



# Perfectly positioned for Insurance Linked Securities

Insurance Linked Securities (ILS) have become popular with investors as an alternative asset class, and with insurers as a means of accessing greater quantities of affordable risk transfer capacity. ILS permit an insurer to purchase additional protection for low frequency high severity losses, including natural and non-natural perils, operating in the traditional insurance market, typically in the form of catastrophe “cat” bonds, collateralised reinsurance or industry loss warrants.

Investors are attracted to ILS because returns are non-correlated with the general financial markets. Although specialist cat funds remain the largest investor in ILS, mutual funds including pension funds and institutional investors have increased their participation in this asset class significantly.

## Guernsey's ILS offering

Guernsey's long track record and existing expertise gained in the investment funds and insurance sectors are optimised and combined in the ILS offering. Fund managers and promoters with capital to deploy are brought together with transformation managers who understand insurance risk.

Guernsey provides access to capital markets notably the London Stock Exchange (LSE) and other international exchanges including Hong Kong, Toronto, Ireland and Euronext, as well as the Channel Islands Stock Exchange (CISX).

The Guernsey domiciled DCG Iris Fund has been established as a closed-ended feeder fund into the Low Volatility Plus Fund managed by Credit Suisse Asset Management's ILS team. Dexion Capital has raised over £60 million for the fund which has been listed on the Main Market of the LSE.

Please refer overleaf to the more detailed case studies pertaining to the facilitation of traditional transformer protected cells and the Solidum Re Eiger IC Limited vehicle which involves a CISX and Vienna dual ILS listing.

## Why Guernsey for ILS?

Guernsey benefits from its proximity to London, favourable time zone, proportionate and speedy regulation (which provides a fast-track facility to the Specialist Fund Market of the LSE), modern infrastructure and experienced professionals and service providers - legal, accounting, actuarial and administrators. Furthermore the existence of over 30 licensed banks makes it possible to access very competitive letters of credit.

Guernsey is politically and economically stable with no external government borrowings.

Guernsey has an advantage as a domicile for ILS as it can demonstrate substance already present in existing structures. A number of major fund and insurance managers have offices and staff present in Guernsey and there is a large pool of qualified non-executive directors, experienced in providing management functions.

## The differentiating factors

A major differentiator of Guernsey is the ability to offer two innovative cells structures; Incorporated Cell Companies (ICCs) and Protected Cell Companies (PCCs) with some ILS funds availing themselves of both structures within their ILS growth strategies. These structures provide a low cost, low administration vehicle to access returns from the reinsurance market.

At the time of writing there are in excess of 50 protected cells established in Guernsey across 4 different PCC platforms having written fully collateralised reinsurance, primarily covering property catastrophe risks, marine, crop and other classes such as premium reinstatement or prize indemnity. Protected cells in Guernsey are also being used to conclude ISDA arrangements (International Swaps and Derivatives Association - which has produced standardised documentation/contracts for derivative transactions) as an alternative to a reinsurance contract.

For ILS funds which prefer not to co-mingle their assets in a third party sponsored PCC, a dedicated PCC provides the security of a standalone, ring-fenced entity set up solely for the use of one ILS fund with the convenience of segregated cells for each separate transaction.

There is flexibility in the type of reinsurance contract being entered into by each protected cell, provided that the cell is fully funded up to its maximum aggregate exposure by a combination of contract premium and investment funding injected by the ILS fund.

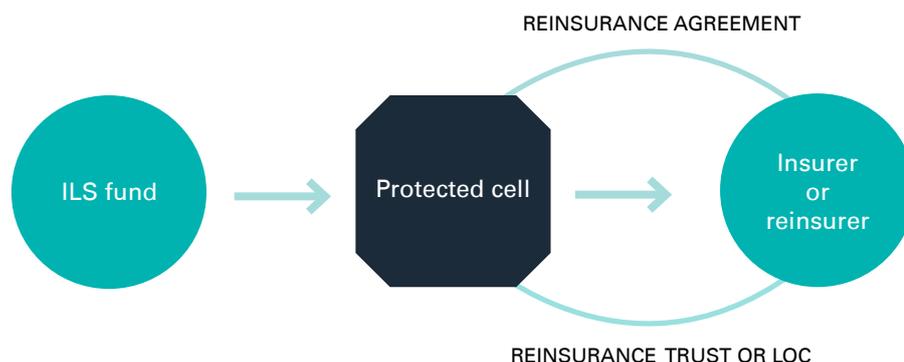
Creating a separate Incorporated Cell (IC) within an existing Guernsey ICC or creating a standalone ICC owned by an ILS fund has the benefits of providing lower establishment and running costs than with standalone Special Purpose Vehicles (SPVs) but still with equivalent legal segregation of cellular assets and liabilities. A principal benefit for the ICC structure is managing counter-party credit risk.

Some ILS funds are limited as to how much capital can be invested with a single incorporated vehicle. As the PCC structure is a single corporate entity (despite the robust segregation of assets and liabilities within individual cells) this credit limit can be quickly exceeded. However, the IC structure reduces the counter-party credit risk measurement to each cell allowing much larger aggregate relationships to be built under the direction of a single board.

