

GUIDE TO LISTING OF PIK NOTES ON THE CISE: PRIVATE EQUITY TRANSACTIONS IN THE CHANNEL ISLANDS

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PREFACE

Following the introduction of the Finance (No 2) Act 2005, the opportunities for UK portfolio companies of leveraged buyout and private equity funds to generate tax deductions for interest on the financial instruments frequently used in leveraged buyout transactions have been significantly restricted. Typically in these transactions, interest on loans to the portfolio company by the private equity fund will accrue on a regular basis but will not be payable until the private equity fund achieves its exit. This Guide describes one of the few remaining alternatives, the issue of Payment-in-Kind notes on the Channel Islands Securities Exchange.

We recognise that this Guide will not completely answer detailed questions which clients and their advisers may have; it is not intended to be comprehensive. If any such questions arise in relation to the contents, they may be addressed to any member of the team, using the [contact information](#) provided at the end of this Guide.

Appleby

Jersey and Guernsey

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1. **PIK NOTES**

The changes introduced in 2005 (which came into effect for all loan relationships created from 4 March 2005) provide for limited exceptions which allow deductibility of interest payments (or the discount on a deep discount bond) on an accruals basis if the borrower is a small or medium sized enterprise and the creditor is either UK resident or not resident in certain offshore centres, or where the loan is from a limited partnership which qualifies as a collective investment scheme and the borrower is a small or medium sized enterprise, all of the partners are either UK resident or not resident in certain offshore centres and the partnership provides written confirmation of that fact. Otherwise, the portfolio company will only be entitled to tax deductibility of interest payments when they are actually paid (or in respect of deep discount bonds when they are redeemed).

One solution, which allows a tax deductibility of interest as it accrues, is the issue by the portfolio company of funding bonds or payment in kind (**PIK**) notes. In this way, interest payment obligations are met by the issue of further PIK notes and no cash is required to be paid. The issue of the further PIK notes is treated as payment of interest equal to the value of the PIK notes issued for tax deduction purposes.

2. **CISE LISTING**

Where note holders or limited partners (as the private equity fund is likely to be tax transparent) are not UK resident, they will be subject to UK withholding tax on the value of the notes issued. There is however a statutory exemption from UK withholding tax where the PIK notes are issued as quoted funding bonds and, as the Channel Islands Securities Exchange (**CISE**) is a recognised stock exchange, a simple quotation can be achieved by listing the funding bonds on the CISE.

The CISE is an extremely flexible exchange and is a convenient and inexpensive route to achieve this tax saving.

In many cases the CISE will treat the funding bonds as specialist debt issued by a special purpose vehicle to sophisticated investors and the listing requirements and continuing obligations set out in the Listing Rules of the CISE (**Listing Rules**) are in this case not particularly onerous. Detailed in Appendix 1 are the applicable conditions of the Listing Rules for listing and in Appendix 2, the applicable continuing obligations of the Listing Rules. Whilst a listing document will be required, generally no additional accounting information will need to be prepared beyond the existing audited accounts of the issuer or its subsidiaries, and listing fees will be limited to £4,000 plus £500 for each separate issue of funding bonds. No further annual listing fees are required (other than the sponsor's annual fees).

In December 2013, the UK Inland Revenue (now HM Revenue & Customs) designated the CISE as a Recognised Stock Exchange under Section 841 of the Income and Corporation Taxes Act, 1988, the CISE was approved as an Affiliate Member of the International Organisation of Securities Commissions, it became an Associate Member of the International Capital Market Services Association and it was officially recognised by the Australian Securities Exchange.

3. **APPLEBY SECURITIES (CHANNEL ISLANDS) LIMITED**

Appleby Securities (Channel Islands) Limited is a listing sponsor to the CISE. Appleby Securities (Channel Islands) Limited would expect to charge a moderate sponsorship fee and would charge an annual responsibility fee for so long as the securities continued to be listed on the exchange. When compared to the withholding tax liabilities which would otherwise be incurred on the payment of interest for issue of non-listed PIK notes, the issuer will obtain substantial overall savings and will generally recover the cost of listing within the first year.

