

- Investment Fund Vehicles in the BVI
- Fund structures
- Recognition or registration under SIBA
- Fund functionaries and service providers
- BVI fund managers

The British Virgin Islands and Investment Funds

This guide provides an overview of the various investment fund vehicles available in the British Virgin Islands (BVI). It concentrates on regulated investment funds and, in particular, hedge funds, since these constitute a large majority of the investment funds domiciled in the BVI and make up approximately one quarter of all offshore hedge funds established worldwide.

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The investment funds industry in the BVI is regulated by the Investment Business Division of the Financial Services Commission (the **FSC**) and the primary legislation which governs the industry is the Securities and Investment Business Act, 2010 (**SIBA**).

Under Part III of SIBA and the Mutual Fund Regulations, 2010, regulated funds are categorised as private funds, professional funds or public funds. Not all investment funds will be subject to SIBA as it only regulates open-ended funds (i.e. funds whose equity interests are redeemable at the option of the investors). Closed-end funds (i.e. funds whose equity interests are not redeemable at the option of the investors) are not subject to direct regulation in the BVI.

While many jurisdictions offer a domicile for investment funds, there are a number of advantages to establishing an investment fund in the BVI. These include:

- a tax neutral environment;
- a stable political and economic jurisdiction which is committed to remaining fully compliant with all supra-governmental bodies responsible for policing the world's financial markets;
- a recognised and respected legal system derived from English Common Law and supplemented by modern local legislation;

- a dedicated Commercial Court with a specialist judge and court staff;
- no regulatory restrictions on investment policies or strategies or on performance and other fee arrangements for private and professional funds;
- no requirement to appoint local directors, local functionaries or local auditors;
- a fast track procedure for professional funds;
- the ability to amend the constitutional documents of the fund without (in most scenarios) requiring a vote of the members;
- statutory segregated portfolio ring-fencing; and
- comparatively low start-up and ongoing fees and costs.

Investment fund vehicles in the BVI

Sponsors and fund managers considering establishing investment funds in the BVI may choose to structure the fund as one of the following:

- a BVI Business Company;
- a Limited Partnership; or
- a Unit Trust.

The majority of BVI investment funds are established as companies limited by shares under the BVI Business Companies Act, 2004. Limited Partnerships are also common while unit trusts are relatively rare.

BVI Business Companies

A BVI Business Company is a separate legal entity from the investing shareholders. The shareholders of a BVI Business Company have no direct legal or beneficial interest in any of the assets of the company which are instead legally and beneficially owned by the company itself.

The BVI Business Companies Act provides a great deal of flexibility in terms of structuring funds. By way of example, there is no concept of “authorised capital” or “share capital” and therefore there is no requirement for there to be any par value or capital attributed to shares. A company only has to state in its memorandum of association the maximum number of shares that it is authorised to issue. The directors may also designate different series of shares within each class without the need to amend the constitutional documents of the fund, giving flexibility to funds wishing to use series accounting techniques to achieve equalisation of performance fee allocations among shareholders.

Limited partnerships

BVI limited partnerships are established under the Partnership Act, 1996. A limited partnership is formed by a general partner and at least one limited partner executing Articles of Partnership and the registered agent submitting a Memorandum of Partnership to the FSC. The Articles of Partnership do not have to be filed with

the FSC and form the internal governing document of the partnership dealing with issues such as partnership contributions and withdrawals and the day-to-day running of the partnership.

A limited partnership does not have a separate legal personality distinct from its partners. The General Partner is therefore ultimately liable for the debts and obligations relating to the limited partnership. As a matter of BVI law, a limited partner is not liable for the debts and obligations of the limited partnership (save for the amount contributed) so long as the limited partner does not participate in the control of the partnership business.

Unit trusts

Unit trusts are established pursuant to a deed of trust. A unit trust arrangement is not a separate legal entity. The Trustee has legal capacity and holds the assets of the fund on the terms of the deed of trust for the investors in the unit trust scheme. Under BVI law, the holders of units in a unit trust scheme are the beneficial owners of the trust assets.

If the Trustee of a BVI unit trust is a company incorporated in or operating out of the BVI then the Trustee will require a trust licence under the BVI Banks and Trust Companies Act, 1990 and an investment business licence under SIBA as well as having to apply for recognition of the unit trust as a fund under SIBA.

