



PRACTICAL LAW

MULTI-JURISDICTIONAL GUIDE 2012

INVESTMENT FUNDS

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British Virgin Islands

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RETAIL FUNDS

1. What is the structure of the retail funds market? What have been the main trends over the last year?

Open-ended retail funds

About 215 funds are registered as public funds under the Securities and Investment Business Act 2010 (SIBA). A public fund is a retail product and can market its shares (in the case of a company) or units (in the case of a unit trust) to any member of the public inside or outside the British Virgin Islands (BVI). Only open-ended funds must be registered under the SIBA.

The public funds market is relatively mature and there have only been a few registrations in the last 12 months. There has been no significant change in market practice.

Closed-ended retail funds

Closed-ended funds are not directly regulated. While there is a growing market for using the BVI as a domicile for closed-ended funds, few of these funds would be accurately described as retail funds. Therefore, *Questions 2 to 14* focus on open-ended retail funds registered as public funds under the SIBA.

Regulatory framework and bodies

2. What are the key statutes, regulations and rules that govern retail funds? Which regulatory bodies regulate retail funds?

Open-ended retail funds

Regulatory framework. The primary legislation is the SIBA. On the SIBA coming into force, the Mutual Funds Act 1996 was repealed and all funds previously recognised or registered under the Mutual Funds Act 1996 were automatically deemed to be recognised or registered under the SIBA. The Mutual Funds Regulation 2010 (MF Regs) and the Public Funds Code 2010 (PF Code) is secondary legislation issued under the SIBA.

Regulatory bodies. The Financial Services Commission (FSC) regulates funds and other investment business carried on in or from within the BVI. Within prescribed parameters, the FSC can make secondary legislation to further regulate public funds.

Closed-ended retail funds

Regulatory framework. See *Question 1, Closed-ended retail funds*.

Regulatory bodies. See *Question 1, Closed-ended retail funds*.

3. Do retail funds themselves have to be authorised or licensed?

Open-ended retail funds

BVI fund. A public fund can be established as a company or unit trust. A public fund carrying on business in or from within the BVI must be registered under the SIBA. A company or unit trust is deemed to carry on business from within the BVI even if it carries on business outside the BVI, if either:

- It is incorporated in the BVI (in the case of a company) or governed by BVI laws (in the case of a unit trust).
- It solicits an individual within the BVI to subscribe for or purchase its fund interests. However, a fund does not solicit an individual where the subscription or purchase is a result of an approach made by the individual to the fund without any solicitation being made by or on behalf of the fund.

A foreign fund (that is, a fund incorporated outside of the BVI in the case of a company or governed by a non-BVI law in the case of a unit trust) does not carry on business in the BVI solely by reason of the fact that it is managed or administered in or from within the BVI or otherwise appoints a BVI functionary.

A public fund must appoint an investment manager, administrator (see *Question 6, Open-ended retail funds*), custodian (see *Question 7, Open-ended retail funds*) and auditor, all of which must satisfy the FSC's fit and proper criteria. The FSC also assesses the directors (in the case of a company) or the trustee (in the case of a unit trust) against the fit and proper criteria.

In addition, to qualify to invite any member of the public to subscribe for fund interests, the invitation must be made in a prospectus registered by the FSC. The prospectus must:

- Be approved by the board (or the trustee).
- Provide a full and accurate disclosure of all information that investors would reasonably require and expect to find for the purposes of making an informed investment decision.
- Comply with the requirements for a prospectus set out in the MF Regs and the PF Code.

Section 12 of the MF Regs contains brief requirements for the contents of a prospectus. The PF Code contains a schedule of more prescriptive contents.



The fund must submit a written application to the FSC for registration as a public fund using the FSC's omnibus application form. An application is typically made at the same time for registration of the Fund's first prospectus. The application must be accompanied by a completed Form A for each of the directors of the fund (unless such persons have previously been approved by the FSC's Approved Person's Unit). The prospectus and copies of each of the agreements between the fund and its functionaries must also be submitted. An application fee of US\$1,000 (as at 1 November 2011, EUR1 was about US\$1.4) is payable for the registration of the fund. An additional application fee for the registration of the prospectus of US\$250 is payable. On registration of the fund and the prospectus, further fees of US\$1,500 and US\$500 (respectively) are payable. The annual registration fee for the fund is US\$1,500. The FSC's Performance Accountability Policy and Supervisory Service Standards state that a completed application for registration of a public fund should be completed within two weeks.

