

Protected Cell Companies (PCC) Frequently Asked Questions

What is a PCC?

A Protected Cell Company (“PCC”) is a single legal entity comprised of a core, and a number of segregated parts, or “cells.” A PCC is formed by a sponsoring entity. The sponsor (in this case Marsh) manages the PCC through a Board of Directors and provides minimum regulatory and operating capital (the “core”). Under the applicable laws governing PCCs, this structure creates a legal segregation of the PCC’s assets and liabilities into a number of different cells and a central core. Each cell is completely independent and separate from the other cells, as well as from the core of the company.

The undertakings of one cell have no bearing on the other cells. Each cell is identified by a unique name, and the assets, liabilities and activities of each cell are ring-fenced from other cells.

In a PCC, as a general matter, creditors of a particular cell only have recourse to the assets of that particular cell and not to any other cell or to the PCC core, subject to the satisfaction of all required conditions.

A PCC captive is a licenced insurance and/or reinsurance company organized and regulated pursuant to the insurance/captive law of its domicile.

Who is a PCC suitable for?

It may be an ideal solution for:

- an organization too small, based upon premium spend, to form its own single parent captive;
- companies who are unable or unwilling to join forces with others in the same industry in a group captive;
- companies who are required to segregate insurance assets and liabilities, examples include: by division or territory; regulated and non-regulated business;

risks associated with a joint venture, a special project or a strategic alliance;

- companies wishing to access the reinsurance market; and
- companies with a legitimate need for confidentiality regarding their cell ownership.

What are the Similarities between a traditional Captive and a PCC Cell?

A traditional captive and a PCC cell operate in a very similar way:

- both a captive and a PCC will be licenced insurance or reinsurance companies, and will be subject to all applicable insurance laws, rules and regulations;
- both a traditional captive and a PCC cell have the potential of providing similar advantages to its shareholders, such as cost effective risk-financing vehicle; reduced overall insurance costs by retaining insurer profits and reducing overhead; access to the reinsurance market; cover for uninsurable or “difficult to place” risks; flexibility in programme design; optimisation of risk transfer and risk retention; and
- both a traditional captive and a PCC cell typically require captive management services.

What are the Differences between a traditional Captive and a PCC Cell?

Whilst a traditional captive and a PCC operate in a very similar way, there are some differences between the two including:

- The risks within each PCC cell will be legally segregated from other cells. In a captive all business is “co-mingled”.

- the cost of a PCC Cell to a shareholder is likely to be less than the administration costs associated with owning a captive;
- the interests of the owner/sponsor of the PCC do not have to coincide in all areas with those of the shareholders of each PCC Cell;
- a PCC cell will typically require less of a time commitment from the shareholder than a captive, as the Board of Directors of the PCC and its captive manager typically provide the majority of administrative and management activities. These economies of scale can generally produce a lower operating cost to the shareholder.

How do I incorporate and licence a cell in the PCC?

This will vary across the domiciles. However these processes are similar in both Isle of Man and Washington D.C. Initially, Marsh will work with prospective users of a cell to establish the feasibility of owning a cell and insuring certain risks through a cell. Assuming the prospective user of a cell elects to proceed with the cell, an application from the prospective cell owner/shareholder will need to be made to the PCC Underwriting Committee—Marsh Captive Solutions will assist with the application process. This application will include a business plan and pro forma financials. Once this has been approved, Marsh Captive Solutions will submit, on behalf of the cell owner/shareholder, an insurance licence application, along with the business plan, application fee and pro forma financials, to the Insurance Regulator. Once the Regulator approves the licence and the cell has been set up it can then write insurance business.

What level of capitalisation is required in a cell?

The level of capitalization will depend on the requirements of the PCC sponsor and the Insurance Regulator in the PCC's domicile. Capital for both Isle of Man and Washington D.C. may be contributed in the form of cash or an approved letter of credit. Under certain circumstances, additional forms of capitalization may be contributed with approval of the Insurance Regulator and PCC sponsor.

What's the minimum premium spend?

The estimated minimum premium is in the region of £250,000 for Isle of Man and \$500,000 for D.C. Keep in mind that the cell needs to be in a position of covering its basic running costs.

Where can I establish a cell in a Marsh-owned PCC?

Marsh currently owns PCC captives in the Isle of Man and Washington D.C.

Where else can I have a cell in a PCC?

There are more than 30 domiciles offering some form of PCC type legislation, including Bermuda, Cayman Islands, Guernsey and various U.S. domiciles.

How much control do I have over the cell?

As a cell shareholder, you would have general control of your cell and the insurance business written through the cell as specified in the Cell Participation Agreement. Certain activities including but not limited to writing new business in the cell, changing the cell's business plan, changing reinsurers and declaring dividends will require pre-approval from the Board of the PCC and / or the domicile regulator.

How much does a cell cost to run?

