

RISKY BUSINESS - INSURANCE LINKED SECURITIES IN GUERNSEY

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Guernsey has long been established as a leading jurisdiction for insurance business; having been providing captive expertise for almost 40 years.

Guernsey recently retained its title of European Captive Domicile of the year at the UK Captive Services Awards, defeating Dublin, Gibraltar, Isle of Man, Luxembourg and Malta, and is the fourth largest captive domicile in the world.

However, what is notable is the surge in alternative risk transfer business being structured through Guernsey, particularly utilising insurance-linked securities (**ILS**) and insurance transformers.

Alternative risk transfer (**ART**) uses methods other than traditional insurance and reinsurance to provide risk bearing entities with protection, mostly through the involvement of capital markets investors. ART therefore usually involves convergence of investment and insurance expertise, which is why it is not surprising that Guernsey has seen such an increase in these transactions, with its long-standing wealth of expertise in both sectors.

Types of ILS Products

ILS products typically include catastrophe bonds (**Cat bonds**), industry loss warranties (**ILWs**) and sidecars. Cat bonds are risk-linked securities that transfer catastrophe risks to capital market investors. ILWs enable a purchaser to buy protection based on insurance industry losses arising from a specific event, rather than from the buyer's losses. Sidecars are special limited purpose (re)insurance companies which assume a portion of the ceding (re)insurer's underwriting risks (including losses and expenses) in exchange for a proportional share of the premium. ILS products typically cover natural catastrophes (hurricanes, earthquakes), life insurance (mortality and longevity) and man-made events (fire, terrorism, even lottery jackpot losses).

The sponsors of ILS products are (re)insurance companies, governments and companies who use ILS to transfer their (re)insurance risks to a diverse group of capital market investors, which generally include cat funds, hedge funds, private equity funds, pension funds, banks and (re)insurers. ILS products are used by sponsors as an alternative risk management solution to achieve capital efficient and flexible underwriting capacity, finance growth and to spread the risk to the capital markets. In this way ILS have become a viable alternative to the traditional (re) insurance markets.

By way of example of an ILS sidecar transaction, Appleby Guernsey has recently advised a major global provider of ART services in relation to a collateralized marine reinsurance structure using a Guernsey SPV reinsurance company as a sidecar, with investment fund investors effectively providing the collateral through preference share subscriptions into the structure.

Listings

Although the ILS in that transaction were not listed, Guernsey is well placed to accommodate ILS listings. Guernsey provides access to the London Stock Exchange (**LSE**) and other international exchanges, including Hong Kong, Toronto, Ireland, Euronext, as well as the Channel Islands Securities Exchange. Guernsey has a wealth of experience in listings, being the jurisdiction of incorporation for more non-UK entities listed on the LSE than any other jurisdiction.

Transformers

At Appleby we are also seeing a large increase in interest in the use of Guernsey vehicles as insurance transformers, i.e. vehicles through which reinsurers or insurers transform risks from the capital markets into insurance or reinsurance form, or vice versa. For example:

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- Derivative in – reinsurance out: the vehicle acquires protection as protection buyer under a derivative with Party A and acts as insurer under an insurance contract with Party B as insured;
- Reinsurance in – derivative out: the vehicle is the insured under an insurance contract with Party A and acts as protection seller under a derivative with Party B.

Typically, the Guernsey pioneered protected cell company is used, or an incorporated cell company, and a different cell of the cell company can be used for each type of transaction. With a Guernsey cell company, the assets and liabilities of each cell are legally segregated from those of the other cells and those of the core of the protected cell company or the umbrella incorporated cell company, but with the advantage of cost savings from only being required to have one board of directors.

Rent-a-captive

A further example of risk transfer activity we are seeing is the use of cell company rent-a-captives to insure risks and receive premiums and also enter into reinsurance contracts/risk transfer transactions with third parties.

Conclusion

In conclusion, Guernsey insurance business appears to be in a notably healthy phase, with 89 new international insurers licensed in the Island during 2013, taking the total number of such insurers to 758 at the end of 2013.

Appleby’s team of lawyers are based in key offshore jurisdictions that are significant players in the global (re)insurance market – including Bermuda, British Virgin Islands (BVI), Cayman, Hong Kong, Isle of Man and Jersey - and are therefore well placed to advise clients that are seeking to carry out business in any of these offshore jurisdictions or transact business with locally-based insurers.

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