

PRESERVING VALUE DURING FUND RUN OFF PERIODS: THE LONG-TERM BENEFIT OF A LIQUIDATING TRUST



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How to effectively manage the end of life of a collective investment vehicle has long presented challenges for fund managers balancing a reduction in economic returns, as capital is returned to investors with ongoing and seemingly ever expanding regulatory and other obligations associated with the proper administration and maintenance of a modern fund structure.

Trapped assets, in particular those with limited current value or liquidity, can make the managed wind-down of a fund particularly difficult. We are seeing an increase in open-ended and closed-ended funds who wish to proceed with dissolution but remain in limbo, with no end in sight due to issues with realising and distributing certain assets and investments.

Not only does a prolonged wind-down result in unnecessary time spent by management but it can also result in excessive service provider costs

and holding fees which become disproportionate to the returns and assets under management, to the detriment of investors.

When paired with a solvent voluntary liquidation, the establishment of a liquidating trust for the assignment of trapped or illiquid assets can be an effective solution for any fund wishing to preserve potential long-term asset realisation whilst freeing up resources via timely dissolution to the benefit of all stakeholders. The objective of a liquidating trust is to expedite the wind-down process and to create efficiencies, allowing investors to receive proceeds in an orderly manner. A liquidating trust also reduces the potential of liability claims against the funds and/or its directors, allowing for a final resolution to the fund's affairs whilst providing a means for which long-tail assets can be managed down and ultimately distributed to the investors in a manner which maximizes value.

This pairing is not only beneficial to the fund but, where relevant, the trustee can engage with existing management, its principals, and directors in a consulting role so that asset background and understanding is not lost during the wind-down process. Again, this can be invaluable to the preservation of value. This flexibility and ability to retain knowledge in the asset wind-down period can be an important factor when

looking to drive efficiencies and ensure maximum final returns to investors.

Alternatively, existing management can also choose to remove themselves entirely from the process should they wish not to assume any significant role following the establishment of the liquidating trust. This can be a useful consideration if the incumbent fund management is looking to say retire from the industry and there is no other viable succession plan in place.



Why A Liquidating Trust?

A liquidating trust in the Cayman Islands can be established for the benefit of any asset type, save there being no restrictions or known contingent litigation, and can be tailored to the requirements of the fund as the trust's settlor.

Asset types that we have seen structured into liquidating trusts include

potential class action claims which have yet to be consummated, shareholdings in private operating companies, portfolios of small to mid-cap publically listed equities, litigation stubs and illiquid investment portfolios with limited secondary market opportunities. Common amongst these asset classes was the long tail to the expected realisation timelines, with recovery periods ranging from twelve months to in excess of five years.

The form of liquidating trust can vary in both structure (standalone or umbrella) and type (discretionary, revocable, irrevocable trusts, etc.). A discretionary Cayman Islands STAR Trust is especially well suited to a liquidating trust scenario in situations of prolonged wind-down due to the flexibility it allows when determining the trust's objects.

The trust may be set up for a purpose or for persons or indeed a mix of both. Investors may be named as discretionary beneficiaries and would therefore not have entitlement to the assets, other than on a realisable event. Alternatively, if the STAR trust is set up whereby the trust's primary purpose is to carry out a business plan, the business plan may be drafted to provide clear guidance to the trustee when exercising its discretion and it would be an integral part of the trust deed. Examples of the guidance that may be incorporated into a business plan could include details of the specific assets that the trust is intended to hold, how these assets are intended to be realised,

which investors are intended to benefit and to what extent, and any other relevant provisos. The business plan would also be clear on the parties who hold the power to vary it if needed.

This means that investors not only benefit from future asset realisations, which could have been disclaimed or written-off prior to commencing a standalone voluntary liquidation, but also from the cost efficiencies that can be achieved from both a timely dissolution of the fund and the realisation and distribution of any residual assets in an efficient and practical manner.

In the Cayman Islands, a regulated trust company, would act as trustee and have absolute discretion over the management and administration of the STAR trust.

Although, where relevant, the trustee may also seek the assistance of other professionals to manage the realisation of the residual assets, be it asset auctions or sales in the secondary market, as well as those principals or directors who wish to remain engaged in a consultative capacity following the voluntary liquidation. Furthermore, a STAR trust requires the appointment of an enforcer who will ensure that the trustee fulfils their fiduciary obligations

in accordance with the trust instrument. This role may be delegated to a third party and further provides comfort to investors that the liquidating trust is being administered for their benefit and in accordance with the provisions of the trust deed.

With market pressures, high interest rates and volatility likely to continue into 2024, it is likely that a growing number of funds and fund managers will be considering options as to how a managed wind-down might be effectively delivered and the use of a liquidating trust should be an option which is explored given the potential to unlock long term value.



About R&H Trust & Corporate

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About R&H Restructuring

R&H Restructuring is a multidisciplinary team with a diverse range of offshore multi-jurisdictional advisory, restructuring and insolvency experience with offices in the Cayman Islands and British Virgin Islands. Their team of insolvency practitioners, asset recovery experts and qualified accountants has great depth of experience in dealing with distressed situations and the associated complexities of cross-border insolvencies and disputes in the Cayman Islands, British Virgin Islands and Bermuda, as well as across the Eastern Caribbean region. R&H Restructuring is an affiliate of Rawlinson & Hunter LLP in the Cayman Islands.

