Guernsey: an ideal domicile for continuation funds

Briefing Summary: Continuation funds have grown significantly in recent years as an alternative to traditional closed-ended fund exit options, driven by ongoing difficulties in the IPO market and M&A activity.

Service Area: Acquisition and Leveraged Finance, Investment Funds, Investment Managers

Sector: Private Equity

Location: Guernsey

Content Authors: Matthew Brehaut

Created Date: 02 January 2024

Guernsey provides an ideal domicile for continuation funds, with proportionate, principle-based regulation, and a neutral tax environment, facilitating quick-to-market establishments and competitive ongoing costs.

What is a continuation fund?

The "secondaries" market was until recently a comparatively small market: investors exited long-term illiquid positions (the classic characteristics of closed-ended private equity, venture capital, real estate and infrastructure funds) by selling their fund interests, often at a significant discount.

Such limited partner ("**LP**") led transactions are characterised by an LP approaching prospective purchasers and, once a price is agreed, transferring its partnership interests to the buyer, who becomes a limited partner in the fund and assumes the seller's rights and obligations in respect of the transferred interests.

By contrast, general partner ("**GP**") led transactions typically involve a transfer of the ownership of assets held within existing funds, normally at the instigation of the GP, with existing LPs given the option to remain exposed to those assets or sell out. A continuation fund is a specific type of GP-led secondary transaction. One or more portfolio companies within an existing fund are sold into a new structure (formed specifically for such purpose). That new structure is then managed by the same sponsor.

Key Contacts

Annette Alexander
PARTNER, GUERNSEY
+44 (0)1481 732067
EMAIL ANNETTE

Christopher Anderson
PARTNER, GUERNSEY
+44 (0)1481 741537
EMAIL CHRISTOPHER

Andrew Boyce
PARTNER, GUERNSEY
+44 (0)1481 732078
EMAIL ANDREW

Matthew Brehaut
PARTNER, LONDON
+44 (0)20 7614 5620
EMAIL MATTHEW

Tom Carey
PARTNER, GUERNSEY
+44 (0)1481 741559
EMAIL TOM

David Crosland
PARTNER, GUERNSEY
+44 (0)1481 741556
EMAIL DAVID

What is the purpose of a continuation fund?

Continuation funds:

- Provide extended exposure to one or more specific portfolio companies. Due to the fixed life of a closed ended fund (typically 10-12 years), there is an obligation to liquidate assets and return cash to investors. Continuation funds facilitate an extended holding period for certain assets, the objective being that investors in the continuation fund can ultimately benefit from the additional time the GP has to enhance the value of the assets and thereby generate enhanced returns to investors.
- Provide existing investors with a liquidity option, granting them the option to realise for cash ("cash out") some or all of their interest in the assets being sold to the continuation fund; any interests not sold are "rolled over" into the continuation fund (meaning the "rolling" investors remain exposed to those assets).
- Raise commitments from both new and rolling investors. These new moneys facilitate "follow-on" investments to enhance or complement the assets and further improve returns.

Trends in continuation funds

GP-led transaction volume doubled in size from $26 billion in 2019 to $52 billion in 2022.[1] Continuation fund transactions are estimated to account for ~80% of such GP-led transactions.[2] This growth is likely to continue, with the largest managers pushing growth in secondaries funds and a large percentage of LPs planning to increase their exposure to this area.[3]

What is driving this growth?

Fund managers are experiencing difficulties in realising assets held in their funds as those funds come to the end of their terms. Sluggish IPO markets and M&A activity have made traditional exit routes harder, making it more difficult to return cash to investors, which in turn inhibits the fundraising process. Continuation funds provide another liquidity option to return cash to investors to help keep this process moving.

As Bain[4] reported:

- During the first half of 2023, buyout-backed exits fell to 65% compared to the same period in 2022. Total exit value (annualised) is down 54% and exit count (annualised) down 30% compared with 2022.
- The resulting "LP cash squeeze" saw global private capital raised during the first half of 2023 fall 35% compared to the same period in 2022. On an annualised basis, this is heading for a 28% decline in value and a 43% decline in terms of funds closed compared with 2022.

