Offshore securitisation in Jersey and Guernsey

The Channel Islands are one of the most trusted jurisdictions for European offshore securitisations, as Roger Le Tissier of Ogier & Le Masurier discovers.

In recent years there have been many innovations within the securitisation industry, alongside significant growth in the number of programmes and the amounts raised in the capital markets. Figures are difficult to access within the industry, but Ogier & Le Masurier has acted as legal adviser to in excess of $100bn of programmes in the Channel Islands in the last year. Assets securitised included loan books, nursing home rental income, public house rental income and trade receivables.

The programmes are usually organised through structures that involve a number of companies and trusts incorporated in offshore jurisdictions. The advantages of doing so include the ability to ensure bankruptcy remoteness, ring-fencing of assets, non-consolidation through orphan special purpose companies (SPVs), modern laws based on UK principles, and adequate security structures. There are experienced service providers, including lawyers, administrators, accountants and stock exchanges, within the offshore jurisdictions, and the legal systems are well understood by lawyers and promoters onshore. The offshore jurisdictions also provide tax neutrality, and programmes in the Channel Islands have been rated AAA, confirming their status.

The offshore jurisdictions most used in recent years are the Cayman Islands and the Channel Islands, with increasing use of the latter.

Financial stability

In May 2000, the Financial Stability Forum (FSF) published the results of its investigation of the principal offshore finance centres and the implications for global financial stability. The FSF endorsed Guernsey and Jersey as the leaders, both of which are well supervised and which co-operate with other jurisdictions. The Islands' reputations for probity and stability has contributed to the remarkable development in securitisation business over the last decade. Other advantages include:

- the Islands' constitutional relationship with the UK and EU give them special advantages of social, political and economic stability while protecting their fiscal independence, particularly in respect of EU directives on tax harmonisation. They are also members of the OECD, a factor of major importance to certain categories of investor;
- the ratings agencies are comfortable with Guernsey and Jersey, with Standard & Poor's giving each an AAA sovereign rating; and
- their location in the European time zone, as issues can be addressed as they arise in real-time.

The tax treatment of an SPV issuer and of the debt securities being issued is key to the selection of domicile. A Guernsey or Jersey-exempt company will not be subject to Guernsey or Jersey withholding tax on the payments of interest on debt securities and will not be subject to Guernsey or Jersey income tax on its worldwide overseas profits. The legal framework is supportive of securitisation transactions, as evidenced both by the ratings given to notes issued and by the number of complex transactions established here.

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There are modern companies and insurance laws on the statute books and there is continuing consultation between the regulators (the Guernsey Financial Services Commission and the Jersey Financial Services Commission), the finance industry and legal practitioners, as to the development of new legislation.

The regulators' performance, both in terms of quality and timely response, has been, and will continue to be, crucial to maintaining the Islands' reputations as prime locations for debt issuing SPVs. The Commissions will not generally carry out a detailed documentary review or impose ongoing regulatory requirements (other than usual reporting obligations, among other things, on the occurrence of a material change). This policy results in a swift and flexible approach which, as a result of their commercial awareness, means that the Commissions can respond positively and in a timely fashion.

The transparent regulatory regime allied to the strong infrastructure and service providers is attracting more complex transactions to the Islands, including ABCP conduits, synthetic securitisations and alternative risk transfers (ART) securitisations.

ABCP conduits

As they become more aware of the need to manage their balance sheets and to comply with more stringent capital adequacy requirements, financial institutions and originators are increasingly using securitisation techniques and structures. While the global players have well established securitisation strategies, the smaller financial institutions are now looking at the advantages that can be gained. Financial institutions are also keen to provide balance sheet management capabilities to their existing corporate clients, as well as to market structured securities to new investors.

Conduits represent an important part of this new strategy.

The first conduit structure was established in Jersey in 1993 (Deutsche Bank's Rhein-Main Programme). Since then, there has been consistent growth in the number of asset-backed commercial paper conduits, recent examples being Scaldis (Fortis), Moriarty (Abbey National) and Perry (Bank of America) and Viking (for Unibank).

Viking is a multi-seller, multi-currency asset-backed commercial paper programme. A newly-incorporated SPV owned by a charitable trust acts as purchaser, acquiring or financing the acquisition of pools of receivables from the originator in each transaction.

The acquisition of the receivables is funded by the issuance of commercial paper by its sister company, also an SPV, under the same charitable trust. This structure has several advantages.

