
BRICKFIELD
FUND FINANCE
RECRUITMENT
The working guide
to fund finance –
Guernsey and Jersey
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The Channel Islands host two of the world's major international finance centres, Guernsey and Jersey, which are less than 30 miles apart. Each Island's successful combination of stability and reliability combined with tax neutrality for fund structures has kept them at the forefront of global finance for almost half a century. During this time both Guernsey and Jersey have gained a strong reputations as prime locations in which to establish investment funds.

There is healthy competition between these neighbouring jurisdictions, and this has driven the development of highly skilled financial service workforces in order to provide an unparalleled welcome to businesses and investors alike, and ensure ease of access to the major UK investor market.

Fund structure

Funds in Jersey and Guernsey follow similar forms and can be established as a partnership, a unit trust or a company.

In both Jersey and Guernsey, the most popular fund structure is the limited partnership model – being a limited partnership with corporate general partner (GP), often with an interposed general partner limited partner (GPLP) between the corporate GP and the fund limited partnership. In each jurisdiction, it is clear that a debt or obligation incurred by a general partner in the conduct of the activities of a limited partnership is a debt or obligation of a limited partnership.

Both jurisdictions also provide for cell companies (which allows for the creation of cells in which assets and liabilities are statutorily segregated and in the case of incorporated cells, are treated as separate legal persons).

To this basic framework any number of entities, from a variety of jurisdictions, can be added including: (i) fund asset-holding vehicles; (ii) carried interest and fee-sharing vehicles/structures; (iii) feeder funds; (iv) parallel funds; and (v) co-investment and other managed entity arrangements, each of which may guarantee and cross-collateralise lending (subject to and depending on any restrictions in the constitutive documents).

Often structures include feeder vehicles through which certain classes of investors aggregate their commitments into the main fund. Those feeder investors, for a variety of reasons (such as investor tax status or ERISA considerations for US investors), are not able to invest in the main fund directly.

There are a number of ways in which collective investment funds may be regulated in Guernsey and Jersey depending on the sophistication and size of the investor pool (which allows for lighter touch, notification-only establishment in some circumstances); however, the manner of regulation very rarely would impact the ability of a fund vehicle to either borrow or grant security over assets. Lenders will be concerned to ensure adherence to conditions attached to any regulation and therefore a review of regulatory consents would always form part of our local legal due diligence.

Both jurisdictions have recently seen the introduction of the limited liability company (LLC) (with a few legislative steps to be concluded in Guernsey). The advent of the Jersey/ Guernsey LLC was driven with US investors (and managers) in mind, who are well-versed in those vehicles. These LLCs have separate legal personality and can be registered as a body corporate. They have flexible governance and management structures, and we expect to see their use as fund vehicles increasing.

Usually, local counsel are instructed after the term sheet has been settled, although there are instances where we are asked for input earlier, particularly if there is an unusual fund structure or security package proposed. The first task when presented with an agreed term sheet is usually to check that the local entities and security package are correctly set out and commence due diligence so that any necessary local adjustments can be picked up early.

Due diligence

The type of fund structure, as well as the type of financing arrangement, will affect the due diligence to be completed. Due diligence documentation requests are often best sent direct to the local fund administrator, who will be in the best position to provide these documents. There is a limited amount held on public files in respect of certain entities so public searches, although important, will not reveal the majority of the required documents.

Where the fund is domiciled in Jersey or Guernsey, local counsel will review the fund establishment/constitutional documents and will usually conduct the review described elsewhere in this guide (in conjunction with the lead lawyers). Similarly, we would also review side letters and subscription agreements through a Jersey or Guernsey lens broadly as set out in the main section of this guide. Any side letters or subscription agreements would be written under the same law as the constitutive document (i.e. Guernsey or Jersey law); however, as many of the issues arising are commercial, it is usually a task shared between lead and local counsels.

