

# Hedge funds in the British Virgin Islands: regulatory overview

Clinton Hempel, Carey Olsen

[global.practicallaw.com/w-007-6405](http://global.practicallaw.com/w-007-6405)

## MARKET OVERVIEW

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

The regulatory regime applicable to investment funds in the British Virgin Islands (BVI) differentiates between open-ended and closed-ended funds. Most hedge funds are open-ended funds, regulated under the Securities and Investment Business Act 2010 (SIBA). Open-ended hedge funds are regulated by the Financial Services Commission either as private funds, professional funds, public funds, approved funds or incubator funds. As at 30 June 2019, there were just under 1,498 funds recognised or registered under SIBA. The majority of these are recognised as professional funds (938), followed by private funds (326), public funds (37), approved funds (108) and incubator funds (74). BVI funds are predominantly used as non-retail funds.

## REGULATORY FRAMEWORK AND BODIES

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

#### Regulatory framework

Open-ended hedge funds are governed by the Securities and Investment Business Act 2010 and the Mutual Funds Regulation 2010.

The Securities and Investment Business (Incubator and Approved Funds) Regulations 2015 governs approved and incubator funds.

This regulatory regime distinguishes between the various fund types, as follows.

**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.

**Professional funds.** In relation to a professional fund:

- Fund interests can only be issued to professional investors (see *below*).
- The initial investment for all investors (other than exempt investors) cannot be less than USD100,000 or the foreign currency equivalent.

A professional investor is a person:

- 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 fund property; or

- a substantial part of the fund property.
- Who has signed a declaration that he or she:
  - whether individually or jointly with his or her spouse, has net worth in excess of USD1 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.

**Approved funds.** An approved fund is restricted to having:

- No more than 20 investors.
- A maximum net asset value of USD100 million.

**Incubator funds.** An incubator fund is restricted to having:

- No more than 20 investors.
- An initial investment for all investors of at least USD20,000 or the foreign currency equivalent.
- A maximum net asset value of USD20 million.
- A maximum lifetime of two years (with a possible extension of one year) after which:
  - the fund must be converted to either a private fund, a professional fund or an approved fund; or
  - the business of the fund must be terminated.

#### Regulatory bodies

The Financial Services Commission (FSC) is the regulatory body for open-ended funds, including public funds.

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

All regulated funds must submit their financial statements to the Financial Services Commission (FSC) within six months of the financial year end of the fund.

Public, private and professional funds must have at all times appointed an investment manager and an administrator, which must satisfy the FSC's "fit and proper" criteria. There is no requirement for either the investment manager or the administrator to be located in the BVI. An investment 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 41 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).

An investment manager or administrator requires a licence under the Securities and Investment Business Act 2010 (SIBA) if it is a BVI entity or has a physical presence in the BVI.

### Risk

Public funds must comply with the corporate governance and high-level principles for business under the Public Funds Code 2010. Private funds, professional funds, approved funds and incubator funds are not subject to the same level of supervision by the FSC as public funds. Therefore, the requirements considered necessary for the protection of investors that apply to public funds do not apply to private funds, professional funds, approved funds and incubator funds. As a result, investing in these funds can be riskier for investors than investing in a public fund.

### Valuation and pricing

Public funds must adopt detailed pricing and valuation policies. Details of the policies must be made available to investors in public funds.

Under the Public Funds Code 2010, the assets of a fund must be valued using market prices. Also, where practical, the valuation of an asset must be checked against a primary and secondary source. Assets for which there is no readily available market price can be valued using pricing models to determine fair value if the use of the pricing model has been approved by the fund's governing body.

Public funds must establish and maintain:

- A clear and comprehensive policy (or policies) for the valuation of the fund property.
- Sufficient procedures to ensure that the valuation policy is effectively implemented.

The public fund must ensure that the valuation policy and procedures:

- Are fully and clearly documented.
- Are appropriate for the nature, size, complexity, structure and diversity of the fund and the fund property.
- Comply with the requirements of the Public Fund Code 2010.
- Are consistent with the provisions concerning valuation in the fund's constitutional document and prospectus.
- Are carried out by parties that have the appropriate level of experience and competence to properly fulfil their roles.

