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FUND FINANCE FRIDAY

The Imitation Game – Insurance, Reinsurance, Reinsurance Access Funds ... and Fund Finance

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For many years, most bankers and finance lawyers assumed that any involvement in insurance or reinsurance projects meant venturing into the dark arts of financial services and exercising a degree of alchemy that only a Hogwarts education could have prepared them for! However, the past number of years has seen insurance in many ways become the “it” thing of the moment, with a host of names we most commonly associate with private equity now actively involved in the insurance world - both in terms of strategies they pursue and capital they court.

Conyers advises a majority of all new reinsurers on their establishment in the Cayman Islands and Bermuda, and we have recently witnessed a new form of the insurance imitation game, being what we call “reinsurance access funds” – funds established in the Cayman Islands to allow investors to gain exposure to an equity investment in, and thereby the underwriting activity of, a reinsurer (typically also established in Cayman or Bermuda). With a fund comes fund finance of course, and this note shares some thoughts on Cayman Islands reinsurance-connected transactions and our experience on fund finance deals in this world.

What is reinsurance?

In short, reinsurance is insurance for insurance companies. It allows insurance companies (for example, those that many readers would have life or home insurance policies with) to ensure

that they are not at risk of being over exposed to a singular event (for example, a hurricane or an unexpected global pandemic) by allowing them to pass on the risk of some of the insurance contracts they have issued to another insurer (a reinsurer!). The reinsurer isn't doing this for fun of course, and an ocean of actuarial and quantitative analysis goes into calculating both the premiums charged on the original contracts and then the premiums paid by insurers to reinsurers, but plenty have gotten it correct and are successful household names (Berkshire, Munich Re, Swiss Re, Hannover Re).

Why would a reinsurer be established in the Cayman Islands?

Whilst traditionally the Cayman Islands has deservedly been recognised as a leading captive insurance jurisdiction, around 70% of all insurance licences issued by the Cayman Islands Monetary Authority ("CIMA") in recent years have been for commercial or affiliate reinsurers, with private equity groups, traditional reinsurance and insurtech increasingly selecting Cayman for the establishment of side cars and reinsurance platforms.

The ideal jurisdiction of domicile for a new reinsurer is driven by a multitude of factors, and there is no "one size fits all," but some of the reasons we are seeing clients consider Cayman to be not only a viable option, but also a premier jurisdiction for establishing a new reinsurer platform are:

- **Regulatory Capital**: CIMA will consider tailored capital and/or accounting models and is not tied to EU Solvency II models;
- **Flexibility on Staffing**: certain reinsurers may engage a local insurance manager as a service provider rather than having to put "boots on the ground" on day one (but if they do have employees in Cayman they get to enjoy the benefits of year-round sunshine and first world infrastructure!);
- **Speed to Market**: much like CIMA's approach to funds, CIMA's approach to licensing a reinsurer is thorough but predictable - published timeframes for the approval of a new insurance licence is 6 to 8 weeks from the time of submission of a complete application; and
- **Financial, Political and Economic Certainty**: Cayman's stability (financially, politically, economically), particularly relative to other offshore domiciles (for example, the Cayman Islands runs an attractive budget surplus), is especially attractive to reinsurers.

What has this got to do with fund finance?

Over the past two to three years we have seen an increase in bespoke fund products established above reinsurance companies in order that sponsors related to major reinsurers (which is now commonplace) or forming their own reinsurers can offer investment opportunities and exposure for their investors to a reinsurance platform. These funds often seek to put in place subscription-based and/or asset-based facilities (in the latter case where the Cayman fund is more likely to be guarantor or pledgor alongside a subsidiary borrower – the reinsurer).

Whilst the strategy pursued by a fund is rarely a material factor from a credit analysis perspective in a subscription-based deal there are, as a result of the particular characteristics of many of these reinsurance access funds, a number of points which can give rise to additional consideration by lenders/funds and their advisers in these deals including:

- the LPA (or limited liability company agreement - LLCA) tends to be much more bespoke in these transactions. While some reinsurance access funds are more broadly offered, in many cases they are created with a particular subset of investors in mind who may actively input on the documentation;
- in some instances the LPA/LLCA may cross refer to or incorporate other negotiated documents applicable to the structure (governed by a foreign law in some cases) which have been used as forums for negotiation of commercial points or to set out governance models. On occasion these need particular consideration as to how they interplay with capital call rights;
- the general partner may have bespoke governance and approval processes owing to certain tax or regulatory structuring either at the fund level or below (the fund vehicle may also be a Cayman Islands LLC with an equivalent bespoke governance model);
- it is much more likely that there will be an existing or contemplated asset-based financing occurring at the reinsurance company level (below the fund) and so consideration needs to be given to the approvals and security which the fund will be asked to grant in this regard and the subordination of one loan to another; and
- timing can be an issue if asset-based security is provided as an equity pledge over a regulated reinsurance vehicle will almost certainly require the pre-approval of the applicable regulator.

None of the above issues have proved to be insurmountable in our experience, but when they do come into play it is of course useful to have a firm experienced in insurance to handle!

So it’s a brave new world in reinsurance?

For the time being, the trend of insurance converging with private equity and fund finance seems set to continue. We expect to see more and more products and solutions emerge to allow private equity to access insurance strategies and vice versa and with that will come more interactions with the fund finance world – so watch this space!