- Partnership DD - Where a partnership is the fund vehicle of choice, our review will follow the process set out in the guide, and we will need to be aware of each of the points flagged. However, we will also look out for (amongst other points):
  - scenarios where a Jersey or Guernsey partnership acts by a non-Jersey/Guernsey GP (if required for economic or administrative reasons) as this will impact the opinions, etc. that we can give; and
  - the expiry of the investment period of a fund occurring during the life of the facility, which we are seeing more frequently. In these cases, and where an extension to the life of the fund is not contemplated, we will specifically need to consider whether drawdowns from investors can be made following expiry of that fund term.
- Company DD - Where a Jersey or Guernsey company is used, we must review the manner in which calls are made

from investors. We often see that the articles of association or, in Guernsey, articles of incorporation provide that shares must be allotted when calls are made from investors. In this case we would recommend that amendments are made so that allotment of shares is not a fixed requirement and instead the commitment to fund is made independently of share issuance so that calls are simply made pro rata to investors' percentage interests at the relevant time. This does not preclude a separate contractual obligation to issue shares; however, the funding should not be conditional on such an issuance. This is because there are certain scenarios where an allotment of shares might not be easily possible or desirable. For example, in the case of bankruptcy, there may be additional steps required in order to allot the shares.

- Unit Trust DD – The unit trust instrument is usually drafted with similar language to a limited partnership agreement, and the due diligence exercise would be similar. A trustee's liability is generally limited to the assets that it holds on trust.

Borrowing power and the power to grant security are clearly key points to check. For clarity, it is preferable to see specific provisions in the case of a limited partnership agreement or unit trust instrument, although a well-drafted general power may be sufficient. Companies would have unlimited corporate capacity in any event.

More generally, the review of the limited partnership agreement or other constitutional document will consider set-off provisions and consider whether investors have the right to set off amounts owed to them by the limited partnership or the general partner, particularly against amounts owed by them on a capital call. Jersey law and Guernsey law are clear that provisions of this type are enforceable in accordance with their terms both prior to and after the onset of insolvency. We would expect the facility agreement to include a provision that no right of set-off be exercised, so that the value of the capital commitments is preserved. Security notices should be drafted so as to ensure that the investors are aware of this restriction.

If Jersey or Guernsey lawyers are consulted early in the process, we can assist with the drafting of the relevant constitutive document to cater for specific concerns including the above.

Although it is possible to address some concerns in the finance documents and in a notice to investors, restrictions on calling capital or that affect lender enforcement action following a default can prove challenging. Please see further detail in the following section of this chapter.

Facility agreement

From a Jersey or Guernsey perspective, as with other jurisdictions, there are particular items that usually affect the drafting of the facility agreement, and additional specific language may be required.

Advisers will need to ensure that:

- the parties reflect the constitution (including any delegated agency, trustee or manager authority) of the local entities that are parties (usually as borrowers or guarantors);
- representations, warranties, undertakings and events of default are drafted with the entity type and local law in mind (for example, representations, undertakings or events of default in relation to bankruptcy processes or local regulatory requirements);
- local security requirements are properly defined; and
- any specific items arising as a result of the due diligence exercise.

Where a right of set-off is included in the limited partnership agreement (or other constitutive document), advisers should seek to include a covenant in the facility agreement that such right would not be exercised by the general partner (or relevant party, e.g. the manager).

Where feeder funds are used there may be a greater degree of risk to a lender, as the lender will be a further step removed from the ultimate investors and source of funds for repayment of borrowings, and will need to rely on a chain of drawdowns (both at the master fund level and subsequently at the feeder fund level) in order for capital commitments to be paid down into the master fund borrower. To mitigate this risk, we would recommend that where possible the feeder vehicle is joined as a party to the finance documents (although this is not always permitted under the relevant constitutional documents).

As set out in the main section of this guide, the typical security package for each main type of fund finance facility is as follows:

- **Subscription line facilities:** (i) security over capital call rights; and (ii) security over the bank account into which capital call proceeds are paid in to;
- **NAV facilities:** (i) security over the fund's ownership interests in portfolio holding company vehicles; and (ii) security over the bank account into which investment proceeds are paid in to; and
- **GP/manager facilities:** one or more of: (i) security over the general partner's priority profit share to be paid by the fund to the general partner; (ii) security over the bank account into which such priority profit share is paid; and (iii) security over any regular fees paid or payable to the GP or manager.