## The Hexagon PCC Group

The Hexagon PCC Group has established Guernsey PCCs which are licensed and regulated by the Guernsey Financial Services Commission (GFSC). It currently acts for three leading ILS funds, two of which are in the top eight global ILS asset

managers. The Hexagon PCC Group has established more than 20 protected cells in Guernsey, each writing one or more fully collateralised reinsurance contracts with assets at risk exceeding US\$300 million.



### How does it work?

1. An insurer will approach both the traditional and ILS market (usually through a broker) seeking reinsurance/retrocession capacity for catastrophe type risks. For example a contract with an aggregate limit of US\$20 million might have a US\$5 million premium.
2. The ILS fund will assess whether the proposed rate and return on capital is appropriate for the underlying risk and will provide a suitable investment return for its shareholders.
3. The board of the PCC will review the underwriting information, complete underwriting procedures to accept the proposed risk and review all contract wordings.
4. The ILS fund provides investment funding of US\$15 million to the cell in return for cell shares to fully collateralise the maximum exposure under the reinsurance contract when added to the contract premiums.
5. Collateral funding is held in a reinsurance trust account or as security for a letter of credit for the benefit of the reinsured.
6. The cell issues a catastrophe excess of loss or similar type of aggregate reinsurance contract to the insurer or reinsurer signed in Guernsey by directors of the PCC.
7. The contracting cell receives the contract premium net of any brokerage into the trust or security account.
8. In the event that there are no claims under the reinsurance policy, the collateral and profit can be released back to the investing ILS fund very quickly at the end of the policy term.

This methodology is tried and tested having been used since the first Guernsey transformer cells were created.

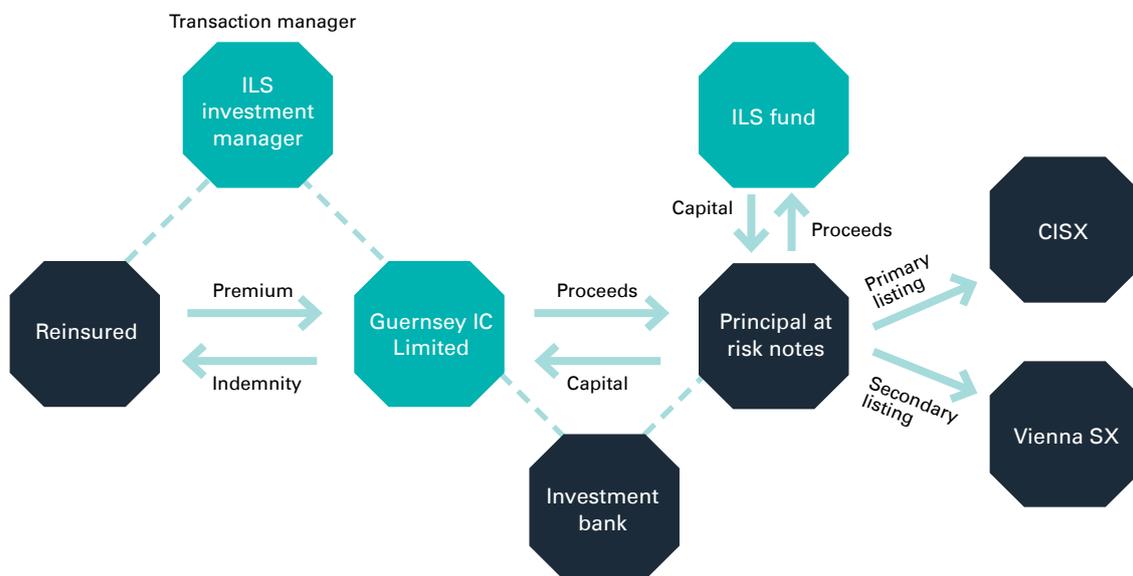
## Case study: Solidum Re Eiger IC Limited

Since 2006 Aon in Guernsey has been involved with over 80 ILS transactions with annual transactions increasing year on year. Aon was involved with Solidum Re Eiger IC Limited, an insurance vehicle which listed bonds with a value of US\$52,500,000 on the CISX - the transaction was a reinsurance placement accepted by an IC from a US cedent. It was the first CISX listing where natural catastrophe perils are the underlying exposure for "principal at risk" notes. The transaction incorporated a dual listing with the Vienna Stock Exchange.



Bedell Cristin Guernsey acted as sponsor for the CISX listing. Managing Partner Mark Helyar, who completed the listing, commented:

*"Guernsey and the CISX are ideally placed to support this business because of the specialist insurance and professional sectors able to provide a high quality, transparent marketplace for securitising catastrophe risk in a well regulated and respected jurisdiction."*



## About the manager

Solidum Partners AG based in Zurich, Switzerland specialises in insurance-event linked securities and offers advisory and portfolio management services for investments into this emerging asset class.



Cedric Edmonds, Partner at Solidum Partners and Director of Solidum Re Eiger IC Limited said:

*"Solidum Partners chose Guernsey as a jurisdiction for its incorporated cell reinsurance company and private cat bond platform due to the Incorporated Cell Company legislation and the quality and 'can do' attitude of the service providers. Solidum was the first entity to issue private cat bonds and to date the only entity to have their private placement cat-linked notes traded. The current listing on the CISX is the next step to broader dissemination and acceptance."*