# A holistic view

**A protected cell company established in Malta may emerge as a viable corporate structure for re/insurers seeking to mitigate any increases in compliance and capital costs under Solvency II, says Matthew Bianchi**

Malta is the only fully fledged EU member state to allow for the licensing and establishment of insurance and reinsurance Protected Cell Companies (PCCs) and cells. Ganado & Associates, Advocates has buttressed the growth of this insurance sector in Malta.

The PCC Regulations provide for the creation of insurance and reinsurance cells within the company. The assets and liabilities of each cell are segregated from each other as well as from the assets and liabilities of the core. Regardless of the number of cells, the PCC remains a single legal entity at all times.

Cell shares are issued to the promoters of each cell and the capital raised from the cell share issue constitutes the first assets of a cell. The PCC in its own right and each cell issued by the company is licensed separately by the Insurance Regulator in Malta – the Malta Financial Services Authority.

The ability to segregate assets and liabilities in distinct cells allows the board of a PCC to establish a multiplicity of underwriting books within the company with each cell owner at all times retaining full protection of their assets from any unforeseen

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financial problems of other cells or the core. Each underwriting book and the profits made therefrom are beneficially owned by the promoters of each cell. This feature has been the key to the rapid growth of the PCC sector in Malta because it has allowed unrelated cell owners to acquire cells in one structure and thus leverage on the advantages achieved by the tapping into a common management and administration system at the core of the company without losing any access to the underwriting profit or investment return within their cells.

In this sense the PCC offers cell owners the unique opportunity to create a highly efficient underwriting facility.

## QUANTITATIVE IMPACT STUDIES

Each cell is required to maintain an adequate solvency margin, commensurate with its own risk. However assuming Solvency II requirements become applicable to the PCC as a single entity rather than in relation to each cell within the structure, PCCs will be able to offer prospective cell owners the possibility of writing business in an environment comparable to that of an incubator: where expert management conversant with the Solvency II requirements is readily available.

The QIS5 exercise currently underway will present PCCs domiciled in Malta with an opportunity to assess the impact of the new standard formula under Solvency II. The results of the current exercise will shed light on the efficiency gains expected to be made through the PCC structure in relation to the new capital requirements. Further analysis on the potential effect of the PCC in relation to the capital requirements may only be made after the conclusion of the QIS5 exercise and after further feedback from the local Regulator. However, deductions as to the new governance requirements may tentatively be made.

Much of the success of PCCs as gateways to the insurance market in the Solvency II era will depend on the degree of sophistication of the internal management structures put in place. Organic growth may be experienced as PCCs develop their management approach to incorporate specialised committees within the structure. Start-ups in the insurance and reinsurance market may thus be facilitated even further as the structure grows.

## A NEW ERA

The sophistication of management systems may also spur improved information flows. This would in turn ensure an improved degree of risk management.

The PCC structure may furthermore be best suited to harness possibilities for the standardisation and continuous development of the new documentation requirements.

As single legal entities, it may be anticipated that PCCs would submit one Own Risk and Solvency Assessment (ORSA) with respect to the structure as a whole. Although corporate governance procedures relating to each cell will naturally not be identical, as this would defeat the spirit of risk-management itself, a common approach





may be adopted by the PCC management which permeates the structure as a whole. The board of directors would be the final arbiters in determining the risk-management strategy to be adopted, in concurrence with the owners of the different cells.

The power of this common approach to corporate governance should not be underestimated. Improved communication and facilitated access to expert management should further the goals of Solvency II, being among others a better understanding and management of risk. Standardisation in relation to documentation of governance procedures should furthermore open opportunities for rationalisation of resources. Put simply, start-ups and established players will have the opportunity to understand and efficiently address risk at no extra burdens other than that of latching on to the PCC structure by purchasing cell shares.

The implementation of Solvency II will herald a new era for regulation of insurance and reinsurance companies across Europe and beyond. Focus will shift away from formalism to a risk-based economic approach.

We envisage a future where market players will seek more efficient solutions to risk management in order to keep capital and corporate governance requirements in check. It might be argued that the cumulative effect of the Solvency II regime will lead to the facilitation of pro-competitive synergies among market participants. The PCC seems to be an efficient and cost-effective way to achieve such goals while maintaining and bolstering quality management systems.

Solvency II will help us understand that risk is not just about numbers but also about focusing on quality management coupled with a holistic understanding of risk. The PCC may just prove to be the corporate structure which fosters a quantum leap in corporate governance under Solvency II while still facilitating market entry to new participants.

**THE BRIEF**

PCC offers cell owners the unique opportunity to create a highly efficient underwriting facility

QIS5 will enable PCCs domiciled in Malta to calibrate the new standard formula under Solvency II

Solvency II Directive will allow holistic understanding of risk

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