A public fund must ensure that the valuation and net asset value (NAV) functions are undertaken by the fund's administrator or a third-party valuation service provider, independently of the fund's governing body and other functionaries. The governing body of a public fund must also ensure that the persons controlling the fund's manager (or who are otherwise responsible for carrying out the fund's investment function) are independent from the persons controlling the fund's administrator (or who otherwise have responsibility for the valuation function). To ensure that there is sufficient independence in applying the fund's valuation policy, a segregation of responsibilities must be ensured between the parties concerned with the process of valuing the fund's property and those concerned with calculating the fund's NAV (where appropriate). If necessary, the fund's governing body can appoint a valuation committee to oversee the application of the valuation policy.

A public fund must have procedures in place to arrange for information about the valuation process to be provided to investors on request.

The fund's prospectus must contain the following:

- The person or persons who are responsible for undertaking valuations of the fund property, preparing NAVs and valuing the fund interests, the person or persons with oversight responsibility, and where the valuations will be undertaken.
- A description of any material conflicts of interest associated with the parties carrying out the valuation process, including whether the fund manager has any role in the valuation of the fund property.
- How frequently (in days), and at what time or times of day, the fund property and the fund interests will be valued, and a description of any circumstances in which the fund property and fund interests can be specifically valued.
- The basis on which the fund property will be valued, including the methodology and procedures for undertaking the valuation.
- An indication of the circumstances in which a valuation can be suspended.
- A statement that full details of the fund's valuation policies are contained in a written valuation policy, together with any other information concerning the valuation process that is available to investors on request and indicating how this information can be obtained.

### Systems and controls

A public fund must:

- Establish and maintain such policies and procedures as are appropriate for the nature, size, complexity, structure and diversity of the fund and the fund property. The public fund must also ensure that these procedures are fully and clearly documented.
- Establish and maintain a policy for the issue and redemption of fund interests, and procedures to ensure that the policy is effectively implemented and fully and clearly documented, including provisions for:
  - the dealing days and times in the dealing day on which the fund will be available to receive requests for the issue and redemption of fund interests;
  - the procedures for effecting the issue and redemption of fund interests and the settlement of transactions;
  - the steps required to be taken by an investor redeeming fund interests before he/she can receive the proceeds of redemption;
  - the minimum number of fund interests which any one person can hold and the minimum number or value of fund interests which can be the subject of any one transaction of purchase or redemption;
  - the circumstances in which the redemption of fund interests can be suspended; and
  - when and where the most recent issue and redemption prices will be published and the investment exchanges (if any) on which fund interests are listed or dealt.
- Take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities between its governing body and functionaries, so that the business and affairs of the fund can be adequately controlled and monitored by the governing body.

### Insider dealing and market abuse

**Insider dealing.** On summary conviction, the maximum sentence for insider dealing is a fine of USD40,000 and/or imprisonment for a term of three years. On indictment, the maximum sentence is a fine of USD100,000 and/or imprisonment for a term of five years. A person who has information as an insider (that is, the information is inside information, the person knows that it is inside information and

---

has the information from an inside source) commits an offence if he/she either:

- Deals in price-affected securities that the information relates to where:
  - the dealing (that is, the acquisition or disposal) takes place on a securities market; or
  - the person dealing relies on a professional intermediary or is himself/herself acting as a professional intermediary.
- Encourages another person to deal in securities that are (whether or not that person knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing will take place on a securities market.
- Discloses the information to another person, other than in the proper performance of the functions of his employment, office or profession.

Inside information is defined as information which:

- Relates to one or more particular securities, or one or more particular issuers (and not to securities or issuers generally).
- Is specific or precise in nature.
- Has not been made public.
- Is likely to have a significant effect on the price of any securities if it were made public.

A person does not commit an offence by virtue of dealing in securities if he/she can prove that:

- He/she acted in good faith in the course of his/her:
  - business as a market maker; or
  - employment in the business of a market maker.
- The information which he/she had as an insider was market information and it was reasonable for an individual in his/her position to have acted as he/she did despite having that information as an insider at the time. This defence takes into account the content of the information, the circumstances in which the person first had the information and in what capacity, and the capacity in which he/she acted when the determination was made.
- He/she acted in compliance with the market rules applicable to the securities market concerned.
- He/she acted in connection with an acquisition or disposal which was under consideration or the subject of negotiation (or in the course of a series of such acquisitions or disposals) and with a view to facilitating the accomplishment of the acquisition or disposal (or series of acquisitions or disposals). The information which he/she had as an insider must be market information arising directly out of his/her involvement in the acquisition or disposal (or series of acquisitions or disposals).
- He/she did not at that time expect the dealing to result in a profit attributable to the fact that the information was price-sensitive information in relation to the securities.
- He/she reasonably believed at the time that the information had been, or will be, disclosed widely enough to ensure that none of those taking part in the dealing will be prejudiced by not having the information.
- He/she would have done what he/she did even if he/she had not had the information.

