

# **Chapter Three : A Study of Protected Cell Company**

## **< 1 > Concept of Protected Cell Company**

Insufficient loss experience and market data complicate the underwriting process and result in high parameter risk: the uncertainty over the true value of expected losses. Also, many new risk classes are related to entrepreneurial risks and therefore generate moral hazard risks. Many traditional insurers feel uncomfortable assuming these types of risks. Hence, alternative solutions such as Alternative Risk Transfer (ART) are frequently better suited to create a win-win situation for both transaction partners. Protected Cell Company (PCC) is one type of ART forms. But what is Protected Cell Company (PCC) ? And how does it create a win-win situation for transaction partners ? In this chapter, we will focus on the study of PCC.

A PCC operates in two parts, with a core and an infinite unlimited number of cells, as shown in figure 3-1. There are many possible structures, and the eventual structure adopted is tailored to the needs of the sponsor and users in each case. The following describes a typical arrangement. A new cell owner is met with minimum establishment costs and administration. The core capital can be a large amount, enabling full insurance risk transfer to be incorporated within the company's contracts, or alternatively can be a nominal amount, in cases where individual members provide cellular capital<sup>1</sup>.

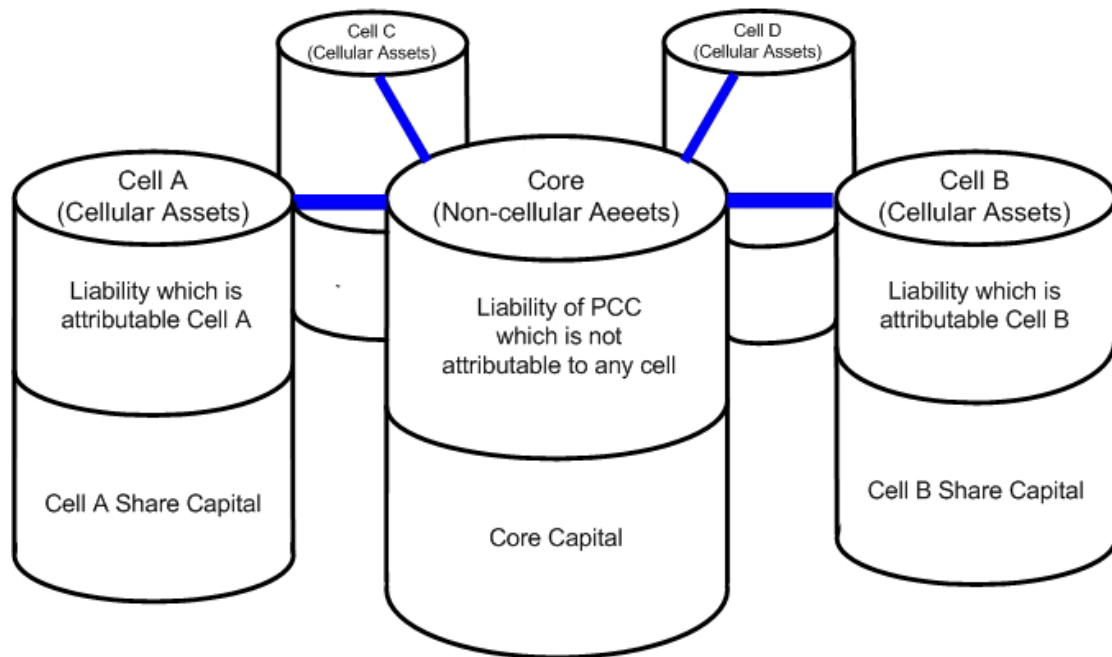
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<sup>1</sup> Tim Edwards (2001), 2

Creditors of a PCC cell only have access to cellular assets of that particular cell. Should the assets be insufficient to discharge the cell-owner’s liabilities, creditors then have recourse to the non-cellular assets which are the responsibility of the PCC sponsor. In most cases, the cell owners are expected to collateralize any underwriting risk within their cell.