Non-BVI fund. A non-BVI fund (that is, domiciled outside of the BVI) can seek registration as a public fund or recognition as a recognised foreign fund. It generally only needs to do this if it either:

- Wishes to solicit an individual within the BVI to subscribe for or purchase its fund interests.
- Is otherwise carrying on business in or from within the BVI. Appointing a manager or administrator located in the BVI is expressly excluded from the meaning of carrying on business in or from within the BVI.

A non-BVI fund may become a recognised foreign fund under the SIBA if all of the following apply:

- It is subject to an authorisation and supervisory regime in the jurisdiction in which it is constituted that, in the FSC's opinion, provides BVI investors with protection at least equivalent to the protection provided under SIBA for investors in public funds.
- Adequate arrangements exist for co-operation between the authorities in the home jurisdiction and the FSC.
- The fund is being operated and managed in compliance with the authorisation and supervisory regime to which it is subject.

An application must be made to the FSC for recognition as a foreign fund using the omnibus application form. A full explanation must be provided as to how the criteria for recognition are satisfied. An application fee of US\$700 is payable and the annual recognition fee is US\$1,000.

Closed-ended retail funds

See *Question 1, Closed-ended retail funds*.

Marketing

4. Who can market retail funds?

Open-ended retail funds

A fund cannot be promoted in or from within the BVI unless the fund is registered or recognised as a fund or a foreign fund

(see *Question 3, Open-ended retail funds*). The person carrying on the promotion may need to be licensed under SIBA to promote the fund. For example, subject to certain safe harbours such as acting for a company within the same group, providing business to a company for which you act as a director if no extra remuneration, a licence is required to (SIBA):

- Carry on business as an investment adviser. Promotion of a mutual fund by a third party in or from within the BVI may, depending on the circumstances, amount to investment business within the meaning of SIBA.
- Arrange transactions in mutual fund interests.

Closed-ended retail funds

See *Question 1, Closed-ended retail funds*.

5. To whom can retail funds be marketed?

Open-ended retail funds

Public funds can be marketed to any member of the public both:

- In the BVI.
- Outside the BVI (subject to foreign regulations).

However, the offer must be made by way of a registered prospectus (see *Question 3*).

A recognised foreign fund is permitted to market its interests in the BVI in accordance with the authorisation and supervisory regime of its home jurisdiction.

Closed-ended retail funds

See *Question 1, Closed-ended retail funds*.

Managers and operators

6. What are the key requirements that apply to managers or operators of retail funds?

Open-ended retail funds

A public fund must appoint an investment manager and an administrator, which must satisfy the FSC's fit and proper criteria (see *Question 3, Open-ended retail funds*). There is no requirement for either to be located in the BVI. A manager or administrator generally satisfies the FSC's fit and proper criteria if it both:

- Carries on business in a recognised jurisdiction. The FSC has issued a list of recognised jurisdictions, comprising 39 of the most widely used financial services centres.
- Meets the local requirements to carry on the business (including, where applicable, holding any licence). However, if there is no local requirement to hold a licence, this does not prevent the functionary from satisfying the FSC's fit and proper criteria.

A manager or administrator requires a licence if it is a BVI entity or has a physical presence in the BVI (*SIBA*). Safe harbours include managing for a group company where no additional remuneration is payable.

Closed-ended retail funds

Carrying on business as a closed-ended fund is not directly regulated (see *Question 1*). However, an investment manager or administrator (among others) requires a licence to provide certain activities for closed-ended funds (SIBA). For example, a BVI company acting as a manager or administrator of a closed-ended fund typically requires a licence under SIBA, although there are safe harbours. However, a non-BVI company acting as manager or administrator does not generally require a licence, unless it carries on business through a physical presence in the BVI.

Assets portfolio

7. Who holds the portfolio of assets? What regulations are in place for its protection?

Open-ended retail funds

A public fund must have a custodian, who must both:

- Be functionally independent from the manager and the administrator.
- Meet the FSC's fit and proper criteria. The custodian will generally meet this criteria if it carries on business in a recognised jurisdiction and meets the local requirements to carry on the business (see *Question 6, Open-ended retail funds*).

Closed-ended retail funds

See *Question 1, Closed-ended retail funds*.

Legal fund vehicles

8. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures?

Open-ended retail funds

Legal vehicles. A public fund can be formed as a:

- **Company.** A company limited by shares registered under the BVI Business Companies Act 2004 (BCA) is by far the most common type of legal vehicle used. Investors are issued shares in the company.
- **Unit trust.** A unit trust can be formed under BVI laws. Unit trusts issue units.