It should be noted that certain UK resident limited partners may be liable to tax on the receipt of PIK notes issued to them and US limited partners may also face tax liabilities. However, it may be possible

to structure the funding bonds so that those bond holders who would otherwise be liable to withholding tax may elect to receive PIK notes, while those bond holders who would incur an unfunded tax liability on PIK notes can elect to receive cash interest. Alternatively, the issuer may issue PIK notes to all bond holders but those who would be liable to an immediate tax charge could redeem such amount of PIK notes as is necessary to meet the liability to tax.

For more specific advice on listing PIK Notes on the CISE or other private equity transactions in the Channel Islands, we invite you to contact one of the following:

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For the convenience of clients in other time zones, a list of contacts available in each of our jurisdictions may be found [here](#).

APPENDIX 1**CONDITIONS FOR LISTING**

1. An issuer must be duly incorporated or otherwise validly established according to the relevant laws of its place of incorporation or establishment and be operating in conformity with its memorandum and articles of association or other constitutional documents.
2. A private issuer of debt securities listed pursuant to the relevant Chapter of the Listing Rules must normally have produced independently audited accounts for the three financial years preceding the application for listing, unless the requirement is waived by the Exchange pursuant to the Listing Rules. In exceptional cases the CISE may accept a shorter period. Where such an issuer is guaranteed, the guarantor of the issuer must also provide copies of its latest independently audited accounts to the CISE.

Note: the CISE will generally be prepared to accept subsidiary accounts where the holdco is newly incorporated or treat the holdco as a special purpose vehicle in which case no accounts will be required.

3. The applicant's securities must be eligible for deposit in a clearing and settlement system acceptable to the CISE. The Listing and Membership Committee will, in consultation with the issuer's sponsor, designate an approved clearance system to be used for each security. This information will be published by the CISE on its trading system.

A clearance system may be one of the following:

- Euroclear
- Clearstream
- Cash settlement via the sponsor

However, despite the foregoing, the CISE will generally grant issuers a derogation from this requirement where the issuer considers that the level of liquidity anticipated in respect of the transaction does not merit putting the securities into a clearing or settlement system.

4. A trustee or other appropriate independent representative appointed to represent the interests of the holders of asset-backed debt securities must have the right to access appropriate information relating to the assets.

Note: this is not generally applicable to PIK notes.

5. Listed securities must be freely transferable and tradable and fully paid securities must be free from all lien. Securities may, however, be subject to transfer restrictions or compulsory redemption:
 - where the holding of such securities may result in a regulatory, pecuniary, legal, taxation or material administrative disadvantage for the applicant or the holders of its securities as a whole; or
 - to maintain a minimum holding per holder, as specified in the Listing Document.

In exceptional circumstances approved by the CISE, an applicant may take power to disapprove the transfer of securities provided that the exercise of such power would not disturb the market in those securities.

