CLIENT MEMORANDUM

The UK Government Releases Final Regulations for Establishing an ILS Regime in the UK

ILS Market Participants to Consider for January 1, 2018 Renewals

July 24, 2017

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In significant news for ILS market participants, the new regulations that will create the legal framework for an ILS market in the UK are expected to be approved after Parliament has reconvened following the summer recess, and come into force by October 31, with the potential for market participants to take advantage of the new UK regime in time for January 1, 2018 renewals. The Risk Transfer Regulations and the Risk Transformation (Tax) Regulations (**Regulations**) are designed to make the UK an attractive additional option for ILS participants who currently conduct their business in other jurisdictions such as Bermuda or Guernsey. The Regulations passed with cross-party support, reaffirming that all sides of the political spectrum in the UK remain committed to the London reinsurance market.

We have previously reported on the draft Regulations and the various consultations related thereto. These memoranda can be found using the following links: An ILS Regime for the UK: Responses to UK Government Consultation Papers and Proposed ILS Regime for the UK.

The Regulations amend UK company and insolvency law to allow for protected cell companies (**PCCs**), which had not previously existed under UK law, for the purpose of "insurance risk transformation." Each PCC will have a "core" that administers the PCC, manages each cell and enters into reinsurance transactions on behalf of the cells in the PCC. Although the cells will not have a separate legal personality, the statutory segregation and ring-fencing of assets and liabilities in a cell mean that the assets of one cell cannot be used to discharge the liabilities of another.

The Regulations also exempt insurance special purpose vehicles (**ISPVs**) or PCCs from corporation tax for the insurance risk transformation profits and provide a complete withholding tax exemption for non-UK investors.

One useful difference between the draft Regulations and the final Regulations as laid before Parliament is that a PCC assuming a new risk or set of risks from an undertaking may now make a notification of a new protected cell to the PRA within five business days of a PCC assuming the risk(s), whereas the draft Regulations provided that notifications must be submitted to the PRA in advance as part of a pre-approval requirement. This is extremely helpful in terms of acknowledging the commercial realities of a typical ILS transaction timetable and giving the PCC the flexibility it needs to be dynamic and operate nimbly within the space, and should help to make the UK an attractive additional jurisdiction for ILS.

There have also been welcome developments in relation to the tax treatment:

- There is no longer any restriction on the extent to which a cedant group can invest in the ISPV or PCC without the ISPV or PCC being ineligible for the tax exemptions. H.M. Treasury has responded to concerns that the proposed restriction would not accommodate initial "seed investment" from the cedant group by dropping altogether the idea of a maximum limit on the cedant group's investment; and

- The situations in which the favourable UK tax treatment is lost as a result of tax compliance failures by the ISPV or PCC have been narrowed, so that the tax exemptions are only "switched off" for more serious matters, such as deliberate or repeat offences.

These are significant developments for reinsurers that want to establish ILS vehicles whilst taking advantage of London's position at the forefront of the global reinsurance business and we look forward to advising clients on their ILS vehicles and investments in the UK market.

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July 24, 2017

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