We have highlighted some key features of each type of security and how this is taken pursuant to Jersey and Guernsey law below.

Jersey

Security in Jersey is taken pursuant to the Security Interests (Jersey) Law 2012 (SIL 2012).

Perfection requirements vary depending on the type of collateral which is being secured. However, SIL 2012 introduced a public security interests register (SIR), and registration on this register, in most cases, will perfect security over any Jersey situs collateral.

Capital call security, priority profit share/ management fees security (subscription line and GP facilities)

Security is granted over the right to call for capital from investors under the relevant establishment or constitutive document.

In order to create security, the grantor (GP in the case of a limited partnership) enters into a security agreement attaching the security interest to the collateral. Such security interest is perfected by the registration of a financing statement in respect of the secured collateral on SIR in favour of the secured party.

When reviewing the constitutional/establishment documents we will check for any delegated capital call rights to a manager or any other party. If so, then that manager (or other party) should grant security over those delegated capital call rights (in addition to the GP).

Also mentioned elsewhere in the guide, cascading security and notices to investors are familiar issues that we encounter regularly in the Channel Islands.

Where security cannot be granted directly in favour of the secured party, e.g. if the constitutional documents of a vehicle (usually a feeder vehicle) contain limitations as to borrowing or guaranteeing, preventing such entity from providing direct security, then the lender may take cascading security in Jersey as an alternative with an appropriate power of attorney and step-in rights being included in the security agreement.

Investor notices are not necessary under Jersey law for the purposes of perfection or priority; however, the market position is that investor notices are required as a condition precedent where capital call security is to be granted. The notice enhances lender protections and may also provide practical advantages in the event of enforcement of the security. The requirement is usually that the notice is given at the time of the creation of the security or within one to three days.

Other than in the case of significant single investor exposure, we would not expect to include a requirement for acknowledgements from investors.

In the case of a GP facility where security is granted over priority profit share, management fees or carry, it will be granted in a similar manner; however, key considerations will be as to whether there are any transfer restrictions in the LPA or relevant management agreement that restrict the ability of the general partner or manager to grant such security.

Bank account security (subscription line, NAV and GP facilities)

Attachment and perfection of this type of security is achieved by: (i) the secured party having "control" of the collateral; and/ or (ii) registration of a financing statement on the Jersey SIR. The secured party can achieve control of an account in several different ways; however, most commonly this will be achieved by the account bank agreeing in writing to comply with the instructions of the secured party or if the security agent is the same entity as the account bank (in which case that constitutes control).

If the account bank is different, a notice and acknowledgement will need to be agreed with the account bank in advance of the grant of the security. Jersey account banks often have their own form of notice and acknowledgement.

It is also necessary to review the account mandate and terms and conditions relating to the secured account to ensure that the bank account is in the name of the correct entity (often managers operate accounts on behalf of the general partner) and there are no prohibitions or restrictions on the creation of the security.

Interests in portfolio holding company vehicles security (NAV facilities)

Security will be granted over the borrower's ownership interests in Jersey portfolio holding entities. This is typically partnership interests in a Jersey partnership or shares in a Jersey company, but could be units in a Jersey property unit trust.

Attachment and perfection (which is necessary for the purposes of priority) is achieved by entering into a security agreement and:

1. Where those portfolio company interests are shares in a Jersey company or units in a Jersey unit trust:
   - the secured party having continued possession of the original share/unit certificates; and
   - by registration of a financing statement on the Jersey SIR in favour of the secured party in respect of the secured collateral.
2. Where those portfolio company interests are partnership interests in a Jersey limited partnership by registration of a financing statement on the Jersey SIR in favour of the secured party in respect of the secured collateral.

Guernsey

Security in Guernsey is taken pursuant to the Security Interests (Guernsey) Law, 1993 (the SIL 1993).

Other than in respect of certain specific types of assets such as real estate and aircraft, which are not relevant here, there is no requirement for security over Guernsey situs collateral or security granted by a Guernsey entity to be registered on a public register.

Priority between security interests in the same collateral is determined by the order of creation of those security interests.