**Misleading statements and market manipulation.** It is an offence for a person to do any of the following for the purpose of inducing another person to enter, offer to enter into or refrain from entering into an agreement or arrangement which constitutes investment

business, or to exercise or refrain from exercising any rights conferred by an investment:

- Make a statement, promise or forecast which he/she knows is misleading, false or deceptive.
- Dishonestly conceal any material facts.
- Recklessly make (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive.
- Do any act or engage in any course of conduct if:
  - this act or course of conduct creates a false or misleading impression as to the market, price or value of an investment; or
  - this is for the purpose of creating the impression which induces another person to deal in the investment, refrain from doing so or exercise (or refrain from exercising) any rights in relation to that investment.

A person commits an offence in this regard only if either:

- The statement, promise or forecast is made in, or from, the BVI.
- The facts are concealed in, or from, the BVI.
- Any arrangement which is entered into is made in or from the BVI.

A person does not commit an offence if either:

- The statement, promise or forecast was made in respect of a securities market and he/she proves that he or she acted in compliance with the market rules applicable to the securities market concerned.
- He/she undertook the act or engaged in the course of conduct in respect of a securities market and he or she proves that:
  - he/she reasonably believed that the act or conduct would not create an impression that was false or misleading; or
  - he/she acted in compliance with the market rules applicable to the securities market concerned.

On summary conviction, the maximum sentence is a fine of USD40,000 and/or imprisonment for three years. On indictment, the maximum sentence is a fine of USD100,000 and/or imprisonment for five years.

## Transparency

**Public funds.** A public fund is required to disclose to the FSC any matter that may reasonably be expected to have a significant regulatory impact on the fund including:

- The suspension of valuation, dealing or redemptions.
- Any matter that could impact on the ability of the fund to continue to carry on business.
- Any incident of fraud or other criminal activity that is connected with, or may affect, the public fund's business and which is material to the safety, soundness or reputation of the fund.
- The appointment or resignation or removal of a director, authorised representative or auditor or any change in the address of the fund's place of business.
- Any change in the place or places where the fund's financial or other records are kept.
- If the fund is incorporated under the laws of a jurisdiction outside the BVI, any material change in the nature and scope of the fund's business.
- Any proposed amendment to its constitutional documents.

- Its intention to issue an offering document not previously provided to the FSC or its intention to amend any offering document previously provided to the FSC.

Where a public fund proposes to make any changes to the rights of investors which the investors are not required to approve, the fund must give each investor notice of the change (where practicable, prior to the change being made).

**Private and professional funds.** A private fund or a professional fund must provide written notice to the FSC of:

- The appointment, resignation or removal of a director, authorised representative or auditor, or any change in the address of the fund's place of business.
- Any material change in the nature and scope of the fund's business (if the fund is incorporated under the laws of a jurisdiction outside of the BVI).
- Any amendment to its constitutional documents, the issuance of any offering document not already provided to the FSC or the amendment of any document previously provided to the FSC.

**Incubator funds.** An incubator fund must submit a semi-annual return to the FSC detailing:

- The number of investors in the fund.
- The total investments in the fund.
- The aggregate subscriptions to the fund.
- The aggregate redemptions paid to investors.
- The net asset value of the fund.
- Any significant investor complaint received by the fund and how the complaint was dealt with.

An incubator fund must also file an annual return with the FSC to confirm that it is not in breach of the requirements of the Securities and Investment Business (Incubator and Approved Funds) Regulations 2015 and to provide any other information as the prescribed form requires.

**Approved funds.** An approved fund must file an annual return with the FSC:

- Confirming that it is not in breach of the requirements of the Securities and Investment Business (Incubator and Approved Funds) Regulations 2015.
- Setting out any significant investor complaint received by the fund and how the complaint was dealt with.
- Providing any other information as the prescribed form requires.
- Providing details as of 31 December of the preceding year about the:
  - number of investors in the fund;
  - total investments in the fund;
  - aggregate subscriptions to the fund;
  - aggregate redemptions paid to investors; and
  - net asset value of the fund.