PCCs can either be newly incorporated or, alternatively, an existing company can be converted to a PCC<sup>2</sup>. The conversion option has proved to be relatively straightforward, and is clearly an attractive option where there is already an established company in the chosen location.

**Figure 3-1 The Structure of Protected Cell Company ( PCC )**



<sup>2</sup> Guernsey Financial Services Commission, “The Protected Cell Companies Ordinance (Guernsey), 1997”

## **< 2 > Development of Protected Cell Company**

The idea of PCC was developed in Guernsey by Steve Butterworth, director of insurance for Guernsey Financial Services Commission, after he attended a board meeting for a podiatrist association in the early 1980s (Gorski 2002). The association members were suspicious of other members and used individual contracts with the association's captive to protect their own assets against the liabilities of other members. Butterworth's initial plan was to strengthen the rent-a-captive structure for statutory protection, but Butterworth unsuccessfully referred the statutory protection idea to Cayman and Guernsey in 1987.

Then in 1997, the Guernsey fund industry faced a similar situation with umbrella funds. At that time, multi-class umbrella funds were common but, if structured as a company, the assets of one class were available for the liabilities of another. This compared with unit trusts where the legal structure was that each class was a separate trust and the assets of one were not available for the liabilities of another. The fund industry was of the view that companies were more welcome in Europe than unit trusts as only the UK understood trusts, and the idea of removing the risk of contagion by companies' legislation was born. The growth in Guernsey of hedge funds and derivatives funds, when structured as umbrellas, used subsidiary SPVs for each class to limit the risk of contagion. However, this was cumbersome and administratively expensive. Through the help of a local Guernsey lawyer, advocate Nik van Leuven, the first draft of the legislation ( Protected Cell Companies Ordinance ) was produced.

Thus Guernsey was the first jurisdiction to introduce the concept of PCCs in 1997 and established it under the Protected Cell Companies Ordinance<sup>3</sup> It was Guernsey's response to the demand from companies who wished to take advantage of the captive approach to risk management, but did not want to establish their own captive.<sup>4</sup>

The introduction of PCC legislation has laid the foundation of Guernsey's rent-a-captive business. It has proved of particular interest to the promoters of association captives into separate cells, or classes, within a PCC. A more recent development has been the use of PCCs as Special Purpose Vehicles (SPVs) to facilitate either the translation of capital market transactions into insurance transactions or risk transfer conduits to enable securitization of future income streams. For example, in the US, the main purpose of PCC is adopted to provide a basis for a domestic insurer as one means of accessing alternative sources of capital and achieving the benefits of insurance securitization. The recent and main development of PCC and its domicile legislation is listed as Table 3-1 as follows :

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<sup>3</sup> Guernsey Financial Services Commission, “The Protected Cell Companies Ordinance (Guernsey), 1997”

<sup>4</sup> Guernsey Financial Services Commission : Insurance Division Industry Information  
<http://www.gfsc.guernseyci.com/insurance/industry/intins/index.html>

**Table 3-1 The recent and main development of PCC and its domicile legislation**

Year	Domicile	Legislation
1997	Guernsey	These entities originated in Guernsey, specifically by means of The Protected Cell Companies Ordinance 1997
1998	St. Vincent and The Grenadines	St. Vincent and The Grenadines with their International Insurance (Amendments and Consolidation) Act of 1998 which allows "protected premium accounts" introducing elements of the PCC
1999	Mauritius	Mauritius (which approved The Protected Cell Companies Act of 1999 [amended in 2000])
	Five states in USA--Illinois, Iowa, Rhode Island, South Carolina, and Vermont-	Five states--Illinois, Iowa, Rhode Island, South Carolina, and Vermont <sup>5</sup> --now allow for the Protected cell company. Rhode Island was the first to enact legislation in 1999, with Illinois following in June 1999. South Carolina's took effect in August this year. In Iowa, protected cell legislation was signed into law in April 2000. All states' legislation was aimed specifically at formation of protected cell companies.

