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Guernsey Cellular Companies

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The concept of the protected cell company was pioneered in Guernsey in 1997 and, since then, numerous jurisdictions, both onshore and offshore, have followed Guernsey's lead and introduced similar legislation.

This article briefly examines the Guernsey protected cell company (**PCC**) and a more recent variation of the cellular company concept, the Guernsey incorporated cell company (**ICC**).

As an example of the use of these Guernsey cellular vehicles in groundbreaking transactions, a Guernsey ICC and IC was used in the market leading £16 billion BT Pension Scheme longevity swap transaction, and a Guernsey PCC and PCC cell could equally have been used.

Guernsey PCCs

Introduction and structure

A PCC is a single legal person and the creation by a PCC of a cell does not create, in respect of that cell, a legal person separate from the PCC. A PCC (including its core and all of its cells) is a single company, with one set of constitutional documents and one board of directors (which directs matters in respect of the core and each cell).

A PCC has a core, which is the PCC excluding its cells, and may create one or more cells for the purpose of segregating and protecting cellular and core assets. Whilst the PCC itself is subject to an incorporation process through the Companies Registry in Guernsey, there is no such process for a cell and a cell can be created by resolution of the board of directors of the PCC. Depending on the business the cell is to conduct there may also be regulatory considerations.

Shares may be issued in respect of the core and a cell may (although is not required to) issue cell shares. Dividends may be paid on shares in the core and on shares in a cell.

Segregation of assets and liabilities

The key element of the PCC as compared to an ordinary non-cellular company is the statutory segregation of its assets and the limitation of liability that can attach to those assets.

Non-cellular company structures can be established with share class arrangements to differentiate between asset classes and the benefits due to holders of specific classes of shares. This however remains an internal arrangement between the members of a company, and the company and as a result there is a risk that creditors of a company do not and do not need to recognise this class arrangement. Therefore creditors of a class with insufficient assets to meet its liabilities could potentially access the assets of a financially strong class fund.

There is a risk of "contagion" in non-cellular company class arrangements, which is removed by the statutory segregation of assets and liabilities that applies to PCCs. The position of the creditors of a PCC depends on whether the corresponding liability of the PCC is attributable to a particular cell or to the core. If a PCC cannot satisfy the liabilities of a cell out of the assets attributable to that cell then the creditors of that cell do not have recourse to the other cells or the core.

Assets attributable to a particular cell are, subject to the terms of any recourse agreement, only available to the creditors of the PCC who are creditors in respect of that cell and are absolutely protected from the creditors of the PCC who are not creditors in respect of that cell. Similarly, core assets of a PCC are, subject to the terms of any recourse agreement, only available to the creditors of the PCC who are creditors in respect of the core and are absolutely protected from the creditors of the PCC who are not creditors in respect of the core.

To facilitate the operation of this:

- the assets of a PCC are either cellular assets or core assets and it is the duty of the directors of a PCC (i) to keep cellular assets separate and separately identifiable from core assets and (ii) to keep cellular assets attributable to each cell separate and separately identifiable from cellular assets attributable to other cells; and

- a PCC is under a statutory duty to inform persons with whom it transacts that it is a PCC and for the purposes of the relevant transaction, identify or specify the cell (or that it is the core) in respect of which that person is transacting.

Although statutory segregation is in place, it remains common to also see contractual segregation in contracts being entered into by PCCs.

Guernsey incorporated cell companies

Introduction and structure

The ICC has been put forward as a progression of the PCC principles of segregation of assets and liabilities. In contrast to an PCC, each cell of an ICC is a separately incorporated vehicle.

An ICC is a single legal person and each cell of an ICC (an **IC**) is also a single legal person, separate from its ICC. So the creation by an ICC of an IC creates, in respect of that IC, a separate legal person. An example of their separate nature is that an ICC has no power to enter into transactions on behalf of any of its ICs and an IC has no power to enter into transactions on behalf of its ICC or the other ICs of its ICC.

The ICC and each of its ICs will be incorporated in Guernsey with its own (separate) registration number and each having their own constitutional documents. There will be a separate board of directors for each, although they will be comprised of the same persons.

Segregation of assets and liabilities

As the ICC and each IC are separate legal persons, creditors of the ICC or the relevant IC only have access to the assets of that particular company.

