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UPDATE

Continuation Funds. How Jersey, Guernsey & the Cayman Islands offer fast and cost-effective solutions

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Against the backdrop of a stalled IPO market, higher financing costs and reduced deal-flow, fund managers are increasingly looking to the disposal of portfolio companies to continuation funds as an alternative strategy to return cash to investors. The formation of a continuation fund allows the manager to sell one or more portfolio companies to a new vehicle, with a longer time horizon than the 'main fund' vendor, and which can be financed by a combination of electing main fund investors and/or new, third party, investors. These disposals and the formation of the related continuation fund vehicle generally require swift execution, with participants understandably reluctant to pay the establishment and running costs attached to creating and operating the main fund, so there are compelling reasons to consider establishing a continuation fund in an international finance centre, even if the main fund in question is domiciled elsewhere. In this update, we look at those reasons and some examples of the benefits that can be obtained by using an international finance centre such as Jersey, Guernsey or the Cayman Islands.

With Bain Capital's 2023 Mid-Year Report (a key barometer of resilience, trends and growth in the market) confirming a 35 per cent decline in private capital fund raising in the first half of 2023 and declining fund investments and exits relative to the first half of 2022, fund managers are increasingly turning to continuation funds as an alternative means of exiting portfolio companies and providing liquidity to investors.

Regulatory certainty and flexibility, tax neutrality, speed to market and cost efficiency have long been the simple messages 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 or structure investment vehicles but in the midst of a market downturn in which traditional divestment routes are harder to find, these qualities take on renewed significance to those looking to structure the disposal of a portfolio company to a longer-term vehicle. In many cases, it simply won't be cost effective to establish a continuation fund in a jurisdiction and environment in which the new vehicle will be subject to all the usual regulatory and operational costs of the main ('blind pool' and multi-asset) fund.

The IFCs provide environments in which the applicable level of fund regulation and its associated costs can be reduced where a continuation fund has only one or a handful of assets and few investors, who are not actively marketed to for the purposes of AIFMD.

Here we look at a continuation fund case study to see how establishment in an IFC can benefit the participants.

Continuation fund case study

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 fund to acquire certain assets of the existing fund and facilitate additional investment into those assets. 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 approval processes available in IFCs (see below). 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.

By using IFC structures a fund manager could complete the entity establishment and regulatory approval process in an IFC within the minimum recommended 20 business days that the Institutional Limited Partners Association (ILPA) recommends fund managers give to investors to consider their options in respect of the continuation vehicle.

The well-developed limited partnership laws in Jersey, Guernsey and the Cayman Islands offer appropriate statutory safe harbours to investors seeking to vote on and influence continuation fund operations without thereby losing their limited liability status by participating in the fund's management, providing flexibility to all continuation fund participants as they negotiate the new vehicle's future terms.

The fast-track formation and regulatory approval processes available in the IFCs

Each of Jersey, Guernsey and the Cayman Islands offers the ability, upon completion of participant due diligence, to establish vehicles on a 'same-day' basis and the fund manager can also take advantage of the private fund regulatory regimes in each Island, 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 in a few days. The financial services regulators in Jersey, Guernsey and the Cayman Islands each have teams dedicated to the approval of investment funds.

There is no requirement for a depositary to be appointed, with none of the associated costs and negotiation of service terms and, in many instances, if not required by investors, an audit and its attendant costs can also be dispensed with. If there is no active marketing of an IFC continuation fund into the UK or EEA, there will be no need for the fund to appoint and pay a licensed AIFM for UK/EEA marketing purposes.

Where the IFC continuation fund is established as a limited partnership, a Jersey or Guernsey private fund's general partner (GP) can generally benefit from a regulatory licencing exemption and, in most cases, the GP does not fall to be regulated at all in the Cayman Islands, all of which is helpful if the timing is particularly acute.

In Jersey or Guernsey, single asset holding structures are generally not required to be regulated as funds at all given their lack of risk spreading. And where a Jersey fund is to have multiple assets but there is no active marketing to investors in the UK or EEA (particularly where those investors participate by way of reverse solicitation), Jersey's unregulated fund regime can also be used, reducing operational costs relative to regulated private fund regimes.

Speak to us

If you are considering launching a continuation fund swiftly and cost effectively please do speak to us about the advantages that establishment in Jersey, Guernsey and the Cayman Islands can provide. Our team is currently active in advising a number of IFC continuation funds and we look forward to working with you and your lead counsel to share those advantages and our experience.

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