Fund structures

BVI law facilitates a number of alternative structures for investment funds including the following common structures:

- Single class funds which are set up with a single class of investor shares giving investors the opportunity to participate in a single investment portfolio.
- Multi-class funds (sometimes referred to as umbrella funds) which issue equity interests in a number of different classes to enable investors to participate in a range of investment portfolios. The objective is normally to achieve cost efficiency but, since the portfolios are only segregated for internal accounting purposes, a conventional company is subject to the inherent risk of cross class liability. To deal with this issue, multi-class funds can be incorporated in the BVI as Segregated Portfolio Companies under which the assets attributable to a particular portfolio are segregated by statute and not available to meet the liabilities of creditors attributable to any other portfolio.
- Master/feeder funds which are structured to enable subscriptions made in separate feeder vehicles to be pooled into and managed as a single master fund portfolio. A typical example of a master/feeder fund would involve United States domiciled taxable investors investing directly in an onshore vehicle (often a Delaware limited partnership) and United States tax exempt and non-United States investors investing in an offshore vehicle (normally a BVI Business Company). Each “feeder” fund then invests all its assets in an offshore “master” fund (normally a BVI Business Company). The principal objective is to enable investors that are subject to differing tax or other regulations or with distinct requirements to participate together in the same investment portfolio having common investment objectives. The structure achieves economies of scale for portfolio related activities.
- Single investor funds are widely used by institutions, funds of funds and high net worth individuals as an alternative to managed account contracts. By establishing a fund such investors maintain the flexibility and limited liability of a corporate vehicle which can engage its own service providers.

Recognition or registration under SIBA

SIBA requires all investment funds formed in the BVI and falling within its definition of “mutual fund” to be recognised or registered as a fund by the FSC.

SIBA defines a “fund” as a company or any other body, a partnership or a unit trust incorporated, formed or organised, whether under the laws of the BVI or the laws of any other country which:

- (a) collects and pools investor funds for the purpose of collective investment; and
- (b) issues fund interests that entitle the holder to receive on demand or within a specified period after demand an amount computed by reference to the value of a proportionate interest in the whole or in a part of the net assets of the company, the partnership, the unit trust or other similar body, as the case may be, and includes:
 - (i) an umbrella fund whose shares are split into a number of different class funds or sub-funds; and
 - (ii) a fund which has a single investor which is a fund not registered or recognised under SIBA.

The three categories of regulated investment funds are as follows:

Private funds

A private fund is restricted to either (a) having no more than 50 investors or (b) only making an invitation to subscribe for or purchase fund interests on a private basis.

Private funds must be recognised by the FSC before they carry on business. Historical policy guidelines issued by the FSC under the previous mutual funds regime suggested that a fund will be regarded as having commenced its business when a prospectus, or other document the purpose of which is to make an invitation to purchase or subscribe for shares of the fund, is published.

Professional funds

A professional fund may carry on its business or manage or administer its affairs for a period of up to 21 days without being recognised under SIBA.

The interests in a professional fund may only be made available to “professional investors” and the minimum initial investment by each professional investor must not be less than \$100,000 (or other currency equivalent), unless the investor is an “exempted investor” in which case there is no minimum initial investment.

A “professional investor” is a person (i) whose ordinary business involves, whether for that person’s own account or the account of others, the acquisition or disposal of property of the same kind as the property, or a substantial part of the property, of the fund; or (ii) who whether individually or jointly with his spouse, has a net worth in excess of US\$1,000,000 (or other currency equivalent).

An “exempted investor” means:

- (a) the manager, administrator, promoter or underwriter of the fund; or
- (b) any employee of the manager of the fund.

Public funds

A public fund is generally viewed as a retail product. Accordingly, the regulatory burden placed on a public fund is considerably higher than that of a private fund or a professional fund.

Public funds must be registered by the FSC before they carry on business. Registered public funds may not make an invitation to the public or any section of the public to purchase shares unless prior to such invitation they publish a prospectus which complies with SIBA and the Public Funds Code, which is approved by and signed on behalf of the fund's directors and which is registered by the FSC.

Fund functionaries and service providers

SIBA requires a fund wishing to be recognised or registered to appoint the following functionaries:

- an investment manager;
- an administrator;
- a custodian; and
- an auditor.

However, private or professional funds may apply for an exemption to appoint an investment manager, custodian or auditor.

In considering an application for recognition or registration, SIBA requires that the manager, investment advisor, administrator and/or custodian of a BVI mutual fund satisfy the FSC's fit and proper criteria. Generally, the FSC will accept a functionary that is located in a Recognised Jurisdiction. At this point in time, the following countries have been designated by the FSC as Recognised Jurisdictions:

Argentina, Australia, Bahamas, Bermuda, Belgium, Brazil, Canada, Cayman Islands, Chile, China, Curacao, Denmark, Finland, France, Germany, Gibraltar, Greece, Guernsey, Hong Kong, Ireland, Isle of Man, Italy, Japan, Jersey, Liechtenstein, Luxembourg, Malta, Mexico, Netherlands, New Zealand, Norway, Panama, Portugal, Russia, Singapore, Spain, South Africa, Sweden, Switzerland, United Kingdom and United States of America.