Cost – the programme framework is set up at the outset meaning that repeat transactions can be done quickly and at lower cost. From a regulatory perspective, consent for the issuance of debt securities issued at the start and will not generally require further documentary review on each particular transaction. The use of standardised transaction documentation results in further costs savings.

Smaller size of transaction – originators with smaller pools of receivables are able to access the capital markets without incurring the costs of a full asset-backed securitisation.

Confidentiality – certain originators are attracted by the fact that the investors will not necessarily be informed of the particular assets comprising receivables acquired or financed by the conduit.

Frequently, European conduits are structured to access the deeper liquidity of the USCP market. This may be done by incorporating a Delaware subsidiary of the Channel Islands SPV to act as the US issuer, with the USCP being guaranteed by the Channel Islands SPV issuer, or by a co-issuance of USCP by the Channel Islands SPV issuer and Delaware subsidiary, so that the liability of the co-issuers is joint and several.

Other developments stem from the proposals by the Basel Committee on banking supervision, which may result in liquidity margins becoming more expensive. Conduit structures are now being developed that are not only capable of issuing asset-backed CP, but which may also originate medium-term notes that do not require the same level of liquidity support.

Synthetic securitisation

Traditionally, securitisation has been based upon a true sale of the underlying assets by the originator to the SPV, much attention being given to ensure that an effective transfer takes place to avoid consolidation difficulties. However, as transactions extend to new asset classes and new jurisdictions, synthetic securitisation has been developed whereby the economic effect of a securitisation is achieved without a true sale and the consequential costs and legal considerations associated with it.

In C*Strategic Asset Redeployment Program 1999-1 Limited, the underlying portfolio of loans held by Citibank was identified as the reference portfolio, but the transaction did not involve any transfer of legal title of the portfolio assets to the SPV issuer. Accordingly, it was not necessary to notify underlying borrowers of any transfer for the purposes of perfecting an assignment. The SPV issuer invested the proceeds of issuance in Pfandbriefe and at the same time entered into a credit default swap with Citibank. If a credit event (as specified in the credit default swap) takes place, the SPV issuer is obliged to liquidate a portion of the Pfandbriefe in order to make a payment to Citibank under the credit default swap. The holders of the junior notes would suffer any first loss arising from the non-availability of the liquidated Pfandbriefe to meet the principal repayment obligations. The economic effect was that Citibank's exposure to the borrowers is reduced, and this is reflected by a 20% capital adequacy weighting being applied to the loans in the reference portfolio.

More recently, Barclays Capital has arranged Europa One, which is the first pan-European, pan-jurisdiction collateralised mortgage-backed securities transaction. The originating bank, Rheinische Hypothekenbank, retained the loans on its balance sheet, but transferred the credit risk to the SPV issuer – again by means of a credit default swap. That the mortgages comprising the reference portfolio spanned a number of different legal jurisdictions made the absence of the need to formally assign interests in the mortgages a primary motivation for using a synthetic securitisation.

ART securitisation

As the convergence of capital markets and the insurance industry continues, ART securitisation is set to become an important part of the securitisation business. The pressure on the insurance industry to manage capital costs is likely to lead to the application of capital market techniques for the purposes of financing insurance risk. Guernsey and Jersey have been the chosen locations of the SPVs for a number of insurance securitisations and, as the industry develops, they are well positioned to develop with it. A recent securitisation in Guernsey was structured as a protected cell company, as this legislation is available for insurance products.

Channel Islands Stock Exchange

The Islands have recently introduced the modern Channel Islands Stock Exchange (CISX). This provides a fast and efficient service in listing debt securities at a competitive price compared with other jurisdictions.

Protected cell companies

A recent innovation in Guernsey has been the introduction of legislation for protected cell companies ('PCCs'), whereby the assets of one class of the company are not available in respect of the debts of the other classes. The legislation is shortly to be extended to all securitisation vehicles, which should assist in cutting administration and set-up costs for any programme by allowing a number of programmes to be organised through the same PCC, thereby avoiding costs of having a number of companies.

Market leaders

The Channel Islands have established themselves as a main jurisdiction for European-originated transactions and are increasingly seen as the market leaders for the more innovative structures. The finance industry has built up considerable experience in all aspects of the securitisation process, and the regulators, helped by the legal firms, have developed streamlined regulatory practices that are effective to protect the reputation of the Islands, while permitting an ever more innovative range of transactions to be done. ■

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