

**EXPLANATORY MEMORANDUM TO**  
**THE RISK TRANSFORMATION (TAX) REGULATIONS 2017**  
**2017 No. 1271**

**1. Introduction**

1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

**2. Purpose of the instrument**

2.1 This instrument implements a new tax framework for qualifying transformer vehicles that issue insurance linked securities (ILS). It is designed to attract such business to the United Kingdom (UK). ILS are an alternative form of risk mitigation for insurance and reinsurance firms. In contrast to conventional cover arranged with a reinsurance company, they offer insurance and reinsurance firms a means of transferring risk to a transformer vehicle. The transformer vehicle issues ILS to the capital markets to ensure that it has sufficient assets to be able to meet any liabilities as they fall due.

2.2 This instrument sets out which transformer vehicles are qualifying transformer vehicles and introduces a bespoke tax regime for these vehicles.

**3. Matters of special interest to Parliament**

*Matters of special interest to the Select Committee on Statutory Instruments*

3.1 None.

*Other matters of interest to the House of Commons*

3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and Northern Ireland and is not a financial instrument that relates exclusively to England, Wales and Northern Ireland.

**4. Legislative Context**

4.1 Section 183 of the Finance Act 2016 confers a power on Her Majesty's Treasury to make provision, by regulations, about the tax treatment of transformer vehicles and their investors. This is the first use of that power.

4.2 This instrument defines a transformer vehicle as a qualifying transformer vehicle if it is a company that is authorised to carry out insurance risk transformation by the Prudential Regulation Authority under Part 4A of the Financial Services and Markets Act 2000.

4.3 It ensures that profits arising from the activity of insurance risk transformation carried out by a qualifying transformer vehicle are not chargeable to corporation tax and that there is no requirement for the company to deduct income tax from interest payments to investors.

4.4 This is subject to two conditions which protect the regime against tax avoidance and abuse.

4.5 This instrument, together with the Risk Transformation Regulations 2017 (S.I. 2017/1212), provides a tax and regulatory regime which will allow the United Kingdom to become an attractive domicile for qualifying transformer vehicles.

## **5. Extent and Territorial Application**

5.1 The extent of this instrument is the United Kingdom.

5.2 The territorial application of this instrument is the United Kingdom.

## **6. European Convention on Human Rights**

6.1 The Financial Secretary to the Treasury, Mel Stride, has made the following statement regarding Human Rights:

“In my view the provisions of the Risk Transformation (Tax) Regulations 2017 are compatible with the Convention rights.”

## **7. Policy background**

### *What is being done and why*

7.1 The instrument makes provision for a bespoke tax regime for qualifying transformer vehicles undertaking insurance risk transformation by issuing ILS.

7.2 This type of insurance risk transformation gives insurers and reinsurers the option to transfer insurance risks to capital market investors. ILS are often used to mitigate risks arising from catastrophic natural disasters, for example, and are an important feature of the global reinsurance market.

7.3 The market for ILS has grown significantly in recent years and it is estimated that insurance risk transformation provides worldwide capital of around \$70bn which is approximately 12% of all insurance capital. The UK however does not have a fit-for-purpose tax framework in order to compete in the growing market for risk transfer.

7.4 The policy objective is to deliver a trusted and robust tax and framework alongside the newly created regulatory and supervisory framework which ensures that the United Kingdom is an attractive domicile for qualifying transformer vehicles issuing ILS. This should allow the UK to become a leading market for insurance risk transformation and make a major contribution to the continued growth and development of global insurance risk transformation.

## **8. Consultation outcome**

8.1 On 1 March 2016, the government published an initial consultation setting out its approach to the corporate structure, taxation, authorisation and supervision of qualifying transformer vehicles. The consultation closed on 29 April 2016.

8.2 The government received 21 responses from insurers and reinsurers, professional services firms, investment banks, industry groups and private individuals. All responses were supportive of the government’s intention to create a competitive framework for insurance transformation and were broadly supportive of the proposed regulatory and tax regime.

8.3 An overview of this consultation and a list of respondents is available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/571091/Insurance\\_Linked\\_Securities\\_final\\_web.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571091/Insurance_Linked_Securities_final_web.pdf).

- 8.4 On 23 November 2016 the government published a further consultation on “Regulations implementing a new regulatory and tax framework for Insurance Linked Securities” which outlined in detail the regulations designed to introduce an effective and competitive framework for qualifying transformer vehicles in the UK. The consultation closed on 18 January 2017.
- 8.5 The government received 19 responses from insurers and reinsurers, professional services firms, investment banks, industry groups and private individuals. The responses broadly agreed with the government’s proposed framework contained within the draft Risk Transformation (Tax) Regulations 2017 and the Risk Transformation Regulations 2017.
- 8.6 A consultation of 8 weeks considered appropriate as the number of interested parties was relatively small and most were already working closely with government on the introduction of the tax and regulatory regimes for qualifying transformer vehicles, this allowed the regulations to be introduced as early as possible.

## **9. Guidance**

- 9.1 HMRC’s General Insurance Manual will be updated to introduce guidance on the taxation of qualifying transformer vehicles ahead of the new regime for qualifying transformer vehicles coming into force.

## **10. Impact**

- 10.1 There is no impact on charities or voluntary bodies. For businesses the impact is expected to be negligible. This instrument will facilitate the growth of the risk transformation market in the UK through the removal of obstacles to that growth and will affect a small number of businesses who will incur negligible one off costs to familiarise themselves with the new rules. It is not expected that there will be any on-going costs.
- 10.2 There is no impact on the public sector.
- 10.3 A Tax Information and Impact Note covering this instrument was published on 23 November 2016 alongside the draft Risk Transformation (Tax) Regulations 2017 and is available on the website at <https://www.gov.uk/government/publications/tax-regime-for-insurance-linked-securities/tax-regime-for-insurance-linked-securities>. It remains an accurate summary of the impacts that apply to this instrument.

## **11. Regulating small business**

- 11.1 The legislation does not apply to activities that are undertaken by small businesses.

## **12. Monitoring & review**

- 12.1 The tax regime introduced by this draft instrument is intended to facilitate the growth of the risk transformation market in the UK. The number of qualifying vehicles entering the market in the UK will be monitored through information collected from tax returns and communications with affected companies.

## **13. Contact**

- 13.1 Darryl Wall at HM Revenue and Customs Telephone: 03000 585977 or email: [darryl.wall@hmrc.gsi.gov.uk](mailto:darryl.wall@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.