In the Isle of Man, the following costs will be incurred:

- Minimum Management fee to Marsh of £25,000
- Insurance License application fee £750
- Annual license fee 0.2% of net premium written (min. £500; max £3,500)
- Audit review of business plan and license application £2,000

In Washington D.C., the following costs will be incurred:

- Minimum Management fee to Marsh of \$45,000
- Annual fee for certificate of authority of \$300
- Initial one-time license application fee \$500
- Annual premium tax of 0.250% on direct premium written / 0.225% on reinsurance premium written (min. \$7,500; max \$100,000)

These costs are subject to change.

Can I have more than one cell?

Yes, you can have as many cells as you need but each cell must receive individual approval by the Regulator and each cell will need to be properly funded and capitalized.

Am I protected from other cells?

Yes, as a general matter, each cell stands alone and the assets and liabilities attributable to it are completely segregated from the assets and liabilities attributable to the PCC core and each other cell, subject to the satisfaction of all required conditions.

How much capital do I need to put in to get the cell running?

The amount of capital required will depend on the nature of business to be written in the cell, premium and risk retentions levels.

Should I be concerned about the risk profile of the other cells/cell shareholders in the PCC?

No, as cells are totally segregated from each other and the insolvency of one cell cannot impact another cell, the nature of the risks and the risk management controls of other cells should not be of concern to individual cell shareholders.

What protection can I buy to protect my exposure?

Reinsurance protection can be purchased for the risks in a cell in the same way as reinsurance protection is purchased by a traditional captive. Any reinsurance purchased must be approved by the Board of the PCC and must comply with the PCC's minimum security requirements.

Is the cell more lightly regulated than other captives?

No, the insurance regulation for each of the cells is the same as that for a traditional captive that is licenced under the same jurisdiction as the PCC.

Will a cell work for smaller/middle market companies?

A cell may be the ideal solution for smaller/middle market companies as the administration cost associated with a cell will likely be less than with a traditional captive.

Can I put different risks from different divisions within my company into the same cell or do I need multiple cells?

The same cell may be used if there is no need for segregation of risks of the different divisions. Different cells may be used if there is a need for segregation of risks of the different divisions.

What is the difference between an Incorporated Cell Company ("ICC") and a PCC?

An ICC is very similar to a PCC except that each ICC cell is individually incorporated which means that each ICC cell is in fact its own legal entity. Each ICC cell will have its own Articles of Incorporation, By-laws, and Board of Directors which will likely differ from those

of the other cells and the PCC core. A PCC is a single legal entity. The majority of domiciles currently only offer PCC legislation.

The insurance regulations in Washington D.C. governing captives permit cells within one PCC insurer to be structured as either Incorporated Cells ("ICs") or Protected Cells ("PCs"). As explained above in reference to an ICC, each of the ICs is a separately incorporated entity and can be formed as any type recognized corporate entity, including a limited liability company (LLC). For companies seeking a U.S. Federal tax deduction, use of an IC may provide cell shareholders with an advantage over use of a traditional PC. While the separate legal nature of the IC is one positive fact in the overall structure, the actual Federal tax position of the IC will depend on all of the underlying facts and circumstances of the individual cell and its insurance program. Marsh makes no representation or assurances that U.S. Federal income tax treatment as an insurance company will be achieved through an IC.

How much of my/my company's management time is needed to run a cell?

Very little. As stated earlier, a PCC cell is not a separate legal entity so individual PCs do not have their own board of directors. Individual ICs will, however, have their own board of directors.

Can I buy all my insurance through the cell and then reinsure it out?

Yes, this can be done to the same extent that it can be done in a traditional captive, subject to the reinsurance being approved by the Board of the PCC.

Can my PCC cell be converted to a single parent captive if my business grows enough?

In the Isle of Man PCC, a cell in itself is not an entity and therefore it cannot convert into a captive which is an entity. A cell owner could set up a captive and transfer the risks in the cell to the newly formed captive via a loss portfolio transfer. This same treatment would also be true for a Protected Cell in PCCs domiciled in Washington D.C. In an Incorporated Cell ("IC") in Washington D.C., the shareholder could convert the IC into a captive by amending the IC business plan and articles of incorporation.

How much money will I make from running the cell?

As with a traditional captive, this will depend on the profitability of the business written.

Is a feasibility study needed now and every time I want to add new business?

Feasibility study for any business to be written by a cell is recommended, to determine the viability of the use of a cell, together with financial projections. The extent of the feasibility review or study will depend on

the complexity of the business. In addition, a business plan, together with the financial projections, will need to be prepared for submission to the Board of the PCC and to the Regulator. Each time a new class of risk is proposed, a further business plan must be prepared for the PCC Board and the Regulator.

What are the tax implications for the cell shareholder?

Marsh does not provide tax advice. You are encouraged to consult with your own tax advisors.

For more information on Mangrove PCC visit www.mangrovepcc.com. To learn more about other solutions offered by Marsh, visit www.marsh.com or contact your local Marsh representative.

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