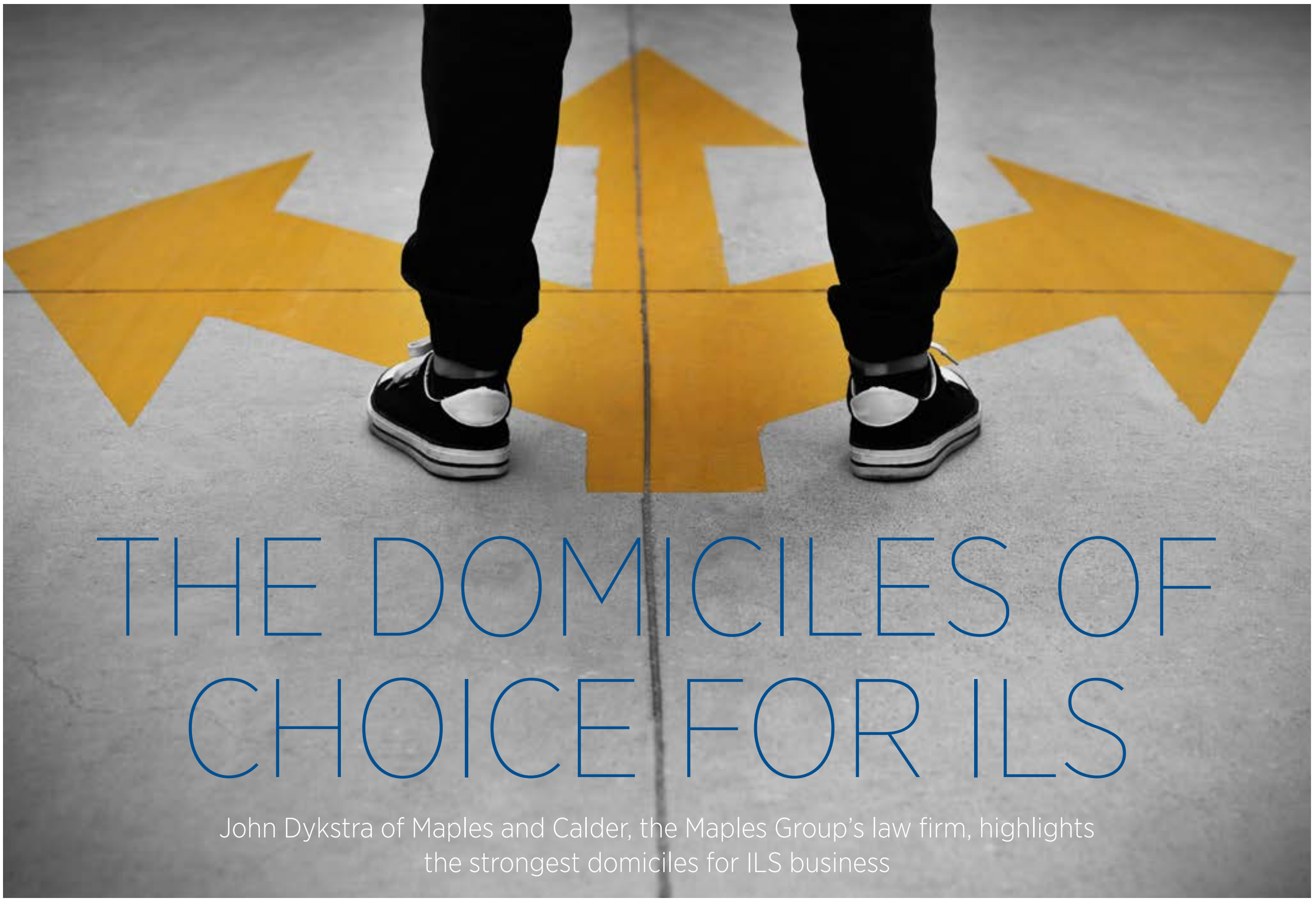

THE DOMICILES OF CHOICE FOR ILS

John Dykstra of Maples and Calder, the Maples Group's law firm, highlights the strongest domiciles for ILS business

In recent years, we have experienced what seems to be a never-ending stream of catastrophic events grabbing news headlines, including hurricanes, earthquakes, wildfires and even pandemic events. There have been concerns that sponsors and investors might shy away from ILS in the face of this onslaught of catastrophic events and the resulting claims on transactions. Despite all the headline-making events, market leaders anticipate strong issuance levels in 2020, in part due to a significant amount of maturities expected this year. Once again, the ILS market is proving to be very resilient.

ILS remains in high demand from both investors and sponsors and is not merely a novel product sitting at the fringes of the capital markets. With a track record stretching back into the mid-1990s, catastrophe bonds and other ILS products have convincingly demonstrated their staying power in the face of many challenges, including the financial crisis when ILS issuance continued unabated while other sectors of the capital markets came to a halt.

Following the financial crisis, when jurisdictions were actively seeking out new opportunities, ILS was quick to catch the attention of financial centres that previously had not been interested in attracting the ILS market. For many years, catastrophe bonds had been set up with a Cayman Islands issuer, save for a small number of European-focused deals that used an Irish issuer. Other jurisdictions were either not interested in the product or they lacked an appropriate regulatory framework. The Cayman Islands has been receptive to catastrophe bonds going all the way back to the very first 144A deals and quickly became the dominant jurisdiction for catastrophe transactions.