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<sup>5</sup> E. Costle and K.Schauer (2000)

Year	Domicile	Legislation
2000	Bermuda	Bermuda’s segregated Accounts Companies Act set rules for segregated accounts company, and permits the registration of such company <sup>6</sup>
2001	Barbados	Barbados amended the Companies Act to provide for the establishment of segregated cell companies <sup>7</sup>  Third Supplement to the Gibraltar Gazette No. 3,228 of 14th June 2001
	Gibraltar Gazette	Gibraltar’s The Protected Cell Companies Ordinance 2001 set rules for the PCCs
2002	British Virgin Islands	In September 2002 the British Virgin Islands government amended the Insurance Act 1994 to create a regime for registration and regulation of Segregated Portfolio Companies ( also known as protected cell companies ) <sup>8</sup>

### < 3 > Definition of Protected Cell Company

Before we analyze the feasibility of Protected Cell Company, first we should understand the definition of Protected Cell Company.

Protected Cell Company is also called “segregated cell company”, “segregated account company<sup>9</sup>”, or “segregated portfolio company<sup>10</sup>”. In a simple

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<sup>6</sup> S. Henry (2000), 32

<sup>7</sup> M. Heimols, (2002), 95

<sup>8</sup> P. Ireland (2003) , 1

<sup>9</sup> M. Heimos (2002), 95

term, PCC is a corporation whose patrimony is composed of assets contained in structurally separate parts named "cells" [cellular assets], which are legally and functionally separate, distinct and independent among each other, and of assets not constituting "cells" [non-cellular assets], also structurally and legally independent, that has as main legal characteristic the fact that the portion of capital designated to a specific cell is neither liable for the general obligations, commitments or liabilities of the corporation nor for the specific liabilities of the other cells.<sup>11</sup>

Erik Banks ( 2004 ) , from the viewpoint of captive, defined Protected Cell Company as : “A captive insurance company similar to rent-a-captive, rent-a-captives allow renters to shield their capital and surplus from other renters in the captive as long as the rent-a-captive's owner remains solvent. If the owner's liquidity becomes deficient, renters may be exposed because their assets may have to pay claims to others. Cell companies on the other hand, typically guarantee each "cell" within the company will be shielded not only from sharing capital and surplus with other cell owners, but also from any legal action against the cell's assets. With legal protection designed to provide more robust protected of customer accounts ( cells ) ,cells are separated by statute, rather than shareholder's agreement, meaning commingling of assets is not possible”.

When Protected Cell Company is used for securitization, according to NAIC Protected Cell Company Model Act, it can be describe as : “A protected cell company may establish one or more protected cells with the prior written approval of the commissioner of a plan of operation or amendments thereto submitted by

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<sup>10</sup> H. Smith and T. Pitcairn (2001), 163-164

<sup>11</sup> Francisco Pérez Ferreira, “The Protected Cell Companies in a Nutshell”, legalinfo-panama,2001

the protected cell company with respect to each protected cell in connection with an insurance securitization. Upon the written approval of the commissioner of the plan of operation, which shall include, but not be limited to, the specific business objectives and investment guidelines of the protected cell, the protected cell company may, in accordance with the approved plan of operation, attribute to the protected cell insurance obligations with respect to its insurance business and obligations relating to the insurance securitization and assets to fund the obligations. A protected cell shall have its own distinct name or designation, which shall include the words "protected cell. " The protected cell company shall transfer all assets attributable to a protected cell to one or more separately established and identified protected cell accounts bearing the name or designation of that protected cell. Protected cell assets shall be held in the protected cell accounts for the purpose of satisfying the obligations of that protected cell.”

And for the definition of each term :

- ( 1 ) "Protect cell company" means a domestic insurer that has one or more protected cell
- ( 2 ) "Protected cell" means an identified pool of assets and liabilities of a protected cell company segregated and insulated by means of this Act from the remainder of the protected cell company's asset and liability
- ( 3 ) "Protected cell assets" means all assets, contract rights and general intangibles, Identified with and attributable to a specific protected cell of a protected cell company.
- ( 4 ) "Protected cell liabilities" means all liabilities and other obligations identified with and attributable to a specific protected cell of a protected cell company.
- ( 5 ) "Protected cell account" means a specifically identified bank or custodial



account established by a protected cell company for the purpose of segregating the protected cell assets of one protected cell from the protected cell assets of other protected cells and from the assets of the protected cell company's general account.