Capital call security, priority profit share/ management fees security (subscription line and GP facilities)

Security is granted over the right to call for capital from investors under the relevant establishment or constitutive document.

Security is created by way of assignment of the relevant rights pursuant to a security interest agreement, which must: (1) be in writing; (2) be dated; (3) identify and be signed by the security provider; (4) identify the secured party; (5) precisely identify the collateral; (6) specify the events of default; and (7) identify the secured obligations.

The security is typically granted by the entity with the right to call for capital and the entity to which commitments are made, so in the case of a limited partnership, both the GP and the limited partnership.

When reviewing the constitutional/establishment documents we will check for any delegated capital call rights to a manager or any other party. If so, then that manager (or other party) should grant security over those delegated capital call rights (in addition to the general partner).

A notice of assignment must be given to the investors in order to create the security, and there is market consensus that such notices can be delivered by email or by way of an investor portal at the time of, or shortly after, entry into the security interest agreement, but in any event prior to utilisation, with negotiations usually focused on the evidence to be provided of delivery of such notices.

Other than in the case of significant single investor exposure, we would not expect to include a requirement for acknowledgements from investors. However, the SIL 1993 provides for investors to specify an address within Guernsey at which notice of security can be validly given for the purposes of the SIL 1993. This allows investors to specify in the constitutive or subscription documents that notice of capital call security can be served on them at the address of the fund's administrator in Guernsey. This flexibility in the SIL 1993 allows notice to be validly served on the fund's administrator and for the fund's administrator to provide acknowledgment of the notice of security on behalf of the investors, albeit that lenders will typically want comfort that the notice has in fact been sent to investors as well.

Where security cannot be granted directly in favour of the secured party, e.g. if the constitutional documents of a vehicle (usually a feeder vehicle) contain limitations as to borrowing or guaranteeing, preventing such entity from providing direct security, then the lender may take cascading security in Guernsey as an alternative with an appropriate power of attorney and step-in rights being included in the security agreement.

As noted above, there is no requirement to register security in Guernsey and no separate perfection steps to establish priority.

In the case of a GP facility where security is granted over priority profit share, management fees or carry, it will be granted in a similar manner; however, key considerations will be as to whether there are any transfer restrictions in the LPA or relevant management agreement that restrict the ability of the general partner or manager to grant such security.

Bank account security (subscription line, NAV and GP facilities)

Security over accounts is created pursuant to a security interest agreement, which either:

- assigns the rights to the bank account to the secured party; or
- grants control of the account to the bank in circumstances where the account bank and the secured party are the same person.

Assignment of the rights to the account is the most common approach, and, in this case, notice of assignment must be given to the account bank. The majority of account banks in Guernsey have their own forms of notice and acknowledgment, which should be agreed with the account bank in advance of the grant of the security.

It is also necessary to review the account mandate and terms and conditions relating to the secured account to ensure that the bank account is in the name of the correct entity (often managers operate accounts on behalf of the general partner) and there are no prohibitions or restrictions on the creation of the security.

Interests in portfolio holding company vehicles' security (NAV facilities)

Security over ownership interests in Guernsey portfolio holding entities will vary depending upon the type of holding entity. The ownership interests are typically partnership interests in a Guernsey limited partnership or shares in a Guernsey company, but could be units in a Guernsey property unit trust.

Security over ownership interests in Guernsey portfolio holding entities is created pursuant to a security interest agreement, which:

- where the ownership interests are certificated, provides for the secured party to have possession of the original certificates of title (i.e. the share/unit certificates) relating to the ownership interests in the relevant Guernsey portfolio holding entity; and/or
- assigns title to the ownership interests (i.e. the shares, units or limited partnership interests) to the secured party.

Where the ownership interests are certificated, for example shares in a Guernsey company, it is usual for the secured party to take security by way of both methods but with title by way of assignment not being completed (by registration in the company's register of members or the limited partnerships register of partners) until the occurrence of an event of default.

Where security is created by assignment of title to the ownership interests, a notice of assignment must be given to the underlying portfolio holding entity and it is usual for an acknowledgement to be provided by the portfolio holding entity.

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