John Dykstra

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The Cayman Islands

This was not at all surprising as the Cayman Islands is well-recognised as a leading financial centre for securitisations and other structured finance products, as well as being one of the world's leading offshore insurance centres. With expertise in both areas, the jurisdiction is well positioned for a hybrid product such as catastrophe bonds, which are structured as a securitisation but with an overlay of insurance licensing and regulatory oversight by the insurance regulator. It has also been helpful that the Cayman Islands has always made a conscious effort to be welcoming to innovative new structures, while other financial centres have been hesitant to embrace change.

When other areas of the markets seized up during the financial crisis, the appeal of ILS became more evident. The non-correlation of ILS to other financial products, which allowed ILS issuance to continue unabated, made it very appealing to financial centres seeking out new product lines to fill the gaps in their deal books.

ILS in Bermuda

A number of financial centres developed new regulatory regimes or overhauled their existing regulatory regimes to better accommodate the requirements of the ILS market. Bermuda was one of these financial centres. Bermuda missed out on the ILS market in its early days, despite having the expertise and dominance in the insurance markets. When Bermuda overhauled its regulatory regime to draw in ILS deals, it also launched an aggressive marketing campaign focused on its existing deep connections in the global insurance community. While other domiciles failed to gain any noticeable traction, Bermuda's efforts paid off handsomely.

Bermuda is not the only new contender to emerge over the past few years. Both the UK and Singapore have set up new regulatory regimes to draw in ILS transactions. Both countries have made a very aggressive push to win a segment of the ILS market, but both regimes face significant challenges.

Speed of execution and tax efficiency have proven to be real challenges for the UK's ILS regime. Only time will tell if the UK is able to resolve these issues. In the meantime, there is the added uncertainty of how Brexit will impact the appeal of setting up a transaction in the UK. The UK is a leading insurance domicile in its own right and can lean on some of its leading domestic insurers to provide support for its new regime. However, it remains to be seen how eager non-UK sponsors will be to use the UK's ILS regime. What advantages can the UK's ILS regime offer over what is available from other established ILS jurisdictions?

The Singapore appeal

The appeal of Singapore's new ILS regime is cost. Singapore has been offering to rebate a significant amount of the set-up costs of deals that are established with a sufficient business presence in Singapore. Smaller deals that would otherwise not make financial sense can suddenly make the numbers work because their set-up costs are substantially defrayed. However, these financial incentives are being offered for only a limited time. When these financial incentives fall away, the primary rationale for setting up a transaction in Singapore will fall away with them.

Maples Group – covering the bases

The Maples Group is well-positioned in the current ILS market. We offer legal and/or fiduciary services in all of the key jurisdictions. We have acted as legal advisers on these transactions going back to the very earliest days of the market. With teams based in Bermuda, the Cayman Islands, Ireland, Singapore and the UK, we cover both the historically dominant jurisdictions and the leading newcomers.

> "ILS remains in high demand from both investors and sponsors and is not merely a novel product sitting at the fringes of the capital markets"

Other financial centres have attempted to carve out a niche in the ILS market, but without much success. Even though it is a strong market, the ILS market is not large enough to support a large number of competing jurisdictions. Competition is healthy, but it is also important that a jurisdiction has a sufficient amount of experience with the product. There is not room for more than a few jurisdictions and it seems clear which jurisdictions have locked up the lead positions.

Conclusion

Bermuda and the Cayman Islands are the two leading domiciles, with Bermuda holding the dominant position for the past few years. Bermuda's position is not unassailable, and the Cayman Islands could snatch back the lead position if market participants become dissatisfied with certain aspects of Bermuda's regulatory regime, or if they grow concerned about the financial stability of Bermuda in general.

The UK and Singapore are the two newcomers to watch. If Singapore does not extend its financial incentives, it is difficult to see the appeal of its ILS regime. The UK's ILS regime may have long-term appeal, but the UK first has to come through a period of general uncertainty as a result of Brexit.

As mentioned, other jurisdictions have also attempted to break into this market. Several jurisdictions have gone so far as to draft and implement new laws and regulations focused specifically on creating a framework suitable for ILS products, and yet in some cases this has not drawn any appreciable interest. It is clear that putting a tailored regulatory framework into place is not in itself sufficient to draw in business. ILS is a sophisticated product that requires experienced and sophisticated service providers who understand it and who can provide a top level of service. Likewise, it is critical to have a regulator that has an experienced understanding of the product. A new jurisdiction lacking service providers and a regulator with solid experience in this market will struggle to put forward a convincing case that it is ready to handle these deals. Even jurisdictions with well-developed ILS regimes and a great deal of knowledge and experience among their service providers have found that it can be a challenge to maintain their market position.

A good example of this is the Cayman Islands, which just a few short years ago enjoyed a near monopoly on this product. The Cayman Islands remains a leading offshore insurance domicile, but Bermuda has replaced the Cayman Islands as the leading ILS domicile. The lesson is clear: healthy competition in this market means that an incumbent cannot be complacent about its position.

The increased competition among the world's financial centres for their share of the ILS market is healthy for the market. Over time, the surviving jurisdictions may develop particular niches within the market, aligned with their particular advantages, and this will serve the market well. There may not be room for a large number of jurisdictions in this market, but a small number of key jurisdictions offers up healthy competition while preserving the necessary experience and expertise that this type of sophisticated product requires if this market is going to continue to grow and mature.

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