- ( 6 ) "Protected cell company insurance securitization" means the issuance of debt instruments, the proceeds from which support the exposures attributed to the protected cell, by a protected cell company where repayment of principal or interest, or both, to investors pursuant to the transaction terms is contingent upon the occurrence or nonoccurrence of an event with respect to which the protected cell company is exposed to loss under insurance or reinsurance contracts it has issued.

Besides, according to Morton Lane 2001, no matter what the purpose PCC is used for, PCC can also be defined as : *“Protected Cell Company is a single legal entity consisting of a core and unlimited number of individual cells, whereby the cells are statutorily segregated from each other., Consequently, as the main characteristic each cell and its assets and liabilities is separated from the other cells and protected by statute, Thus, the nature of segregation claims to be effective against third parties, creditors, although entering into contracts with the legal entity of the PCC as a whole-contracts on behalf of an individual cell explicitly-only have access to the assets of the designated cell and, under certain circumstances, to the assets of the core”*.

#### **< 4 > Characteristics of Protected Cell Company**

A PCC operates in two parts, the core and the cells, with one single core and an infinite number of cells. A new cell owner is met with minimum establishment costs and administration as once authorization has been granted, a simple share transfer from the core cell takes place and as minimum capital requirements are met by the core cell, the cell owner requires only to provide risk capital. Within the cell the client takes ownership and purchases reinsurance as required<sup>12</sup>.

Thus the main characteristics of PCC are as follows:

- a) **A single legal entity:** The PCC as a whole is considered as a single entity and it follows that only one set of account is prepared, audited and submitted to the authorities each year. Only one regulatory fee is paid but there will be an addition for each cell. Each "cell", although being separate individual patrimonies, does not constitute separate entities themselves.<sup>13</sup>
- b) **Each cell has legal separation :** A cell owner can put business in, with appropriate premium, plus any other supporting assets, in the knowledge that the cell has complete legal separation. These assets(and of course, liabilities) in the cell are totally segregated from the other cells; thus, theoretically there is no danger of any loss arising out of the activities of other cell owners.<sup>14</sup>
- c) **Segregation of assets and liabilities :** The assets allocated to each specific cell may only be liable for liabilities incurred by such cell and thus should not be attached by creditors of the other company's cells. The liabilities unrelated to a specific cell are covered by the non-cellular assets or the core cell. The core assets respond -on subsidiary grounds- once the specific

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<sup>12</sup> D. Moore (1999), 52-54

<sup>13</sup> F. Ferreira (2001)

<sup>14</sup> J. Parkinson (2002), 264-266

cellular assets are depleted. Creditors of a PCC cell only have access to cellular assets of that particular cell plus the company's noncellular assets (though, under certain circumstances, access may be able to be limited to cellular assets only). Should the assets be insufficient to discharge the cell-owner's liabilities, creditors then have recourse to the non-cellular assets which are the responsibility of the PCC sponsor. In most cases, the cell owners are expected to collateralise any underwriting risk within their cell. Creditors who have contracted with the PCC in respect of one particular cell only will, either: (a) only be able to make claims against the assets of that cell or (b) in some domicile, it be able to make claims both against the assets of that cell and against the general non-cellular assets of the company. No matter under (a) or (b), creditors have no sources to the assets of another cell

- d) **"Core" patrimony** : In addition to protected assets there also general assets unrelated to particular cells. A portion of the PCC's patrimony is composed of general assets ("non-cellular" assets), which are separate and distinct from each of the assets composing the protected cells, creating what is commonly known as the "core cell";
- e) **No limit to number of cells** : Once being established, the PCC can grow without limit. Where a PCC is form to segregate the various subsidiaries or sub groups of a parent groups, additional companies can be incorporated without problems.
- f) **Can be converted to/from conventional company** : PCCs can either be newly-incorporated or, alternatively, an existing company can be converted to a PCC. The conversion option has proved to be relatively straightforward, and it is clearly an attractive option where there is already a local company.

