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Cell Companies in Guernsey

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Guernsey introduced legislation permitting the formation of cell companies through the Protected Cell Companies Ordinance in 1997 – the first country in the world to do so. Incorporated cell companies were introduced in Guernsey through the Incorporated Cell Companies Ordinance in 2006. Both of those ordinances were consolidated into the Companies (Guernsey) Law, 2008 (the "**Companies Law**"). This note summarises the Companies Law.

Protected Cell Companies

A Guernsey protected cell company ("**PCC**") is a single legal entity. It is one company with one board of directors, one memorandum and articles of incorporation and one company registration number.

A PCC comprises a core and any number of cells. Assets which are not comprised in a cell are deemed to be comprised in the core. No regulatory or filing processes are required to create a cell of a PCC. Cells can be created simply by a resolution of the board of directors of the PCC. However, if the PCC is regulated other considerations may apply.

The key issue which differentiates a PCC from a traditional (non-cellular) company is the segregation of its assets. A PCC is able to limit its liability in respect of a particular contract to a specified pool of assets rather than exposing all of the assets of the PCC to liability in respect of every contract, as would be the case with a noncellular company.

When a PCC contracts, the directors of the PCC must identify the pool of assets to which the counterparty will have recourse in respect of that contract. That pool of assets may comprise a cell or the core of the PCC. By default, any liability not attributable to a cell of a PCC automatically attaches to the core. However, if the directors intend a transaction to be made in respect of a particular cell or the core but fail to identify that cell or the core to the counterparty then the directors can incur personal liability in respect of that transaction, although the directors have a statutory right of indemnity out of the core assets in certain circumstances.

The crucial protection which the Companies Law affords creditors of a PCC is that losses in one cell of a PCC do not affect profits in another cell or the core. If a PCC is unable to satisfy liabilities it owes to a creditor out of the assets of the specified cell that creditor has no recourse to the assets of other cells or to the core.

Because a PCC is a single legal entity, the cells of a PCC cannot contract with each other or with the core. These issues can be resolved by interposing a company (for example, a subsidiary of the PCC in question) which is able to contract with both cells or the cell and the core to achieve the same economic outcome as would have been the case were those cells able to contract with each other or were the cell in question able to contract with the core.

Of course, cells of two different PCCs can contract with each other. In addition, it is possible for a PCC to implement an internal arrangement whereby the assets of one cell may be attributed to other cells or to the core or vice versa and for recourse agreements to be entered into whereby creditors are explicitly granted recourse to assets of the PCC other than the cell (or core) in respect of which they are primarily contracting.

The Companies Law does not dictate how the share capital of a PCC must be structured. Traditionally the share capital of a PCC is divided into ordinary voting (or management) shares in

respect of the core and non-voting redeemable shares in respect of each cell. Cell shares are often issued as redeemable shares because there is no statutory mechanism for winding up a solvent cell under the Companies Law. Therefore, a practice has developed of redeeming all of the shares in issue in a cell in order to achieve a de facto winding up of its affairs.

The shares issued in respect of each cell of the PCC constitute a separate class of shares. Accordingly, although those cell shares may not have voting rights at general meetings of the company they do have class rights which must be observed and can only be varied with the consent of the holders of that class of shares.

Investment funds structured as PCCs tend to have a very small issued share capital in their core. Cell shares are issued to investors meaning that each cell may have a very large issued share capital. Conversely, a general insurance company structured as a PCC would usually issue at least £100,000 in core shares in order to meet the minimum capital requirement imposed on Guernsey licensed insurers under the Insurance Business (Bailiwick of Guernsey) Law, 2002 (the "**Insurance Law**"). Because a PCC is a single company, it is not necessary for each cell to be capitalised to this level too. Notably, each incorporated cell of an ICC must be separately capitalised.

Availability of PCCs

The consent of the Guernsey Financial Services Commission (the "**GFSC**") is required for the formation of or conversion of an existing company into a PCC. When originally introduced PCCs were only available as licensed insurance companies and investment funds and these remain the two most popular uses for PCCs. Nowadays, any company whose affairs are administered by a licensed person in Guernsey may be established as a PCC. However, a PCC may not be a licensed insurance manager or intermediary, a bank, or, a licensed fiduciary.

Incorporated Cell Company (ICC)

The ICC is based on the same principles as the PCC: segregation of assets and limited recourse of creditors to specified pools of assets rather than to all of the assets of the company. Like a PCC, an ICC may establish any number of incorporated cells. Unlike protected cells in a PCC, each incorporated cell of an ICC is a separately registered legal entity with its own memorandum and articles of incorporation, its own company registration number and its own board of directors. The Companies Law allows the composition of the board of each incorporated cell to be different to the composition of the board of the ICC provided that at least one of the directors of the cell is also a director of the ICC.

The fact that each incorporated cell is a separately registered legal entity provides greater flexibility in relation to the ability to convert, migrate and amalgamate incorporated cells and may be regarded as strengthening the segregation of each incorporated cell's assets and liabilities.

Like a PCC, the consent of the GFSC is required for the formation of and conversion of existing companies into an ICC or an incorporated cell. The formation of an incorporated cell involves more formality than the formation of a cell of a PCC. It requires a special resolution of the shareholders of the ICC of which the incorporated cell will form part as well as registration of the incorporated cell with the Guernsey Registry (together with the associated documentation).

