COLLAS CRILL

Liquidity options for fund managers

MAY 2020

COVID-19 has caused significant social and economic disruption across the globe. This has created some significant challenges for the investment fund industry, and as the crisis unfolds fund managers may need to consider their options for managing liquidity in the funds they manage.

We have set out some of the tools that may be at the disposal of fund managers during this challenging period, along with some of the Jersey law considerations that they may need to consider.

Some practical points

There are a number of practical points that managers will need to consider whilst seeking to manage the liquidity of their fund vehicles:

- Even during times of crisis, a manager is constrained by the powers that are granted to them under the terms of the fund documents, and they will generally not be able to take any actions that are not expressly permitted under those documents.
- Both the Jersey Private Fund Guide (**JPF Guide**) and the Jersey Code of Practice for Certified Funds (**CIF Codes**) expressly require that all investors are treated fairly. This is particularly relevant during a time of market stress, and managers are under a duty to ensure that no investor is given an unfair advantage.
- We would suggest engaging in a dialogue with key investors as part of the fund's strategy to manage liquidity, particularly where the fund has cornerstone investors or a limited partner advisory committee (LPAC) who will need to be on board with potential changes to the constitution of the fund. Care should be taken, however, to avoid any preferential disclosures being made.
- The fund will need to continue to comply with its investment policy and any investment and borrowing restrictions set out in the fund's constitutive documents.
- General principles of good corporate governance will continue to apply. When market pressures require decisions to be taken quickly there may a temptation to dispense with the usual decision-making process, but where difficult decisions about the management of the fund are being made it is more important than ever that board meetings of the fund and the manager are held to formally approve decisions being taken and that approval should be properly documented, supported by appropriate legal, financial and other specialist advice where relevant. Our briefing and detailed Q&A on taking board and shareholder decisions virtually, including signing electronically, can be read here.
- If the general partner or manager is subject to the Jersey economic substance law, or board meetings are required to be held in Jersey for other tax or regulatory reasons, then the relevant requirements will need

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to be considered in conjunction with certain temporary relaxations that may be available. Our briefing on the economic substance law position can be found here.

- Where appropriate, it may be necessary to notify or procure consent from lenders, investors and the Jersey Financial Services Commission (**JFSC**) before they are implemented.

Making distributions *in specie*

Where a fund's liquidity is under strain managers may wish to make a distribution *in specie*, i.e. they may wish to distribute the assets of the fund directly to investors, rather than selling them and distributing the proceeds. As noted above, managers will need to be mindful of whether the fund's constitutive documents allow them to do this, and whether making such a distribution would be fair to all investors.

There are some additional considerations when making a distribution to investors (whether or not it is a distribution *in specie*) under Jersey law. If the fund is a company, the Companies (Jersey) Law 1991 requires the directors of a Jersey company making a distribution to pass a statutory solvency statement confirming that the company is able to pay its debts as they fall due for a period of 12 months following the date the distribution is proposed to be made, or until the company is dissolved, whichever first occurs. *In specie* distributions typically need to be approved by a shareholders' ordinary resolution even if they are envisaged in the company's constitutional documents, and if *in specie* distributions are not expressly permitted, then a special resolution will usually need to be passed to authorise the distribution.

If the fund is a limited partnership, the Limited Partnerships (Jersey) Law 1994 (the **LP Law**) only allows distributions to be made to limited partners where the limited partnership is solvent. For the purposes of the LP Law, a limited partnership is solvent while the general partner is able to discharge the debts and obligations of the limited partnership (excluding liabilities to partners in respect of their partnership interests) as they fall due out of the assets of the limited partnership without recourse to the separate assets of the general partner. If a distribution is made while the partnership is insolvent, then there is a statutory clawback mechanism in the LP Law where a limited partner may need to repay the distribution for a period of six months from the date of the distribution. There may be additional clawback mechanism within the limited partnership agreement.

Options under the fund terms

It may be helpful for the overall term of the fund, or the investment period, to be extended. A fund's constitutional documents will often contain provisions to allow for a limited extension of its term or investment period, either by the fund's manager or general partner acting unilaterally or, more commonly, with investor consent. Alternatively, fund documents can generally be amended to extend the life of the fund with investor consent.

We would also suggest reviewing the terms of the fund closely to determine what flexibility a manager may have in managing the fund. For example, the fund documents may contain recycling provisions that allow the fund to reinvest capital received from its assets.

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Fund financing

If the fund is not yet fully drawn down, the fund may be able to procure a subscription line facility, where a lender will take security over the general partner's right to make drawdown requests to the fund's investors. If the fund is fully drawn down, then the fund may be able to borrow based on the net asset value of its assets, known as a NAV Financing. Such a financing may be required to assist the fund's portfolio companies, or provide liquidity to investors, but whether the fund is able to borrow in this way will depend on the fund's constitutional documents. If such a financing is not envisaged in the fund's documents, then investor consent may be required, or it may be that financing is permitted for 'follow-on investments' which may fit with the fund's requirements.