Advantages. The BCA is widely admired for its flexible and comprehensive company regime. A unit trust is also flexible, but does not benefit from the backing of company legislation.

Disadvantages. Unit trusts are not as widely used as companies and in many parts of the world the concept is unfamiliar.

Closed-ended retail funds

Legal vehicles. See *Question 1, Closed-ended retail funds*.

Advantages. See *Question 1, Closed-ended retail funds*.

Disadvantages. See *Question 1, Closed-ended retail funds*.

Investment and borrowing restrictions

9. What are the investment and borrowing restrictions on retail funds?

Open-ended retail funds

Retail funds are not specifically subject to any investment or borrowing restrictions, although the prospectus must clearly set out the investment strategy. In addition, the prospectus must disclose any restrictions to which the fund voluntarily submits itself.

Closed-ended retail funds

See *Question 1, Closed-ended retail funds*.

10. Can the manager or operator place any restrictions on the issue and redemption of interests in retail funds?

Open-ended retail funds

Restrictions on issue and redemption of fund interests are permitted, but must be disclosed to investors in the registered prospectus. In addition, the PF Code requires a public fund to adopt policy and procedures for the issue and redemption of fund interests. The policy must both:

- Be appropriate for the nature, size, complexity, structure and diversity of the fund and the fund property.
- Meet prescribed minimum criteria set out in the PF Code including the timing of the dealing and redemption of fund interest.

Closed-ended retail funds

See *Question 1, Closed-ended retail funds*.

11. Are there any restrictions on the rights of participants in retail funds to transfer or assign their interests to third parties?

Open-ended retail funds

A public fund can include restrictions on transfer of its fund interests. These restrictions must be disclosed in the registered prospectus.

Closed-ended retail funds

See *Question 1, Closed-ended retail funds*.

Reporting requirements

12. What are the general periodic reporting requirements for retail funds?

Open-ended retail funds

Investors. The audited financial statements must be made available to investors with the registered prospectus within six months of the year end.

Regulators. A public fund's audited financial statements must be filed with the FSC within six months of the year end. A fund must submit an annual return to the FSC by 30 June each year, in relation to the position of the fund on 31 December of the previous year.



Closed-ended retail funds

Investors. See *Question 1, Closed-ended retail funds*.

Regulators. See *Question 1, Closed-ended retail funds*.

Tax treatment

13. What is the tax treatment for retail funds?

Open-ended retail funds

Funds. A fund registered under the SIBA is exempt from all provisions of the Income Tax Act. It will not be liable to BVI payroll tax unless it has employees in the BVI. Customary fees paid to directors are generally outside the scope of the payroll tax.

Resident investors. The following are exempt from income tax (*Income Tax Act*):

- All dividends and amounts that a fund formed as a BVI company pays to investors (including redemption proceeds).
- Capital gains realised by investors in relation to fund interests of a fund formed as a BVI company.

There are no estate, inheritance, succession or gift taxes payable in the BVI in relation to shares in a fund. Technically, income tax may apply to income and capital gains arising from interests in funds both:

- Formed as limited partnerships or unit trusts.
- Which are held by persons resident or domiciled in the BVI.

However, as the income tax rate is currently zero (and is not expected to change), this is academic.

Non-resident investors. The following are exempt from payment of income tax (*Income Tax Act*):

- All dividends and amounts paid by a fund to non-resident investors (including redemption proceeds).
- Capital gains realised by non-resident investors from fund interests.

There are no estate, inheritance, succession or gift taxes payable in the BVI in relation to shares in funds.

Closed-ended retail funds

Funds. A closed-ended fund established as a company is exempt from all provisions of the Income Tax Act. The same rules apply as for open-ended retail funds (see above, *Open-ended retail funds: Funds*).

Resident investors. The same rules apply as for open-ended retail funds (see above, *Open-ended retail funds: Resident investors*).

Non-resident investors. The same rules apply as for open-ended retail funds (see above, *Open-ended retail funds: Non-resident investors*).

Reform

14. What proposals (if any) are there for the reform of retail fund regulation?

There are no proposals to reform retail fund regulation.

HEDGE FUNDS

15. What is the structure of the hedge funds market? What have been the main trends over the last year?

The BVI is generally regarded as the second largest jurisdiction for the domicile of hedge funds. As at 31 March 2011 there were just under 2,700 funds recognised or registered under the SIBA. There is no specific distinction made in the licensing process between hedge funds and funds of hedge funds. In the first quarter of 2011, the FSC recognised or registered 57 funds under the SIBA. The overall level of new funds versus cancellations has been largely static in the past 12 months.

