Title: Insurance Linked Securities - implementing a new framework for the UK **IA No:** 4024(1) - HMT **RPC Reference No:** RPC-4024(1)-HMT **Lead department or agency:** HM Treasury **Other departments or agencies:**	**Impact Assessment (IA)** **Date:** 5/4/2017 **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** James Usmar, james.usmar@hmtreasury.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANDCB in 2014 prices)	**One-In, Three-Out**	**Business Impact Target Status**
£0	£0	£0	In scope	Qualifying provision

What is the problem under consideration? Why is government intervention necessary?

Insurance Linked Securities (ILS) transfer insurance risk to the capital markets. ILS is a rapidly growing sector of the global reinsurance market, currently worth over $70bn. The University of St. Gallen estimates that the ILS market could grow to a value of $87bn by 2019. The UK does not currently have a fit for purpose regulatory and supervisory framework for ILS. Currently, the majority of ILS business occurs in overseas territories such as Bermuda, Cayman Islands, Guernsey and Jersey. The ILS project aims to develop a fit for purpose regulatory and tax framework for ILS in the UK, so that the UK can compete in the ILS market and retain its position as a leading global reinsurance hub.

What are the policy objectives and the intended effects?

The intended policy effect is to encourage ILS to take place in the UK, reinforcing the London's position as the largest global hub for commercial and speciality insurance and reinsurance. London would be the first major financial centre to offer ILS solutions and we think that a major and well trusted financial centre can help grow the global ILS market, attracting new capital into the market and supporting innovative new products. ILS requires highly specialised expertise and we would expect the regulations to result in increased business activity for the specialist insurance, reinsurance and professional services sector in the UK.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The government considers a new approach to regulation necessary as the UK does not currently have a fit for purpose regulatory and supervisory framework for ILS vehicles. If the government did not produce regulations amending FSMA 2000 (and instead maintained the status quo), then there would be little incentive for ILS business to take place in the UK. Currently, no ILS vehicles are domiciled in the UK. The regulations proposed in Option 1 are contained in the Risk Transformation Regulations 2017. They create a new, voluntary corporate structure to conduct ILS business, called 'Protected Cell Companies'. As this new corporate structure is voluntary, there will be no cost to business. The introduction of a new regulated activity to FSMA helps create a more streamlined supervisory approach to ILS. The regulations are therefore permissive so we assume the benefits of undertaking ILS business will be at least equal to the cost of complying with the regulations.

Will the policy be reviewed? It will not be reviewed. **If applicable, set review date:** Month/Year

Does implementation go beyond minimum EU requirements?		No		
Are any of these organisations in scope?	**Micro** No	**Small** No	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)		**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: Date: 18 April 2017

Summary: Analysis & Evidence

Policy Option 1

Description: Implementing a new regulatory and supervisory framework for Insurance Linked Securities in the UK

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
2017	2017	N/A	**Low:** 0	**High:** 0	**Best Estimate:** 0

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0	N/A	0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised costs by 'main affected groups'

The 'main affected groups' identified are businesses wishing to use ILS in the UK. This includes insurers, reinsurers, ILS funds, insurance management service companies, capital markets and legal expertise. This policy option will make it easier to establish ILS vehicles in the UK. At this point, it is not clear what the size of the market will be, and there are no ILS transactions domiciled in the UK, so we have not been able to fully monetise costs or benefits as there are no comparisons which can be made.

Other key non-monetised costs by 'main affected groups'

This option creates a new corporate structure for ILS business in the UK, called 'Protected Cell Companies' (PCCs). The use of PCCs is voluntary in the proposals and therefore the net cost to business is zero. It is reasonable to assume that for any business taking up the opportunity, the benefits will at least be equal to the costs. The PRA and FCA have produced cost benefit analyses on the streamlined registration and supervisory process which argue that this option will not result in significant additional costs for firms as the information required should be at the firm's disposal.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

This policy option will make it easier to conduct ILS deals in the UK. At this point, it is not clear what the size of the market will be, although the University of St. Gallen estimates that the global ILS market could grow to a value of $87bn by 2019.

Other key non-monetised benefits by 'main affected groups'

We expect there to be benefits to business from the new, voluntary corporate structure and the streamlined authorisation and supervisory process. The corporate structure offers administrative savings as opposed to registering a new company for each ILS deal and applying for authorisation from the FCA and PRA. The streamlined registration and supervisory process is designed to be time saving and efficient for business.

Key assumptions/sensitivities/risks | **Discount rate** | 3.5%

A key assumption is that these proposals will create a new market in the UK and that no ILS business has taken place in the UK.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**Score for Business Impact Target (qualifying provisions only) £m:**
Costs: 0	**Benefits:** 0	**Net:** 0	

Evidence Base (for summary sheets)

1. The policy issue and rationale for Government intervention

Insurance Linked Securities (ILS) transfer insurance risk to the capital markets. The UK does not currently have a fit for purpose regulatory and supervisory framework for ILS business.