Again, to facilitate the operation of this:

- the assets and liabilities of an ICC and each IC are segregated;
- it is the duty of the directors of an ICC and each IC (i) to keep the assets and liabilities of the ICC separate and separately identifiable from the assets and liabilities of the ICs and (ii) to keep the assets and liabilities of each IC separate and separately identifiable from the assets and liabilities of the other ICs and the ICC; and
- the directors of an ICC and its ICs are required to ensure that in respect of every transaction that is entered into that it is stated whether the transaction is being entered into by the ICC or by an IC (and if so which IC).

Examples of uses

Whilst the PCC was originally developed out of the insurance industry (and remains very popular and effective for insurance structures) cellular companies are now broadly used in a variety of areas. Save for PCCs and ICCs being excluded from holding certain Guernsey regulatory licences, in theory there is no limit on what a Guernsey PCC or ICC could be used for.

Investment funds

- Cellular companies have facilitated the structuring of multi-class funds as companies, as by removing the risk of contagion between classes increased protection is afforded to investors. There can also be benefit to investors from a cost efficiency perspective (discussed below).

  Cellular companies offer structural flexibility for funds in that they allow for multiple classes, which can be differentiated in many ways, including by investment policy, underlying asset class, risk appetite and investor type.

Investment funds structured as cellular companies tend to have small issued share capital in their core, with such shares being owned by management. Cell shares are then issued to investors, with each cell having a large issued share capital and the investors deriving their rights, obligations and benefits from their holding of shares in the relevant cell (and the performance of that particular cell).

Rent-a-fund cell

- Similar to the rent-a-captive, some service providers have established cellular companies to provide bespoke investment services to clients. A client can acquire its own dedicated cell in a regulated investment vehicle and have the flexibility of appointing an investment manager of their choice to that cell, having an investment strategy of their choice implemented for their cell and can structure as they like within the cell.

Private investment structures

- Cell companies can be used to create private investment structures for a single family (with different investment requirements) or for unrelated clients each investing through one or more dedicated cell. Holding investments through different cells but as part of the same corporate structure may allow investment managers greater freedom in managing their mandate, and in particular with regard to risk. They may also be useful for multiple managed account structures.

Insurance related structures

- Insurance managers with their own cellular company can offer cells to third parties as rent-a-captives. In such cases, the core of the PCC is owned and capitalised by a local insurance manager. A cell can then be offered to a client to write insurance for that client's benefit. Shares in the relevant cell are issued to the client so that it can receive the economic benefit arising from the business written.

  In contrast to the position described above for an investment fund, an insurance PCC often has a larger core capital to meet regulatory capital requirements. As a PCC is a single legal entity it is then not necessary for each cell to be capitalised to this level. This would not be the same analysis for ICs, which are separate legal entities. Whilst the core capital can be a large amount, with new cell owners benefitting from this for regulatory capital purposes, new cell owners also have the option to structure to suit their needs and provide their own cellular capital if more appropriate.

- Insurance companies can use their own cellular structures not only to offer captive services to their own client base but also to the clients of other insurers who may not have such a structure. As an alternative to establishing their own captive for reinsurance arrangements an insurer could potentially also use a cell for its own purposes, alongside the cells used by clients.

- Separate cells can be used for individual policies or products, thereby segregating risk and assets in a cost effective manner.

- Without the need to establish separate structures and the associated regulatory capital and costs, long term and general insurance can potentially be written through separate cells of the same cell company.

- A cell of a PCC can write a derivative contract with the liability of the cell under that derivative contract being insured by an insurance company. This type of transformer can provide the insurance company with exposure to a different type of investment product but through its traditional business method, the writing of an insurance policy.

Private wealth/family office solutions

- The use of private trust companies to allow participation by family or professional advisers can be extended further through cellular companies. Assets can be segregated according to risk or ownership participation, assisting in the management and enjoyment of the required assets.

- A family's wealth can be apportioned and succession managed. Different assets and beneficial interests can be apportioned between cells to help segregate entitlements whilst preserving the advantages of the pooled cellular framework. Different share classes can be issued to suit the type of benefit to be given. Ultimately, either the core or underlying cells can be gifted during the owner's lifetime or on death.

Various - SPVs/holding structures/multi-purpose vehicles/real estate/IP/tax

- Cellular companies can be formed for use as securitisation vehicles, in cases where a cell may issue instruments where repayment is to be funded from the investments of that cell.