Regulatory framework and bodies

16. What are the key statutes and regulations that govern hedge funds in your jurisdiction? Which regulatory bodies regulate hedge funds?

Regulatory framework

The primary legislation is the SIBA and the regulator is the FSC (see *Question 2*). Open-ended funds can be registered as public funds or recognised as private or professional funds (SIBA). Closed-ended funds are not required to be licensed under the SIBA or otherwise.

Private funds

A private fund is restricted to either:

- Having no more than 50 investors.
- Only making an invitation to subscribe for or purchase fund interests on a private basis.

See also *Question 19, Private funds*.

Professional funds

Professional fund interests can only be issued to professional investors (see below). Also, the initial investment for all investors (other than defined exempt investors) cannot be less than US\$100,000 or the foreign currency equivalent.

A professional investor is a person either:

- Whose ordinary business involves, whether for his own account or the account of others, the acquisition or disposal of property of the same kind as:
 - the fund property; or
 - a substantial part of the fund property.
- Who has signed a declaration that he both:
 - whether individually or jointly with his spouse, has net worth in excess of US\$1 million or its foreign currency equivalent; and
 - consents to being treated as a professional investor.

Exempt investors comprise:

- The manager, administrator, promoter or underwriter of the fund.
- Any employee of the manager or promoter of the fund.

Regulatory bodies

The regulator is the FSC (see *Question 2*).

17. How are hedge funds regulated (if at all) to ensure compliance with general international standards of good practice?

Risk

There are no express requirements in relation to risk for private or professional funds.

Valuation and pricing

There are no express requirements in relation to valuation and pricing for private or professional funds. The PF Code requires public funds to adopt detailed pricing and valuation policies and keep them under regular review. Details of the policies must be made available to investors of public funds.

Systems and controls

There are no express requirements in relation to systems and controls for private or professional funds.

Insider dealing and market abuse

Part V of the SIBA created offences of insider dealing, misleading statements and market manipulation. Part V of the SIBA applies to all BVI persons and not just those carrying on financial services business.

Transparency

Private and professional funds must adopt and file a copy of their offering document with the FSC.

Money laundering

All funds must comply with the:

- Anti-money Laundering Regulations 2008.
- Anti-money Laundering and Terrorist Financing Code of Practice 2008.

Many funds comply with the client verification requirements set out in this legislation by outsourcing the function to its administrator. If the administrator is located outside the BVI but in a recognised jurisdiction (see *Question 6, Open-ended retail funds*), the fund can generally comply with the client verification rules of the home jurisdiction, to comply with the BVI regulation.

Short selling

There are no restrictions on short selling.

Marketing

18. Who can market hedge funds?

See *Question 4*.

19. To whom can hedge funds be marketed?

Private funds

A private fund can be restricted in one of two ways:

- To a maximum of 50 investors. Where the number of investors is limited, there are no limitations on how the fund is marketed, provided the number of investors limitation is observed.
- To making an offer on a private basis. Guidance on the meaning of private basis indicates that:
 - the fund must market to a group of persons that have some kind of connection (for example, clients of the fund manager);
 - offering to more than 300 separate investors would probably not be on a private basis.

Professional funds

A professional fund can only market its fund interests to a professional investor (see *Question 16, Professional funds*).

For differences between local funds and foreign funds, see *Question 4*.

Investment restrictions

20. Are there any restrictions on local investors investing in a hedge fund?

There are no restrictions on local investors investing in a hedge fund.

Assets portfolio

21. Who holds the portfolio of assets? What regulations are in place for its protection?

A private or professional fund must appoint a custodian (see *Question 7*). However, there is an exemption from the requirement to appoint a custodian where the FSC can be satisfied as to the alternative arrangements for custody of the fund's assets. Guidance from the FSC provides that an exemption from the custodian requirement will generally be available for:

- Funds which have appointed prime brokers.
- Feeder funds in master-feeder structures.
- Funds operating as a fund of funds.
- Funds in the process of winding down.
- Funds investing in esoteric assets.

Requirements

22. What are the key disclosure or filing requirements (if any) that must be completed by the hedge fund?

A private or professional fund must file any offering document with the FSC within 14 days of the date of its issue to any investor. Side letters do not need to be filed.

All regulated funds must submit an annual return for statistical and reporting purposes setting out summary financial information as at 31 December.



23. What are the key requirements that apply to managers or operators of hedge funds?

The same rules for retail funds apply (*see Question 4*).

