now 17.11.3) of Chapter 17 of the Insurance Rules apply in cases where the cell which is being wound up is insolvent, and not even recourse to the core would be able to help the said cell. The provision has been aligned with foreign legislation. Where a cell of a cell company which is being wound up is insolvent, we would understand that the operation of a cell would stop and that the only thing that would need to be done is see what would happen to the portfolio and to the assets and liabilities. Furthermore, it is to be noted that once the cell company advises that a cell is winding up, the competent authority will ask for the authorisation certificate of the said cell. As a result, the cell cannot conduct new business. It is to be noted that the said requirement has been drafted to ensure that where a cell of a cell company which is insolvent is being wound up, the PCC can continue to operate as normally. However, the PCC cannot interfere with the powers of any administrator or liquidator appointed to wind up the particular cell. This requirement has been included to ensure that the liquidator or administrator is able to perform all the acts necessary to wind up the insolvent cell. In fact, the same provision has not been included in the section dealing with the winding up of a solvent cell.

6.1.7 ***Industry Comment:*** *As for the transfer of cells, the main concern with respect to these provisions is that of ensuring: (i) the integrity of the assets and liabilities being transferred; and (ii) that any related underlying obligations (such as reinsurance treaties) are transferred universally without requiring novation and/or assignment of such underlying obligations, that is, ensuring that universal succession is achieved. Therefore, it is crucial that, for the purposes of a cell transfer, it is not only the insurance policies / business that are transferred, but also that any and all property, rights, liabilities, contracts debts, obligations,*

actions and legal proceedings attributable to a cell are also automatically transferred upon completion of the cell transfer.

MFSA's Position: The MFSA would like to clarify that with respect to transfers of the cellular assets of a cell of a cell company to another cell or another cell company, the provisions of Section 17.4.7 clarify the manner in which the assets and liabilities of a cell and any underlying obligations will be transferred. It is to be noted that these requirements have been aligned with Article 245 of the Companies Act related to a merger.

7.0 Way Forward

A Circular informing market participants on the publication of the proposed amendments to the PCC Regulations and the applicable Insurance Rules will be issued together with this Feedback Statement.

Once the amendments to the Companies Act (Cell Companies Carrying on Business of Insurance) Regulations are published, the MFSA will issue another circular informing the market.

8.0 Contacts

Any queries or requests for clarifications in respect of the above should be addressed by email on ipsu@mfsa.mt.