Jersey: Downstream structuring for top sponsors

Leading private equity sponsors investing in larger scale primary deals increasingly require innovative structuring solutions to access transactions that are not available via a conventional M&A process. Jersey investment holding vehicles provide an adaptable platform for delivering these solutions as well as for conventional buyouts.

This article from Maples and Calder (Jersey) LLP, the Maples Group's law firm in Jersey focuses on the features of Jersey holding companies that are attractive from a global Private Equity (PE) acquisition/structuring point of view and other uses of Jersey as part of the downstream investment process.

One of the main attractions for top sponsors looking to maintain a stable of coveted assets is the 'best in class' investor return prospects which those assets have the potential to achieve.

It has been suggested that the mid-market deal space (and within that the secondary and tertiary landscape) has been the most competitive and possibly overcrowded segment of the global PE market in recent years. The considerable pressure on increasing investor returns continues unabated. Among mid-market dealmakers the constant pace and number of participants involved in preemptive bid and conventional auction processes persists.

Strong top sponsor appetite continues to exist for investment opportunities that attract greater potential for value creation over the lifetime of an asset, even where such transactions may involve more upfront cost and complexity. Another trend developing among top sponsors and larger asset managers involves the acquisition by them of minority stakes in smaller rival PE operations. Drivers behind these types of investments include increasing management and performance fees across the sector, a need for permanent capital by mid-market buyout groups and a different and more creative way of deploying uncommitted equity.

The most commonly commented upon challenge for sponsors of all sizes remains (and is not going anywhere), that the level of undeployed capital, or 'dry powder', available in the market is so steep that you could ski off it. How PE houses continue to put investor capital to hard work requires innovative and creative investment strategies supported by the use of investment holding vehicles with sufficient flexibility to implement such strategies.

Jersey holding companies: structural neutrality

Rather than using vehicles from the 'home' jurisdiction of a sponsor or the jurisdiction(s) where a target business is located, structuring via a neutral venue that provides a level playing field for investors is generally preferred.

A primary motivator for selecting an international finance centre like Jersey for a tiered investment/acquisition holding structure is being able to take advantage of fiscal regimes that do not result in corporate, capital gains, and other tax leakage on the profits of the investment-holding vehicle itself. Often, onshore tax is incurred at the asset or portfolio company level or on income or gains accruing to ultimate investors.

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Examples of Jersey featuring in some of the most significant top sponsor PE investments in 2019 include:

(a) A joint venture between two of the largest North American global investment management firms in Abu Dhabi oil pipeline. The first western investment of this nature in Abu Dhabi infrastructure ($4bn).

(b) The multibillion-dollar acquisition of a market data platform from a top sponsor syndicate by an international global financial markets business.

(c) A permanent capital investment by North American asset manager in an established private equity platform.

Jersey investment vehicle benefits

The main commercial and structural benefits to using a Jersey investment holding company for downstream investment structuring include:

(a) Jersey company law being based on English company law but with greater flexibility (for example, see below in relation to capital extraction);

(b) An extremely favourable corporate tax regime;

(c) No stamp duty on the transfer of shares and so should not be subject to

tax/stamp duty on future disposal;

(d) Jersey's close proximity to London and same time zone makes closing transactions simpler;

(e) Can achieve structural subordination of intra-group / acquisition financing;

(f) Target group management / MEP friendly, i.e. facilitates the alignment of target management objectives with those of the PE investor; and

(g) Allows for simplified dividend flows to PE investment vehicles and therefore ultimate PE investors.

The growing emphasis on investment vehicles maintaining substance in well-regulated international finance centres mean the air links to and from Jersey and its domestic infrastructure put it in an excellent position.

As an alternative form of exit, Jersey companies are also suitable vehicles for IPO and have been listed on all the world's major exchanges.
Corporate flexibility: investor return
One of the key advantages of using a Jersey investment company is the flexibility of Jersey company law in relation to returns to investors – whether by means of dividend, redemption or buy-back of shares or capital reduction. In particular, monies payable on the redemption or buy-back of shares may be funded from any source, including certain capital accounts.

A Jersey company may also make a distribution from a wide range of sources, not merely from distributable profits/reserves.

Tax regime
A zero rate of income tax applies to virtually all Jersey investment holding companies. However, if required, it is possible to ensure that a Jersey company is tax resident in another jurisdiction provided that:

(a) It is centrally managed and controlled in another place outside of Jersey;

(b) It is resident for tax purposes in the other place; and

(c) The rate of corporate tax to which the company will be chargeable in that other place is 10% or more.

Evolution and structuring utility
As Jersey has kept pace with the changing nature of both mid-market and top sponsor buyout transactions as well as alternative investment strategies, it has played a useful role in connection with structuring for senior management / executive incentivisation arrangements and also intra-group debt financing.

Management incentivisation: MEPs/EBTs
Rewarding, motivating and retaining senior employees and attracting new high profile executives to portfolio companies requires a well-structured, tax efficient and effectively administered equity incentive plan.

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As part of the conventional buyout process, it is usual for share based incentive plans to be designed to align the activities of executives and senior employees with the requirements of the PE group investor. Typically, share plans operate in conjunction with either a management equity plan (MEP) framing how and when equity interests are issued to executives and senior management by the top acquisition holding company or an employee benefit trust (EBT). An EBT is generally an offshore trust where the trustee's duty is to act in the interests of the employees (and certain qualifying former employees) who are beneficiaries under the EBT.

MEPs attaching to Jersey holding companies and Jersey EBTs that form part of downstream PE investment models fulfil a number of functions depending on the plan structure, the stage in its life-cycle and the target company structure.

It is common for EBTs to allow for multiple share plans to be managed through a single trust arrangement for larger groups of companies.

Incentive plans for the PE management team are often more creative and can be tax efficient depending on the individual manager/executive's country of residence and domicile. Plans include structuring of carried interest, share incentives, bonus deferral and partnership interest management.

Debt listing

The International Stock Exchange (TISE) in the Channel Islands has seen a dramatic increase in the listing of quoted Eurobonds used to finance downstream PE investment. This has been in line with the significant volume of secondary and tertiary auction processes conducted in the past seven to eight years.

Designation as a recognised stock exchange by HMRC has enabled TISE to facilitate the tax efficient listing of debt securities issued as part of a large number of mid-market buyout transactions. The HMRC designation is important because qualifying debt securities listed on TISE are eligible for the quoted Eurobond exemption. That exemption allows an issuer within the UK tax net to make interest payments on listed securities gross, i.e. without deduction of withholding tax at a rate of up to 20%. Similar exemptive regimes apply in Ireland and elsewhere.

There are a number of other key advantages of listing intra-group PE debt on TISE including:

(a) Unlike other European stock exchanges, TISE is not bound by any EU directives, including Market Abuse Regulation, and is able to be considerably more flexible in its approach;

(b) TISE does not require an issuer to appoint a local paying agent in the Channel Islands or for the notes to be issued in a clearing system;

(c) TISE is aware of transaction time constraints which affect issuers and will commit to meeting an agreed transaction timetable; and

(d) Listing fees levied are competitive with other Eurobond exchanges.

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