Innovative insurance solutions through the use of cell companies in Guernsey

Guernsey pioneered the cell company concept when in 1997 it introduced the Protected Cell Company (PCC). It has since also introduced the innovative Incorporated Cell Company (ICC).

In addition, the Island has made legislative advancements that have created a regulatory environment which allows for their flexible use.

Guernsey's experience, expertise, flexibility and creativity mean that it is leading the way in providing cutting edge solutions to meet clients' complex risk transfer needs.

Transformer cells

These are cells which are used to convert a capital market instrument, such as a credit derivative written on ISDA (International Swaps and Derivatives Association) terms into an insurance contract, such as a credit indemnity policy in this case.

The benefit of these cells is that they help banks and capital markets to access reinsurance markets where premium is generally lower than in direct markets. The cell acts as a go-between to transact, for example, a credit default swap with the bank on ISDA terms, and with the corresponding reinsurer by way of a traditional reinsurance policy, which mirrors the risks inherent in the credit swap derivative. As the cell retains no risk, there is no requirement for the cell to retain any capital, so long as the (re)insurer has a sufficiently high security rating.

Cells converting intra-group reinsurance into third-party reinsurance (using a third party reinsurance cell)

These cells are owned by highly secure financial institutions which charge an arrangement fee for the use of their cell to enable international insurance groups to gain credit for reinsurance ceded to subsidiary companies. By having the cell assume the reinsurance from the parent insurer, and cede the business to the subsidiary reinsurer, the parent is usually able to secure credit for the reinsurance because the cell is a third-party reinsurer. Consequently, whilst the cell retains no risk, it is able to achieve a benefit to the insurance group by way of regulatory arbitrage.

Fronting cells

These are cells which are owned by third parties to enable large multi-national corporations to access the reinsurance market. The cells retain no risk, but are simply used to issue an insurance policy to the insured which is mirrored by a reinsurance policy between the cell and a reinsurer. The cell retains no risk but the multinational corporation is able to access cover in the cheaper wholesale reinsurance market.

Insurance Linked Securities (ILS)

In recent years there has been an increased use of ILS, such as catastrophe bonds, to securitize insurance risks and transfer them to the capital markets. Cell companies can be used as special purpose vehicles (SPVs) as an essential part of the structure to which is created for such transactions.

Fully collateralised reinsurance cells

These cells act in a similar way to 'sidecar' vehicles, whereby the cell is fully capitalised by a financing vehicle (e.g. investment fund or private equity) to the extent of the risk exposure. The cell then writes a high level reinsurance layer within the catastrophe programme of the reinsured.

In the event that a claim impacts the layer, the cell is fully collateralised and therefore can pay the full exposure without any credit risk. From the cell investor's perspective, he is attracted by an investment opportunity which has uncorrelated risk compared with its other investments.

The investment is made in the expectation that it will earn investment income on its investment together with the premium paid to the cell to take on the risk. As the cell cover will expire after one year, or in a shorter period depending on the underlying catastrophe exposure, the investor, depending on the claims experience, will see a return of capital and income within twelve months or such longer period as agreed.

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