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UPDATE

# Jersey, Guernsey & Cayman as jurisdictions for fund liquidity solutions

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There are many things for a fund manager to consider once they have identified a need for liquidity and/or additional capital in their funds or portfolios. Jurisdiction selection for a co-investment or continuation vehicle may not necessarily spring to mind at first but there are compelling reasons to consider an international finance centre, even if the fund in question is domiciled elsewhere. In this update, we take a look at those reasons and give some simple examples of the benefits that can be obtained by using an international finance centre.

Regulatory certainty and flexibility, tax neutrality, speed to market and cost efficiency – the simple message of International Finance Centres (**IFCs**) such as Jersey, Guernsey and the Cayman Islands to prospective fund managers. These qualities are always high on the list of considerations for a fund manager looking to raise capital but in the midst, and the aftermath, of the COVID-19 Pandemic, these qualities take on renewed significance to those looking either to raise additional capital for their portfolio companies through co-investment vehicles and/or top-up funds or to restructure their holdings into a longer term vehicle.

The last three or four years have been buoyant years for private fundraising but, according to Preqin figures, investors have seen net cash flows over that period turn negative as capital drawn down by private funds has exceeded capital distributed. Liquidity concerns that have been heard in corners of the LP community for some time have been forced onto centre stage by the COVID-19 Pandemic, exacerbated by the impact of poor public market performance on the value of investors' liquid assets (sometimes referred to as the 'denominator effect').

With minds turning to a restarting of economies as the European and US markets begin to emerge from 'lockdown', businesses will be able to start assessing their capital needs in the wake of the COVID-19 Pandemic with those in the retail, hospitality and travel sectors likely to be most in need of a financial stimulus. In a survey of its members published on 8 April, the Institutional Limited Partners Association (**ILPA**) stated that over half of its members have reported an increase in capital calls since the beginning of the Covid-19 Pandemic (although there will be multiple factors contributing to this increased rate of capital calls, not just the immediate need for capital support).

Managers who have recently completed a successful fundraising will be hoping to take advantage of the current market environment by deploying capital at attractive valuations. However, managers of fund vintages that are substantially fully deployed and/or approaching the expiry of their term will need to think creatively to raise additional capital for their portfolio companies and/or to avoid having to exit a good investment in a bad market. Particularly in a cost conscious environment against the backdrop of some investor liquidity concerns.

The current environment could generate a range of different capital requirements, each of which will be unique and will need to be considered accordingly. We've examined two very simple examples to illustrate how IFCs can offer cost effective and quick solutions.

### Case Study 1 – the co-investment vehicle

> *A full scope EU AIFM has called almost all of its available capital in one of its EU funds. The fund manager has identified an urgent need for additional capital for one of its portfolio companies. The investment period has recently expired but there are a further six years until the fund is due to terminate. A number of the fund manager's North American and Asian investors have expressed interest in participating in co-investments alongside the fund.*

In this scenario, mechanisms in the fund documents such as recycling, re-investment and follow-on provisions are unlikely to be helpful as the fund does not have undrawn commitments to call on.

Typical fund financing capital call facilities will also not be available where there are no, or limited, undrawn commitments. The fund could consider implementing a NAV facility (with the bank taking security over the portfolio company rather than undrawn commitments) but this will likely require amendments to the fund's documentation and may have adverse tax consequences for certain investors in the fund.

Alternatively, the fund manager could establish a co-investment vehicle for one or more of its existing investors to provide additional financing to the portfolio company. Subject to compliance with conflict and allocation provisions, this should be possible without amendment of the existing fund terms.

Establishing the co-investment vehicle in the EU would require full compliance with the AIFMD, even if the prospective investors in the co-investment vehicle are not based in the EU. The fund manager may also need to reappoint, and pay additional fees to, any third party AIFM it is using.

Alternatively, the fund manager could establish the co-investment vehicle in an IFC with an SPV manager taking advice from the fund manager. The AIFMD is not directly applicable to vehicles established in Jersey, Guernsey or the Cayman Islands as the islands are not part of the United Kingdom or the European Union. Provided that there is no need to actively market the vehicle to investors in the European Union, AIFMD compliance can be entirely avoided. This can represent a significant financial saving, particularly as there is no need to appoint a depositary in relation to the vehicle, which may seem disproportionate and undesirably costly in the circumstances.

If there is a need for EU marketing to certain investors, vehicles established in an IFC can take advantage of cost-effective and targeted marketing to select EU jurisdictions through the relevant private placement regimes.

The co-investment vehicle generally will not be subject to fund regulation in the host IFC and there would be no regulatory requirement for an offering document or other formal disclosure document.

### Case Study 2 – the GP led restructuring / continuation vehicle

> *A fund manager has a fund approaching the end of its term. The fund has a number of remaining assets which the manager believes can be further developed with additional time and capital. The fund also has valuable assets which the manager believes cannot be realised at an appropriate value in the current market. The fund manager has engaged with its investors and whilst a number are supportive of additional investment in the portfolio and longer hold periods, a large number are having liquidity issues and want to exit the fund on schedule.*

With the support of its investors, the manager has decided to establish a continuation vehicle to acquire assets of the existing fund and facilitate additional investment in certain portfolio companies. As part of the transaction, existing investors will have the option to continue into the new vehicle, exit their investment or a combination of both. Additional capital will be raised from a mixture of existing and third party investors which will provide liquidity to existing investors wishing to exit but will also generate additional capital to be deployed in existing and/or new investments. Transactions of this nature are complicated as there are a range of stakeholders with differing, and often conflicting, interests.

The timetables for entity establishment and required regulatory approvals in the jurisdiction of the current fund vehicle would require the fund manager to begin the process immediately, alongside its commercial discussions with investors, in order to avoid a delay to completion of its transaction. This places additional pressure on the manager's operational teams who have to manage the regulatory process on top of the commercial process and run the timetables concurrently.

Alternatively, the manager could defer the legal/regulatory process for the new vehicle until it has more certainty regarding its requirements, following full consultation with the various stakeholders, by taking advantage of the fast track formation and regulatory approvals processes available in IFCs. The fund manager can focus on the commercial aspects of the transaction, without front loading regulatory and establishments costs, whilst remaining confident that when necessary, the structure for the continuation vehicle can be established, regulated and ready to accept commitments within even the most ambitious of timetables.

Each of Jersey, Guernsey and the Cayman Islands offers the ability to establish vehicles on a 'same-day' basis and the relevant Registries have remained open for business as usual (albeit on a remote working basis) throughout the Covid-19 Pandemic.

The fund manager could also take advantage of the private funds regimes in each of Jersey, Guernsey and the Cayman Islands, which provide a sophisticated and light touch approach to regulation for professional investors. In each jurisdiction the requisite regulatory approvals can be obtained quickly and efficiently. The financial services regulators in Jersey, Guernsey and the Cayman Islands each have teams dedicated to investment funds who have remained responsive throughout the COVID-19 Pandemic, undistracted by broader issues affecting banking and insurance sectors which have been affecting regulators in larger jurisdictions.

The fund manager could complete the entity establishment and regulatory approval process in an IFC within the minimum recommended 20 business days that ILPA recommends fund managers give to investors to consider their options in respect of the continuation vehicle.

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