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10 Things You Need To Know About...Structuring a repackaging transaction using a Cayman Islands SPV

Authors: Barnabas Finnigan, Counsel

Special purpose vehicles (SPVs) are commonly employed as a structuring tool in many cross-border and structured finance transactions, and repackaging transactions are no exception. The Cayman Islands has a long history of acting as a structuring jurisdiction for repackaging SPVs. The stable political climate, flexible corporate regime and well established, creditor friendly legal system within the Cayman Islands, coupled with the availability of tried and tested bankruptcy remote SPV structures, the option of using segregated portfolio companies and the possibility of listing notes on the Cayman Islands Stock Exchange, make it an ideal choice of jurisdiction for establishing a repackaging vehicle.

1. Repackaging transactions follow mature and well-established structures which provide a trusted and stable platform for investors

Repackaging transactions, or “Repacks” as they are more commonly known, have been around in one form or another since the early 1980s. Repacks follow well-established, “tried and tested” structures that have demonstrated great resilience through multiple market cycles. Their relative simplicity has been one of their continuing attractions and has helped these structures perform well during periods of economic downturn and market stress, ensuring they continue to be popular with investors.

In its most basic form, a Repack structure involves the establishment of an SPV issuer (the Issuer) to acquire an underlying asset, and this asset is then used as collateral to underwrite the issuance by the Issuer of a new note (or other form of debt security) to an investor. This two-step process allows the structuring bank to change the nature of the security being offered, or “repackage” it, to remove any features that may be undesirable to investors, and/or to include additional features that may make the security more attractive to investors.

Some of the drivers for establishing a Repack structure include:

- Mitigation of currency/exchange rate risk – investors with income streams in one currency, for example U.S. dollars, may not wish to have exposure to assets generating income in another currency, whether because of internal controls, or concerns around exchange rate risk, or for other reasons. In order to facilitate the investment into the underlying collateral, the Issuer will acquire the underlying debt instruments denominated in the undesirable currency and issue notes on substantially the same terms as the underlying collateral in the required currency. A currency swap will be put in place in order to alleviate the exchange.
- Mitigation of interest rate risk – Repack structures are often set up to allow investors wanting a fixed rate return to invest in fluctuating rate instruments or vice versa. In this case, the Issuer will acquire the underlying floating rate note, and issue a fixed rate note using the floating rate note as collateral (or vice versa). Any risks arising from the interest rate fluctuation can be addressed by putting an interest rate swap in place.
- Jurisdictional risk – Repack structures may be used in certain circumstances to neutralize any jurisdictional risk arising in connection with a particular structure or investment involving collateral located in a particular jurisdiction. The Repack structure allows the investors to access the underlying collateral by way of an investment through notes issued by an issuer in a stable jurisdiction such as the Cayman Islands.

- Enhancement of original product – Repacks can be used to boost the marketability and liquidity of the underlying securities by: (a) issuing notes that are rated; (b) listing the notes (or in some cases issuing the notes through an issuer that is itself listed) on a reputable stock exchange such as the Cayman Islands Stock Exchange or the Irish Stock Exchange; or (c) changing some of the characteristics of the underlying collateral such as term or denomination.

2. Repack transactions use standardised documentation which allows for more efficient structuring

Because Repack structures are already well established, they benefit from documentation that is broadly standardised across the market, meaning that individual programs can be set up quickly and efficiently. Once a Repack program is in place, it is very straightforward to undertake individual issuances, as the documentation will be in a pre-agreed form and will be subject to minimal negotiation. This makes it possible to issue multiple series concurrently and for the transactions to be originated, documented, booked and executed within a relatively short time span and with minimal negotiation of the documentation required.

In recent years, the market has moved towards even more standardised documentation, with a number of arranging banks choosing to adopt modular structures that allow greater flexibility in how the Repack structure can be used, without the need for extensively negotiated bespoke documentation.

3. Cayman Islands Repack Issuers can facilitate the issuance of multiple series of notes through a program structure

Repack structures can be used for one-off transactions, but more typically they are set up as note issuance programs, focusing on acquiring collateral fitting a certain profile. This allows the Issuer to be utilized on an ongoing basis for multiple note issuance transactions using a standardized set of documents. Where a program structure is put in place, the documentation will be streamlined, with an initial offering document and set of program level documents containing the general terms of the program being put in place on launch, and then supplemental documentation being put in place for each new trade under the program, incorporating the terms of the overarching program level documents, together with any amendments or specific terms required for a particular series.

In order for a program structure to operate effectively it must be possible for the collateral underpinning each note issuance, as well as the obligations of the Issuer in respect of each series of notes, to be effectively separated from the collateral and note obligations of each other series issuance. Typically this will be achieved by way of a contractual arrangement whereby the investors in each series agree that they will only have recourse to the Issuer for obligations arising in connection with, and against the collateral relating to, that

specific series of notes. Provided that such contractual segregation is possible and recognized as a matter of the governing law of the program, then a Cayman Islands court would generally uphold any such contractual arrangement between the parties.

