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Offshore fund finance in 2020, the year in review

Service area / Banking and Finance

Legal jurisdictions / Bermuda, Cayman Islands, Guernsey, Jersey

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While 2020 has, at the risk of understating it somewhat, brought unexpected events and personal and professional adjustment, our experience offshore is that market participants have, on the whole, continued to show a robust appetite for fund finance products, which have themselves continued to mature and evolve admirably in response to the broader macroeconomic landscape.

Within that more global trend, we set out below some brief thoughts and highlights from each of our respective jurisdictions over the last 12 months.

Bermuda

Bermuda's experience of 2020 has, like most jurisdictions, been shaped by its response to the pandemic (resulting in its sovereign ratings being affirmed by both Moody's and S&P). Bermuda has also continued to bolster its credentials in marine conservation and space exploration with the passing of legislation in February to support a submarine cable protection zone in the Atlantic region and the successful supporting role of Bermuda's NASA tracking station in monitoring the recent historic launch in November of two NASA astronauts into orbit aboard a SpaceX rocket from Florida's Kennedy Space Centre. Aside matters of sea and space, the year concludes with over 2,000 funds administered in Bermuda and the jurisdiction continuing to dominate the global insurance-linked securities (ILS) sector, with capacity set to grow substantially as a consequence of the pandemic. 2020 has also seen growth in the fund finance space in Bermuda, and as Bermuda continues to develop its fund offering we fully expect that trend to continue into 2021 as new players enter the market, particularly in the private equity space.

Bermuda's government continues to collaborate closely with regulators and industry professionals to provide innovative fund products to support the jurisdiction's ability to keep pace with evolving market demand. This year, the following fund-related developments are also of note:

- **Amendments to the Investment Funds Act** – Amendments to Bermuda's Investment Fund Act to bring closed-ended investment funds and overseas investment funds within scope became operative on 1 January 2020. The amendments also introduced a new class of closed-ended investment funds – the Professional Closed Fund. These amendments are intended to provide for the application of enhanced supervisory and regulatory requirements to a wide variety of fund structures to complement Bermuda's economic substance framework and related guidelines applicable to the fund industry.
- **CFATF assessment / OECD "white listing"** – Following the Caribbean Financial Action Task Force's assessment of Bermuda's regulatory regime in January, Bermuda was confirmed as a global leader in combatting money laundering and anti-terrorist financing. Bermuda's place on the European Union's list of fully cooperative tax jurisdictions was also subsequently confirmed at the EU's ECOFIN meeting in February, securing a positive result for both global business and the Government.
- **ISACs** - The Incorporated Segregated Accounts Companies Act 2019 came into force on 15 January 2020 and allows for the formation of ring-fenced individual segregated accounts with separate legal personality and the capacity, powers, rights and privileges of a natural person. Incorporated segregated accounts companies (ISACs) are intended to complement the existing landscape of corporate structures

available in Bermuda. It is expected that ISACs will be of interest and practical application to the asset management, family office, insurance and investment fund sectors, particularly with respect to multi-asset structures. We look forward to seeing how this new corporate offering is received by the global business community including by lenders on fund finance facilities. Lenders should be aware that, similarly to the current segregated account company regime, the new ISAC regime provides that an individual segregated account (ISA) can be wound up without winding-up its overall ISAC or any of the remaining ISAs, thus maintaining the principle of statutory segregation on insolvency, and that liquidators cannot apply the assets and liabilities of an ISA to the liabilities of any other ISA, or to the liabilities of the ISAC's general account unless the terms of the relevant instrument or contract provide so or (in the absence of any such instrument or contract) as the court directs.

- **PE opportunities** – Recent diversification of investment strategies has seen an increased interest from US and European private equity groups to create Bermuda domiciled structures or to invest in existing Bermuda funds and/or insurance opportunities.
- **ESG Considerations** – Bermuda has long been a proponent of sustainable investing. The COVID-19 pandemic has accelerated the growth of new environmental, social and governance (ESG) products and business structures to complement traditional ILS funds that already benefit from ESG-compliant status. Furthermore, the development of funds in the blockchain and digital asset space that integrate ESG factors in their business models may lead to greater opportunities for the use of sustainable financing products. Further information on ESG considerations in Bermuda can be found in the following previous briefings:

  ESG and the global insurance industry: Bermuda as a pathway to encourage sustainable growth