The type of financing and the point at which the lending is made in the life cycle of the fund will determine the asset(s) over which a lender may take security. A lender of a subscription line facility may take security over the right to call funds from investors as well as security over the fund's bank accounts whereas if the fund is fully drawn, there is unlikely to be commercial value to the lender in taking security over that right to call. Both types of assets are likely to be Jersey law assets and would be secured in favour of the lender by way of a Jersey law-governed security interest agreement with the security registered on the Jersey Security Interests Register.

EU Alternative Investment Fund Managers Directive (AIFMD)

If a fund is an alternative investment fund (AIF) that has marketed into the EU/EEA under the AIFMD, then any borrowing at the level of the fund may impact on whether the fund manager/alternative investment fund manager (AIFM) is 'sub-threshold' for the purposes of the EU AIFMD and Alternative Investment Funds (Jersey) Regulations 2012, and the level of borrowing should be closely monitored.

Under Jersey's AIFMD regime a 'sub-threshold' AIFM is subject to lighter-touch regulatory oversight, reporting and disclosure requirements. To qualify as a sub-threshold AIFM a manager must manage leveraged assets valued at less than €100 million, or manage unleveraged and closed-ended assets valued at less than €500 million. If a Jersey AIFM moves above the relevant threshold (for example, it manages a previously unleveraged fund with more than €100 million of assets, which then takes on leverage), then the Jersey AIFM may need to make an application to the JFSC to be registered for 'AIF services business' under the Financial Services (Jersey) Law 1998.

Sale of assets/investor interests

The fund may be able to sell certain of its assets to another fund manager, or particular assets to a trade buyer to generate liquidity. Where a fund chooses to sell its assets it will need to be mindful of any requirements or restrictions contained in the fund's constitutive documents.

Alternatively, if an individual investor in the fund wishes to generate liquidity it may choose to sell its interest to another investor in the fund, or to a third party. This is a scenario that is often contemplated by fund

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documents. For closed-ended funds the consent of the fund or general partner is generally required to allow an investor to exit the fund before the end of the fund's term and (where applicable) to admit new investors to the fund. When granting consent for the transfer of interests in a fund, the fund or general partner should be mindful of any regulatory and/or tax impact the transfer may have on the fund, and the proposed new investor will need to meet the relevant requirements in for example the Jersey Private Fund Guide or Jersey Expert Fund Guide.

General partner-led restructurings

An increasingly popular option for closed ended funds is to enter into a restructuring process which is led by the fund's manager or general partner. These are often complex transactions with highly bespoke terms, but broadly the fund's assets are sold to a new 'fund vehicle' (which will generally be constituted on different fund terms to the original fund) with investors given the opportunity to either 'roll' their interest into the new fund, or to redeem the value of their investment. This allows certain investors to exit the fund if they wish, while allowing others to retain, or even increase, their investment.

This process can be useful at the end of a fund's planned life where a manager believes there is significant unrealised value in its portfolio, but that market conditions are not right to dispose of the assets at the end of the fund's term, or where some investors wish to exit the fund while others wish to retain their investment.

Sale of a stake in a General Partner

Where an investment manager wishes to raise capital by selling a stake in a Jersey general partner or manager (the **General Partner**) of an investment fund there are a number of potential issues that will need to be considered. Notably:

- any sale must comply with the General Partner's constitutional documents, including, if applicable, any shareholder agreement;
- financing documents may require lender's approval ahead of the sale of any interest in the General Partner;
- the fund's limited partnership agreement may require investor consent prior to the transfer of an interest in the General Partner;
- where the General Partner is a regulated entity and the ownership percentage of any incoming or outgoing beneficial owner passes certain thresholds, prior consent from the JFSC may be required;
- if the investor will appoint a director to the board of the General Partner, then if the General Partner is regulated, prior JFSC consent will be required;
- where the fund is a Jersey Private Fund, changes to the beneficial ownership may need to be notified to the JFSC through a Notice of Change filing or as part of the annual return submitted by the Designated Service Provider; and
- agreements with service providers to the fund, for example its Designated Service Provider or custodian, may contain change of control provisions which would allow them to terminate their appointment following

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a change in the beneficial ownership of the General Partner.

Where an investor in the fund becomes insolvent

The JPF Guide, Expert Fund Guide and CIF Codes state that, in the absence of an express provision in the fund's constitutive documents, where the transfer of an interest in a fund is made to a personal representative or trustee as a result of the death or bankruptcy of the original holder, the personal representative or trustee will be deemed to meet the requirements to be an investor in the fund, i.e. they will be deemed to be an eligible investor for the purposes of the JPF Guide or an Expert Investor for the purposes of the Expert Fund Guide.

Where a fund is the subject of insolvency proceedings

Where an application is made by any person for the commencement of any insolvency proceedings, appointment of any receiver, administrator or provisional liquidator under the law of any country in respect of the fund or any of its subsidiaries, a notification must be made to the JFSC under the JPF Guide or Expert Fund Guide, as applicable.

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COLLAS CRILL

For more information please contact:



Matt Gilley

Partner (Advocate) | Jersey

t: +44 (0) 1534 601691 | **e:** matthew.gilley@collascrill.com

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