Contracts are made with an ICC itself or with the relevant incorporated cell. The ICC cannot bind any of its incorporated cells. It is possible for the ICC to own shares in one of its incorporated cells, but an incorporated cell is prohibited by the Companies Law from owning shares in the ICC. As a consequence of each incorporated cell being a separately registered legal entity, incorporated cells can contract with each other. Consequently there is no equivalent of the recourse agreement or arrangements in respect of ICCs.

Conversions

There are a range of conversions possible with PCCs and ICCs. The process to effect a conversion is the same regardless of the particular transaction being considered: the consent of the GFSC is always required as well as a special resolution of the shareholders of the entity which wishes to convert.

The conversions which are possible are:

- a non-cellular company may convert into a PCC;
- a non-cellular company may convert into an ICC;
- a PCC may convert into an ICC;
- an incorporated cell may convert into a non-cellular company;
- an incorporated cell may transfer from one incorporated cell company to another;
- a non-cellular company may convert into an incorporated cell and transfer to an ICC;
- a PCC may convert into a non-cellular company;
- incorporated cells of an ICC may be subsumed into their ICC and subsequently converted to a non-cellular company; and
- a PCC cell can convert into a non-cellular company in which case the conversion must also be approved by the shareholders.

Notably, an ICC cannot convert directly into a PCC and a non-cellular company cannot convert directly into a cell of a PCC.

Since incorporated cells are separately registered legal entities they are able to take advantage of Guernsey's migration and amalgamation legislation giving them the freedom to become registered in other jurisdictions and to amalgamate with other entities within and beyond Guernsey. This would not be possible with cells of a PCC because they are not separately registered legal entities.

Common uses for PCCs and ICCs

The PCC is often used and indeed, was originally introduced, to enable Guernsey licensed insurance managers to offer cells

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to third parties as rent-a-captives. In those circumstances, the core of the PCC is owned and capitalised by the local insurance manager. A cell can be offered to a client to write an insurance contract for that client's benefit. Shares in the cell are issued to that client in order that the client has an economic interest in the cell and can benefit from any profits accruing from the business written. The cell will often reinsure its liabilities into the reinsurance market.

Both PCCs and ICCs are commonly used as umbrella investment funds with each cell being used as an investment vehicle for different asset classes.

The PCC is also often used in insurance transformer transactions whereby the cell of a PCC writes a derivative contract such as a credit default swap and the liability of the cell under that derivative contract is insured by an insurance company. The transformer provides the insurance company with exposure to a more varied form of investment product (the derivative) but through its traditional business method, the writing of an insurance policy. PCCs and ICCs are also often used in insurance linked securities transactions. More information on insurance linked securities transactions can be found here.

Incorporated cells are often used in longevity transactions whereby the incorporated cell insures the liabilities of a pension fund and reinsures that liability with a third party reinsurer. Because incorporated cells are separately registered legal entities and because they are able to take advantage of Guernsey's migration and amalgamation legislation, they are more popular vehicles than protected cells for such transactions - see our Longevity risk solutions article.

Insolvency

The general insolvency provisions under the Companies Law apply equally to PCCs and ICCs. Subject to the comments below, a PCC can be wound up in the same way as a non-cellular company. However, on the winding up of a PCC the liquidator must observe the special nature of the PCC.

Since each cell of the PCC is not a separate company it cannot be independently wound up. Consequently, there are two other insolvency procedures applicable to cells of a PCC:

- **Administration** – administration is available to non-cellular companies, PCCs, cells of PCCs, ICCs and incorporated cells. This process is only available if the company or cell is insolvent and the court considers that the making of an administration order may achieve the survival of the company or cell or the more advantageous realisation of its assets.
- **Receivership** – receivership is only available to cells of a PCC and only where the assets of the cell are likely to be insufficient to discharge the claims of creditors of the cell and the making of a receivership order by the court will result in the more orderly winding-up of the business of the cell and the making of a distribution of its assets to those entitled to have recourse thereto.

Notably, both of these processes are only available where the body in question is or is likely to become insolvent. A solvent cell or other entity cannot avail itself of those processes. It is for this reason that most cells of a PCC issue redeemable shares so that, upon the conclusion of the business written by the cell, the affairs of the (solvent) cell can be wound up through the redemption or repurchase of the issued redeemable shares.

Unlike a cell of a PCC, an incorporated cell can be wound-up in the same way as a non-cellular Guernsey company.

If any cell of a PCC is unable to pay its debts, technically the PCC as a whole is unable to pay its debts because the PCC is a single legal entity and a creditor of that cell could apply to wind up the entire PCC. However, on any application to the Guernsey court to wind up a PCC on the basis that one of its cells is unable to pay its debts the Guernsey court would be expected to refuse to order the winding up of the PCC as a whole in recognition of the nature of a PCC. Nonetheless, it is common for contractual documentation relating to PCCs to provide that in the event that the assets of a particular cell become exhausted any rights of the creditors against that cell are extinguished and any right of that creditor to petition for the winding up of the PCC is excluded.

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