

Finding the right solution

Penny Hudson
explains why
Caledonian's new
Gibraltar PCC
could provide
the perfect
insurance solution
for European
businesses



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Many companies that wish to proactively manage their risk simply do not have sufficient capital or premium to warrant setting up a captive with all the inherent expense that goes with it.

The benefits of protected cell or segregated account companies (PCCs/SACs) are now widely known, and an ever-increasing number of risk managers whose employers do not have the desire to establish full-blown captives are seeing these vehicles as attractive solutions to propositions which fall between conventional risk transfer and self-insurance.

A captive established within the European Union (EU) requires a minimum capitalisation of €2m (US\$2.5m) (€3m if liability classes are written). Many corporations do not wish to lock away this amount of cash and are, therefore, denied the opportunities available to captive owners. In addition, captives established outside the EU are finding that fronting costs have escalated substantially since 9/11.

Caledonian is launching a fully-authorized multi-line PCC in Gibraltar which will be able to accept risks in most classes of insurance throughout the EU and could offer potential solutions by offering cost savings and direct-writing opportunities into the EU. Caledonian believes its PCC, which will be funded either by a consortium of private investors from the insurance industry or a European-rated insurance company, will be the first independent vehicle of its kind to offer a full range of products within the EU.

Cell structure

A PCC is a corporate body, established under specific legislation that can be segregated into legally distinct portions known as the 'core' and underlying 'cells'. Each cell has the ability to access a segment of the PCC's overall share capital as well as introduce additional working capital of its own, usually by preference shares, allowing policyholders to maintain sole ownership of an entire cell.

Business transacted through a cell is

ring-fenced from the activities of other cells, and although a cell is not a separate legal entity in its own right, its revenue streams, assets and liabilities are kept separate from other cells and from the core. As a PCC is single legal entity, the creation of a new cell within the PCC does not create, in respect of that cell, a legal entity separate from the company.

A PCC must state that it is one by including 'Protected Cell', 'PCC' or any cognate expression approved in writing by the regulator in its name, and each cell must have its own distinct name or designation.

A PCC can create and issue shares (cell shares) in respect of any of its cells. The proceeds of the issue (cell share capital) are comprised in the cellular assets attributable to the cell in respect of which the cell shares are issued. A PCC may pay a cellular dividend. The PCC produces its accounts as a consolidated company and solvency is proven using regulatory insurance forms on an aggregate basis. The cells do need to fill in some insurance forms on an individual cell basis, but this is only for details of premiums and claims.

Core capital

The core is required to hold a minimum guarantee fund, the amount of which depends on whether the company is based in the EU or not, and whether the PCC is writing direct business or reinsurance, if there is to be liability insurance class of business in the cells. For an insurer established within the EU this will range from €2m to €3m of capital. The net admissible assets for the core plus those of all the individual cells must exceed the minimum required margin for solvency at any point in time. The core is, therefore, in place to help the individual cells meet the solvency requirements without each having to finance the full minimum capital requirements for an insurance company.

The core will also pay any expenses relating to the company as a whole such as administration, audit and legal fees, and would expect a fee from each cell to cover these expenses and the cost of holding capital. The cell will, however, be required to inject capital if the PCC

requires additional capital for the overall solvency of the company owing to the cell's high level of premiums (see 'Protection of core assets').

Cell capital

A cell may inject a minimum capital (€1 for example) and it must have sufficient funds for it to be able to cover all its potential liabilities. Each company wishing to open a cell will need to be examined on its own merits. Rigorous 'KYC' (know your client: due diligence and compliance) will need to be in place to ensure that the ultimate owner of each cell has the financial backing to honour its liabilities, and the relevant regulators will undertake due diligence checks on all cell owners.

Protection of cells

The core company is not permitted to undertake insurance business in its own right and so has no insurance liabilities. Each cell is only liable for its own debts and not for those of any other cell within the company, and has no legal rights over any other cell's assets. The cells are accounted for like individual companies, each with its own technical account and balance sheet. They have their own separate contracts, income, expenses, assets and liabilities, and their only interaction with the core is fees paid.

Protection of core assets

Legislation may state that if a liability arises relating to an individual cell and if that cell's assets have been exhausted, the core's assets shall be used secondarily to satisfy the liability. However, this situation has never been tested in court. The possibility of exposure of the core's assets shows how important it is to assess very carefully each potential new cell prior to allowing it to be established within the PCC.

Reaping rewards

The specific overheads of a PCC can be shared between the owners of the cells via a fee (which may be a flat fee or a percentage of premium), making it more cost effective. This makes a PCC a strategic and flexible risk financing option providing covering and capacity where existing markets may be restrictive.

Furthermore the PCC gives access to



other benefits of a traditional captive insurance company, including:

- Stable and lower risk financing costs
 - A focal point of a risk financing strategy
 - Access to reinsurance markets
 - Increase in net cash flow
 - Insurance cover, which may be difficult to obtain in the standard market.
- It is likely that companies who will use a PCC will have one or more of the following:

- A wish to proactively manage the total cost of risk
- An ability to retain risk
- Uninsurable risks or high levels of retentions
- A requirement to access the reinsurance market.

Caledonian has identified several types of company which the product might interest:

- Professional firms (for example, lawyers and accountants) looking to fund excesses in professional indemnity cover over time
- Corporations looking to assume more of their own risk, but that do not wish to commit sufficient capital to meet EU minimum statutory requirements
- Alternative risk financing entities (captive, associations, or those using existing rent-a-captive/PCC solutions) with risks within the EU wishing to use Gibraltar's passporting rights to write directly into all EU states without fronting
- Medium-size corporations self-insuring property/business interruption exposures including aggregates or each-loss deductibles

Why Gibraltar?

Gibraltar is a vibrant and successful finance centre, and because it is a full member of the EU, policies issued there are valid throughout the European Economic Area (EEA). It is regulated to the full extent of European requirements, yet has a fiscal regime which is sympathetic to captive structures, giving it a strong position as domicile of choice for a protected cell company.

- Any corporation with operations within the EEA looking for alternative risk transfer, but lacking the finance or desire to establish a fully-funded captive
- Multinationals that own captives outside the EEA, but need local paper for their European exposures.

If surpluses within cell accounts are retained over the early years, these may build to a sufficient size for them to be used to provide seed capital for a stand-alone captive. Cells, therefore, are often used as a first step to establishing full captive vehicles.

As an experienced captive manager, Caledonian is excellently positioned to assist clients with all the stages of such transitions. Caledonian celebrated its tenth anniversary earlier this year. This product completes the portfolio of products it has been seeking to achieve. Caledonian, and its clients, can now look forward to many more years of finding solutions to risk financing propositions.