Any person carrying on business in, or from within, the BVI as an investment manager or administrator of a fund must hold a licence issued by the FSC (*SIBA*). This is subject to some limited safe harbours.

A BVI company which acts as manager or administrator of any fund, regardless of the location of its operations, both:

- Is deemed to carry on business from within the BVI.
- Requires a licence.

A non-BVI company generally only requires a licence if it has a physical presence in the BVI by, for example, maintaining an office in the BVI. Merely acting as manager or administrator of a BVI fund from outside the BVI does not bring the manager or administrator within the scope of *SIBA*.

To become licensed, an applicant must demonstrate that all of the following satisfy the FSC's fit and proper criteria:

- The applicant.
- Its directors and senior officers.
- Any significant shareholders.

The Regulatory Code, 2009 (secondary legislation issued by the FSC) was amended to apply to persons licensed under *SIBA* in 2010. The Regulatory Code requires adoption of various procedures and policies, and requires licensees to abide by overriding principles such as a requirement to "conduct its business with integrity".

Legal fund vehicles and structures

24. What are the main legal vehicles used to set up a hedge fund and what are the key advantages and disadvantages of using these structures?

Legal vehicles

BVI funds are established as:

- Companies limited by shares under the BVI Business Companies Act, 2004 (*BCA*).
- Limited partnerships under the Partnership Act 1996.
- Unit trusts governed by the laws of the BVI.

The vast majority of BVI hedge funds are established as companies under the *BCA*.

Advantages

Companies under the *BCA* have the advantage that the *BCA* is widely regarded as cutting edge corporate legislation and provides a modern and flexible regime suitable for use as a hedge fund vehicle.

Disadvantages

Unit trusts are not a familiar concept in many parts of the world.

25. What are the advantages and disadvantages of using onshore and offshore structures?

Onshore

Advantages. The BVI is itself frequently used as an offshore jurisdiction for foreign investors (*see below, Offshore*). The BVI fund regime is consistent with all applicable international standards. The regime has a clear distinction between:

- Retail funds (public funds), where a higher degree of regulation is appropriate.
- Non-retail funds (private and professional funds), where:
 - there is greater flexibility and a lower burden of regulation;
 - the funds are restricted as to how they can be marketed and who can become investors.

The fund regime is tax neutral, leaving investors to be taxed as appropriate in their home jurisdictions.

Disadvantages. Investors from other jurisdiction that use structures in, for example, the BVI may have domestic issues such as reporting requirements.

Offshore

Advantages. For investors from other jurisdictions (such as the US) that use their own domestic structures there may be a perceived lower risk due to additional regulation.

Disadvantages. Products domiciled in their own domestic jurisdictions often lack flexibility and impose greater restrictions (for example, investment restrictions or by minimum liquidity requirements).

Tax treatment

26. What is the tax treatment for hedge funds?

See Question 13.

Restrictions

27. Can participants redeem their interest? Are there any restrictions on the right of participants to transfer their interests to third parties?

Redemption of interest

Redemption terms are generally at the discretion of the fund but should be both:

- Disclosed in the offering document.
- Set out in the fund's constitutional documents.

Redemption terms vary enormously depending on a number of factors, including the:

- Fund's investment strategy.
- Assets' liquidity.
- Investor base.

Transfer to third parties

Funds are also free to impose transfer restrictions. However, these must be set out in the fund's constitutional documents, as shares in BVI companies are freely transferable unless otherwise provided. In practice, most funds provide, at a minimum, that the approval of the fund's board of directors is required to transfer interests.

Reform

28. What (if any) proposals are there for the reform of hedge fund regulation?

The SIBA and the MF Regs came into force (and the Mutual Funds Act 1996 was repealed) on 17 May 2010. Although this was the biggest change since the Mutual Funds Act came into force in 1998, the popular distinction of private, professional and public funds has been retained. Much of the change actually reflects the codification of the FSC and industry practice over recent years.

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Areas of practice. Investment funds; private equity; hedge funds; financial services regulation.

Recent transactions

- In 2009 to 2010, participating in a focus group set up by the Financial Services Commission in relation to the Securities and Investment Business Act 2010 and associated legislation.
- Ongoing assistance to Portuguese and foreign entities in negotiating distribution agreements and complying with the necessary regulatory steps for marketing funds in Portugal.

Qualified. England and Wales, 2002 (non-practicing); British Virgin Islands, 2008

Areas of practice. Investment funds; private equity; hedge funds.

Recent transactions. As partner in the firm's Investment Funds and Regulatory Department, advising on all aspects of the formation and restructuring of investment fund vehicles in the BVI.

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