

The British Virgin Islands and Investment Funds

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

1. INTRODUCTION

The investment funds industry in the British Virgin Islands 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-ended funds (i.e. funds whose equity interests are not redeemable at the option of the investors) are not subject to direct regulation in the British Virgin Islands.

While many jurisdictions offer a domicile for investment funds, there are a number of advantages to establishing an investment fund in the British Virgin Islands. 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 dedicated specialist judge and court staff;
- no regulatory restrictions on investment policies or strategies or on performance and other fee arrangements;
- no requirement to appoint local directors, local functionaries or local auditors;

- a fast track procedure for professional funds;
- the ability to amend the memorandum and articles of association 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.

2. INVESTMENT FUND VEHICLES IN THE BRITISH VIRGIN ISLANDS

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

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

The majority of British Virgin Islands 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.

2.1. *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 longer a 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 a great deal more flexibility to funds wishing to use series accounting techniques to achieve equalisation of performance fee allocations among shareholders.

2.2. *Limited Partnerships*

British Virgin Islands limited partnerships are established pursuant to 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 liable for the debts and obligations relating to the limited partnership. As a matter of British Virgin Islands law, a limited partner is not liable for the debts and obligations of the limited partnership so long as the limited partner does not participate in the control of the partnership business.

2.3. 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 British Virgin Islands law, the holders of units in a unit trust scheme are the beneficial owners of the trust assets.

If the trustee of a British Virgin Islands unit trust is a company incorporated in or operating out of the British Virgin Islands then the trustee is likely to require a trust licence under the British Virgin Islands Banks and Trust Companies Act, 1990 as well as having to apply for recognition of the unit trust as a fund under SIBA.

3. FUND STRUCTURES

British Virgin Islands 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 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
- 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.

4. RECOGNITION OR REGISTRATION UNDER SIBA

SIBA requires all investment funds formed in the British Virgin Islands and falling within its definition of “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 British Virgin Islands 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.

5. 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 British Virgin Islands mutual fund satisfy the FSC's fit and proper criteria. 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.

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.

6. 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 British Virgin Islands. 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 further regulatory requirements set out in SIBA, the Mutual Funds Regulations and the Public Funds Code, 2010. Further details are available on request.

7. 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 onboarding 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.

8. FEES PAYABLE TO THE FSC

Fees payable by BVI funds to the FSC are competitive and lower than 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.

9. 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 under SIBA must apply for a Category 3, Sub-Category B licence to manage mutual funds. If they also wish to manage closed ended 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 open 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 ended 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.

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 license 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”;
- 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 (which may include funds domiciled outside of the BVI) as well as any number of closed ended funds domiciled in the BVI which 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 can not exceed US\$400 million and the capital commitments of all of the closed ended 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.

10. HARNEYS' INVESTMENT FUNDS TEAM

Harneys is a leading offshore law firm, the oldest and largest law firm in the British Virgin Islands, and is at the forefront of private sector legislative initiatives in the British Virgin Islands.

Harneys has the largest Investment Funds team in the British Virgin Islands, and is consistently ranked as the leading authority on the British Virgin Islands Investment Funds Industry by the major legal and funds directories.

The Investment Funds practice is comprised of a team of specialist investment funds lawyers headed globally by Ross Munro who also acts as the head of the British Virgin Islands team. Together with its affiliated trust company, Harneys Services, the department provides legal advice and related corporate and trust services to approximately one third of all regulated funds and fund management companies established in the British Virgin Islands.

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 regulated public funds and acts for the principal sponsors of public funds domiciled in the British Virgin Islands. 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 and articles of 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.

FURTHER INFORMATION

Please contact one of the following Harneys lawyers if you require additional information on investment funds in the British Virgin Islands:

Ross Munro

Partner - Investment Funds & Regulatory
ross.munro@harneys.com
+1 284 494 7850
British Virgin Islands

Philip Graham

Partner - Investment Funds & Regulatory
Philip.Graham@harneys.com
+1 284 852 2551
British Virgin Islands

The foregoing discussion and analysis is for general information purposes only and not intended to be relied upon for legal advice in any specific or individual situation.

January 2013