

ILS: BERMUDA AS THE JURISDICTION OF CHOICE

by Sarita Ebbin

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Bermuda has overtaken the Cayman Islands as the domicile of choice for insurance-linked securities (**ILS**), according to the October 2015 Willis Capital Markets & Advisory report.

In Q3 of 2011 Bermuda's share of the ILS market was 18 per cent but by Q3 of 2015 Bermuda issued more than two-thirds of the global catastrophe bond (**cat bond**) capacity.

Bermuda has emerged as a leader in the global ILS market only four years after implementing a specific regulatory framework to facilitate the formation of such instruments through a new licence class for insurers.

In 2009, the Bermuda Monetary Authority (**BMA**) introduced the concept of a Special Purpose Insurer (**SPI**) - the insurance vehicle of choice for ILS transactions. Bermuda's regulatory and supervisory framework also provides for the creation of sidecars, Industry Loss Warranties (**ILWs**), and collateralised reinsurance vehicles.

The ILS market has benefitted from a large investor base and the existing (re)insurance expertise in Bermuda. As we can see Bermuda is well placed to be the jurisdiction of choice for ILS, however we must consider what Bermuda can do as a jurisdiction to improve and/or complement the existing ILS market in order to retain our top spot for the foreseeable future.

What follows are only suggestions about possible ways forward and in no way purports to be an exhaustive, conclusive or entirely feasible list of possibilities on how to keep Bermuda as numero uno. The goal of this article is however, to trigger thought and perhaps dialogue about how Bermuda can retain its reputation as the leading ILS jurisdiction while also increasing our market share in other areas as a result of ILS connections.

The convergence of (re)insurance and capital markets has surged over the last four years as institutional investors have recognised that investment in ILS allows for diversification and also has the ability to produce attractive risk adjusted returns. ILS funds typically invest in cat bonds, ILWs and a variety of opportunistic reinsurance products through a licensed insurer. The ILS insurance vehicle is typically owned and operated in tandem with the ILS fund, with the fund allocating capital to the ILS insurance vehicle to fund specific ILS participations underwritten by that vehicle. The ILS insurance vehicle distributes earned premium and investment profits to the ILS fund and the ILS fund in turn pays distributions to their investors.

As the ILS fund and the ILS insurance vehicle are so intertwined, perhaps it would be useful to have a fund class that is specifically for use within the ILS space. Many ILS transactions are for a fixed period, and any calculations at the fund level mirror those at the ILS insurance vehicle. Accordingly, a specific ILS fund class might remove the requirement to appoint a broker, custodian, auditor or even an investment manager that is authorised or licensed by a recognised foreign regulator because the only investment made by the ILS fund would be in the shares of the ILS insurance vehicle. A new ILS fund class as outlined above would provide an extremely flexible regulated fund. In addition, the ILS fund application could be submitted and approved as a part of the application to the BMA's assessment and licencing committee (**ALC**) so that the approval process is streamlined and approval from the BMA and the registrations can take place simultaneously.

It might also be beneficial to consider offering a dual insurance and investment management licence to managers who will perform the relevant functions in respect of the ILS fund(s) and the ILS insurance vehicle(s) within their group. Again, such an application for a dual licence would form a part of the application to the ALC and would streamline the process.

In recent years, we have seen SPIs and ILS funds structured as segregated accounts companies (**SAC**) under the Segregated Accounts Companies Act 2000. However, as the Investment Funds Act 2006 is currently drafted, it is not possible to have different segregated accounts classified as different classes of fund (including open and closed ended). Such an allowance would enable companies to register as SACs and structure individual segregated accounts to be registered as different classes of fund in order to suit the needs of the investor (similar to funds structured through a series of sub-trusts in a unit trust). This will allow for the consolidation of the value of the various funds for marketing purposes while allowing investors options and diversification within one company.

We must also recognise the positive impact that individuals have had in making Bermuda the jurisdiction of choice for ILS. As such, the continued partnership of industry stakeholders, government and regulators is important as Bermuda presents a united front to the rest of the world.

As the ILS market continues to grow in Bermuda, we must remain at the forefront of innovation in order to retain the number one spot. In doing so, we will likely enhance the jurisdiction's appeal to other sectors that are closely linked with the ILS market, or perhaps we will develop a new product altogether.

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