GUIDE

APPLEBY

GUIDE TO CELL COMPANIES IN GUERNSEY

CONTENTS

APPLEBY

PREFACE

Guernsey pioneered the introduction of the protected cell company (**PCC**) in 1997. Nearly a decade later in 2006, Guernsey introduced a second type of cell company, the incorporated cell company (**ICC**), to further enhance the innovation. The applicable law is found in the Companies (Guernsey) Law, 2008 (the **Law**).

The PCC was originally introduced and is still often used to enable Guernsey licensed insurance managers to offer cells to third parties as rent-a-captives. Both PCCs and ICCs are often used as umbrella investment funds with the individual cells being utilised as investment vehicles for a range of assets. Both PCCs and ICCs are often used in insurance transactions, but are extremely versatile and have a wide range of applications in financial services and structured finance activities generally. Aside from certain licensed activities, there is no restriction on what cell companies can legitimately be used to achieve.

It is recognised that this Guide will not completely answer detailed questions which clients and their advisers may have; it is not intended to be comprehensive. If any such questions arise in relation to the contents, they should be addressed to any member of the Corporate team, using the contact information provided at the end of this Guide.

Appleby
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1. **THE LEGAL NATURE AND STATUS OF THE PCC**

The PCC is a company with all the usual features: a set of memorandum and articles of incorporation, a registered office, a share capital and a board of directors, being subject to all of the normal requirements of the Law. The unusual feature of the PCC is that it can create any number of cells known as "protected cells" (**PCs**) the assets and liabilities of which are separate from those of the PCC (the assets of which are referred to as "non-cellular" or "core" assets).

Importantly, the PCs are not themselves separate legal entities. The PCC acts for and on behalf of the PCs which themselves cannot transact. Consequently, a PCC must inform any person with whom it transacts that it is a PCC and go on to identify whether it is the core or a PC, in which case it must identify the specific PC, with whom the person is contracting. A failure to specify the relevant pool of assets, cell or core, in the documentation could result in the directors incurring personal liability for the transaction concerned.

Each PC may have its own cell shares the proceeds of which form part of the "cellular assets" attributable to that cell. Similarly, where a PC has liabilities, those liabilities are attributable to that PC only. As such, the creditors of one PC cannot have recourse to the assets of other PCs or to the core (or PCC). This rule is subject only to specific recourse agreements which are discussed separately below.

The ability of the PCC to distinguish between core and cellular assets and liabilities it its key advantage, enabling a number of portfolios to be established in the same company with liability for specific portfolios limited to specific pools of assets rather than exposing all assets of the PCC.

2. **THE LEGAL NATURE AND STATUS OF THE ICC**

The ICC is based on the same principles of segregation of assets and limited recourse of creditors in respect of liabilities. The rationale behind the creation of ICCs was to provide additional flexibility and more protection to creditors.

The distinguishing feature of the ICC is that its cells (**ICs**), any number of which can be created, are separately incorporated and are therefore distinct legal entities with their own board, share capital, memorandum and articles of incorporation and accounts. It is of note that the board of the ICC and the boards of the ICs must be identically composed and so any director of an ICC must also be a director of each of its ICs therefore no person may be a director of an IC unless also a director of the ICC.

The applicable principles of segregation of assets and liabilities are similar: the assets and liabilities of the cells are segregated from the assets and liabilities of the ICC and from the assets and liabilities of the other ICs.

An IC, as a separate legal person, is distinct from its ICC and can therefore contract with third parties in its own right. The directors must ensure that in respect of every transaction entered into it is clearly stated whether it is the ICC or an IC (and the name of the IC) that is the contracting party.

3. **INCORPORATION AND THE CREATION OF CELLS**

There are specific restrictions on the type of entities that may be incorporated or converted into a PCC or ICC and certain entities, including banks and fiduciary companies, are not permitted to be incorporated as or converted into a PCC or ICC. In all cases, the prior written consent of the Guernsey Financial Services Commission (**GFSC**) is required to the incorporation or conversion.

A PCC can create PCs simply by board resolution. PCs do not require registration with the Registrar of Companies (**Registrar**). In order to create cells, an ICC must first pass a special resolution authorising an application for the incorporation of the ICs.