Actually, a number of PCCs have been converted from a conventional company where, perhaps, a traditional captive had a wish to segregate its business. This has occurred in a takeover or restructuring situation where a cell could be created for the old business with new business, possibly split into various sub groups, forming other cells. Companies may also want to segregate various classes of business to keep the funds for short-tail business separate from long term liability or financial business.<sup>15</sup>

- g) **Flexibility in cell capital** : Whilst there are legal minima and limitations on changes relative to the core capital as that is the legal entity, there is complete flexibility in the capital of each cell. Indeed, although it may be called capital it can be considered more in the nature of a supporting guarantee fund and if the business change so this capital can be changed with regulatory and core approval.
- h) **Duty of information** : It is the responsibility of the PCC to inform all persons with whom it enters into contracts that they are dealing with a PCC.

In summary, a PCC, structurally speaking, involves a core capital, cellular capital, cellular assets and liabilities, and core assets and liabilities. The ring-fencing rules are also applicable to any liquidator or receiver of the entity. Thus the insolvency of a cell should not affect the business of the whole entity or the performance of the other cells. For each business, activity or agreement contracted, the PCC must disclose which cell is contracting or if the entity is committing its core assets or both, core and specific cell assets. The entity must

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<sup>15</sup> J. Parkinson (2002), 265

keep accounting books showing the corresponding patrimonial divisions among the segregated cells and the core cell within the entity.

## **< 5 > Usage of Protected Cell Company**

The main usage of protected cell company can be classified into three purposes : captive, collective investment schemes, and special purpose vehicle.

### **5.1 Captive**

#### **5.1.1 Rent-a-Captive**

The single captive was only for the big boys, so how did the smaller boys get into this? Some of them could group together. They joined together as a multiple group to form their captive. But the problem would be the allocation of costs and the allocation of losses on claims. One group member might be rather better than another group member. Then the development went further into the "rent-a-captive". The person needing insurance did not form his own captive. Somebody else did that for them. Outside professionals ran an operation which had underneath it a series of captives that one could rent. The professionals ran and owned it, and the customer had his subsidiary captive, which he rented.

PCC can operate on exactly the same basis as rent-a-captive, but the difference is that the individual cells ( accounts ) of traditional rent-a-captive are segregated by contract, not the statutory protections, with a shareholders' agreement being used to avoid cross-contamination. This has proved to be a successful structure for many years, though it is

the view of many sponsors and users that the greater safeguards available from the PCC facility, offering statutory protection, are of considerable benefit. The PCC owner offers traditional rent-a-captive services to clients with the added security of statute to support the segregation of assets and liabilities between cells. This has been popular with insurance companies who have wanted to 'lock in' their good policyholders, especially those with better than average loss experience who have been considering establishing their own captives. This concept has also been used by some insurers to attract good business away from competitors who have no such facility.

### **5.1.2 Life insurance**

PCC can provide a mechanism in which life insurance companies can legally segregate the assets of life, pension and individual policyholder funds. Offshore life insurers also have embraced the concept of PCCs to provide added protection to policyholders. Using separate cells for individual policies or products does not greatly increase running costs but ensures segregation of risk (and supporting asset classes). Should the life insurer decide to write also general business and become a composite, the PCC structure is one of the few accepted corporate structures to accommodate this without having to establish a separate general insurer (with associated cost of capital and marginal costs).<sup>16</sup>

### **5.1.3 Composite Insurer**

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<sup>16</sup> C. Jennings (2004)

PCC can be an insurance company where the asset of life business needs to be legally separated from those of non-life business.