### Money laundering

The BVI has a strict anti-money laundering and anti-terrorist financing regime in place. The BVI government, the FSC and other statutory bodies liaise with regulators in other jurisdictions to ensure compliance with international standards of good practice. All hedge funds are subject to the:

- Proceeds of Criminal Conduct Act 1997 (as amended).
- Anti-money Laundering Regulations 2008 (as amended).

- Anti-money Laundering and Terrorist Financing Code of Practice 2008 (as amended).

This legislation provides a BVI hedge fund with the option to outsource client verification requirements to its non-BVI based administrator if the administrator is based in a recognised jurisdiction.

### Short selling

There are no markets for securities in the BVI. Therefore, short selling activities are governed by the jurisdiction of the exchange where the securities are listed.

## MARKETING

### 4. Who can market hedge funds?

The person carrying on the promotion may need to be licensed under the Securities and Investment Business Act 2010 (SIBA) to promote the fund. For example, subject to limited exceptions (such as acting for a company within the same group, or providing business to a company for which a person acts as a director without receiving remuneration), a licence is required under SIBA to:

- 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 regulated investment business as set out in SIBA).
- Arrange transactions in mutual fund interests.

### Onshore hedge funds

A fund incorporated or established in the BVI cannot be promoted in or from within the BVI unless the fund is registered as a mutual fund with the BVI Financial Services Commission.

### Offshore hedge funds

A fund incorporated or established outside of the BVI cannot be promoted in or from within the BVI unless the fund is recognised as a foreign fund by the BVI Financial Services Commission.

### 5. To whom can hedge funds be marketed?

#### Onshore hedge funds

Public funds can be marketed to any member of the public both in and outside of the BVI (subject to foreign regulations). However, the offer must be made by way of a registered prospectus.

A private fund can either have a maximum of 50 investors or offer interests in the fund on a private basis only. Incubator and approved funds are limited to 20 investors.

#### Offshore hedge funds

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.

## INVESTMENT RESTRICTIONS

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

There are no restrictions on local investors investing in a fund if the hedge fund is approved by the Financial Services Commission under the Securities and Investment Business Act 2010 and the regulations for public offers are followed.

---

## ASSETS PORTFOLIO

---

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

---

A private or professional fund must, subject to limited exceptions, at all times have a custodian appointed. A public fund is required to appoint a custodian in the BVI or a recognised jurisdiction. The custodian must be functionally independent from the investment manager and the administrator and meet the Financial Services Commission's fit and proper criteria.

According to guidance from the Financial Services Commission, an exemption from the custodian requirement will normally be available in the following circumstances:

- Funds who have appointed prime brokers that perform the same function.
- Feeder funds in master/feeder structures.
- Funds operating as fund of funds.
- Funds in the process of winding down.
- Funds that invest in esoteric assets.

## REQUIREMENTS

---

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

---

A private or a professional fund must file any offering document with the Financial Services Commission (FSC) within 14 days of the date of its issue to any investor. Amendments to the offering documents previously provided to the FSC must be notified to the FSC within 14 days.

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

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

---

#### Onshore hedge fund managers

A person carrying on business in or from within the BVI as an investment manager, adviser or administrator of a fund must hold a licence issued by the Financial Services Commission (FSC).

The person carrying on promotion of the fund may also need to be licensed under the Securities and Investment Business Act 2010 (SIBA) to promote the fund. For example, subject to limited exceptions (such as acting for a company within the same group, or providing business to a company for which you act as a director without receiving remuneration), a licence is required under SIBA to either:

- 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 regulated investment business as set out in SIBA).
- Arrange transactions in mutual fund interests.

#### Offshore hedge fund managers

Fund functionaries which are located outside of the BVI are not required to be regulated in the BVI if the FSC is satisfied (on application) that the functionary's jurisdiction of establishment and location has a system for the effective regulation of investment business, including funds.

A list of current recognised jurisdictions is published by way of a statutory instrument.

## LEGAL FUND VEHICLES AND STRUCTURES

---

### 10. 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?

---

BVI funds are established as either:

- Companies limited by shares (including as segregated portfolio companies) under the Business Companies Act, as amended (BCA).
- Limited partnerships under the new Limited Partnership Act 2017 (LP Act) (*see below, Limited partnerships*).
- Unit trusts governed by the laws of the BVI.