APPENDIX 2**CONTINUING OBLIGATIONS**

1. It is a prerequisite of listing that an issuer executes a Listing Undertaking in the form set out in the Listing Rules, undertaking to comply with the Listing Rules and, in particular, with all relevant continuing obligations. Observance of the continuing obligations is essential to the maintenance of an orderly market in securities and to ensure that all users of the market have simultaneous access to the same information. Failure of an issuer to comply with any applicable continuing obligation may result in the CISE taking the enforcement actions described in Chapter III of the Listing Rules.
2. As soon as practicable following the publication of the annual report and accounts or unaudited financial statements (if the issuer is exempted under the law of the country of incorporation from preparing audited accounts) the issuer shall send one copy of the annual report and accounts to the CISE and publish it on the CISE's website or refer the CISE to publicly available information placed on the internet.
3. Generally, and apart from compliance with all the specific requirements of the Listing Rules, the issuer shall keep the public, the CISE, the holders of the securities of the issuer and other holders of its listed securities informed as soon as reasonably practicable of any information relating to the issuer (including information on any major new developments in the issuer's sphere of activity which is not public knowledge) which:
 - is necessary to enable them and the public to appraise the position of the issuer;
 - is necessary to avoid the establishment of a false market in its securities; and
 - might reasonably be expected materially to affect market activity in and the price of its securities.
4. Information that is required to be disseminated pursuant to clause 2 above or otherwise under the Listing Rules must not be given to a third party before it is notified to the CISE except as permitted as follows. An issuer may give information in strict confidence to its advisers, an agent employed to release the information, and to persons with whom it is negotiating with a view to effecting a transaction or raising finance, including prospective underwriters of an issue of securities, providers of finance or loans or the places of the balance of a rights issue not taken up by shareholders. In such cases, the issuer must advise the recipients of such information that it is confidential and that they should not deal in the issuer's securities before the information has been made available to the public. An issuer shall notify information to the CISE by the method laid down by the CISE from time to time.
5. An issuer whose securities are listed on the CISE and on any other exchange must ensure that equivalent information is made available at the same time to the CISE and such other exchanges.
6. The issuer shall immediately disclose to the CISE:
 - any change in the rights, powers or privileges of any class of listed debt securities, including any change in their rate of interest, and any change in any of the rights, powers or privileges of any class of securities into which the listed debt securities are convertible or for which they are exchangeable;
 - any decision to call, purchase, redeem or cancel any of the listed debt securities by the issuer. The information must also state the amount of the debt securities to be called, purchased, redeemed or cancelled and the amount of debt securities to be outstanding after the transaction or series of transactions is completed;
 - any proposed changes in the constitution or capital structure of the issuer; and
 - any appointment of a new director or a resignation or removal of a director.

7. If the listed debt securities may be converted into or exchanged for securities of another company, or are guaranteed by another company, the issuer must ensure that adequate information is at all times available to the CISE and the holders of the listed debt securities:
- concerning the business and affairs of the other company; and
 - concerning the rights, powers and privileges of the securities into which the listed securities are convertible or for which they are exchangeable.

As a minimum, the information provided to satisfy the former point must include the annual report and accounts of the company, any interim financial accounts, and all other information necessary for a realistic valuation of the listed debt securities to be made.

8. In addition to the specific requirements set out in the Listing Rules, the issuer shall submit to the CISE for review copies of drafts before they are issued of any announcements or advertisements, the subject matter of which involves a change in or relates to or affects arrangements regarding trading in the listed debt securities on the CISE, including suspensions or cancellations of listings.
9. The issuer shall send to the CISE, as soon as practicable after they are issued by the issuer (or on its behalf), one copy of the following:
- all resolutions of the issuer, in respect of the listed issue, passed other than in the ordinary course of business;
 - any document relating to a take-over of, merger by and offer to purchase the issuer;
 - all notices of meetings in relation to the listed issue;
 - forms of proxy in relation to the listed issue;
 - reports;
 - announcements; and
 - any other similar documents.
10. The issuer shall submit one copy to the CISE of any document sent by the issuer (or on its behalf) to holders of the issuer's listed issue as soon as practicable after such documents are issued.

The term "Partner" is a title referring to a member, shareholder, director, employee or consultant of equivalent standing and qualifications of one of the partnerships, limited liabilities companies and other entities which are for the time being authorised by Appleby Global Group LLC to carry on the business of legal practices under the Appleby name. A list of the Partners of any Appleby partnership, members of any Appleby limited liability partnership, or of the members, shareholders or directors of any Appleby limited company and of any other non-shareholders who are termed "Partners" of any legal practice is available for inspection upon request. Appleby is an organisation of separate entities and legal practices comprising both corporate and partnership for, each established to provide legal services under the Appleby name from the numerous jurisdictions in which it is based.

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