  ESG Investing in Bermuda

Cayman Islands

In addition to the pandemic, a protracted lockdown, and closed borders, 2020 in the Cayman Islands has included a major earthquake (resulting in a sink hole in the airport runway that looked for a time to threaten the annual mass migration of Cayman counsel to the Fund Finance Association's Global Symposium in Miami), a tsunami warning, and a near miss with a category 4 hurricane. Beyond natural disasters however, some points of note include:

- **The Private Funds Law** – As most of the market is doubtless now aware, the Cayman Islands introduced a new regulatory regime for closed-ended investment funds in the first quarter of the year, and subsequently amended that regime in July. More recently, the Cayman Islands Monetary Authority has published a statement of guidance, providing further information on types of structure that may be classified as "non-fund arrangements" and thus fall outside the scope of the regime. In the context of fund finance transactions, and in particular subscription-based facilities, the primary point of note has been the potential impact of non-registration on a fund's (and thus lender's) ability to call and receive capital from investors. While individual lenders have exhibited varied approaches and risk tolerances at the margins, the legal community has collaborated well to quickly develop sensible market practices (often involving a separate covenant and condition precedent around registration) and sponsors, counsel, and lenders alike are now largely familiar with the process and import of the legislation. Further detailed consideration of the regime in this context can be found in our prior briefings:

  The Cayman Islands Private Funds Law: a practical guide for fund finance lenders

  Amendment to Cayman Islands Private Funds Law and fund finance considerations
- **"White listing" of the Cayman Islands** – As a result of a minor delay in the enactment of the Private Funds Law, the Cayman Islands was unexpectedly and briefly added to the European Union's list of non-cooperative jurisdictions for tax purposes in February. Following extensive efforts by the Cayman Islands authorities and service providers in the jurisdiction, tens of thousands of entities have now been registered under the legislation in a very brief period and, as anticipated, the European Union reversed its decision at the next meeting of the European Council, confirming the jurisdiction's adherence to global transparency and regulatory standards.
- **Perfection and notices** – We see a continued increase in the focus lenders are placing on the specific manner in which funds propose to notify investors of capital call security (for example in relation to investor portals) and certain other benefits that notices can afford if properly delivered (including in relation to set off and the "Abraaj" type risk of commitments being released or waived without lender consent). More details on this small but potentially vital point for lenders can be found in the following previous briefings:

  Fund finance and releases of investor commitments in Cayman: How can lenders protect themselves?

  Capital Call Security Perfection in the Cayman Islands – Who, How, What, When and Why

  LP notices: self-isolation, defaults and capital call security in the Cayman Islands

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Guernsey

As an island, Guernsey has fared relatively well during the pandemic. As a result of imposing an early protracted lockdown and continuing self-isolation requirements for those coming in through its borders, Guernsey has managed to virtually eradicate the presence of the virus. This has meant that life has, post-lockdown, returned to relative normality. Guernsey's financial services industry has proven to be the solid foundation on which the relatively recent history of Guernsey has been built and continues to support the jurisdiction's economic response to the global pandemic. Financial services business and indeed the fund finance sector has continued apace both during and post-lockdown. Subscription line facilities have become part of the early conversation when structuring new funds. As a result, with longstanding sponsors continuing to raise next generation funds and with renewed interest from first time sponsors, the fund finance subset of Guernsey's financial services offering has seen a definite uptick in activity. Add to this the raft of renewals and refinancing in the space and it is fair to say that Guernsey is a hive of activity. The same can be said for industry's response to the ever-changing landscape with the following of note more recently:

- **Limited partnerships migrate to Guernsey** - Guernsey has long provided a simple migration and re-domiciliation regime for companies into Guernsey. This regime was extended in July to allow non-Guernsey registered limited partnerships to move their seat of registration to Guernsey. This is in response to a surge in interest in non-Guernsey funds and their managers moving to Guernsey to benefit from a number of advantages to using Guernsey including clearer economic substance rules. Importantly, the migration in or out of Guernsey will not, as a matter of Guernsey law, create a new limited partnership; the partnership is deemed to continue on its registration in Guernsey and de-registration in the jurisdiction of origin (or vice versa, as the case may be). For further information, please read our previous briefings:

  Guernsey's new fast track application regime for managers of overseas funds

  Guernsey introduces statutory migration regime for limited partnerships
- **Green funds and finance** - We are now seeing oversubscriptions for Guernsey's regulated green funds. Seven such green funds have now been registered with a combined total net asset value of more than £3.3 billion as at the end of the March 2020 with more funds in the pipeline. Carey Olsen Guernsey supported six of these funds with the latest being True North's forestry fund. To keep up this momentum, Guernsey's Green Fund rules will be incorporating the European Union's green taxonomy. This momentum, in the context of wider global interest in ESG initiatives generally, opens the door for new lines of fund finance business for lenders and we have already seen interest in specific ESG supportive facilities being offered.
- **Investor notifications on assignment** – As an already key element in subscription line facilities (where the main security is the ability to call investors' monies in the event of a default) and as a consequence of the "Abraaj" case, a lot of focus in executing fund facilities is placed on the sending of investor notices and confirming the ability to "get" monies from investors should a default occur. While on the whole a sense of pragmatism prevails in agreeing what is acceptable to both lender and borrower on the notification side, "Abraaj" has introduced certain additions to lender requirements, the key one of which is confirmation from headline investors that their commitment is callable. For the UK/European fund finance market this is fairly new and as yet not an entrenched element, but rather is beginning to creep in, particularly where there is a US/Canadian element to the structure.
- **Funds, tax and economic substance** - Guernsey's Revenue Service updated the economic substance legislation to bring "self-managed" funds into the scope of substance requirements with effect from 1 October 2020. These include requirements as to location and frequency of board meetings, location of "core income generating activities" and adequate personnel, premises and expenses. Guernsey funds are required to appoint a Guernsey-based fund administrator, and this administrator can help with satisfying these requirements. More details on this point can be found at:

  Guernsey to update economic substance legislation
- **Revision of financial services laws** - The Guernsey Financial Services Commission (GFSC) has proposed legislation revising the main investment, banking and fiduciary supervisory and enforcement laws. The legislation is in the process of being approved by all of the islands in the Bailiwick of Guernsey and is expected to be enacted in early 2021. Most of the changes simply streamline the operations of the GFSC. Other amendments will alter the way, for example, certain supervised role holders of licensees will notify and await the GFSC's no objection before their appointment. Additionally, a separate and more stringent enforcement law has been proposed. Information gathering powers and sanctions have been expanded in line with international guidelines and will apply to certain non-licensees. We expect more guidance and rules on the application of these revised laws over the next six months.

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Jersey

Like most jurisdictions, the pandemic, and our response to the pandemic, has been a major focus in Jersey in 2020. Our finance team has been involved in a wide range of instructions relating to the pandemic response, including advising on government loans to support the airline industry, advising the States of Jersey on their fundraising to support pandemic-related initiatives, and writing the Jersey coronavirus business disruption loan guarantee scheme to support local businesses through the pandemic. Alongside our finance work, our investment funds practice remains strong and Carey Olsen continues to advise more Jersey-domiciled funds than any other offshore law firm. In 2021, the Jersey finance industry's 60th year, Jersey will look beyond the pandemic towards becoming a centre of excellence for sustainable finance. From a funds and fund finance perspective, 2020 has seen the following developments:

- **Jersey fund vehicles** – Jersey has introduced an easy to use statutory regime to allow non-Jersey limited partnerships to migrate to Jersey. The Jersey Private Fund remains the vehicle of choice as a fund product and has successfully been used for a variety of different purposes ranging from mega funds such as SoftBank Vision Fund but also smaller, private investment structures. Jersey offers a variety of fund vehicle options, including companies, cell companies (incorporated or protected cell), limited partnerships (regular, separate and incorporated), limited liability partnerships, unit trusts and the forthcoming limited liability companies (LLCs). For further details on the statutory migration regime for limited partnerships, please read the following briefing:

  Jersey introduces statutory migration regime for limited partnerships into Jersey

- **Fund manager relocation** – Jersey is an increasingly popular choice for fund managers who wish to either relocate key principals or otherwise establish a physical presence to benefit from tax neutrality and certainty, and from political stability. The island also offers highly developed infrastructure, a familiar legal system and an established and internationally recognised regulatory framework. More details on this can be found in the following briefing:

  Jersey fund manager relocation

- **US managers** – we have experienced a sharp increase in US managers seeking access to European Union/European Economic Area capital through the use of Jersey vehicles. This trend is also evidenced by assets under management for funds incorporated in Jersey with US managers/promoters having more than doubled from 2015-2019, as reported by the Monterey Jersey Fund Report 2019. Throughout 2020, we have advised various US managers using Jersey vehicles, often as a Jersey Private Fund and with a Delaware LLC as the general partner (GP) for co-investment purposes. More information can be found in the following briefing:

  Jersey market update: The increasing use of Jersey vehicles by US managers

- **Co-investment facilities** – There has been notable growth throughout the year in the number of co-investment facilities being made available as new and existing lenders seek to develop or strengthen relationships with fund sponsors and individual high net worth borrowers by providing liquidity options that enable sponsors and their key employees to leverage their own investments in a fund.