Where contractual segregation is not possible, an alternative would be for the parties to establish a Cayman Islands Segregated Portfolio Company (SPC) to act as the Issuer. An SPC is a single legal entity whose assets and liabilities can be allocated to different cells or segregated portfolios within the company. Where assets have been allocated to a particular segregated portfolio, those assets are held as a separate fund which is not part of the general assets of the company itself. Such segregated portfolios are held exclusively for the benefit of the owners of those segregated portfolios and any counterparty to a transaction linked to those segregated portfolios. Only persons who have entered into transactions with a segregated portfolio, or who otherwise have become creditors of the segregated portfolio concerned, will have recourse to that segregated portfolio's assets. Any asset which attaches to a particular segregated portfolio is not available to meet liabilities of the SPC or any of the other segregated portfolios.

4. Cayman Islands Repack Issuers can be structured to ensure bankruptcy remoteness

One of the key considerations for the parties in establishing a Repack transaction is to ensure that the structure is "bankruptcy remote". The primary purpose of a bankruptcy remote structure is to avoid any risk of the assets held by the Issuer from becoming subject to bankruptcy proceedings in the event of the bankruptcy of one of the transaction counterparties (or, in the case of a program where more than one series of notes has been issued, to ensure that a default in respect of one series of notes, or the related collateral, would not cause a default or bankruptcy event in respect of the structure as a whole).

In order to achieve bankruptcy remoteness, the Issuer will need to be structured in such a way that it is legally independent from both the seller/issuer of the underlying collateral and the investors in the notes, and that none of the other transaction parties is able to exercise any direct control over the Issuer. Cayman Islands bankruptcy remote Issuers will typically utilise an orphan trust structure.

This means that legal title to the shares of the Issuer will be held by a corporate trust provider (the Share Trustee) that is independent from both the seller/collateral issuer and the investor, and also from the other transaction parties. A nominal number of shares will be issued by the Issuer to the Share Trustee at par value, and beneficial title to the shares will be held by the Share Trustee on the terms of a charitable trust established pursuant to a declaration of trust (the Declaration of Trust) for the benefit of one or more qualifying charities. The Share Trustee will only be entitled to act in relation to the shares of the Issuer on and subject to the terms of the

Declaration of Trust. In order to further ensure independence of the Issuer, a majority (and commonly all) of the directors of the Issuer will be professional directors provided by a corporate administrator in the Cayman Islands.

Given the orphan nature of the Repack Issuer, the directors will need to ensure that any transactions undertaken by the Issuer are entered into on a limited recourse basis. This means that any liability of the Issuer will be limited to the assets held by the Issuer in connection with the transaction (and, as noted above, in the case of a program, the liability of the Issuer in connection with each series will be limited to the proceeds of the issue of that particular series). Limited recourse protections will be built into the transaction documents to ensure that the Issuer is not put in a position where it incurs liabilities that it would not otherwise be able to meet.

In addition to the limited recourse provisions, and in order to support the bankruptcy remote analysis, the transaction documents should also contain non-petition language. This means that the transaction parties agree not to petition for a liquidation or winding up of the Issuer until following the termination of the financing transaction, avoiding the risk of an early termination of the structure as a result of the winding-up of the Issuer during the life of the transaction. Typically the non-petition protections will extend for a period following the termination of the transaction to ensure that any residual claims are also captured.

5. The Cayman Islands offer an ideal political, legal and fiscal environment for establishing a Repack Issuer

The Cayman Islands are recognised as a leading international financial centre, combining a well-established, stable and trusted legal and political framework with a flexible yet robust corporate regime, creditor-friendly laws and a tax neutral environment. These are all important considerations for investors and structuring banks when deciding where to establish a Repack Issuer.

As a British overseas territory, the legal system is based on English common law, and the Privy Counsel forms the ultimate court of appeal. The laws of the Cayman Islands are passed by a democratically elected parliament and the electoral system is based on the British parliamentary model.

The Cayman Islands are a tax neutral jurisdiction, and there is currently no income, capital gains or withholding tax imposed by the Cayman Islands government on any Cayman Islands company (whether an SPV or an SPC) or arising within the Cayman Islands as a result of any transactions entered into with a Cayman Islands company. Furthermore, a Cayman Islands Issuer can apply to the Cayman Islands government for a tax exemption certificate confirming that for a period of 20 years from the date of the certificate the Issuer will not be subject to any such taxes in the Cayman Islands.

