WRITTEN BY DOMINIC WHEATLEY

20 YEARS OF PROTECTED CELL COMPANY DEVELOPMENT

27 JUNE 2017

Guernsey Finance Chief Executive Dominic Wheatley reflects on the progeny of protected cell companies within the region, and their evolution towards becoming a popular tool in the funds sector.

Protected cell company (PCC) structures celebrated their 20th anniversary earlier this year. Originally developed in Guernsey, primarily for use in the island's captive insurance sector, they have since gone on to be used as an alternative application for the structuring of many types of products.

Other jurisdictions have renamed them in an attempt to differentiate, but effectively all cell company legislation globally has been based on that which was originally formulated in Guernsey.

Indeed, while many will be familiar with the use of PCCs in a captive insurance setting, they have at the same time become an established route in collective investment schemes and the funds sector as a whole – being useful in both closed and open-ended funds.

We expect this demand to continue with practitioners so alive to the possibilities they offer.

Cell structures

The essential features of the PCC remain unchanged – a single legal entity comprising a core and any number of cells, with statutory cellular segregation such that the assets and liabilities of one cell are not available to the shareholders and creditors of the core and other cells, enabling cells to run different strategies without the risk of contagion, while enjoying cost savings from being one overall company.

While legislative amendments have tweaked the basic form, such as permitting recourse agreements or cellular arrangements, and enabled conversion, such as enabling a cell to convert into a non-cellular company, the greatest development has been in the uses to which PCCs have been put.

"Twenty years on from their initial purpose, they have a much wider application including SPVs, private wealth vehicles and within securitisations," says Frances Watson, partner at Guernsey-headquartered offshore law firm Mourant Ozannes.

She says it is this flexibility, along with ease of use, speed and lower costs that are the key advantages of the PCC.

"A cell of a PCC is established by board resolution and the established suite of agreements with third-party service providers is simply updated to include each new cell," explains Watson.

Economies of scale are therefore obtained through the PCC being just one legal entity, requiring just one board and one set of service providers, thereby allowing savings to be made on both legal and other professional fees.

In the funds sector, PCC use is most prevalent in vehicles established as umbrella funds with a number of sub-funds – structured as cells. Each cell can have different investment objectives and even different investment advisers.

Mark Douglas, head of Guernsey Fund Services at Moore Management, is one of those who has witnessed the PCC evolution.

He says that while their use in funds is now widely understood, he points out the quirks of the structure, including its adaptation to meet very specific jurisdictional requirements.

"Firstly, it is not possible to mix closed-ended cells with open-ended cells in the same PCC as it is the main structure itself that is approved by the Guernsey Financial Services Commission as either a closed-ended or open-ended fund, with all cells having to have the same characteristics in this respect," he said.

"Secondly, we have recently established a new Shariah-compliant PCC for a client as the articles of the existing PCC contained provisions which were not compatible with Shariah law – for example, the charging of default

interest – so it is worth remembering that a PCC has one set of articles that will apply to all cells."

Douglas agrees with Watson that reduced costs and time of setting up new funds or cells due to operational efficiencies are the main selling points of PCCs.

"Regulatory application fees are significantly reduced for new cells of an open-ended PCC compared to standalone funds while for a closed-ended PCC, new cells can be established very quickly as they only require a notification to the local regulator," says Douglas.

Continued development

Zedra's Guernsey office has one of the oldest PCCs in its product suite – the ZPCC, established in 1999. It has been widely used since then both in the UK and around the world by many managers and parties as a tax-efficient investment vehicle (by virtue of being granted UK reporting fund status on a cell-by-cell basis) and for making sizeable investments into the whole spectrum of asset classes ranging from plain vanilla to real property, private companies and other alternative investments.

Zedra director Mark Cleary sees further life for not only the ZPCC structure – now in a more mature phase of its life cycle – but for PCCs generally.

"Twenty years is not a long time in the grand scale of things, but it nonetheless remains incumbent to imagine what other untapped uses and opportunities yet to be thought of and how we might exploit these," he said.

"Guernsey offers a compelling blend of stability, institutional robustness and access to first-class professional services, track record and the rule of law and respect for property rights. These circumstances provide all the essential nutrients to attract managers and investors."

In addition to creating the PCC, Guernsey has subsequently introduced incorporated cell company (ICC) legislation, with the aim of enhancing creditor protection and offering additional flexibility. While the ICC has the same principles of statutorily ring-fencing assets and liabilities, it achieves this through each incorporated cell being its own legal entity. This means the ICC can offer a lower cost solution but with the potential advantages of each incorporated cell being a separate legal entity.

For Steve Butterworth, director of insurance at the Guernsey Financial Services Commission until 2003 and the man widely credited with developing Guernsey's PCC concept, further evolution would tally with how he foresaw the structure eventually being used.

"I always thought that once the concept became internationally accepted, its use would become widespread across financial services," says Butterworth. "That has been the case, but I am still surprised at some of the areas it is not more widely used, including by institutions for mergers, acquisitions and disposals."

"It is an ideal piece of legislation for a banking group, especially to ring-fence assets and liabilities. As a result, there is still development and diversification to come in the area of PCCs."

Innovation

While the 20-year anniversary of the PCC has been highlighted, Guernsey's innovative streak is still in effect today, with the recent launches of the Manager Led Product – aimed at alternative investment fund managers seeking to market into one or more EU member states under the national private placement regime – and the Private Investment Fund (PIF), which recognises that certain investment funds are characterised by a relationship between management and investors that is closer than that of a typical agent. The PIF has already generated significant attention with two launched towards the end of April, just four months after the new structure was developed and released to the global investment community.

Guernsey also recently saw the first commercial deployment of blockchain technology – a distributed database that maintains a continuously growing list of ordered records which is inherently resistant to modification.

As a leading international finance centre, we look forward to continued innovation emanating from the jurisdiction in the years to come.

An original version of this article was first publish in HFM Week, June 2017.

WE ARE GUERNSEY is the brand under which Guernsey Finance promotes the island's financial services sector internationally. Guernsey Finance - the promotional agency for the island's finance industry internationally - is a joint industry and Government initiative responsible for the promotion of Guernsey. Under the leadership of Chief Executive Rupert Pleasant, the agency ensures that the core values and competencies of the island's finance sector are accepted and respected by the global community and that financial business development flows are enhanced. Registered Office: Guernsey Finance, Somers House, Rue du Pre, St Peter Port, Guernsey GY1 1LU Company registration number: 38776

PO Box 655, St Peter Port,
Guernsey, GY1 3PN
+44 (0)1481 720071
INFO@WEAREGUERNSEY.COM