Guernsey corporate and finance update Q2 2024

Briefing Summary: Our corporate team outline the latest developments within the corporate and finance market in Guernsey including NAV facilities for Guernsey funds and how the jurisdiction will benefit from the new LSE rules.

Service Area: Banking and Finance, Corporate, IPOs and Equity Capital Markets, Investment Funds, Listing Services

Location: Guernsey

Content Authors: Andrew Tually, Andrew Boyce, Sukhvinder Chana

Created Date: 24 July 2024

NAV Facilities for Guernsey Funds: What's the noise about?

As late as 2022, the net asset value ("**NAV**") credit facility was seen as a relatively underutilised sector of the fund financing product offering. However, the interest and demand for NAV facilities has sharply increased with sponsor borrowers wishing to take advantage of the benefits that NAV facilities can offer in the current fund raising and M&A environment. Here, we highlight some of the key features of NAV facilities and the main advantages that can be gained from their use.

What is a NAV facility?

A NAV credit facility is a type of term or revolving credit facility where one or more (i.e. they can be offered on both a bilateral or syndicated basis) banks or alternative lenders provide lending/credit to a fund or its subsidiaries, the LTV ratio and collateral requirements for which are based on the NAV of the fund's portfolio of investments. This contrasts with the more widely utilised subscription line or capital call facilities which look to the uncalled/undrawn commitments of the fund's investors as the collateral for the facility. Private capital funds will look to NAV credit facilities at the end or near the end of the fund's investment period when it has typically utilised/drawn down the majority of its investor capital commitments. In this scenario, funds are typically not able to access subscription line facilities because they do not have sufficient remaining uncalled capital commitments from investors to allow for either the requisite amount of borrowing or indeed the purpose of the borrowing does not meet lender criteria.

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

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

Key distinction between NAV facilities and subscription line facilities

The key distinction between a NAV facility and a subscription line facility is that a NAV facility looks down the structure to the underlying investments of a fund and/or the associated distributions, cash flows or other amounts received from those investments, as the main collateral and risk basis for the credit facility, whereas a subscription line facility looks up to the uncalled capital commitments of investors in the fund. The investments of the fund are therefore seen as the primary source of repayment in a NAV facility in contrast to a subscription line facility where uncalled capital commitments of investors in the fund form the basis of the collateral.

The NAV facility market

The increased use of the NAV facility product is attributable, at least in part, to the recent macro-economic conditions (e.g. global occurrences such as the pandemic and regional conflicts) in which the ability to properly value and hence buy, and more importantly sell, assets has hampered exits for investment funds. This in turn has impacted the liquidity for their investors. The NAV facility market has accelerated as a result by providing a liquidity solution for sponsors needing or choosing to hold good quality assets for a longer than normal period, while awaiting a more favourable environment for exit opportunities.

NAV lenders have mainly been traditional bank lenders, but as the market has accelerated there has been increasing interest from a considerable number of alternative lenders such as private debt funds. The key points of difference between the two types of lenders, i.e. the sources of their debt financing capability, approaches to risk, and general comfort with and understanding of the collateral, has enabled borrowers to obtain financing solutions that are more bespoke to their specific needs. On the other hand, the advent of the rating of NAV loans has allowed access to a new asset class for debt funds with an institutional (and, in particular insurance, company and pension fund) investor base.

Key considerations of NAV facilities

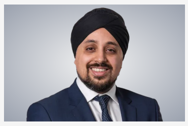
While the NAV facility solution has become far more "commoditised" than previously perceived, the differing types of lenders, borrowers and underlying assets in the sector mean that there will inevitably be a variety of factors to consider when structuring and documenting a NAV facility. Some of these considerations include:

- Security package – the nature, breadth and form of the security package is a key component and will very much depend on the type of assets and how they are held by the borrower;
- Cash sweeps/repayments – how much of the cash flow/distributions from the collateral assets will be used to pay down the facility versus being available for distribution to the borrower's investors can vary;
- LTV - the maximum permitted LTV ratio is a key metric of a NAV facility and the nature and sensitivity of the LTV triggers will vary (depending on factors such as the lender and the ability to value relevant assets); and

Key Contacts

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

Andrew Tually
PARTNER, GUERNSEY
+44 (0)1481 741527
EMAIL ANDREW



Sukhvinder Chana
SENIOR ASSOCIATE, LONDON
+44 (0)20 7614 5610
EMAIL SUKHVINDER

- Portfolio concentration and holding structure – most lenders require a minimum number of assets/diversity in the portfolio, and that the assets are aggregated in a holding structure so as to allow a clear and easily accessible security package in an enforcement scenario.

NAV facility rationale

The rationale for using a NAV facility can be wide and varied, and ranging from the specific needs of the fund/sponsor in question relating to the life of the fund and the assets held by the fund to a specific need for liquidity. Examples of NAV facility usage include:

- Injecting liquidity into existing portfolio companies where other financing is not available or is only available on more onerous or expensive terms (which is particularly apparent in the current high interest rate environment).
- To finance add-on acquisitions and follow-ons, particularly near the end of a fund's life, in order to maintain and even enhance both individual asset and overall fund performance.
- To refinance more expensive existing asset-level debt.
- To provide some element of liquidity to a fund's investors in the context of elongated hold periods on high quality assets pending more favourable exit opportunities.
- Where private credit funds as lenders are attracted to the enhanced margins of NAV facilities and insurance companies are increasingly more willing to access the asset class as lenders as these are often term loans with longer tenors which can now be rated.