#### **5.1.4 Member Associations –**

PCC can provide insurance trading where an association or organization whose members share a common business interest are able to access insurance arrangements offering better cover and prices than in the conventional market, while at the same time offering legal protection for individual member's assets, by placing them in separate 'cells'

#### **5.1.5 Global programme solutions**

PCC is also used to restructure global insurance programs through a captive-type operation.<sup>17</sup> It can segregate risk by group subsidiary or operating company. Captive capital can be provided by subsidiaries rather than wholly by group. Segregated risk information can be used to identify risk management needs. Individual subsidiary underwriting can be carried out for low-level and primary layer losses. Profit recognition on a subsidiary basis can be achieved as individual cell results are readily identifiable.

#### **5.1.6 Insurance & Reinsurance**

The PCC can be an insurance or reinsurance company where insurers or reinsurers are able to accommodate the needs of selected clients.

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<sup>17</sup> T. Edwards (2001)

### **5.1.7 Finite Reinsurance**

The PCCs can also be constructed as reinsurance companies where finite reinsurance agreements and securitization contracts can be given separate cells.

## **5.2 Collective Investments Schemes**

The concept of PCC was originally formulated for use in relation to umbrella investment funds. Collective investments schemes which are regulated, are operated through either a company or a trust. A company might be a simple investment company or a PCC using cells for individual sub-funds or classes. While PCCs are operated as investment funds.<sup>18</sup>, these entities are suitable vehicles for the operation of mutual funds, especially in the form of umbrella funds, having each cell as a sub-fund. A sponsor, for example, may structure a multiple series fund by setting up a PCC, in which case each cell may represent the different group of investments for which the distinct classes or series of shares are offered to the fund's investors. The use of a single entity structure for the different funds ("series fund") -in contrast to a "family of funds" structured with multiple entities in which each separate legal entity represents a particular fund- would eliminate or reduce costs, by using -for example- a single board, the same distributor, custodian, transfer and payment agent, and the same prospectus.

## **5.3 Special Purpose Vehicles / Transformers and Securitization**

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<sup>18</sup> F. Ferreira (2001)



The PCC structure can also be used as a platform for any type of SPV<sup>19</sup>, including those established as transformer vehicles to support securitizations<sup>20</sup>. The use of SPV is already well understood and documented. Structuring an SPV as a PCC also has the advantage of enabling the segregation of different classes or categories of investor<sup>21</sup>. For example, particularly risk-averse investors may wish only the coupon exposed, with their capital commitment remaining intact, whereas others may be happy to risk both coupon and capital, in exchange for a higher potential return. This therefore increases both the flexibility and the workability of the program. The proof of true legal segregation of cellular assets is even more important in the area of SPVs than for the more traditional Rent-a-Captive vehicles. There has been immediate success for those institutions that have established PCCs to provide a transformer capability for the provision of segregated SPV facilities. The main benefit is of concentrating expertise and experience, whilst minimizing the transactional costs involved in the separate licensing, operation and control of each program. The reduction in marginal cost is likely to give such institutions a competitive edge<sup>22</sup>.

## **< 6 > Advantages and disadvantages of PCC**

### **6.1 Advantages**

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<sup>19</sup> T. Edwards (2001)

<sup>20</sup> S. Bütow (2001)

<sup>21</sup> T. Edwards (2001)

<sup>22</sup> F. Ferreira (2001)

PCC, known as a single legal entity, is made of individual "protected cells". It has a "core" capital but each cell also has its own capital, provided by the client using that cell. Each cell is completely separate from each other but linked to the common core. The assets of one cell are statutorily protected from the creditors of another.<sup>23</sup> Therefore one advantage of PCC is that a variety of organizations can safely use different cells within one company.

Another advantage of PCC concept is that it is an easy and cost-effective way for a small organization to take advantage of the captive insurance market. Not only is the cost lower, but the amount of senior management time that needs to be spent in dealing with insurance matters can also be considerably reduced.

For securitization purpose increasing use is being made of a corporate structure referred to as the PCC. One of the most significant advantages of using a PCC for a securitization is the quick and low cost creation of a suitable SPV. Full business operations can often be commenced within the space of a few weeks<sup>24</sup>.

