

UPDATE: IMPLEMENTATION OF THE UK'S INSURANCE LINKED SECURITIES FRAMEWORK MOVES CLOSER.

On 12 October 2017 the Risk Transformation Regulations (collectively, the Risk Transformation Regulations 2017 and the Risk Transformation (Tax) Regulations 2017) which implement the UK's new regulatory and tax framework for Insurance Linked Securities ("ILS") were laid before Parliament. The legislation will now be debated and is expected to be passed by Parliament in the next few weeks – this news will be welcomed by industry participants who wish to set up a UK ILS vehicle, although it is recognised that it may now be challenging for most market participants to complete the application process in time for January 2018 renewals.

Delays

To ensure a timely delivery of the UK ILS framework ahead of the January renewal period, it was hoped that the Risk Transformation Regulations would be passed by Parliament ahead of the Summer recess. However, this year's snap general election and the work to re-constitute Parliamentary committees following the election caused a substantial delay to the laying of the legislation. Nevertheless, with the active involvement of the London Market Group's ILS Taskforce (who are advised by Clifford Chance), the drafting of the Risk Transformation Regulations was completed. This legislation provides for a legal framework that will make London a more attractive domicile for ILSs and the final versions can be found on HM Treasury's ILS consultation web page:

<https://www.gov.uk/government/consultations/regulations-implementing-a-new-regulatory-and-tax-framework-for-insurance-linked-securities>

Regulatory requirements

Now that the Risk Transformation Regulations have been laid before Parliament, the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA") are expected to finalise their rules and guidance for Insurance Special Purpose Vehicles ("ISPVs") - the vehicles that will be used to issue ILS in the UK. Once approved by the Prudential Regulation Committee at the end of this month, the PRA and FCA are expected in early

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.

November to simultaneously publish their final rules and guidance in policy statements and supervision statements, which will also respond to industry feedback to their ILS consultation papers published earlier this year – please refer to our previous briefings for details on the ILS consultations¹.

After the PRA and FCA have publicly released their final policy positions and requirements, they are expected to be in a position to begin pre-application discussions with potential applicants. Therefore, applicants wishing to have in place a UK vehicle for the January 2018 renewal or soon thereafter should flag with the PRA and FCA a desire for engagement now and should prepare the basics of their application. These pre-application discussions will assist in the processing of the ISPV application, which could be achieved within 6-8 weeks on a 'fast-track' basis. This could still permit a vehicle to be in place just in time for the 2018 renewal period but timings will be tight. Once a vehicle suitable for multi-use is in place the new regulations should permit adaptation of the vehicle for further transactions quite quickly and easily.

Even if the January reinsurance renewal is not when the first UK domiciled ILS transaction occurs, this will not impact the UK's long-term strategy to compete on a level playing field in collateralised reinsurance and ILS and without doubt, UK vehicles can be in place for the other peak renewal points in early and mid-Summer 2018.

Fully funded

As well as seeing the PRA's final position on the application process, the market is keen to see the final guidance on the PRA's interpretation of the "fully funded" requirement in Article 13(26) of the Solvency II Directive and Article 326 of the Solvency II Delegated Regulation. This issue has been extensively debated and the market remains hopeful that the final position adopted by the PRA will be broadly in line with other jurisdictions, will be clear and practical to apply and will recognise appropriately the effect of the specific contractual provisions included in ILS transactions.

ISPV directors and managers

The respective roles of directors and ISPV managers has generated a lot of discussion between the ILS Taskforce and the Treasury and PRA/FCA, with the ILS Taskforce originally pushing for a regulated activity (so ensuring greater regulation and oversight) for ISPV managers as they would, in effect, run the ILS vehicle. The Taskforce's suggestion was not adopted. Instead, the Treasury and the PRA believe that the Senior Insurance Managers Regime ("SIMR") and the fit and proper requirements in Solvency II will ensure adoption of the high standards needed for outsourcing functions, including by those managers carrying out the day-to-day management of ISPVs. Individuals within the manager who are expected to be assigned 'key function holders' (i.e. those who could be considered to 'effectively run' an ISPV) will need to meet the 'fit and proper' criteria set out in the PRA's Rulebook.

While directors will ultimately be responsible for the operation of an ISPV they will, as explained above, delegate or outsource the day-to-day management of a vehicle to a manager. As such, directors will not be expected to take full

¹ Our previous briefings are: [A UK Framework for Insurance Linked Securities - 23 November 2016](#) and [Update: UK insurance linked securities \('ILS'\) framework to be completed - 27 June 2017](#)

responsibility for the management of operational detail provided that they have acted reasonably in appointing and supervising the managers. Directors have a duty of care and responsibility to the vehicle but as for directors of a company if something does go wrong, a subjective test will be to determine whether a director took 'reasonable steps' in the circumstances to discharge his or her duty of responsibility.

Senior Management and Certification Regime

The PRA and the FCA are currently consulting on amending SIMR to bring it into line with the Senior Management and Certification Regime ("SMCR") which currently applies to banks. The consultations close on 3 November and the consultation documents can be found here:

PRA consultation -

<http://www.bankofengland.co.uk/pr/Documents/publications/cp/2017/cp1417.pdf>

FCA consultation -

<https://www.fca.org.uk/publication/consultation/cp17-26.pdf>

Our briefing [Extension of the Senior Managers and Certification Regimes to the Insurance Sector - 1 August 2017](#) sets out the PRA and FCA's proposed amendments to the SIMR, including how the SMCR could apply to ISPVs. Firms with thoughts on issues relevant to ISPVs, including on accountability of managers and directors, are encouraged to respond to the SMCR consultations.

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