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TWENTY-FIVE YEARS OF PROTECTED CELL COMPANIES

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Originally designed for use in the captive insurance sector, the protected cell company has established itself as a go-to-solution for myriad of different uses in the 25 years since its creation. Here, Guernsey non-executive director Joe Truelove explores some of those uses.

2022 is the 25th anniversary of the introduction of protected cell companies (PCCs) in Guernsey. Back in 1997, this was a truly innovative legal concept which has been copied by many jurisdictions since, often adopting the name of segregated portfolio company.

The concept underpinning the structure is that the PCC is one legal entity within which there are a series of pools of segregated assets and liabilities. Apart from the cells there is also a core which is responsible for the management of the structure and has the board of the entity attached to it. Each of the cells, and the core and their liabilities, are segregated from one another.

Private wealth management open-ended asset allocation umbrella funds

From the captive insurance sector, it was an obvious step to begin to use the PCC as the legal structure of choice for umbrella funds. These open-ended structures still exist and are often managed in Guernsey.

Structures like this one are typically marketed to sophisticated investors and private clients of the private banks which promote them. The cellular structure gives the manager the opportunity to operate an asset allocation model efficiently so that investors may have all of their assets in one or two cells instead of managing multiple small portfolios. The classic model would be to have an income cell, a growth cell and a balanced cell. The costs of operating many small portfolios are reduced for the client and for the manager. There is also a cost saving with respect to the servicing of the structure – there will only be one audit firm required, one board of directors, one administrator and one company secretary.

Multi-manager structures

A number of providers have formed PCCs or incorporated cell companies (ICCs) as ‘platforms’ or ‘incubators’ which they can then use to oversee a number of separate funds, where the management or advice is delegated to a series of investment advisers.

There a number of these structures in existence in Guernsey. This approach helps new investment advisers to build a track record in an established investment vehicle with an investment manager monitoring their performance, together with having regulated service providers and corporate governance principles in place.

Adding a new cell is a cost-effective and straightforward process. Investment advisers can launch one cell or multiple cells if they have multiple strategies. Valuation frequency and exchange listing can be varied for each cell.

Listed PCCs

The London Stock Exchange (LSE) is home to many closed-ended investment companies and Guernsey is the most popular jurisdiction for LSE listed companies after the UK with more than 100 Guernsey-incorporated companies listed, which have included multiple Guernsey-incorporated protected cell companies in the past.

The International Stock Exchange (TISE) is also very familiar with PCCs and the shares of both open and closed ended funds can be listed on TISE. I actually Chair the Board of the World Shariah Funds PCC Limited which is an open ended authorised collective investment scheme with three share classes listed on TISE.

The benefits of utilising a PCC for a listed fund are the speed and cost-effectiveness with which a second cell can be added to a PCC compared to the launch of a new legal entity.

Private equity and real estate ‘deal-by-deal’ PCC structures

In the aftermath of the credit crunch, even established fund managers found it difficult to raise funds for traditional ‘blind pool’ investment funds. As a result of this some managers responded by launching co-investment vehicles, separate managed accounts or club deals. In many instances they have retained the structure of a limited partnership as the co-investment vehicle with a general partner as the manager.

Increasingly however clients are utilising a PCC for these non-fund structures in particular for a ‘deal by deal’ structure; a series of transactions where the potential target investors have complete optionality over whether or not to invest in any given opportunity. The core private placement memorandum and terms remain constant and the variability is with each investment, which is set out in a cellular appendix.

I have served on the boards of several such PCCs, each with multiple cells, which are used by clients as vehicles to structure a series of distinct private equity or real estate transactions. There has certainly been a marked increase in the popularity of PCCs being used in these circumstances.

In this way investors may conduct their own due diligence on each and every transaction rather than rely entirely upon a fund manager. Alternatively, the investors may wish to opt out of sectors, geographies or deal sizes or vary their potential commitment by deal based on their risk appetite at the time or simply available cash flow.

PCC costs

With respect to a cost/benefits analysis of whether forming a PCC is more or less cost-effective than forming a standalone fund. My experience is that if a potential client intends to make more than two distinct investments or sub funds then a PCC will be more cost-effective than launching three separate co-investment vehicles or standalone fund structures.

Conclusion

PCCs are clearly a very useful legal form for the investment management sector whether for open-ended or closed-ended investment funds, whether the cells or the core are listed or not, and for a cost-effective holding company structure where a series of investments is intended. PCCs also work well for managed accounts (one cell per investor) and family offices (one cell per portfolio company to segregate the potential liabilities arising from a series of businesses).

ICCs have not been considered in this article – and although their uses are very similar to those of PCCs they require an article all to themselves!

Joe has been a Director of eight Guernsey incorporated PCCs in the last 10 years including both regulated and non-regulated structures.

This article was first published on Joe’s LinkedIn page.

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