

## Insurance linked securities

Service area / [Corporate](#)

Location / [Guernsey](#)

Date / [December 2017](#)

Insurance Linked Securities (ILS) are financial instruments whose value is directly related to insurance risk and whose performance is not correlated with other asset classes. This makes ILS attractive to investors seeking diversification.

### Overview

A number of top ILS fund managers structure ILS transactions through Guernsey. This reflects Guernsey's heritage as a premier insurance and reinsurance centre - there are around 800 licensed international insurance companies in Guernsey including some rated reinsurers. However Guernsey's state of the art technology is also crucial. Guernsey introduced bespoke rules for special purpose insurers (SPIs) in 2016 and offers both protected and incorporated cell companies.

### Structure

In a typical ILS transaction, investors fund an SPI to insure a specific risk for a defined period. At the end of the period, investors receive back the principal amount invested together with the premium charged for the risk, less claims (if any) and costs.

Such transactions often insure natural catastrophes (such as hurricanes). The SPI will be on risk during the relevant hurricane season and, accordingly, the entire life of the vehicle may be twelve months or less. Life securitisation is another popular transaction which involves the SPI funding upfront commissions owed by life companies to their broker network in exchange for receipt of future premiums due to the life company. In those cases, the SPI may continue for a period of three to six years.

In light of the limited purpose and duration of many SPI vehicles, Guernsey cell companies are a popular option. Protected cells can be formed instantly through a resolution of the board of directors of the relevant protected cell company (PCC) and, in the case of ILS transactions, are subject to a lighter touch regulatory regime (see below). Incorporated cells may be used for transactions which are likely to endure for a longer period of time, such as life securitisations described above. More information on Guernsey cell companies can be found [here](#).

### SPI rules

An SPI writes insurance contracts and so must be licensed to carry on insurance business. However, many ILS vehicles are fully funded - that is to say the amounts raised from investors equal or exceed the SPI's maximum liability under the insurance contract. In recognition of this and the fact that many SPIs are cells of a protected cell company, Guernsey has introduced the Insurance Business (SPI) Rules 2016. The key features of the Rules are that:

- Regulatory approval is immediate. A PCC which has been approved under the Rules may form a new SPI cell without obtaining the prior approval of the Guernsey Financial Services Commission (GFSC). Instead, the PCC must simply notify the GFSC within 7 days after the creation of any SPI cell.
- A fully funded SPI is not subject to any solvency requirements. To qualify as fully funded, the SPI can rely on cash or contingent capital (such as reinsurance, letters of credit and partly paid shares).

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- The SPI can raise capital from Qualified Investors i.e. institutions, funds, listed entities and those with assets in excess of £5 million.

## Solvency II

Guernsey is not in the EU and so is not directly subject to Solvency II. Further, in 2011 Guernsey announced that it would not be seeking recognition as an equivalent jurisdiction. At the time of writing, Guernsey is consulting industry on whether this remains the best approach for the island. However, because ILS structures are invariably fully funded, Solvency II has limited impact.

## Offer to investors

ILS transactions are often private, involving a single institutional investor. Since the SPI usually enters into only a single insurance or reinsurance contract, the vehicle does not comprise sufficient spread of risk to constitute a collective investment scheme worthy of regulation in Guernsey. In situations where there are a number of investors, consideration may need to be given to the information disclosed to those investors in connection with their investment. Under applicable Guernsey regulations, if the SPI proposes to raise funds through a promotion to more than 50 persons, it must comply with the disclosure requirements in Guernsey's prospectus rules and register any offering document with the GFSC.

## Credentials

As the leading Guernsey law firm<sup>1</sup>, Carey Olsen has advised on a number of significant ILS transactions including:

- The establishment of a US\$125m vehicle on behalf of a leading pension fund.
- Acting as Guernsey counsel to Humboldt Re, a Guernsey licensed reinsurer rated A- by AM Best.
- The establishment of 4 SPIs in respect of a series of private ILS transactions valued at £40m.
- The acquisition of the ILS business of Kane and Robus (Hexagon) by Arthur Gallagher.
- Advisor to various transactions structured through Aon's White Rock vehicles in Guernsey.

Carey Olsen advises 62 of the 372 licensed insurance companies in Guernsey and are appointed Guernsey counsel to every single Guernsey-domiciled ILS fund. We also represent seven of the world's top ten largest insurance companies (A.M. Best).

If you would like to find out more about ILS and Carey Olsen's services in this area, please contact a member of our [insurance team](#).

<sup>1</sup> Carey Olsen is the only law firm in Guernsey to be ranked in the top tier of all categories (including insurance) in the Legal 500 UK 2017.

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## Key contacts

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