REFLECTIONS ON THE BIRTH OF THE PCC

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IT IS FAIRLY well known that the PCC was introduced under my stewardship as an insurance regulator in Guernsey 10 years ago. What is less well known is that the concept was conceived (at least intellectually) much earlier, during my time in the Cayman Islands.

There was certainly a Eureka moment! It happened in the Cayman Islands in 1983 or 1984, I forget which year.

There were several events which influenced the way that I was thinking. They were mainly tax-related and concerned US-owned, single-parent captive insurance companies.

Premiums paid to a captive insurer could be disallowed by the authorities as a tax deduction in the parent's tax computation because the insurance company (the captive) was in the same economic family as the policyholder (the parent).

Most tax systems can be unfair, but this one seemed to unfairly penalise those companies having their own insurance companies. Cost savings and dividends from the captive, and better and more efficient risk management, made the parent financially stronger, and able to make a greater contribution to the parent company and thus to the US economy.

There were some exemptions to the "economic family" principle, one of which was used or (from my regulatory perspective) abused extensively! This was for the captive to write more than a prescribed percentage of third party business. It was just what an insurance regulator did not want to see, namely, a captive, which knew its parent risks inside out, starting to write 'other' ill-considered risks, purely driven by tax considerations at parent company level. There were some notable casualties,

particularly amongst captives owned by some major companies, as unexpected and substantial claims soon started to materialise from the unrelated business.

There must be another way I thought to myself! The obvious solution was for the premiums to be paid to an insurer that was not considered part of the happy economic family, but for the parent to still be able to benefit from any profits made from its insurance arrangements.

The Eureka moment came a year or so later sitting in my office in the "glasshouse" (local knowledge needed), reflecting upon a drinks reception following the first annual general meeting of a group of US-based podiatrists, who were very pleased, even though they told me they had made quite a high initial loss. There were several firms of podiatrists owning and participating in the association captive insurer. As podiatry skills varied throughout the association, those with better loss prevention methods were fearful that the losses of their lesser brethren would eat into their own profits. Thus they all separately engaged lawyers whose task it was to protect their client's assets as far as they were able to.

The thought was of a company that had separate parts, with statutory force, each protecting a block of assets from the liabilities of the other parts, whilst still being a single legal entity.

The main single purpose in my mind was the protection (or ring-fencing) of assets but I have to admit, as a Chartered Tax Advisor by background, I also thought of this as a way of solving the problem that US-owned single parent captives were facing. This latter would be the icing on the cake – if it worked of course! It seemed to me to be just an extension of the limited company concept, albeit with some concerns on creditor protection and on international recognition.

It was perhaps a bit too radical for the time and was also too early for Guernsey to consider when I took up my regulatory position there in 1986. I must admit to not being as forceful as I should have been in promoting the idea. Even the insurance sector, which was later to be one of the principal beneficiaries, was only partly in favour. It was, however, in 1994 when the fund sector, which recognised the structure as ideal for an umbrella fund, supported the concept, that we were able to make progress.

The first drafting of the legislation was unsuccessful and a senior lawyer in the local private sector, Advocate Nik van Leuven (who is now HM Procureur to the States of Guernsey) offered to start from scratch and to produce the PCC legislation. When I read his draft, I was delighted, as it was very user-friendly and very much how I had imagined the concept, with one remarkable exception. I had not envisaged that individual cells would be able to issue 'cell shares'. Was this consistent with concept of the 'single legal entity'? I had always considered that the cell participants would receive their profits back by way of return premiums or even by way of loans, but I was thinking only of insurance operations and was persuaded that having the ability to

have cell shares, and thus pay dividends, was the only way that the legislation would be acceptable to potential participants.

Before I saw the draft legislation, I could see numerous insurance uses – rent-a-captives, association captives, life companies for high net worth individuals, composites, joint ventures and securitisations etc., but once I realised that the legislation was an extension of company law, as an ex-practitioner in offshore company management, I could envisage myriads of opportunities, especially in the asset management sector. Of course, whether or not there would be rapid growth in PCCs would depend on several factors, not least of which would be the industry (and especially their international legal advisors) acceptance, as well as its recognition world-wide.

Because it was a new concept (although I later found out that there was private legislation in Bermuda that performed similar functions) it was decided to restrict the uses to insurance companies and collective investment funds, when it made its debut in Guernsey on 1 February 1997.

I was delighted when the Cayman Islands followed with their own version reasonably quickly, although despite my plea to the contrary, they called their version a 'segregated portfolio company'. Later Bermuda would call their version a 'segregated accounts company' – as if a poor old prospective policyholder needed any more confusion!

It was also very encouraging to see certain States in the US introducing their own versions as this would help achieve international recognition we so much hoped for.

The last 10 years has witnessed the rapid evolution and growth of the PCC and also the recent development of incorporated cell companies (ICCs), of which I thoroughly approve. As I write this foreword in early 2008 I believe that there are over 300 such entities with literally thousands of cells. For the future, I really believe that we have only scratched the surface and that cell companies will become a very common vehicle in many structures.

Against this background, I welcome this book on the subject. I am very surprised that it has taken 10 years! The book is written by professionals with extensive experience of the Protected Cell Company. Their insight on a wide array of topics related to the PCC should prove beneficial to the understanding, development process and advancement of the industry.

Good luck with future innovation!

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