Summary

The investment fund world has been and continues to navigate considerable headwinds, the causes of which are wide ranging and much discussed. The resulting context is a current scenario of, on the one hand, more difficult and longer fund raising, and on the other, somewhat depressed M&A activity resulting in elongated hold periods on what are in a more "normal" economic environment high quality assets. NAV facilities have therefore come to the fore as a useful tool in dealing with some of these difficulties. The expansion of the pool of willing lenders (by the entry of alternative lenders) has provided not only the impetus for use but also the ability to tailor the offerings to the specific needs of a wider range of borrower funds.

Carey Olsen's expertise

We have advised on numerous NAV financings in the last 12 months, acting for a mix of both sponsors and lenders. This experience has given us an understanding of the requirements and key considerations of both lenders and investment funds/sponsor borrowers and, as such, we are well placed to identify and help deal with any potential issues that may arise in NAV financings at an early stage and ensure the transaction runs smoothly.

The strength of Carey Olsen's investment funds practice (Carey Olsen advise over 81% of the entire Guernsey-domiciled fund market by assets under management and nearly 74% by number of Guernsey-domiciled funds), has provided us with a unique insight into the interrelation between the fund and any financing solutions. We can advise funds at their formation stage on the potential future use of NAV financings and other fund finance solutions.

Along with our experience on advising on NAV financings, we have advised on numerous continuation vehicles for globally recognised fund managers so can provide advice on whichever liquidity solution a fund requires, particularly in end of fund life type scenarios.

Guernsey poised to benefit from new LSE rules to boost growth and innovation

The introduction of new listing rules to boost demand for listing activity in the UK is expected to directly benefit Guernsey as the leading domicile of choice for non-UK companies listing on the London Stock Exchange.

The UK's Financial Conduct Authority ("**FCA**") has announced new rules for listings on the London Stock Exchange ("**LSE**"), which come into effect from 29 July 2024. The new rules are the biggest change to the listing regime in over 30 years and aim to support a wider range of companies to issue their shares on a UK exchange, increasing opportunities for investors.
The key changes involve introducing a simplified listings regime and removing the distinction between "premium" and "standard" listings. Instead, there will be one category for all equity listings, which has been named "commercial companies". The UK Corporate Governance Code will apply to the new commercial companies category.

The new rules[1] remove the need for votes on significant or related party transactions and offer flexibility around enhanced voting rights. Shareholder approval for key events, like reverse takeovers and decisions to take the company's shares off an exchange, is still required.

Other changes:

- Adjustments to the timing and content of disclosures proposed in relation to significant transactions – giving more flexibility on the timing and content of the disclosures that will be required for acquisitions that are significant transactions.
- Allowing institutional investors to hold enhanced voting rights to ensure that they are not disincentivised from supporting pre-IPO funding rounds or bringing companies to listing in the UK.
- Retaining a requirement that companies must be independent from any controlling shareholder but seeking to support this through disclosures and requirements for directors to formally give opinions on any resolutions proposed by a controlling shareholder when a director considers the resolution is intended or appears to be intended to circumvent the proper application of the listing rules.
- Aligning the closed-ended investment funds category more closely with the commercial companies category, while focusing on protections for transactions relating to investment manager fees.

The overhaul of listing rules better aligns the UK's regime with international market standards and aims to reverse a recent decline in UK listings.[2]

Applications for the admission of securities which were submitted to the FCA before 4:00 pm on 11 July 2024 are expected to be treated as "in-flight applicants" and subject to transitional provisions under the relevant UK Listing Rules Instrument.

Guernsey poised to benefit from changes

Guernsey has for some time been the domicile of choice for non-UK companies listing on the Main Market of the LSE or being admitted to AIM. To the extent the listing rule changes boost growth for listing activity in the UK generally, Guernsey is especially poised to benefit from the same.

The table below shows statistics on domicile (top 15) as at 30 June 2024.

Rank	Country of incorporation	No. of LSE listed companies
1	United Kingdom	1309
2	Guernsey	91
3	Jersey	59
4	Ireland	36
5	British Virgin Islands	29
6	Australia	28
7	Bermuda	23
8	Isle of Man	22
9	Canada	19
10	United States	17
11	Cayman Islands	13
12	India	13
13	Egypt	8
14	China	8
15	Cyprus	8

More than half of all companies listed on the LSE's Specialist Fund Segment are Guernsey-incorporated investment funds.

There are several key advantages of using a Guernsey vehicle for a stock exchange listing:

Guernsey is a well-positioned and international offshore financial centre

Guernsey provides top-tier financial services in a well-regulated, robust and stable environment. The island has high-quality service providers, including administrators, registrars, auditors and legal advisors.

Guernsey is located in the same time zone as London and is easily accessible from both the UK and the major European centres.

