

GREAT FUND INSIGHTS

Selecting your Fund Domicile

Kamar Jaffer

Hello and welcome to Great Fund Insights, Selecting your Fund Domicile, a new video podcast series featuring an expert law firm in an offshore jurisdiction. I'm Kamar Jaffer, a Middle East funds and asset management partner and I will be moderating today's session. During this series, our expert panellists will explore some of the benefits and legal and regulatory considerations for each offshore location. We will also cover frequently asked questions on how to choose the domicile for your fund and why offshore jurisdictions have become a key choice for global alternative investment funds.

Today we will be discussing topical fund trends in the BVI and I am delighted to introduce our guest speakers, Paul Waldron and Tom Cochrane, partners at law firm Walkers. Paul is a partner in the global investment funds group and is based in Walkers' BVI office. He has over 15 years of experience in both hedge funds, private equity funds and approved managers. Paul advises institutional asset managers and established and start-up investment managers on all aspects of investment fund matters. He also regularly works with managers and service providers in the fintech space. Tom is a partner in the funds and corporate group at Walkers in Dubai, where he has been based since 2012. He assists clients on matters of BVI and Cayman Islands' law. Tom's primary focus is on investment funds, including hedge funds, venture capital funds and private equity funds. He regularly acts for leading sovereign wealth funds, financial institutions, asset managers and private equity firms on structuring information of funds. Paul and Tom, thank you for participating in this series.

Paul Waldron

Thank you, Kamar.

Tom Cochrane

Thanks for having us.

Kamar Jaffer

I am delighted to have you with us today. So without further ado, let's get to the first question. Paul, the British Virgin Islands, BVI, is an established fund formation jurisdiction. What are the types of funds that you are currently seeing in the market?

Paul Waldron

Thank you, Kamar. So, at the moment, we are currently seeing a lot of crypto funds. So all kinds of crypto funds really, from open-ended to closed-ended, some quite small funds to some quite large funds. They are being very popular at the moment. We are also seeing quite a few standard hedge funds, your standard open-ended equity and bond funds and then separately we are seeing quite a few closed-ended bonds at the moment. So, in terms of asset classes, there would be your standard private equity, venture capital, real estate funds. So we are seeing a full coverage of the market at the moment.

Kamar Jaffer

And, Tom, what type of vehicles are commonly used in the BVI?

Tom Cochrane

We probably see three key vehicles being used most commonly for BVI funds. The first is the standalone corporate structure, which is set up as a BVI business company and typically we see that as the quickest, the most cost-effective and usually the simplest structure to set up and that pairs well with open-ended funds, so your classic hedge funds, equities funds, forex or crypto funds. A slight variation on that standalone corporate structure is what's known as a segregated portfolio company, or SPC. For those of your listeners who are not familiar with this concept, the SPC is a single legal entity that can create multiple, segregated portfolios or sub-funds and the assets and liabilities of each segregated portfolio or sub-fund are statutorily segregated from the assets and liabilities of other sub-funds and from the general assets of the SPC. So that's a great option if a manager is looking to roll out multiple strategies over time, because there's various cost savings as well as time savings that you can obtain. And in the closed-ended space, what we see is that the limited partnership or LPGP structure is really the market standard. So a few years ago there was a fairly significant overhaul of the BVI partnership regime and there was the introduction of the Limited Partnership Act and since then we have seen increasingly that the limited partnership is the go-to structure for closed-ended funds.

Kamar Jaffer

And turning to Paul, any innovative or creative structures that you've seen being used in the market?

Paul Waldron

Yes, at the moment we are seeing a lot of interest in incubator and approved funds. These are a relatively new type of fund aimed at smaller fund managers and start-up managers. So, taking them in order, an incubator fund is really aimed at start-up managers who are looking to test a strategy at relatively low cost and can be done very quickly. There are a few requirements for an incubator fund. They are sometimes known as a 2020/20 fund. So they're capped at 20 investors. The minimum investment is 20,000 per investor and they're capped at an AUM of USD20,000,000. The advantage of an incubator fund is there is no requirement for an investment manager, administrator, custodian or an auditor. As you can see, they are very low cost to operate. One of the conditions of an incubator fund, though, to bear in mind is that they are a capped duration. So they are capped at a duration of two years. After the two-year duration period you are expected to either convert to a regular fund or to close down or there is an option to extend by one year.