4. **SEPARATION OF ASSETS AND LIABILITIES**

The directors of PCCs and ICCs have obligations to keep assets and liabilities separate and separately identifiable as follows:

- The core (or non-cellular) assets and liabilities of a PCC from the cellular assets and liabilities of each of the PCs.
- The assets and liabilities of each PC from the assets and liabilities of the other PCs.
- The assets and liabilities of the ICC separate and separately identifiable from the assets and liabilities of the ICs.
- The assets and liabilities of each IC separate and separately identifiable from the assets and liabilities of the other ICs.

For PCCs, in practice, this means maintaining separate accounts for each cell in which the assets attributable to each cell are clearly identifiable. PCCs, ICCs and each IC must all keep accounting records in the same way as every other Guernsey company. It is vital in order to ensure the integrity of the cell company structure that it is clear in all cases in respect of which cell the PCC or ICC is transacting. If the accounts show the asset being attributed to a specific cell, there can be no question that any creditor should have recourse other than to the assets of the relevant cell.

5. **CREDITORS**

In order to preserve the integrity of the cell structure, as a general rule the creditors of a cell have recourse to that cell only and not to the assets of other cells or to the core. Similarly, creditors of the core only have recourse to the core and not to the cellular assets. So the creditors of a PC only have recourse to the cellular assets of that PC and have no recourse to the assets of other PCs in the structure or to the core assets. An exception to this rule exists where a recourse agreement has been entered into between the PCC and a creditor providing that protected assets may be subject to a liability owed to the creditor.

A recourse agreement is a written agreement between a PCC and a creditor providing that otherwise protected assets, being the assets of another PC within the PCC or the core assets, may be subject to liability. The directors of the PCC and the relevant PC must approve entry into the recourse agreement and support this with a declaration that in their belief no creditor will be unfairly prejudiced by the recourse agreement. Subject to the provisions of the memorandum and articles of incorporation, entry into the recourse agreement may also require a supporting shareholder resolution both of the core and of the relevant PC.

The Law makes no specific mention of recourse agreements relative to ICCs. The position of creditors of ICCS and ICs will depend on whether the liability is attributable to the ICC itself or to a particular IC as a creditor will only be able to claim against the entity which is liable. If the assets of that entity are insufficient the creditor will not be able to pursue the assets of other ICs or the ICC.

6. **ADMINISTRATION, PUBLIC RECORDS AND ACCOUNTING**

Like other Guernsey companies (save with limited exceptions), PCCs and ICCs must have a resident agent who must be either an individual resident in Guernsey and who is a director or a corporate services provider. Resident agents are required to hold details of beneficial ownership but these details are not a matter of public record although the resident agent may be required to release the information pursuant to a court order or regulatory request.

Cell companies must also adhere to the requirement to file an annual validation once a year before 31 January together with a declaration of compliance signed by a director. The details required to be set-out in the annual validation are:

- the address of the registered office;
- particulars of the directors;
- the particulars of a resident agent (where required);
- the categories of its principal business activities;
- whether the PCC is exempt from audit;
- confirmation that the PCC's register of members is up to date as at 31 December in the previous year;
- that the information contained in the validation was current as at 31 December in the previous year; and
- the number of issued shares and the aggregate value of those shares.

All Guernsey companies must keep accounting records sufficient to show and explain their transactions, disclose with reasonable accuracy their financial position and enable the directors to ensure that the accounts are properly prepared. Accounts must be prepared in accordance with generally accepted accounting principles, be approved by the board of directors and signed on behalf of the board by at least one director.

An ICC may prepare consolidated accounts for itself and for all or any of its ICs just as if it were a holding company. Although the PCC is a single legal entity, in order to satisfy the requirements for the segregation of assets and liabilities, separate records will need to be maintained for each PC for accounting purposes.

There is no requirement to file accounts with the Registry but a copy must be sent to the members within a year of the financial year to which they relate.

For taxation purposes PCCs are treated as single legal entities and are taxed accordingly. ICCs and each IC are separate legal entities and so each is treated separately for taxation purposes.

7. INSOLVENCY

The same principles of winding-up as are applicable to non-cellular companies apply to the winding-up of PCCs, ICCs and ICs subject to certain specific requirements including, significantly, that to deal with cell assets in accordance with the requirement to keep cellular assets separate and separately identifiable from non-cellular assets and cellular assets separate and separately identifiable from cellular assets attributable to other cells.

The winding-up of an ICC must not prejudice the affairs, business or property of any ICs and so during winding-up an ICC must carry on business to the extent necessary for continuance of the business of the ICs. The ICC cannot be dissolved until each IC has ceased to exist as an IC of that ICC.