6. Cayman Islands Issuers offer a high degree of flexibility

The Cayman Islands corporate regime offers a great deal of flexibility, without burdening the Issuer and its directors with excessive regulation. A Cayman Islands exempted company, which is the most popular corporate vehicle used for Repack transactions, offers the following benefits:

- Cayman Islands SPVs are generally incorporated with limited liability and have separate legal personality.
- A Cayman Islands SPV can have a single director.
- There are prima facie no nationality or residency requirements for directors or shareholders of a Cayman Islands exempted company.
- There is no minimum level of authorised or issued share capital for an SPV. A Cayman Islands exempted company has a great deal of flexibility in issuing, redeeming and repurchasing shares. In particular, the company may issue shares at a premium to their par value, and can use any proceeds of the share premium account arising from such issue to pay dividends.
- There are no statutory restrictions under Cayman Islands law preventing a company from providing financial assistance for the purchase of its own shares, and consequently no need for any whitewash procedure.
- Cayman Islands companies have separate legal personality.
- There is no requirement as a matter of Cayman Islands law for a Cayman Islands exempted company to appoint an auditor or file audited financial statements with the Registrar of Companies or any governmental body within the Cayman Islands.
- There are no exchange controls in the Cayman Islands

As noted previously, where the parties require legal segregation between each of the series within a portfolio, rather than simply relying on the contractual segregation, there is also the option of using an SPC to act as the Issuer, with each series of notes being issued out of a separate portfolio.

7. The incorporation requirements for Cayman Islands SPVs and SPCs are quick and straightforward

- Incorporating a Cayman Islands exempted company or SPC is a straightforward process. The Cayman Islands registrar of companies offers incorporation on an express basis, meaning that an Issuer can be established within 1-2 business days.

- In order to incorporate a Cayman Islands company to act as Issuer, the following documents will need to be filed with the registrar of companies:
- a signed copy of the memorandum and articles of association of the company;
- a declaration from the subscriber confirming that the activities of the company will primarily be conducted outside the Cayman Islands; and
- the appropriate filing fee.

The corporate services provider filing the incorporation will typically act as the initial subscriber to the memorandum and articles of association of the Issuer for the purpose of incorporation. Following this, the subscriber share will be transferred to the ultimate shareholder. There is no requirement for a director to be in place at the time of incorporation, although the registrar will need to be notified following their appointment.

The fees for incorporating and maintaining a Cayman Islands company are competitive and are calculated on a sliding scale based on the authorised share capital of the company.

8. The Cayman Islands have a pool of independent directors, Share Trustees and service providers with extensive experience of Repack transactions

The Cayman Islands have a strong and well established financial services industry. There are several large corporate service providers, experienced offshore attorneys and Class A banking institutions with detailed industry knowledge and experience of complex structured finance transactions and Repack structures on hand to provide specialist services to structured finance and Repack SPVs.

In addition to providing independent and corporate directors with extensive market-specific experience in the structured finance space to Repack Issuers, the corporate service providers are also able to offer complementary fiduciary and regulatory support services such as FATCA and CRS reporting, AML services and accounting, audit and financial reporting functions.

9. The Cayman Islands meets international regulatory and compliance standards

The Cayman Islands are a member of the Caribbean Financial Action Task Force (CFATF) and have implemented measures to comply with global FATF and OECD standards on anti-money laundering and anti-corruption. The Cayman Islands have consistently taken a proactive approach to ensuring they are in line with global standards on compliance and adhere to global tax transparency and reporting requirements under FATCA and the Common Reporting Standard (CRS). The Cayman Islands have also recently introduced legislation relating to beneficial ownership and economic substance to bring them in line with current global standards.

10. Where a Repack program or series of notes is required to be listed, the Cayman Islands Stock Exchange offers a flexible and competitive listing solution

In some cases the parties may require a listing of either the Repack program itself, or a particular series of notes, which allows access to a wider investor base and increases the marketability of the program, or specific series. Where this is the case, then the Cayman Islands stock exchange (the “CSX”) is able to provide a solution.

The CSX is a well-regulated and internationally recognised stock-exchange. Not only is it registered with the World Federation of Stock Exchanges as an affiliate member, but it is also designated by the UK Inland Revenue as a “recognised stock exchange”. Accordingly, debt securities listed on the CSX are eligible for the “Quoted Eurobond Exemption”. This allows issuers to make payments of interest on the listed securities gross without deduction for UK tax.

Unlike other listing centres, there are no requirements in the CSX’s listing rules for a local listing agent to be appointed in connection with an application to list specialist debt securities. The lead manager or the issuer’s legal advisors may deal directly with the CSX’s listing department. This approach helps to reduce costs and improve efficiency.

In addition, again unlike other listing centres, the CSX is not bound by the European Union Listing Directives. This permits the CSX be more flexible in its approach to listing securities.

Author:

Barnabas Finnigan
Counsel
barnabas.finnigan@conyers.com
+1 345 814 7759

Other Contacts:

Matthew Stocker
Partner
Matthew.stocker@conyers.com
+1 345 814 7382

Jarladth Travers
Head of Conyers FIG Group
Jarladth.travers@conyers.com
+1 345 814 7773

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For further information please contact: media@conyers.com