- A cellular company can achieve economies of scale by providing a common administrative hub and framework. The cellular approach offers an alternative to traditional group company arrangements.

- A cellular company can hold and manage a diverse range of assets, contracts and interests under single or multiple ownership by separating out risks and potential cross-asset liabilities. A cell company can contract for services through one cell and manage a portfolio of assets in another, together, enjoying the same administrative framework but isolating their respective interests.

- A single cell company can use different cells to offer different types of services, whether to its parent's own group or to third parties.

- Diverse real estate ownership through cells could allow risk, financial and estate management. The ability to group cells can enable varied property interests to be consolidated or segregated, which may assist bank funding and collateralisation or even securitisation of rental streams. Cells could be sold rather than the property itself.
- Cellular companies may offer a method of managing intellectual property portfolios. Income and royalties can be segregated, as can different contracts. Jurisdictional franchises or intellectual property leases can be undertaken from different cells.
- Either in isolation or coupled with the use of other structures, the cell company may offer tax planning opportunities.

Advantages of cellular companies

There are many advantages to cellular structures. While in each instance these will depend on the individual structure and purpose of the transaction a few of the potential advantages are as follows.

Segregation

The protection that the statutory segregation of assets and liabilities provides is the founding advantage of cellular companies.

Using separate cells allows for the segregation of risk along any number of different lines, for example by way of strategy, transaction type, asset class, investor type, counterparty type or jurisdiction.

The use of cells provides not only an ability to segregate assets, liabilities and risk but equally can be used to segregate investments and profit flows.

Certainty

The fact that the segregation protection applied to PCCs and ICCs is provided by statute gives more certainty than contractually created class structures, which run the risk of contagion.

Flexibility

Cellular companies are extremely flexible, allowing different investors, transaction requirements, beneficiaries, risks, strategies, investments, territorial requirements, managers and other matters to be catered for in a single structure.

It is possible to convert different forms of companies and cells into other forms of companies and vice versa.

It is possible to initially set up a PCC or an ICC with no cells and with cells to be added later as needed. This is not only a flexible arrangement but can be cost effective.

Ease of establishment of a protected cell

Once a PCC is incorporated it is easy to establish cells. There is no additional incorporation process and it can be done by resolution and in accordance with any requirements in the constitutional documents.

If a PCC or ICC is already established and licensed by the GFSC, the licensing of further cells is a quicker cheaper procedure than the establishment of new non-cellular companies. The structures are already known to the regulator.

Consistency of management

For a PCC and its cells there is a single board of directors, while for an ICC and its ICs the board for each is comprised of the same persons. Apart from consistency of management across a structure it is also more cost effective from the point of view of director costs.

Cost effective

Cellular structures can be more cost effective due to, amongst other things, a sharing of administration costs, lower set up costs for cells, shared officer and service provider costs, more streamlined regulatory processes for additional cells.

Accessibility

There are many service providers that have established a cellular company and thereafter "rented" cells to third parties (i.e. established cells for use by specific third parties). This is done not only for insurance captives but also for other types of transactions. The service provider incurs the costs of establishing and running the cellular company, while the new cell owner only meets lesser costs in relation to their particular cell. This makes cells more widely available to persons whose resources might not justify their own cell company.

Future cellular innovation

The introduction of cellular vehicles has been a successful and useful contribution by Guernsey to the world's finance industry. In keeping with its pioneering spirit it is expected that Guernsey will in the near future introduce the concept of the "protected cell" to another of its market leading products, the limited partnership. In addition one of the persons acknowledged as being instrumental in the introduction of the PCC by Guernsey [end note 2] has suggested there is potential for further innovations within cellular structures, possibly including: the creation of “branch cells” (sub-cells belonging to individual cells within a PCC); “driver cells” whereby an event drives one cell to trigger opposite reactions in two additional cells; and “filter cells” whose purpose is to expire and their assets and liabilities filter into a separate fund. [end note 3]

End Notes:

1. It is acknowledged that some of the potential uses for cell companies set out are derived from literature on the website of Guernsey Finance.
2. Steven Butterworth, former head of insurance regulation at the Guernsey Financial Services Commission.
3. Fiona Le Poidevin, “ILS and Beyond: Where next for Cell Companies?”, Cell Company Guide 2014, captivereview.com

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