



Navigating your way Offshore

SOLOMON HARRIS  
CAYMAN ISLANDS ATTORNEYS - AT - LAW

# Segregated Portfolio Companies

**Paul H. Scrivener**  
**Kathryn C. Carter**

Insurance Managers Association of Cayman  
11<sup>th</sup> May, 2010

## INTRODUCTION

- Cayman SPC legislation well respected
- Statutorily embedded limited recourse for creditors
- SPs are “silos” or “sealed compartments” within a single company
- As at 31 March, 2010, 122 Cayman SPCs (579 segregated portfolios) – 16% of all Cayman captives - writing premiums of > US\$476 million



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## INTRODUCTION (cont'd)

- Ownership/Participation
- Core/SP relationship
- SP/SP relationship
- Jurisdictional issues
- Financial difficulties
- “Banana Skins”

## OWNERSHIP/PARTICIPATION

- Ordinary or Common Shares held by sponsor/promoter
- Segregated Portfolio Shares may be issued to SP owner but not a requirement
- Rights attaching to Segregated Portfolio Shares
  - Voting?
  - Dividends
  - Redemption
  - Directors?
  - On Winding up

## OWNERSHIP/PARTICIPATION (cont'd)

- Can there be separate classes or series of Segregated Portfolio Shares in respect of the same SP?
- Participation/Shareholders' Agreement
- One SP for each participant or several participants in one SP?
- Moving a client from a pooled SP to their own SP

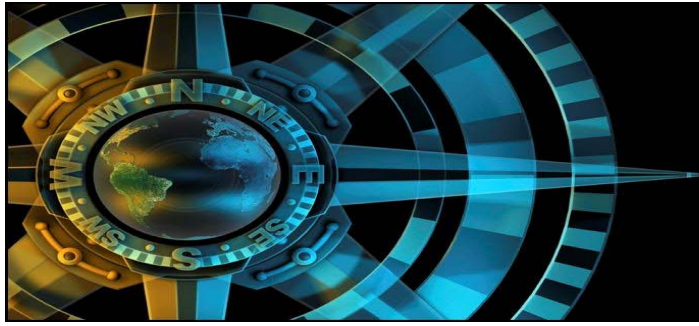


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## RELATIONSHIP BETWEEN CORE AND SP

- Nature of the core
- Nature of an SP
- Articles of Association can be drafted so as to protect core assets from excess SP liabilities
- Can core assets be partially exposed to SP liabilities?



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## RELATIONSHIP BETWEEN CORE AND SP (cont'd)

- Risk distribution issue – no tax deductibility if no unrelated risk insured, but IRS treats SPs as separate companies
- Position if core has to meet excess liabilities of more than one SP
- Retrocession arrangements between core and SP
- In practice, would the core allow one of its SPs to fail?



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## RELATIONSHIP BETWEEN SP AND SP

- The “firewall” between SPs
- Transfer of assets between SPs
- Attempted retrocession arrangements between SPs  
– an SP is NOT a separate legal entity !

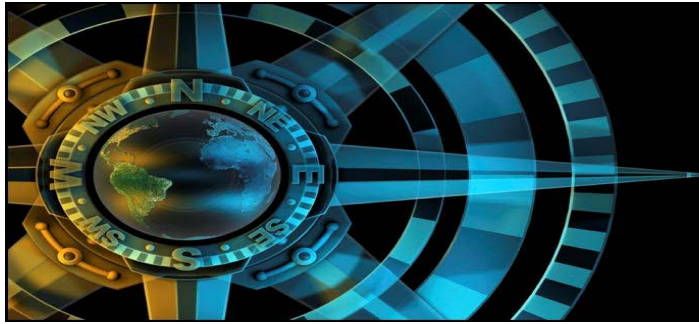


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## JURISDICTIONAL ISSUES

- SPC structure not been tested in court
- How would a challenge arise?
- Challenge might be in relation to:-
  - Structure per se
  - Initial structuring
  - Operational issues
  - Combination

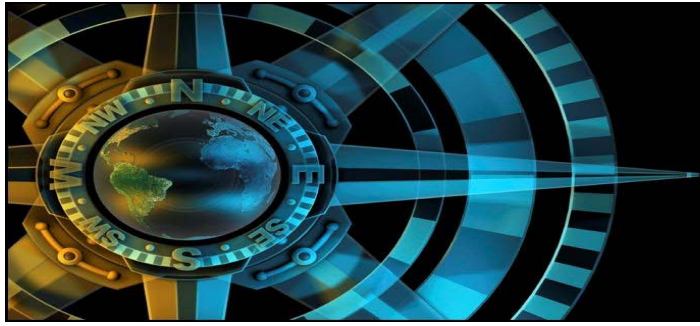


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## JURISDICTIONAL ISSUES (cont'd)

- Jurisdiction in which the SPC is established must have robust SPC legislation and adequate insurance regulatory oversight
- All legal documentation (policies, reinsurance agreements, service provider agreements) needs to spell out fully and clearly the firewall concept
- Governing law and jurisdiction
- In which jurisdiction is the challenge likely to arise?



