

# Jersey ready to go as ILS domicile

**THE** use of insurance-linked securities (ILS) to transform insurance risks to the capital markets has increased and evolved over the last decade and the trend is expected to continue.

The Island of Jersey has a leading reputation among capital market investors and sponsors and is well placed to take advantage of the growing convergence of the capital and re/insurance markets.

ILS products have created investment opportunities for investors to participate in the reinsurance industry. These products are attractive to investors who are looking to diversify their investment opportunities and risk exposure while attracting higher yields. ILS products have generally proved to be uncorrelated to economic risks (credit and interest rate risks) in the capital markets and tend to hold their value in financial downturns, such as in the recent credit crisis.

The products are typically offered through special purpose vehicles and special purpose insurers (SPVs) formed for the sole purpose of entering into re/insurance contract(s) and issuing securities (notes, bonds etc.) to investors to fund the re/insurance transaction. SPVs are generally independent, bankruptcy remote companies. Usually, the underlying risks are fully collateralised whereby the capital market funds paid to the SPV are deposited into a restricted trust or collateral account for the benefit of the cedant. Investment earning on the trust funds plus on the premium paid by the cedant

## Is Jersey a contender as an ILS domicile?

are used to periodically pay the bond coupon to investors. If there is no loss trigger event before the re/insurance contract matures, investors receive back the principal paid in addition to the coupon payments made over the life of the contract. Also, it is possible to collateralise the re/insurance risks of a SPV through the use of soft capital products, for example, a reinsurance contract with another reinsurer or other forms of guarantee or structured security products.

The bankruptcy remoteness of SPVs is generally due to factors such as a requirement that the re/insurance contract contains limited recourse language, limiting the re/insurance liabilities to the amount of collateral posted in the trust or collateral account and the subordination of note payments to investors to the payment of the re/insurance liabilities of the SPV.

While ILS products have been rapidly gaining favour in the capital markets there remains a limited number of parties who invest in ILS products due to their sophisticated nature. As a wider range of investors turn to ILS products as an alternative to traditional capital markets, it is expected that such products will continue to evolve, with increased innovation, greater transparency, ease to market and improved pricing.

Despite market turmoil over the

recent financial crisis the overall trend for ILS products is upwards. Figures published by Aon Benfield in September 2011 show the global Cat bond issuance for the 12 months to July 2011 at \$4.382bn up from \$1.780bn for 2009. Although this is significantly down on the peak of \$8.145bn for 2007 the historical trend is upwards with increases from \$1.144bn in 2001.

Jersey has a proven track record as a jurisdiction for the incorporation of SPVs for many structured product transactions including ILS. It is in the same time zone as London and has a leading global reputation as an offshore financial centre. Jersey's tax neutral environment and flexible legal and regulatory framework enable Jersey SPVs to be structured to meet a wide variety of requirements within the ILS market.

The carrying on of insurance business in Jersey is governed by the Insurance Business (Jersey) Law 1996 (Insurance Law) and is regulated by the Jersey Financial Services Commission. Any Jersey SPV writing re/insurance will be required to obtain a Category B permit under the Insurance Law. Although there is no specific category for SPV related transactions the regulator takes a suitably flexible approach and where appropriate waives the standard capitalisation and solvency requirements.

To date the ILS market has been dominated by issuances sponsored out of the US but this is expected to change with increased demand in

**“Jersey has a proven track record as a jurisdiction for the incorporation of SPVs for many structured product transactions including ILS”**

the UK, Europe and Asia. Jersey has a leading reputation in these markets backed by a deep pool of professional expertise in the capital markets arena. Once you add to the equation that Jersey's tax neutrality and its flexible legal and regulatory regime the Island is in a good position to win a significant share of this developing market. ■



Mark Lewis is a partner and practice group head in the Jersey Corporate and Commercial department. Mark specialises in public securities and investment fund work. He is also the Local Team Leader for Insurance. Mark became a partner of Appleby in 1998 and has been Group Head since 2000.