For investment funds, PCCs are suitable vehicles for the operation of mutual funds, especially in the form of umbrella funds, having each cell as a sub-fund. A sponsor may structure a multiple series fund by setting up a PCC, in which case each cell may represent the different group of investments for which the distinct classes or series of shares are offered to the fund's investors. The use of a single entity structure for the different funds ("series fund") -in contrast to a "family of funds" structured with multiple entities in which each separate legal entity

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<sup>23</sup> S. Penwell and K. Miller (1999). 46

<sup>24</sup> S. Bütow, (2001)

represents a particular fund- would eliminate or reduce costs, by using a single board, the same distributor, custodian, transfer and payment agent, and the same prospectus<sup>25</sup>

Compared with captive, rent-a-captive vehicles can be attractive to smaller buyers. But the downside is that if the captive program goes bankrupt, the assets of the entire program--including those of the insureds--are at risk because some people have expressed concerns about the fact that rent-a-captive commingles assets from different participants. Participants worry that the assets of the captive may be misinvested, yielding reserve losses, or the loss of one firm could be applied to the account of another participant in the situation of dire need. As a result, captive management organization can offer PCC to solve above problem. Besides, when PCC is used for rent-a-captive, it also combines the advantages of a wholly owned captive with the cost advantage of a rent-a-captive, such as :

**A) Cost saving :**

In fact, any type of risk retention can be cheaper than risk transfer, because ( 1 ) it avoids the adverse selection costs of issuing new financial claims to support losses externally, especially if risk retention reserves and premium can be fund internally ; ( 2 ) the loss adjustment expense can be saved by the elimination of asymmetric loss information and claim dispute.<sup>26</sup> Besides, compared with captive, PCC is more cost efficient because each owner of individual cell needn't to pay any incorporation costs and administration costs are usually lower

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<sup>25</sup> F. Ferreira (2001)

<sup>26</sup> C. Culp ( 2002) 352-353

than captive (L. Howard 2000).

**B) Tax**

Tax consideration alone should not drive the establishment of PCC, but neither should be ignored. These tax saving depend strongly on both the domicile of the PCC and the location of the sponsoring firm. For domestic non-life insurance companies in Taiwan, reinsurance premium payments to a captive are tax deductible, although such tax deductible has certain limits.<sup>27</sup>

**C) Investment income and reserve management**

Users of PCC for captive retain the investment income generated by assets held to offset premium and loss reserves. By retaining this investment income, the cost of insurance capital is reduced, possibly creating a significant capital structure advantage for users of prefunded retention and captive programs.

**D) A more efficient way of managing certain risks:**

Similarly, losses resulting from high probability and low severity risks, such as minor damage to buildings, machinery and equipment, can usually be paid out of a company's current cash flow, or be transferred to a captive. Insuring these low and medium risks by traditional means

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<sup>27</sup> According to Value-added and Non-value-added Business Tax Act, Article 11: The business tax rate shall be 2% for insurance premium( deducting ceding premium )and 1% for reinsurance premiums of insurance enterprises. And according to Article 8-2: "The sales of enterprises engaged in banking, insurance, ...shall be exempt from the business tax from January 2006, provided that said sales have been generated exclusively in connection with the enterprises authorized business". Such tax advantage will disappear since January 2006.

involves considerable administration and transaction costs. Thus, retaining them in the form of a captive or paying them out of the current cash flow is more cost efficient.

- E) **Signaling** : Some people argue that captive can be used as a signaling mechanism, for example, argue that captives are a “status symbol” for managers that set them up and can be used to signal management’s commitment to taking risk management seriously.
  
- F) **Providing cover for uninsurable risks:** When PCC is used for captive, it is also suitable for protecting exposures for which there is no cover available on the traditional insurance market, such as political uncertainties, loss of image and patent infringements.
  
- G) **Access to the professional reinsurance market:** When PCC is used for captive or securitization, it has access to the reinsurance market to increase captives' flexibility in structuring their risk portfolio.