Accordingly, an application for recognition or registration of a fund whose functionaries are domiciled in a Recognised Jurisdiction and hold the appropriate regulatory status in that jurisdiction will generally be processed without further assessment of the fit and proper status of such functionaries. The FSC also may accept a functionary domiciled in another jurisdiction if the applicant can satisfy the FSC that the jurisdiction has a system for the effective regulation of investment business including funds business.

Key ongoing requirements for private and professional funds under SIBA

SIBA places various statutory requirements on funds recognised as private or professional funds, including:

- a fund must notify the FSC within 14 days of certain events occurring. These include the appointment or removal of a director, an amendment to its constitutional documents or offering document or a change in the address of the fund's place of business;
- a fund must also notify the FSC at least 7 days prior to the appointment of a new functionary;

- all funds must appoint an authorised representative in the BVI. This entity acts as the conduit between the fund and the FSC. An affiliate entity of Harneys (Craigmuir Authorised Representative Limited) provides this service;
- a fund must submit a copy of its offering document to the FSC, which must contain a prescribed investment warning;
- a fund must appoint and at all times have an auditor to audit its financial statements (although the FSC may exempt certain funds upon application).
- a fund must submit audited financial statements for each financial year to the FSC within 6 months after such financial year end; and
- a fund must have at least two directors, at least one of whom shall be an individual.

Funds registered as public funds must not only comply with the above provisions, but also with further regulatory requirements set out in SIBA, the Mutual Funds Regulations and the Public Funds Code, 2010. Further details are available on request.

Anti-money laundering obligations on BVI funds

The BVI anti-money laundering or “AML” regime applies to all funds as they are classified as “relevant persons” under the Anti-Money Laundering Regulations, 2008. As such a fund will, in summary, be required to:

- put in place investor on-boarding procedures which address typical “know your client” (or KYC) requirements;
- appoint an officer of the fund or another individual as Money Laundering Reporting Officer for the fund (in practice this may be a director of the fund itself or a person provided by one of the functionaries to the fund);
- report suspicious transactions to the BVI Financial Investigation Agency; and
- put in place documentation which outlines how the fund complies with the AML requirements in the BVI.

The BVI rules do provide for funds to outsource all and any of these obligations to functionaries based outside of the BVI, such as an administrator or investment manager. Any outsourcing must, however, be documented in writing.

Fees payable to the FSC

Fees payable by BVI funds to the FSC are competitive and lower than in most other offshore and onshore jurisdictions. A private or professional fund must pay a US\$700 application fee and an annual fee of US\$1,000. A public fund must pay US\$1,000 on application for registration and an annual fee of US\$1,500.

BVI fund managers

BVI domiciled investment managers and investment advisers may either be licensed under Part I of SIBA or approved under the Investment Business (Approved Managers) Regulations, 2012 (the “Approved Manager Regulations”).

Licensee under SIBA

A person seeking a licence to manage open-ended funds must apply for a Category 3, Sub-Category B licence under SIBA to manage mutual funds. If they also wish to manage closed-end funds or managed accounts, they must apply for Category 3, Sub-Category E licence to manage “other types of investments”.

A person seeking a licence to advise open-ended funds under SIBA must apply for a Category 4, Sub-Category B licence to provide investment advice to mutual funds. If they also wish to advise closed-end funds or managed accounts, they must apply for a Category 4, Sub-Category A licence to provide investment advice other than to mutual funds.

The application form for a SIBA licence is substantial. The FSC has stated that a complete application for a SIBA licence should be processed in approximately 6 weeks.

Under the SIBA regime each director and senior officer of, and shareholder holding a “significant interest” (broadly speaking, 10%) in, the person seeking a licence must satisfy the FSC’s fit and proper criteria. References, police reports and declarations on each such person must be provided to the FSC. A detailed business plan must also accompany the application, although exemptions from this requirement are available when the manager is licensed to solely manage mutual funds.

A SIBA licensee is subject to a number of ongoing compliance requirements. Points to note in respect of ongoing requirements include:

- compliance with the Regulatory Code, 2009, which stipulates, among other matters, that a licensee must establish, maintain and implement a compliance policy and compliance systems and controls, as appropriate for the business;
- a licensee must appoint a compliance officer who must be approved by the FSC prior to appointment (although the holders of some categories of licence are eligible for an exemption on application);
- a licensee must appoint a Money Laundering Reporting Officer;
- a licensee must prepare financial statements in accordance with certain prescribed accounting standards (UK, US and Canada GAAP or IFRS). Audited financial statements must be filed with the FSC within six months of the end of the relevant financial year;
- a licensee must appoint an “authorised representative” unless they have a significant management presence in the BVI;
- no disposition, charge, transfer (including an increase or decrease) of a significant interest in the licensee can be made without the FSC’s prior written consent; and
- the prior consent of the FSC is required to appoint a director or senior officer.