Then we have the approved fund. So an approved fund is more aimed at the family offices and friends and family-type fund. It's quite similar to an incubator fund, but the main difference is you are allowed to manage up to 100,000,000 in AUM and there is no duration limit. You need to bear in mind that you are also required to appoint an administrator, but again there is no requirement to have an auditor, so they are quite low cost.

Kamar Jaffer

And, Tom, what are the key regulatory structuring considerations?

Tom Cochrane

Usually when we have a client looking to set up a BVI-domiciled fund, there are a number of questions that we ask them, really to ascertain what legal structure will work best for them and to determine what regulatory obligations would apply. So, the first question we ask is around trying to determine if it's going to be an open or closed-ended fund and we've used those terms a couple of times already. Those terms can mean different things in different jurisdictions. So, just to clarify from a BVI funds perspective, an open-ended fund is one in which the investors can electively redeem periodically, whether that's weekly, monthly, quarterly, what have you, whereas a closed-ended fund is a fund in which the investor has no redemption or withdrawal rights. So they are locked into the fund for a set term. And it is important to understand which category the fund will fall into, because the BVI funds regime is effectively bifurcated along those lines. So that's the key question initially. We also enquire about the subscription capital. Is the intention that the subscription proceeds are going to be paid upfront in their entirety? If so, then typically a corporate structure will work well. However, if the intention is that there will be a drawdown mechanism where investors make a capital commitment and then they make contributions in respect of that commitment over time, then usually the limited partnership or LPGP structure will work best. We also like to enquire about the number of investors that are intended to come into the fund. As Paul mentioned, for certain types of funds, like the incubator or approved fund, there are limits on the number of investors that you can have and for similar reasons we like to enquire about the target raising, since there are limits on the fund's AUM, and finally, you know, we like to enquire about the fund's assets. By way of example, if the fund was to acquire a single asset, then it might qualify for an exemption under the private investment funds' regime, which is something, I think, we will get to in a little bit today.

Kamar Jaffer

Actually that's the next question. Paul, what are the key requirements that apply in relation to private investment funds?

Paul Waldron

Private investment funds are for closed-ended funds, so your typical private equity, venture capital, real estate type funds. So typically they are structured as a limited partnership in BVI and the general partner KPI, the BVI general partner or based elsewhere. It is also possible to structure it as a standard business company or as a segregated portfolio company. In terms of the requirements for a private investment fund, there is no need for an investment manager, an administrator or a custodian. Instead, the BVI has brought in a concept called the Appointed Person. That is effectively an unregulated person who carries out these functions. Typically that would be a director, for example, who would take responsibility for investment management and another director who might take responsibility for administration. Also, a private investment fund is required to appoint an auditor, but the good news is that it doesn't need to be a BVI auditor, so that can be quite a saving. Also, the FSC will provide an exemption from the requirement to appoint an auditor altogether if required, in return for a small annual fee. This recognises the fact that not all investors in a private equity fund will require annual auditors, for example.

In terms of the regulatory regime itself, it applies generally to most closed-ended funds, but there are quite a few exemptions. So the key exemptions from regulation would be single asset funds, single investor funds, joint ventures and arrangements with no external offering. Also master feeder funds fall outside the regulatory permit here.

Kamar Jaffer

And, Tom, we've been touching a bit on the service providers that need to be appointed in respect of the funds. What is the ecosystem around funds in the BVI? What economic substance requirements apply?

Tom Cochrane

Well, I think if we address the economic substance point first. The good news for your listeners out there is being an investment fund in and of itself doesn't constitute a relevant activity for the purposes of the BVI economic substance regime, so the vast majority of BVI-domiciled funds, and we are literally talking 99% plus here, will not have to demonstrate any substance in BVI. There is one caveat, which is that if the fund is carrying out additional activities that may constitute a relevant activity, so, for example, finance and leasing business, then it would need to show substance in respect of those additional relevant activities and it is worth noting that we have got a specialist regulatory team here at Walkers, so if there are any clients who find themselves in that situation, then our regulatory team would be well placed to help.

