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Jersey funds in bespoke transaction structuring

There are many things for managers to consider when they are looking for bespoke structuring in their funds or portfolios, where increasingly diverse and sophisticated structuring techniques are used.

Of course, Jersey has been a key fund structuring jurisdiction for many years, and flagship funds continue to be routinely set up both for long-established and new sponsors, covering the range of asset classes from buy-out, private equity, venture and technology, through to credit and real estate but also including more liquid strategies.

While the core of fund activity continues to be comprised of such blind pool structures, we will instead look at recent experience of deploying Jersey funds and related vehicles in bespoke situations. In the context of significant volatility and swings in market conditions due to a variety of macro factors, many sponsors and managers have increasingly looked to innovative structuring to achieve their strategies – in an echo of the phenomenon of convergence which was witnessed between asset classes in previous economic cycles.

Much of the present activity also derives from changes in investor bases. Liquidity issues are at the forefront of recent trends such as GP-led restructuring deals. These are often accompanied by a widening into new investor groups who may have differing liquidity, as well as regulatory or eligibility requirements.

Designing a flexible structure

Once the need for liquidity or additional capital has been identified, jurisdiction selection may not immediately spring to mind but, there are compelling reasons why many transactions use Jersey structures.

Regulatory flexibility, tax neutrality, track record, speed to market and cost efficiency (factors offered by a centre such as Jersey) are always high on the list when raising capital in a new fund but these qualities take on renewed significance where there is a complex deal driving the structure.
This may arise from having a historical Jersey fund in the structure or may also be relevant even where the fund in question is domiciled elsewhere, but where Jersey can provide a quicker or less complex solution.

In relation to co-investment and parallel funds, typically investor preferences will drive the location of the vehicle through which they invest. These can vary from levels of regulatory fee burden or reporting (often a driver for a Jersey parallel to an EU fund which would otherwise have full Alternative

Investment Fund Managers Directive (AIFMD) obligations) as well as eligibility (often a driver for a Jersey parallel to a Caribbean or North American vehicle).

The Jersey Private Funds (JPF) regime provides a sophisticated and light touch approach to regulation for professional investors, with regulatory approval being obtained quickly and efficiently. The JPF regime can apply to any legal structure, for example:

- Jersey limited partnerships have been enhanced by recent partnership law changes in 2022 and the ability to provide for the migration into Jersey of partnerships established in other jurisdictions which can be helpful in restructuring deals.

- Corporates, and particularly cell companies, have been used in a number of recent single managed account structures in relation to credit funds. The attractiveness of the ability to deliver different cells for consecutive series of underlying credit strategies have become a common route for investors requiring an easily replicable model.

- There has also been a return to the well-established vehicle of the unit trust, which for real estate investment by global investors has retained momentum, particularly since the UK tax elections regime (introduced in 2019) has become the market standard for real estate in that jurisdiction.

JPFs can be open or closed-ended, meaning JPFs can be designed with characteristics to suit many hybrid structuring situations.

At the same time, many hybrid structures will not need to be treated as funds and, accordingly, many co-investment or AIV structures may be able to be treated as investment holding or JV structures which do not require fund treatment.

Finally, many of these deal structures sit alongside financing packages. A wide mix of financing facility types (e.g., subscription line, NAV or asset-based financings or hybrid combinations of these) are regularly seen in the Jersey market.

Deal structures that have recently been popular include the following:

Continuation funds

Continuation funds are now being widely used by institutional investors across closed-ended funds as a tool to actively manage and strategically realign their portfolios. They have also become a means for managers to realign investor bases. This surge has been accelerated by a shortage of reasonably priced, quality assets, incentivising managers to find ways to delay or reset exits for star portfolio assets.

While these manager-led transactions can take a variety of forms, typically the existing fund will sell its existing portfolio, or a strip of that portfolio, to a newly established special purpose vehicle (the continuation fund). Existing investors will have the option to either rollover their interest and/or invest additional capital alongside the new investors in the longer life continuation fund (to the extent of wishing to participate in a longer hold period) or to cash out and gain liquidity, with incoming secondary buyers underwriting the transactions and any corresponding purchase price.

These deals involve a range of stakeholders with differing, and often conflicting, interests, and short timetables, which places operational pressure to manage regulatory processes on top of the commercial deal.

Often deferring the legal/regulatory process for the new vehicle until it has more certainty regarding the deal, by taking advantage of the fast-track Jersey formation and regulatory approval processes can be helpful. This means that managers can focus on transaction mechanics, without front loading regulatory and establishment costs.

The ability to establish vehicles on a ‘same-day’ basis combined with a 48-hour regulatory turnaround for fund approval can assist with this approach.

Annex funds

A further derivative is an annex fund being a newly formed vehicle (normally a partnership), often funded on an accelerated timeline, to inject new capital into investments held by the existing fund. Annex funds are typically raised after the main fund’s investment period and are formed to support follow-on activity in certain existing portfolio companies.

Preferred equity

Preferred equity deals involve a preferred equity provider contributing additional capital to a fund and, in return, being granted priority over the distributions from a defined asset (or group of assets) held by the fund. The priority will typically expire once the investor has received proceeds equal to capital plus a minimum return or multiple. A preferred equity deal is typically structured by transferring relevant asset(s) to a newly established special purpose vehicle, which then issues preferred shares.

Co-investment vehicles

Useful where an investment opportunity is not suitable for a manager’s existing fund, either by reason of liquidity profile of the asset or as a result of concentration limits or other restrictions in an existing fund. It can be particularly relevant in the case of a distressed or special situation deal, or where fund investment periods have expired but there are some years until the fund is due to terminate, but where mechanisms in the fund documents such as re-investment and follow-on provisions are unavailable.

Provided that there is no need to actively market the vehicle to investors in the EU, AIFMD compliance can be avoided for a Jersey co-investment fund.

Typically, a co-investment vehicle generally will not be subject to fund regulation in Jersey and there would be no regulatory requirement for an offering document or other formal disclosure documents.

Even if there is a need for EU marketing to certain investors, a Jersey vehicle can again take advantage of cost-effective and targeted marketing to select EU jurisdictions through relevant national private placement regimes.

Parallel funds and separate managed accounts

We have also seen an increase in parallel funds, allowing participation in the same investment opportunities as the main fund while offering flexibility to tailor the terms and conditions to meet specific requirements. There are overlaps with separate managed accounts (SMAs) which can include variations in fee structures, investment minimums, lock-up periods, or different levels of risk exposure. In some cases, certain investors may have regulatory or legal restrictions that prevent them from investing in the main fund.

Parallel funds and SMAs can also be structured to accommodate these restrictions, allowing investors to participate without violating any regulations. Parallel funds can also streamline the fundraising process by targeting specific investor segments or strategies, i.e., according to criteria such as investor type, geographic location, risk appetite, or investment size. We also see parallel funds enabling managers to customise strategies including fee structures, investment minimums, risk profiles, or regulatory compliance requirements.

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Often a Jersey parallel sleeve will offer familiarity to global investors, but also comfort from a European investor base perspective. For example, Jersey is eligible from an Organisation for Economic Cooperation and Development (OECD) perspective for certain institutional investors.

Conclusion

Many of the elements above are often combined, but generally, this represents an ongoing trend in tailoring elements for different investor dynamics.

This requires a high level of 'transactability' as often various corporate and transaction experiences are required, drawing from different asset classes and deal flow experience, but also deploying experience from finance and security as well as restructuring deals.

As the pattern of widening types and requirements of investors into alternative asset classes continue, we anticipate that this trend will continue.