Approved managers

The Approved Manager regime provides a less onerous regulatory regime for BVI domiciled investment managers and investment advisers and complements the more heavily regulated investment business licensing regime under Part I of SIBA. Eligible fund managers and advisers may submit a simple application form to the FSC and then commence business 7 days later without having to wait for formal approval.

Under the Approved Manager Regulations, an Approved Manager can act as the investment manager or investment advisor to any number of private or professional funds recognised under SIBA, as well as funds domiciled outside of the BVI in a Recognised Jurisdiction and closed-end funds domiciled in the BVI or in a Recognised Jurisdiction, if they have the key characteristics of a private or professional fund.

The key restriction is that aggregate assets under management of all of the open-ended funds cannot exceed US\$400 million and the capital commitments of all of the closed-end funds cannot exceed US\$1 billion.

An Approved Manager will be subject to a relatively small number of ongoing obligations. The key obligations are as follows:

- an Approved Manager must notify the FSC of any change to any of the information provided by the Approved Manager pursuant to its application for approval within 14 days;
- an Approved Manager must notify the FSC of any matter in relation to it or its conduct, which has or is likely to have a material impact or significant regulatory impact with respect to the Approved Manager or its business;
- an Approved Manager must prepare and submit financial statements to the FSC, however, there is no audit requirement;
- an Approved Manager must submit an Annual Return to the FSC by 31 January of each year containing summary details of the business it is carrying on;
- an Approved Manager must appoint a Money Laundering Reporting Officer; and
- an Approved Manager must appoint an “authorised representative” unless it has a significant management presence in the BVI.

About Harneys

Harney Westwood & Riegels is a leading international law firm headquartered in the BVI. We are the oldest and largest law firm in the BVI, more than twice the size of our nearest competitor. We were instrumental in drafting key BVI legislation, including the 1984 International Business Companies Act, the 2003 Insolvency Act, the 2004 Business Companies Act and the 2010 Securities and Investment Business Act. In short, Harneys has been a significant part of the BVI as an international finance centre since the very beginning of its development and we have a depth of experience which no other BVI law firm can match.

Harneys' Investment Funds Team

Our Investment Funds Department is the largest in the BVI and is consistently ranked as the leading authority on BVI investment funds by leading legal and funds industry directories. Our ability to provide a competitively priced, bespoke product to address the unique needs of our fund clients is unmatched in the market.

The Investment Funds Department is comprised of a team of specialist investment funds lawyers. Together with our affiliated business, Harneys Corporate Services Limited (“HCSL”), we provide legal advice and related

corporate and trust services to approximately one third of all regulated funds and fund management companies established in the BVI.

We believe that the following points set us apart from others in the industry:

- our long-standing reputation for quality which generates confidence in investors;
- a large team with unmatched depth of experience;
- investment funds lawyers who work solely on funds matters;
- the only dedicated regulatory practice in the BVI;
- a long history of working with Government on the development of legislation;
- a cordial and professional relationship with the FSC; and
- shared ownership, premises and resources with HCSL which means a joined-up approach to client handling between our legal and services functions.

Legal 500 describes Harneys' Investment Funds team as "...a formidable team in the offshore investment funds space..." and ILFR 1000 writes of them as "...a strong funds team" which gets the "largest share of funds work in BVI".

Our services

In addition to advising on private and professional funds and fund management companies for clients ranging from first time hedge fund managers to large institutional sponsors, the team is also the acknowledged leader in the specialised field of public funds and acts for the principal sponsors of public funds domiciled in the BVI. As well as regulated funds, the team advises a large number of non-regulated closed-end funds, including private equity, venture capital and real estate funds. Harneys' Investment Funds team is committed to providing clients with the following services:

- fund structuring advice including significant expertise in dealing with distressed funds;
- regulatory and compliance advice;
- offering memorandum or prospectus preparation and review;
- preparing constitutional documentation – memorandum and articles of association of a company or the memorandum and articles of limited partnership for a limited partnership;
- administration and management agreement preparation and review;
- fund operating vehicle formation;
- fund management vehicle formation; and
- obtaining regulatory approvals.

The combination of our group of expert lawyers coupled with a strong corporate and trust services team ensures a formation and post formation service of the highest quality.

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