

# Catastrophe-Linked Securities

## Introduction

In the last few years there have been a number of significant developments in the insurance markets. Insurance companies have for the first time begun to transfer certain risks to the capital markets rather than relying solely on the traditional reinsurance market, and investors have been turning to specialist insurance-linked products as an attractive alternative to traditional corporate and asset-backed securities. This has led to the emergence of a new market of structured insurance risk securities, which offer returns linked to the occurrence of catastrophes such as floods, hurricanes and earthquakes. This guide briefly outlines the main features of these new types of investment and explains why Jersey is an ideal jurisdiction through which to structure such transactions.

A catastrophe-linked security is a security with a fixed maturity date where the return will depend upon the occurrence of an insured catastrophe during the defined period, generating losses over and above a fixed amount. If no such catastrophe occurs, the investor will usually enjoy an attractive return over and above that offered by more traditional securities. However, if a large catastrophe does occur, the investor may lose some or all of his investment.

The security is generally issued by a bankruptcy remote special purpose vehicle (SPV) incorporated in an offshore jurisdiction such as Jersey, where the tax and regulatory environment is advantageous.

The SPV enters into a reinsurance contract with the primary insurer, providing the primary insurer with reinsurance cover without exposing the primary user to the credit risk of the reinsurer itself. Furthermore, this gives the primary insurer access to the capital markets as a source of cash, at a time when funds from traditional reinsurance companies are often insufficient to cover the market.

The SPV usually invests the money obtained from the investors in high quality fixed income securities, to cover losses or to repay investors on maturity. In some instances, in order to attract investors who are not prepared to take quite the level of speculative risk involved, the structure has been adapted to protect the principal amount of the security, by providing the investor with Treasury Strips with a par value equal to the principal value of the security, if a catastrophe occurs. Clearly, this variant offers lower potential maximum yield in return for the extra layer of stability.

Jersey was chosen as the jurisdiction of choice for one of the first such catastrophe-linked security issues, and remains an attractive jurisdiction for further such structures for a number of reasons, amongst which are the following:-

- the SPV will pay no taxes in Jersey;
- Jersey has very modern and flexible legislation in this field, in the form of the Insurance Business (Jersey) Law, 1997;

- the purchaser of securities issued by the SPV will usually not, as a matter of Jersey law, be deemed to be carrying on insurance business in the Island, and will not, therefore, be required to obtain a licence;
- the Jersey authorities have experience in dealing with these types of structure and can therefore process applications from SPVs for licences under the Insurance Business (Jersey) Law 1997 quickly and efficiently.

Mourant du Feu & Jeune are able to offer Jersey legal advice on all aspects of these transactions, including incorporation of the SPV, obtaining the necessary regulatory consents and licenses, and drafting offer documentation and ancillary agreements.

Mourant & Co, the trust and company administration arm of Mourant du Feu & Jeune, can offer a full range of administration services for the SPV enabling the structure to be dealt with quickly and efficiently under one roof, from inception to winding up of the structure.

**This Client Briefing cannot form a complete check list and refers only briefly to the provisions of the various laws. Specific legal advice should always be sought in particular cases.**

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