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Briefing note

June 2017

Update: UK Insurance Linked Securities ("ILS") Framework to be completed

In a speech given today at the Association of British Insurers "Brexit – the road ahead" conference, the new Economic Secretary to HM Treasury Steve Barclay confirmed the Government's plan to place the new ILS legislation before Parliament prior to the summer recess with a view to the regime being in force during the autumn of 2017. This legislation will implement the new ILS framework and is aimed at helping London become a global leader in this field. The Government's intention was also confirmed *in a letter sent to the London Market Group ("LMG")* which set up an ILS Taskforce to advise on the new framework.

As legal advisors to the LMG and members of the ILS Taskforce, Clifford Chance has been active in the preparation of the ILS legislation. In this briefing paper, we consider the implication of today's announcement.

Background

The last 18 months has seen extensive engagement between the ILS Taskforce and the Treasury, the Prudential Regulation Authority ("**PRA**") and the Financial Conduct Authority ("**FCA**") to develop the detailed regulations (namely the Risk Transformation Regulations 2017 and the Risk Transformation (Tax) Regulations 2017) that will create the legal and tax framework to bring ILS business onshore. In addition to the regulations, the PRA and FCA will publish detailed guidance in the form of a supervisory statement respectively, which will set out their expectations for authorisation and supervision of the ILS vehicle in the form of an Insurance Special Purpose vehicle ("**ISPV**"). It is expected that the PRA and FCA will publish their guidance when the new legislation comes into force.

For further detail on the impact of the ILS legislation and PRA and FCA guidance, please refer to our previous briefing A UK Framework for Insurance Linked Securities, 23 November 2016.

Timetable

Officials were due to release a final version of the ILS regulations before Easter when Prime Minister Theresa

May announced a snap election. The project was subsequently put on hold as campaigning got underway. There have been concerns since that the regulations would not be up and running in time for renewals at the beginning of next year. However, in the letter to the LMG, Steve Barclay confirmed that the ILS regulations were being finalised so they could be laid in Parliament before the summer recess with a view to being in force in the autumn.

If the legislation is in place during the autumn, it leaves limited time for the PRA and FCA to complete the necessary approval processes for an ISPV in time for the 1st Jan renewals. In a PRA consultation on a Supervisory Statement published in November 2016, the PRA confirmed that it would determine applications for authorisation of an ISPV within six months of receipt but with 'straight forward' applications being processed within a 6-8 week period. The PRA also flagged a requirement for pre-notification of new cells but, after extensive discussion between the Treasury, the PRA and FCA and the ILS Taskforce, it is expected that PRA and FCA may accept post-notification of transactions by individual cells where the ISPV vehicle has been previously approved and the business of the cell is in line with the approved business plan.

We will be looking carefully at the final PRA policy statement to assess whether the necessary approvals are likely to be achievable in time for 1 January 2018. At least for more straightforward applications, the hope is to submit applications in advance of the final implementation of the Regulations to enable preliminary consideration to be given by PRA and FCA at an earlier stage.

Steve Barclay's letter confirms that the Government has a clear commitment to the success of the ILS initiative and we hope that this commitment will result in the necessary resources being available at PRA and FCA to support early applications.

More generally, a timely and practical ILS regulatory approval process will be needed if the UK wants to compete effectively with more established ILS jurisdictions such as Bermuda, Guernsey and Ireland, which have up until now been favoured by the ILS market.

Uncertainties

In addition to the timeframe for approval, there are a number of other outstanding issues which industry participants hope the PRA will clarify in order to make the UK framework attractive compared with other jurisdictions.

In particular, the PRA's final position on the interpretation of the "fully funded" requirement in Article 13(26) of the Solvency II Directive and Article 326 of the Solvency II Delegated Regulation will be critical. Should the PRA apply a narrow interpretation of "fully funded" and not take into account the operation of "limited recourse" provisions in the contractual documents entered into by an ILS vehicle, then this would be out of line with other jurisdictions. This issue has been debated recently between the ILS Taskforce and with the Treasury and PRA/FCA and we are hopeful that the final position adopted by the PRA will be practical and include an adequate degree of flexibility to accommodate the contractual protections in relation to catastrophe bonds and collateralised reinsurance.

How we can help…

As members of the London Market Group ILS Taskforce, Clifford Chance has been actively involved in the development of the UK ILS regime and has worked closely with HM Treasury, the PRA, the FCA and HMRC in developing the regime. We would be happy to discuss the new regime with you and to help you plan to benefit from the opportunities it will create for innovative risk transfer in both the non-life and life insurance sectors.

In delivering ILS solutions, Clifford Chance can draw on the knowledge and transactional and regulatory experience of our leading global insurance practice. Our insurance practice works closely with our tax, capital markets and private funds groups and is well placed to support our clients in delivering tax efficient and market leading ILS solutions in the UK.

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