UK ILS framework offers sidecar options

Sidecars have now become a permanent feature of the reinsurance markets, with multiple new vehicles emerging in the January 2018 renewals.

A key tension in sidecar structuring has been to allow investors the ability to redeploy capital while providing full security to cedants and meeting regulatory requirements.

From the vehicle's and the cedant's perspective, collateral must be held back for estimated losses, on top of which a "buffer" margin is typically imposed to allow for potential adverse development.

The UK's new Risk Transformation Regulations 2017 may allow for other ways to resolve these tensions.

In order to be considered fully funded, assets in a UK insurance special purpose vehicle (ISPV) must at all times be valued at least equal to the aggregate maximum risk exposure (AMRE), and the vehicle must be able to pay its liabilities as they fall due.

The UK regulations note that where there are contractual features (e.g. a rollover agreement) that could result in the AMRE decreasing, the conditions governing return of capital to investors (e.g. a clawback) should be such that the fully funded requirement is maintained. The Prudential Regulation Authority has also implied an element of flexibility and judgement as it relates to the fully funded requirement for UK ISPVs that may allow off-balance sheet support arrangements to be taken into account.

Many collateralised sidecars have replicated liquidity features that are more like funds, such as giving investors in multi-year vehicles the right to opt in or out of renewing risk exposures.

These elections are given with enough notice to allow the sponsor and cedant to plan the amount of capital available at the upcoming renewal period.

Sponsors in some sidecars pre-agree with investors the provisions on rollover and collateral hold-back depending on investor preference and liquidity needs. In the event of a potential shortfall due to late-developing losses, the parties can agree a procedure for clawback of funds or new investments.

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