WRITTEN BY -

MEETING THE NEEDS OF EUROPEAN PRIVATE EQUITY – GUERNSEY'S PERSPECTIVE

28 JULY 2015

At a recent meeting held by Guernsey Finance in London, panellists discussed the effect on offshore centres of the Alternative Investment Fund Managers' directive, base erosion and profit-shifting reforms and other threats to funds' 'bottom lines.'

On the panel were Emma Bailey of the Guernsey Financial Services Commission, Robert Mellor, a tax partner at PwC, Karen Sands, the head of finance at Hermes, James Gee, a London private funds lawyer at Weil, Peter Denton of Starwood Capital Europe Advisers and Tim Hames of the British Private Equity and Venture Capital Association. The moderator was Alastair Stewart, the broadcaster.

BEPS and DPT

Stewart asked whether the push for tax changes and particularly the Organisation for Economic Co-operation and Development's base erosion profits-shifting or BEPS reforms were going to change the way in which fund business was done. One panellist thought it probably would: "I mean, for those who study BEPS, [there are] 15-16 working groups, [there is a] huge amount of potential change across the international tax network, and of course in the UK we now have the diverted profit tax or DPT. It's the first sign of legislative change enacting some of those BEPStype agendas.

"The issue with BEPS and DPT (and anyone who has ever been to the OECD sessions can see this quite clearly) is the target for this tax change is the big, international corporate groups and the mobility of capital and revenue moving across borders to mitigate or avoid tax. The target is not institutional investors, it's not asset managers, it's not their funds, and often what the managers are trying to do is yes, there is a local level of taxation where the investment is made, or the portfolio might sit, yes the investor may pay tax based on their own tax jurisdiction, but you want to return the capital through the fund and to the investors with no additional costs because if there was lots of additional cost, the investors would find ways to invest themselves to see if they could mitigate that.

"It's absolutely changed the atmosphere because we are going to see the unintended consequences hitting our structures. If interest deductibility goes, if treaty access goes, if CFCs (controlled foreign companies) and transfer pricing gets harder, there is going to be a hit on the ability to return capital and revenue through structures and through funds. There's going to be some drag.

"I think [there will be] two consequences in the worst-case scenario…funds structuring as we do now probably won't exist in the future, to some degree. Why would pension funds want to go into a co-mingled vehicle with the risk that other investors impact their ability to access treaties? Why wouldn't they want to be in stand-alone vehicles that are just themselves or similar people? We've really got to change the way we do structures at the moment."

It's good to talk

The chairman asked Emma Bailey, the Guernsey regulator, about her jurisdiction's progress on the subjects of private placements and the third-country passporting issue. Her reply was that she was talking to everybody: "Generally, on the whole I think the private placement regime has been successful for Guernsey as a jurisdiction. Markets have remained open, admittedly some have been easier than others, but what has been really key in the whole way that Guernsey has reacted is that the industry has been proactive in telling us where these difficulties lie. We've been talking to the UK (both FCA and HMT), Ireland, France, Netherlands, Germany, Denmark, Latvia, Italy, Spain, the list goes on. As soon as industry has let us know that there are areas where we might be of assistance in speaking to those counterparts, we have done so. "Your second question is the hot topic of the moment, in terms of where we are with third-country passporting. Again, we are taking every opportunity to speak to our counterparts."

Private placement and the passporting ‘run’

Another panellist commented: “In terms of access to the passport, I’m sure that Guernsey is going to be right at the front of the queue and will do everything possible and will be in a good place to get the passport. The issue is actually whether managers will want to get the passport once it becomes available. This is the issue that people are dodging a little bit and the industry’s in a bit of a bind because everybody wants to be seen as supportive of the passport extended to third countries but of course it comes at a huge price, which is full AIFMD compliance. It may well be that people simply don’t want to take it up.

“The question then becomes ‘have we lost the national private placement regimes?’ These are, despite a lot of concern at the start, working reasonably well. Unfortunately, the way the directive is structured, it is designated to be lost in 2018 and I don’t think the industry’s going to change that because that’s embedded in the way that the timetable of the directive works. The chairman thought that 2 distinct classes of people were going to be operating in the industry: “those who want to go along with that and those who take a deep breath and go down another road.” A panellist agreed: “That’s right. Unfortunately, the ‘other road’ is avoiding marketing in Europe.”

Emma Bailey chipped in again: “We, of course, always thought we needed to be in the passporting ‘run,’ if you like. We’ve had no indication that that means that national private placement is going to get switched off from us, that if that does become the position that we are granted the extension. We do keep asking our counterparts what their views are on that, but as I say, the worst-case scenario would be not to be in the run for the passporting and, as you say, in 2018, national private placement does get switched off in its entirety.”

Will AIFMs become de rigeur?

Another panellist was not too pessimistic: “The good thing about Guernsey as well is that… there’s 2 regimes, there’s optionality. I’d expect Guernsey and a few of the other offshore territories to be in the first wave of announcement. I wouldn’t expect Cayman to be there, and that may cause some managers to decide what they’re going to do around fund location, fund structure. I think as investors increasingly become aware of AIFMD and which countries have the passport or not, again, will investors start to see it as a requirement that they are with a fund or a manager that is an AIFM? So there are reasons why it will be positive as well.”

Karen Sands was less sanguine: “We ‘early adopted’ for AIFMD actually and became an authorised AIFM on 1 July 2014. We have found that the AFIMD has layered the ordinary process, whether it be from an investment (or an investor) perspective with a whole heap – and it literally is a heap – of tasks to become compliant with the AIFMD. That extends [to] investment, investor, investor relations, from a marketing perspective, finance dealing with the numerous fields for Annex IV reporting, and servicing the depositary as well. So it’s quite cumbersome. I personally haven’t seen where the benefits are to the investors and actually what it’s doing is there’s just a gap between your gross and your net IRR (internal rate of return). It’s increasing.”

An original version of this article was first published by Offshore Red, May 2015.

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