- **Investor notices** - Over the last year, most lenders have required that all investors are notified of the grant of capital call security notwithstanding that such notification is not required for perfection or priority purposes under Jersey law. There are a number of benefits to such notification, one being that investors are aware that the GP has covenanted not to cancel the investors' uncalled commitments without the consent of the lenders.

- **ESG - Updates** - ESG announcements are now daily occurrences. The debate about combatting climate change has now clearly shifted within the finance community from "why?" to "how?". It is not just about climate change however, as ESG covers a broad range of issues, from how to help manage environmental degradation, education, health, diversity and inclusion matters to governance aspects such as the operational and regulatory framework of businesses. Undeniably, ESG considerations are becoming the norm.

- **ESG - Financing** - We have seen evidence of heightened interest in ESG considerations from fund managers and, as a result, an increase in ESG linked facilities. We anticipate that there will be a move to more rigorous reporting standards in line with the EU taxonomy, the UK taxonomy (in due course) and local law requirements as these develop, and with this, a change of prominence of ESG requirements in fund documents. We anticipate that increasingly ESG provisions will be built into the fund's constitutive documents, rather than being left to side letters. ESG risks are rapidly becoming credit risks in their own right. There is still much work to be done to align ESG KPIs and the monitoring of such KPIs across different funds and lenders, but hopefully the taxonomies should help to harmonise these

- **ESG - JFSC consultation** - In order to maintain its high regulatory standards, and stand out as a jurisdiction of choice for ESG input, the Jersey Financial Services Commission (JFSC) is currently consulting with stakeholders in the financial services industry on proposals to enhance disclosure and governance requirements for sustainable investments. The JFSC have set out proposals which would require funds with ESG investments to:

  a. issue a public statement (such as a prospectus) in respect of their sustainable investments;

  b. implement relevant investment management processes to (i) verify and document the ESG credentials of the investment in the due diligence process by way of recognised taxonomy and; (ii) undertake an annual review to ensure the continued ESG credentials of the investment; and

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c. adopt appropriate corporate governance and organisational structure to implement and monitor the investment management process, including access to resources with appropriate skills and experience and putting in place appropriate reporting lines.

The scope of these requirements would potentially affect: (i) Private Funds, CIFs and unregulated funds; (ii) foreign funds with Jersey service providers; and (iii) persons registered to carry on investment business under the Financial Services (Jersey) Law 1998 and in each case which invest or advise on funds with ESG investment strategies. The JFSC have emphasised that the scope of the changes will apply only when a fund is specifically marketing or holding itself out to have environmental, sustainable, or socially responsible investments. The feedback for the consultation process concluded on 30 September 2020 and feedback is due to be published by the end of the year.

- **ESG - Carey Olsen** - Robin Smith (banking and finance partner in the Jersey office) moderated an ESG themed panel, "Regulating for a Better Future", at the Fund Finance Association's Virtual Global Symposium this November and Carey Olsen is currently working closely with Andrew Mitchell (a panelist from Equilibrium Futures / Global Canopy). Andrew is engaged as a consultant with Jersey Finance to help drive the development of Jersey as a centre of excellence for sustainable finance.

Asia Pacific

The vast majority of Asia-focused private equity fund vehicles continue to be Cayman Islands exempted limited partnerships.

While regional private equity fundraising in 2020 may have been lower than previous record highs, there is evidence that larger funds with established reputations and a strong track record have nonetheless been successful. Correspondingly, this has resulted in demand for a number of significant new subscription facilities.

In addition, macroeconomic uncertainties have resulted in GPs deciding to take pre-emptive steps to extend existing subscription facilities. We have also seen continued usage of management and GP working capital facilities.

We have received an uptick in enquiries relating to net asset value and hybrid facilities and, while still relatively rare in Asia, it will be interesting to see if these products receive more attention as new lenders enter the market and existing institutional lenders may seek to diversify their loan books.

If Asia Pacific markets can swiftly rebound from the coronavirus, there is every opportunity for strong continued growth in regional private market fundraising, investment and financing activity.

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