## 6.2 Disadvantages

- A) **Limited pool** : A potential disadvantage of PCC is the limited pool of asset which is accessible for recourse. Again the ceding party needs to have a clear understanding of the solvency of the counterparty with whom it is dealing. Furthermore, it is questionable whether the concept would stand up in court in the context of a complex international case

with the involvement of jurisdictions.<sup>28</sup>

**B) Untested vehicle :** From a viewpoint of law, even though the domestic legislation provides that they are all separate and the creditor cannot get at the other cells. But is that necessarily the case? The problem is, from a point of international law, that the guts of the assets are quite likely to be in a country outside the country whose laws govern the cell. How are the courts of that particular country going to look at this? Will they recognize the cell legislation of another country? Will they recognize the ring fencing? It is still questionable whether the concept would stand up in court.<sup>29</sup>

**C) PCC solvency :** In some domicile<sup>30</sup>, cell creditor is able to make claims both against the assets of that cell and against the general non-cellular assets of the company. Although the PCC is a single legal entity, the statutory solvency provision may be within the core itself or divided between the cells or a combination of each. The regulator will assess solvency on the total share capital and the risk mix of the PCC as a whole i.e. the risk gap situation the potential surplus and deficits. Having said that, although each cell as it added will need to be approved, it is not likely that each will have to go through a full registration process and can, in effect 'borrow' capital to support its operation from any surplus that

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<sup>28</sup> M. Lane (2001), 185-186

<sup>29</sup> John J. O'Brien , "Insuring on shore risk through segregated cells – will our firewalls hold up ? ",  
http : [www. Charlestoncaptive.com](http://www.Charlestoncaptive.com)

<sup>30</sup> Such as Guernsey, please refer to its "The Protected Cell Companies Ordinance 1997"

there may be in the core. Thus, in case of its cell is in risky, the regulator would be happy with the additional capital above, in order to support the potential deficit.<sup>31</sup>

**D) Complicated operation :** PCC is a new concept, and it has only been around for about seven years, we think that it is a difficult legal concept, having a company with segregated assets and liabilities, so it needs complicated accounting report and complicated operation. Managing a PCC with several cells means managing several mini-captives ( In fact, each cell is a mini-captive or SPV ) . Perhaps what is even more complex is that the owner of PCC has the responsibility to inform all persons with whom it enters into contracts that they are dealing with a PCC. As the number of its cell increases, this will largely increase PCC owner's management cost.

## < 7 > Conclusion

Since 1997 there has been a development of PCC, a totally new captive type arrangement which has been endorsed by the insurance and reinsurance market and major groups have actually formed PCCs for the use of their clients. There is no doubt at all that this is an area of business that will continue to grow significantly so that whilst the number of captives may slow down, the number of PCCs will not<sup>32</sup>. The use of PCCs will grow and prosper and PCC can be acting as a catalyst

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<sup>31</sup> John R Parkinson, "Captive & Captive Management - For Practitioners and Owners", ISBN 1-901614-16-6, 2002, page 266

<sup>32</sup> Willis Group Holding Ltd., "Abandoning tradition", Reactions. London: Jul 2003, 1

for the fusion of capital and insurance markets. PCCs are an innovative way to help organizations to finance risk, and they are flexible enough to offer a wide range of possible products and solutions. The hardening insurance market will provide a further boost, so will the regulatory and fiscal attack on conventional captives. The number of domiciles offering PCC services will expand, though the head start gained by Guernsey, Cayman and Bermuda will see these locations consolidated as the major centres for this business. In the near future, a further usage of the PCC structure might enable conglomerates to restructure their entire corporate operation, taking advantage of the ring-fencing and demonstrable corporate governance compliance opportunities provided by the statutory segregation of assets and liabilities. That concept would not have been credible even a year ago, but now seems just one step away.

Just as Limited Liability Companies and partnerships were once a new concept, the introduction of limited liability cells should be seen as a part of the evolutionary process of commerce.