Use of ILS has grown very significantly in recent years and is now an established part of the global reinsurance market. ILS or alternative reinsurance capital now stands at around $70 billion, about 12% of overall reinsurance capital. The University of St. Gallen in Switzerland has estimated that the ILS market could grow to a value of $87 billion by 2019.

Currently, the majority of ILS business occurs in offshore territories such as Bermuda, Cayman Islands, Guernsey and Jersey. The ILS project aims to develop a fit-for purpose regulatory and tax framework for ILS in the UK, so that the UK can compete in the ILS market, helping retain its position as a global reinsurance hub. Although Solvency II permits the use of ILS in the UK, no ILS business currently takes place in the UK. This is because the current authorisation process is complex and there is no specific corporate structure available for ILS business. Hence the regime is underutilised and has not been able to compete with other ILS markets.

The government believes that, with the right framework, the UK can make a major contribution to the continued growth and development of the global ILS market. London is the largest global hub for commercial and speciality insurance and reinsurance risks and can offer a cluster of specialist insurance and capital market expertise that is unmatched. The ability for the UK to conduct ILS business would likely promote further innovation within the London reinsurance market. By supporting innovation within a trusted and robust regulatory framework, London should be well placed to become a leading market for alternative risk transfer, attracting new capital to the global ILS market.

2. Policy objectives and intended effects

The government is planning to create a bespoke regulatory framework for Insurance Linked Securities business in the UK.

The main provisions of the regulations are:

1. A new corporate structure for ILS business:
   - We are creating a new corporate structure for ILS business in the UK, called Protected Cell Companies (PCCs). This structure is familiar to the global ILS market and is widely used in other jurisdictions.
   - We will make the use of this corporate structure voluntary for businesses wishing to do ILS business in the UK, therefore there are no mandatory burdens on businesses.
   - Although voluntary, we expect the market to use this new corporate structure due to the administrative savings that the corporate structure offers. Rather than establishing a new company for each ILS deal a company wishes to issue, it adds another cell to the protected cell company. This reduces the administrative cost of establishing a new company.

2. A bespoke tax framework:
   - Protected Cell Companies will be exempt from corporation tax and withholding tax. Investors in these companies will be taxed according to their own jurisdiction. This is in line with current UK tax policy for similar financial structures (e.g. open ended investment companies)

3. A bespoke authorisation regime for ILS business:
    - Although it is already possible to do ILS business in the UK under Solvency II, which was transposed in 2015, we are creating a new regulated activity of risk transformation in the Financial Services and Markets Act 2000 (FSMA) to allow UK regulators to implement a streamlined approach to authorisation and supervision of ILS business in the UK.
    - We have provided for the authorisation and supervision of ILS business through the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The PRA are the lead regulator.
    - The PRA are developing their own approach to the authorisation and supervision of ILS business.

The policy objective of these regulations is to provide a competitive regulatory framework for the UK in ILS business. These regulations implement a new corporate structure, a bespoke tax framework and a bespoke authorisation regime which are familiar with global practitioners in ILS.

The regulations streamline and simplify the process for companies wishing to conduct ILS business in the UK. Two government consultations on the ILS regulations which were issued in March (https://www.gov.uk/government/consultations/insurance-linked-securities-consultation) and November 2016 (https://www.gov.uk/government/consultations/regulations-implementing-a-new-regulatory-and-tax-framework-for-insurance-linked-securities).

3. Policy options considered, including alternatives to regulation

There are no alternative options that are being considered to achieve the intended outcome. Companies are currently permitted to conduct ILS business in the UK under Solvency II, which allows the use of Special Purpose Vehicles. However, there are no ILS transactions currently domiciled in the UK. This is because the current authorisation process is complex and there is no specific corporate structure available for ILS business. Hence the UK regime is underutilised and has not been able to compete with other ILS markets such as Bermuda, Cayman Islands, Guernsey and Jersey.

The aim of the policy is therefore to introduce a fit for purpose regulatory, supervisory and tax framework in the UK. If the government did not produce regulations amending FSMA 2000, then there would be little incentive for ILS business to take place in the UK.

4. Expected level of business impact

This measure is a qualifying regulatory provision for the Business Impact Target.

The proposals affect insurers, reinsurers and ILS firms who wish to undertake ILS business in the UK in that they offer the possibility of using ILS cover in the UK on a more competitive basis than before. They also affect professional services firms and law firms who may be contracted by a PCC.

<u>Quantifying benefits</u>

The regulations will make it easier to conduct ILS deals in the UK. At this point, it is not clear what the size of the market will be, so we have not been able to fully monetise costs or benefits. Below we have outlined what we believe to be the expected impact on businesses using these new regulations.