Flexible corporate law

Guernsey company law offers a number of different corporate vehicles providing a flexible framework that enables capital structures to be tailored to the specific needs of investors. Furthermore, Guernsey company law omits aspects of company laws from other jurisdictions that sponsors and/or investors find problematic or restrictive. For example, financial assistance is allowed (provided that the company is solvent) and a company's ability to pay a dividend or other distribution (which can be paid out of share capital) is dependent on the company's solvency, rather than a need to have sufficient distributable profits.

The regulatory regime

For listed investment funds, Guernsey maintains a proportionate, flexible and competitive funds regulatory regime, adopting a risk-based approach to ensure that appropriate levels of investor protection are maintained, whilst at the same time avoiding unnecessarily complex or burdensome regulation (or granting waivers of certain regulatory requirements where appropriate).

Guernsey's financial services regulator, the Guernsey Financial Services Commission ("**GFSC**") works closely with the funds industry to ensure that the regulatory regime continues to evolve alongside developments in the financial services sector. There is ongoing engagement between the GFSC and industry experts to further the island's interests.

Guernsey's strong NED community

Unlike other jurisdictions, Guernsey has no director residency requirements for Guernsey companies. Fund promoters and trading companies are therefore able to involve Guernsey directors to the extent to which they choose.

Should a Guernsey company require greater involvement of Guernsey based directors, Guernsey's NED community is able to provide the necessary expertise for listed company governance standards and experience in a wide range of asset classes.

Guernsey directors are well versed with the highest standards of governance including the Association of Investment Companies' Code of Corporate Governance as well as the Financial Reporting Council's UK Corporate Governance Code.

The GFSC enjoys a long-standing professional dialogue with local fund industry bodies – including NEDs. This means that local NEDs understand Guernsey's regulatory and economic substance requirements. Separately, the GFSC is an experienced fund regulator and understands the role of NEDs in fund structures. Accordingly, the GFSC regulates the investment sector proportionately with minimal requirements for NEDs to be locally resident.

International cooperation

Guernsey adheres to the highest standards of international tax and regulatory principles and is committed to ensuring that this continues.

Guernsey has given its full support for the transparency principles central to the current G20, OECD and EU tax initiatives and is working as part of the wider international community in the development and effective implementation of internationally agreed standards, including those set by the Financial Action Task Force ("**FATF**") and the Organisation for Economic Co-operation and Development.

Guernsey has been assessed as being amongst the best quality financial centres in the world when measured against the rigorous international standards for tackling money laundering and terrorist financing set by the FATF.

Guernsey also participates fully in numerous international initiatives such as the OECD's base erosion and profit shifting project and developing the global "Common Reporting Standard" and the automatic exchange of information between tax authorities.

Ease of trading in shares/no stamp duty

Shares in Guernsey companies can be traded in uncertificated form through CREST without the need for depositary receipts (required for most non-UK shares in CREST).

Unlike UK equities, shares in Guernsey companies can be traded through CREST without attracting UK stamp tax charges (as long as the company's share register is maintained outside the UK).

Tax neutrality

Guernsey holding companies typically pay income tax at 0% and are not subject to capital gains tax. Generally, collective investment vehicles can also benefit from income tax exemption. Guernsey does not levy withholding tax on dividends and other distributions paid to companies or non-Guernsey resident persons and does not levy withholding tax on interest.

Subject to the UK Takeover Code

Guernsey companies listed in the UK are subject to the UK Takeover Code, so that investors can be assured that they receive the same level of protection that would have been afforded to them if investing in a UK company listed in the UK.

Carey Olsen's capital markets practice

Carey Olsen is the leading offshore law firm for LSE-listed clients advising more than double the number of the next nearest offshore firm.[3] Our LSE-listed clients include investment funds and trading companies.

We advise our clients on structuring, IPOs, convertible and exchangeable bonds issues, private placements, secondary offerings and other rights issues, as well as share buy-backs, scrip dividends, warrants and treasury share programmes and share option/employee benefit schemes and restructurings.

Notable recent listings on which Carey Olsen has advised include Cordiant Digital Infrastructure Limited's £370 million IPO, Taylor Maritime Investments Limited on its US$253 million initial placing, Peel Hunt's £112 million IPO and Castelnau Group Limited's £178 million IPO, as well as the admission to trading of SPACs Fintech Asia Limited and Ikigai Ventures Limited.

We also have extensive experience of advising on public takeovers, whether by way of a general offer or scheme of arrangement. Notable recent transactions include the US$1.61 billion takeover of Hipgnosis Songs Fund Limited (currently awaiting Court approval), the £156 million takeover of Shanta Gold Limited and the £511 million takeover of Industrials REIT Limited.

1 PS24/6: Primary Markets Effectiveness Review: Feedback to CP23/31 and final UK Listing Rules (fca.org.uk)

2 According to the UK Listing Review, the number of listed companies in the UK has fallen by about 40% from a recent peak in 2008. Between 2015 and 2020, the UK accounted for only 5% of IPOs globally.

3 Corporate Advisers Rankings Guide. Published on a quarterly basis, CARG tracks and records details of institutional advisers and their clients listed on the LSE.