The vast majority of BVI hedge funds are established as companies under the BCA. The BCA is widely regarded as cutting edge corporate legislation and provides a modern and flexible regime suitable for use for hedge fund vehicles.

#### Companies limited by shares

**Advantages** The advantages of setting up a hedge fund as a company limited by shares are as follows:

- No corporation tax is imposed on companies incorporated in the BVI.
- There is flexibility as to how a BVI company is managed, and bespoke provisions can be incorporated into the BVI company's constitutional documents.
- Separate legal personality which allows the company to hold all of the fund's assets in its own name.
- There is no concept of authorised share capital in the BVI. As a result, there is no specified maximum number of shares that the company can issue.
- The liability of shareholders is limited to the unpaid amount (if any) in relation to their shares.

#### Limited partnerships

The BVI's new LP Act was brought into force on 6 February 2018. The LP Act provides for the eventual re-registration of all existing international limited partnerships as limited partnerships under the LP Act, and any new BVI limited partnership will be formed and registered under the LP Act.

**Advantages.** Setting up a hedge fund as a limited partnership will confer the following advantages:

- Limited partnerships offer a tax transparent "pass-through" structure.
- It is possible to elect for the limited partnership to have (or not have) separate legal personality.
- Offers flexibility in relation to capital raising, allocation of distributions and carry structure.
- Limited partners are only liable for their uncalled capital unless they take part in the management of the partnership.

**Disadvantages.** The disadvantages of setting up a hedge fund as a limited partnership are as follows:

- As a new and (as yet) judicially-untested structure, investors may not be familiar with the features of a limited partnership.
- To the extent that the limited partnership does not have a separate legal personality, the fund assets must be held by the general partner for the partnership, and the general partner will

---

be liable for all debts and obligations of the partnership to the extent that the assets of the partnership are insufficient to discharge these.

### Unit trusts

Unit trusts are rarely employed in the BVI and specific legal advice should be obtained in this regard.

## TAX TREATMENT

---

### 11. What is the tax treatment for hedge funds?

---

#### Funds

A fund registered under the Securities and Investment Business Act 2010 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. However, as the income tax rate is currently zero, and 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.

## RESTRICTIONS

---

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

---

#### Redemption of interest

Open-ended funds can agree any restrictions on the issue and redemption of interests with their investors at the time they subscribe for such interests. In addition, the Public Funds Code 2010 (PF Code) requires a public fund to adopt policies and procedures for the issue and redemption of fund interests. The policies must be appropriate for the nature, size, complexity, structure and diversity of the fund and the fund property. They must also meet prescribed minimum criteria set out in the PF Code including the timing of dealing and redemption of fund interests. The introduction of additional restrictions in respect of an investor's existing interest can only be achieved in accordance with the consent mechanisms contained in the fund's constitutional documents.

#### Transfer to third parties

There are no statutory restrictions on the ability of investors in open-ended funds to transfer their interests to third parties, although the constitutional documents of the fund will normally contain restrictions.

## PRIVATE PLACEMENT

---

### 13. Are private placements of hedge funds permitted under national private placement rules in your jurisdiction?

---

Private placements are not a feature of the BVI hedge funds market and the majority of funds include specific provisions in their constitutional documents and offering documents preventing placements in the BVI. Specific legal advice should be obtained in this regard.

### 14. What are the requirements for making a private placement of hedge funds?

---

See *Question 13*.

## REFORM

---

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

---

There are no proposals for the reform of hedge fund regulation at present.

---

## Practical Law Contributor profile

---

### Clinton Hempel

---

Carey Olsen

**T** +1 284 394 4030

**F** +1 284 494 4155

**E** [clinton.hempel@careyolsen.com](mailto:clinton.hempel@careyolsen.com)

**W** [www.careyolsen.com](http://www.careyolsen.com)

**Professional qualifications.** South Africa, Attorney, 1996; England and Wales, Solicitor, 1997; British Virgin Islands, Solicitor, 1999

**Areas of practice.** Investment funds and private equity; joint ventures and finance regulation.

#### Recent transactions

- Advising on the launch of two multi-billion US dollar hedge funds.
- Advising a US pension fund manager on investment in a BVI private equity fund.
- Advising a sovereign fund on investment in a BVI company operating in various Latin American countries in the telecommunications sector.

**Professional associations/memberships.** Member of the British Virgin Islands Bar Association.

**Publications.** *Private equity in British Virgin Islands: market and regulatory overview Private Equity Global Guide 2015/16* (co-author).