Size of market

Using the data held by Artemis (the longest running news, analysis and data media service for alternative risk transfer, catastrophe bonds and insurance linked securities), we estimate that there are around 150 firms involved in ILS business worldwide, including firms that may carry out ancillary business to PCCs. (see here: http://www.artemis.bm/marketview/)

In the UK, we estimate that there are around 35-45 businesses involved in ILS who will be affected by these regulations.

We have estimated the size of this market using the data from Artemis above as well as the respondents to the two government consultations on the ILS regulations which were issued in March and November 2016. The March 2016 consultation received 21 responses and the November 2016 consultation received 19 responses.

Registration and administrative costs

The proposed regulations make the activity of risk transformation a regulated activity in the UK. Firms undertaking regulated activities are required to be authorised by the FCA and PRA. Only registered insurers and reinsurers are able to use the proposed regulations, in line with the existing Solvency 2 regulations. This means that firms who want to undertake ILS business will already be registered with the FCA. Therefore, we do not believe there will be a significant business impact.

The regulations create a new corporate structure for ILS business in the UK, called Protected Cell Companies (PCCs). The use of this new corporate structure is voluntary, and therefore there are no mandated business costs within the proposed regulations.

The PRA and FCA have released a joint consultation on the authorisation and supervisory framework set out by our regulations, available here: (http://www.bankofengland.co.uk/pra/Documents/publications/cp/2016/cp4216.pdf). Within the consultation, they have conducted a cost benefit analysis of the actions which would arise from the authorisation and supervision process. The analysis concludes that there is unlikely to be any additional costs borne by business as a result of the authorisation and supervision process.

As stated in the joint consultation, the PRA “does not anticipate that the routine costs are likely to be substantial or disproportionate as the required information should be at the firm’s disposal”. Additionally, “the additional costs of meeting the proposals in relation to the authorisation and supervision of ISPVs…do not create additional requirements to those set out in the Delegated Regulation and Implementing Technical Standards”.

Separately, the FCA have released a consultation on changes which would be made to their Handbook as a result of the proposed regulations, available here: (https://www.fca.org.uk/publication/consultation/cp17-03.pdf). The consultation contains a cost benefit analysis which concludes that there would not be significant additional costs to firms from changes to the FCA Handbook.

Registration and administrative benefits

However, we expect there to be benefits to business from the new, voluntary corporate structure and the streamlined registration and supervisory process. The corporate structure allows one company to be used for multiple ILS deals, offering administrative savings.

Without the regulations in place, each new ILS deal would need a new company to be registered at Companies House, which would be a time-consuming process. Each company would then be subject to authorisation from the PRA and FCA, in order to undertake a regulated activity. This would be an expensive process.

Below is a table that demonstrates some of the savings companies could be expected to see from the new corporate structure of PCCs.

In the left hand column, we have used the example of a PCC with five cells. We have then compared this to a single cell ISPV in the right hand column. If a company wished to do five deals in the current regulatory framework, it would have to create five separate ISPVs, the costs of which are calculated in the table. Both of these examples have the same effect of allowing five ILS deals to take place.

As demonstrated below, the corporate structure allows significant savings to be made when compared to five single cell ISPVs. Not only are these financial savings, but they may also be savings in the amount of time needed to process and authorise the deals. In the case of the five single cell ISPVs, if these deals were submitted to the PRA and FCA sequentially then it is possible that each deal would take 6 weeks to authorise.

	PCC with 5 cells/deals		5 single cell ISPVs		
Application fee (PRA)	£	5,000.00	£	25,000.00	(5x5000)
Registration fee (FCA)	£	2,500.00	£	12,500.00	(5x2500)
ISPV periodic fee (FCA)	£	466.00	£	2,330.00	(5x466)
PCC one-off registration fee (FCA)	£	500.00	£	-	
Total	**£**	**8,466.00**	**£**	**39,830.00**	
Time taken to authorise deal	Approx 6 weeks, cells can be added to PCC quickly		If deals authorised sequentially, then up to 30 weeks (5x6 weeks per application)		

Conclusion

We believe that the direct benefits to business from the regulations will outweigh the costs, otherwise we would not expect business to use the regime. The regulations have been designed to reduce costs to business and attract ILS business to the UK. We expect the new corporate structure to provide administrative savings to companies as it allows one company to manage multiple ILS deals. Due to the lack of ILS deals in the UK, it is difficult to precisely quantify the benefits the regulations offer.

We do not expect the proposals to result in any increase in costs for business. Both the FCA and PRA have conducted cost benefit analyses as part of their consultations on the authorisation and supervisory process. In each case they conclude that the process as set out in their consultations would not impose significant or additional costs on businesses wishing to use the ILS regulations.