The PCC is the only entity under Guernsey law which may appoint a receiver. The Royal Court of Guernsey may make a receivership order where a PCC is unable to discharge creditor claims, and the making of an administration order would be inappropriate but the making of a receivership order would achieve the orderly winding-up of the relevant business and distribution of assets to those who have recourse to them. A receivership order cannot be made if a liquidator has already been appointed or if the PCC has passed a resolution for voluntary winding-up.

Administration orders may be granted by the Royal Court of Guernsey in respect of cell companies where it can be satisfied that the cell company or cell does not or is unlikely to become unable to satisfy the solvency test as set out in the Law, and if the court considers that the administration order may achieve the survival of the cell company (or any part of it) as a going concern and/or a more advantageous realisation of the assets than would be achieved pursuant to a winding-up.

8. ADVANTAGES OF USING A CELL COMPANY

There are a number of advantages of using a cell company structure. The cell structure of both ICCs and PCCs offers an alternative to the traditional group holding arrangement providing economies of scale by reason of a common infrastructure and so offering costs savings in corporate governance and company administration. PCCs are less expensive to administer than would be the case in a company with multiple subsidiaries. A single board, a single company secretary and a single administrator are required. The accounting and taxation treatment of PCCs will also confer measurable benefits and savings. The ICC structure will also be able to provide elements of common infrastructure and accordingly confer similar benefits and savings, accounting and tax benefits, while allowing the ICs within the structure to exploit their status as independent legal entities able to contract freely amongst themselves and with third parties.

PCCs can be particularly quick and easy and consequently economic to establish. The PCs can be created by simple board resolution and do not require registration with the Registrar. There are a number of PCCs established in Guernsey with several hundred cells each holding different assets. Although this is an extreme example, even in such complicated structures PCCs facilitate cost benefits.

In an insolvency situation the cell company structure offers a number of advantages and protections to creditors whether it is the core or an individual cell that finds itself in financial difficulty. In order to preserve the integrity of the cell company structure in liquidation, any liquidator would be required to recognise the rights of each individual cell and protect the assets of each individual cell from the creditors of other cells within the structure. Similarly, a receiver can be appointed to a PC of a PCC without affecting other PCs or the core. Accordingly, the cell company structure can provide protection and flexibility.

The risk segregation feature of the cell company structure offers the key advantage of low risk of contagion thus allowing investors to be segregated according to their risk profile with no danger of losses from riskier investments spreading to investors who have a lower risk profile.

By way of further illustration of the flexibility of cell company structures, the Law is able to facilitate a number of different conversion, integration and migration options enabling companies to change their status in order adapt to the changing demands of the business environment and so continue to achieve success and prosper.

9. EXAMPLES OF USE OF CELL COMPANIES

The cell company is versatile and can legitimately be used for a whole range of activities. Some examples of how cell companies can be used are as follows:

- **As private investment funds**: holding different investments in different cells within the same overall structure offers significant advantages to investment managers particularly in terms of managing risk. A cell structure could be used for any combination of investors from a single family desiring a private collective investment to a group of unrelated clients in each case offering the ability to cater for different investment requirements and profiles.
- **As multi-purpose vehicles**: a cellular multi-purpose vehicle offers the unique combination of a centralised administrative infrastructure with unlimited flexibility including the possibility of managing a diverse range of assets, interests and liabilities all ring-fenced in their respective cells but managed together and so benefiting from the same administrative umbrella.
- **As a tool for family wealth management**: use of the cell company structure alongside trusts can enable family wealth to be carefully managed apportioning assets and planning for succession to suit the exact requirements of the family concerned. Different cells can hold

different assets and interests segregating the owner's assets and liabilities under the same administrative framework. Cell structures can also be used alongside private trust companies to enhance the ability of a family and its advisers to effectively run family office solutions so as to segregate and manage different functions, interests and assets.

There are many other examples of what the cell company can do - it is a versatile corporate tool which has almost limitless possibilities.

Note:

This is a short note on some of the general characteristics of PCCS and ICCs and some of the advantages of such a structure. If you require more specific information, please do not hesitate to contact us. Legal advice should be taken in respect of your specific structure or any specific queries you might have.

For more specific advice on cell companies in Guernsey, we invite you to contact:

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For the convenience of clients in other time zones, a list of contacts available in each of our jurisdictions may be found here.