I think in terms of the ecosystem more broadly, there are probably two key takeaways for your listeners. The first is that within the BVI, there is a wide-range of highly skilled and very experienced professional service providers, so if you have a fund manager looking to set up a BVI fund, then they can utilise the skills and experience of all of those providers within the BVI.

The second takeaway, though, I think, is that the BVI doesn't mandate that a lot of the services that are provided to BVI funds are actually carried out in the BVI. So, as Paul mentioned, you don't need a BVI-based auditor, you don't need a BVI-based administrator, the manager of your BVI fund doesn't need to be BVI-domiciled, the directors of your BVI fund don't need to be resident in BVI. So I think overall it's a helpful position where you can utilise the service providers within BVI if you need to or want to, but at the same time, if you've got existing relationships with service providers in other jurisdictions, then you can continue to leverage those and still take advantage of the BVI funds regime.

Kamar Jaffer

Paul, touching on the fund manager, what options are there in terms of setting up a fund manager in the BVI?

Paul Waldron

There are two main types of investment management product in the BVI. The first one is your standard investment manager. This is aimed at your more institutional managers. This allows you to manage investment funds and other products without any limit, but it's quite a slow and expensive process to set one up. So you are looking at a minimum of three to four months, for example, which generally tends to be too long for a fund launch which has to be much quicker than that. In recognition of this, the BVI brought in what is called the Approved Manager. This is a regulatory-lite product which is aimed at smaller and medium sized managers and can be set up very quickly in tandem with a fund launch. So the idea of an Approved Manager is that they are authorised to manage up to 400,000,000 in open-ended assets or USD1,000,000,000 in closed-ended assets. They can be launched, as I said, in tandem with a fund launch and they are very popular with managers of funds set up in other jurisdictions. So there is no restriction on managing just BVI funds, you can manage funds set up elsewhere and also onshore. A point worth noting as well: with Approved Managers, they are exempt from the BVI economic substance regime. There is no need to have directors or any economic substance on the ground in BVI. So they are proving very popular at the moment and we've seen a very substantial growth in numbers over the last couple of years.

Kamar Jaffer

Tom, what are the legal and regulatory developments on the horizon in BVI?

Tom Cochrane

Well, there's actually been an immense amount of change in the legal and regulatory landscape in the BVI in the last, say, five years and that probably mirrors global trends. We've obviously had the introduction of the Limited Partnership Act that I mentioned earlier. Paul has walked you through some of the key aspects of the private investment funds regime that's been established and as well as those developments, we've also had significant enhancements and developments with respect to matters such as economic substance, anti-money laundering, beneficial ownership, FATCA and CRS. So I think, probably, what we are anticipating for the near term is more of a period of consolidation, at least in so far as it pertains to investment funds in the BVI. That said, I think the BVI authorities will continue to monitor global trends and what best practices are so that they can implement anything that's appropriate in BVI and make sure that BVI remains first in class.

Kamar Jaffer

And, Paul, looking ahead, what is your outlook for the next 12 months?

Paul Waldron

I think for the next 12 months, the Approved Manager products are going to continue to be very popular. It can be used for BVI funds and funds established elsewhere, open-ended funds and closed-ended funds. So I think we will continue to see a lot of growth in launches of those. Separately, I think the private investment fund is going to continue to be very popular. I think private equity, venture capital and real estate are going to be very popular for the next 12 months and then thirdly, I think, there will still be quite a few launches on the crypto side, but I think a lot will depend on where the price of crypto is in 12 months' time in that regard.

Kamar Jaffer

What a great conversation. Thank you very much, Tom and Paul, for joining us today and for sharing your insights into the BVI's legal and regulatory framework for investors and for fund managers. I hope that our viewers have found it as useful as I have. Look out for our next episode in our podcast series, which will be released very soon. Thank you very much and have a good day.