"*Stalled dealmaking and exits have jammed the capital flywheel, putting a premium on liquidity.*" – Bain Capital

Key Contacts

Tony Lane
PARTNER, GUERNSEY
+44 (0)1481 732086
EMAIL TONY

Ben Morgan
PARTNER, GUERNSEY
+44 (0)1481 741557
EMAIL BEN

Why Guernsey? What can Guernsey offer?

Quite simply, onshore continuation funds are considerably more difficult to implement compared to doing so in Guernsey.

Guernsey is a long-established centre of excellence for closed-ended funds. That's why more than a quarter of the largest 30 private equity sponsors[5] trust Guernsey as a funds domicile and it's why Guernsey is the ideal location for a continuation fund, regardless of where the existing fund is domiciled.

Regulation

Guernsey operated a principles-based regulatory regime with the emphasis on proportionality of regulation. Lighter-touch fund regimes help make Guernsey much more user-friendly compared to other jurisdictions. Indeed, single-asset continuation funds are not regulated as collective investment schemes in Guernsey.

Speed

Guernsey's "fast-track" fund regimes enable regulatory sign-off within a maximum of three business days from submission. Private investment funds (available where there are 50 of fewer investors) reduce this to a next-day sign-off. The fund vehicles themselves can be established on a same-day basis (and in as little as 15 minutes if necessary).

Even if the fund vehicle isn't established here, Guernsey offers a quick and efficient means for managers to migrate to Guernsey simply and quickly.

Certainty, stability, familiarity and simplicity

Guernsey's long-established independence has brought with it political stability and certainty. The island remains at the forefront of innovation and legal creativity[6], backed up by a strong legal system, latterly based in large part on English common law principles. Our partnership law provides suitable "safe harbours" to LPs who wish to vote certain matters relating to the fund and its investment without jeopardising limited liability status. Unsurprisingly, Guernsey funds are familiar to private capital investors throughout the world.

You also won't need the services of notaries public or apostilles to get things done. Our company and partnership laws facilitate quick and effective operation and decision making.

Expertise

Guernsey has a wealth of expert service providers which offer first class legal, tax, audit and administration support to fund managers.

Cost effectiveness

The speed to market and lighter touch regulatory regimes mean that Guernsey is able to offer cost-effectiveness, whilst still adhering to the highest international tax and regulatory standards.

There is, for example, no need to establish a fund manager in Guernsey. In the case of a Guernsey limited partnership, the management can be delegated to an existing suitably licensed non-Guernsey entity, with the GP generally able to avail itself of an exemption from the need to obtain a licence in Guernsey.

Also, Guernsey closed-ended funds do not need to appoint a depositary, saving further costs.

Carey Olsen

Carey Olsen is the leading legal adviser to Guernsey's investment funds sector. We advise over 81% of the entire Guernsey-domiciled fund market by assets under management and nearly 74% by number of Guernsey-domiciled funds.[7] As you would imagine, we have advised on numerous continuation vehicles for globally recognised fund managers.

Please feel free to contact us. We would be delighted to share our knowledge and experience in this area.

You can also find out more about Guernsey funds and Carey Olsen's fund expertise by visiting our Guernsey funds website and scrolling down to see various articles.

1 Jefferies, Global Secondary Market Review, January 2023

2 Neuberger Berman, The Rise of GP-Led Secondaries, December 2022

3 Private Equity Wire, PE Top 30 Firms – Latest On The World's Largest Managers, November 2023

4 Bain Capital, Stuck in Place: Private Equity Midyear Report 2023, 17 July 2023

5 Private Equity Wire, PE Top 30 Firms – Latest On The World's Largest Managers, November 2023

6 For example, Guernsey invented the "protected cell company" over 25 years ago, an idea now copied around the world.

7 Per the 29th annual Monterey Insight Guernsey Fund Report.