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## JURISDICTIONAL ISSUES (cont'd)

- Where are the assets that the creditor is trying to attack?
- Does the jurisdiction where a challenge is likely have its own SPC legislation?
- Is the jurisdiction debtor friendly or creditor friendly?
- What are the jurisdiction's rules on conflict of laws?



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## JURISDICTIONAL ISSUES (cont'd)

- What is the jurisdiction's stance on disregarding the protection of limited liability. In the US, the "totality of the circumstances" test
- Importance of making proper disclosure to creditors
- Be able to justify the legitimate business case for the structure
- Onshore legal opinion?

## CONVERSION TO AN SPC

- An existing captive can convert to an SPC
- Needs to be a well thought out business case
- Will the core be exposed to excess liabilities of the SPs?
- Typical scenarios
  - o Rent-a-captive
  - o Unrelated risks eg separate program for self-employed physicians or extending to third party facilities



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## CONVERSION TO AN SPC (cont'd)

- Declaration by at least two directors:-
  - o Current statement of assets and liabilities (i.e. not more than 3 months old)
  - o Statement of actual or prospective material changes in assets and liabilities
  - o Statement that the SPC intends to operate and the assets and liabilities which company proposes to transfer to SPs



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## CONVERSION TO AN SPC (cont'd)

- o Confirmation that the company and each SP will be solvent at point that company is registered as an SPC
- o Confirmation that each creditor of the company has consented in writing to the transfer of assets and liabilities into SPs or written notice has been given to each creditor having a claim against the company exceeding CI\$1,000 (US\$1,220) and 95% of those creditors by value have consented to such transfer



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## CONVERSION TO AN SPC (cont'd)

- Special Resolution authorizing transfer of assets and liabilities into SPs
- CIMA approval
- Change of Name
- Amended and Restated Memorandum and Articles of Association
- Changes to share capital to establish segregated portfolio shares

## CONVERSION TO AN SPC (cont'd)

- Participation/Shareholders' Agreement
- Leave existing program in the core?
- Government Fees
  - o CI\$500 (US\$610) on conversion
  - o CI\$2,000 (US\$2,400) annual fee (in addition to Government fee for an exempted company)
  - o CI\$300 (US\$366) annual fee for each SP but capped at CI\$1,500 (US\$1,829)



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## FINANCIAL DIFFICULTIES

- Is SP of a rent-a-captive a prime candidate for insolvency?
- Position of unsecured creditors in a liquidation
- One problem SP could lead to the collapse of the entire company
- Impact of SPhinX case
- Centre of Main Interest rule



## FINANCIAL DIFFICULTIES (cont'd)

- Receivership orders:-
  - o Relate to one or more SPs rather than to the SPC as a whole
  - o Made by the Grand Court
  - o Grand Court must be satisfied as to actual or likely insolvency of the SP and that receivership would achieve orderly close down of the SP's business and distribution of assets



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## FINANCIAL DIFFICULTIES (cont'd)

- o Who can apply?
- o Likely circumstances in which a receivership order would be sought
- o Interrelationship with winding up
- o Role and powers of the receiver

## FINANCIAL DIFFICULTIES (cont'd)

- o Who would act as a receiver?
- o Protection against legal proceedings unless Grand Court gives leave
- o Affect of receivership order on directors' powers
- o Receiver's fees

## TYPICAL BANANA SKINS

- Failure to physically segregate assets/co-mingling
- Legal documentation drafted as if a SP is a separate legal entity
- Disregard for additional duties on directors of an SPC
- Failure to clearly state in legal documentation on behalf of which SP the SPC is contracting
- Legal documentation drafted on an omnibus base across all SPs rather than having separate documentation for each SP



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## TYPICAL BANANA SKINS (cont'd)

- Failure to always use the full name of the relevant SP including the words “segregated portfolio”
- Typical Directors’ Indemnity in the Articles of Association
- Non-contractual creditors



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