

Establishing an Incubator or Approved Fund in the British Virgin Islands

These extremely popular and flexible funds are governed by the Securities and Investment Business (Incubator and Approved Funds) Regulations 2015, as amended (the **Regulations**) and the Incubator and Approved Funds Guidelines. The BVI has often been described as the “home” of the emerging manager and these two fund products further reinforce that message.

The incubator fund is aimed at start-up managers looking to establish a track record and test a strategy in the most cost-efficient manner. The approved fund is aimed at managers looking to establish a fund for a small, private and longer-term offering in a tested and respected funds jurisdiction.

In order to qualify as an incubator or approved fund, a fund must fall within the requisite thresholds regarding (i) the number of investors, (ii) the maximum value of its net assets and (iii) the minimum initial contributions by each investor (incubator funds only). An approved fund is also required to appoint an administrator to ensure suitable oversight of its operations.

The key features of incubator & approved funds

- Rapid approval times by the Financial Services Commission (the **Commission**) ensuring that the fund can be launched within a timescale that meets the manager’s requirements
- Light regulation and minimal ongoing regulatory obligations
- Limited mandatory information to be contained in an offering document means that the fund can operate using a short-form term sheet, keeping legal costs and time associated with set-up to a minimum
- Stripped back requirements for mandatory functionaries to be appointed (other than the appointment of an administrator for an approved fund). The manager can therefore elect to only appoint functionaries they believe the fund requires from the outset
- No requirement to conduct an audit or file audited financial statements
- The incubator fund has a two-year validity period (with the possibility to extend this by a maximum of 12 months on application to the Commission), which gives the manager time to test their strategy and determine whether the fund is viable before committing to operate as a private, professional or approved fund
- Option to convert to a private or professional fund at a later date, should the fund outgrow the applicable restrictions
- Ability to commence business within two business days of lodging a complete application for approval with the Commission

Criteria for the incubator & approved funds

- **Number of investors:** Incubator and approved funds must have no more than 20 investors. Once this limit is met, the Regulations allow a reasonable time to upgrade the fund to the next level, ensuring a smooth continuity of operation
- **Minimum investment:** For incubator funds only, each investor must be a “sophisticated private investor”, which simply means that they were invited to invest in the fund and must make a minimum initial investment of US\$20,000. There is no prescribed minimum investment amount for approved funds
- **Total assets:** The net assets of an incubator fund must not at any time exceed US\$20 million. The net assets of an approved fund must not at any time exceed US\$100 million

- **Valuation policy:** The fund is required to maintain a clear and comprehensive policy for the valuation of its assets (**Fund Property**) with procedures that are sufficient to ensure that the valuation policy is effectively implemented. The valuation policy shall:
 - Be appropriate for the nature, size, complexity, structure and diversity of the fund and the Fund Property
 - Be consistent with the provisions concerning valuation in its constitutional documents and term sheet/offering document
 - Require valuations to be undertaken at least on an annual basis
 - Include procedures for preparing reports on the valuation of the Fund Property
 - Specify the mechanisms in place for disseminating valuation information and reports to investors
- **Minimum investor disclosures:** Each investor must be provided with a written warning (either in a prominent place in the offering document or in a separate document) that:
 - The fund is an incubator or approved fund, as applicable
 - The total number of investors in the fund is limited to a maximum of 20
 - The fund is suitable for sophisticated private investors (incubator funds only)
 - The fund is limited to the value of its net assets not exceeding US\$20 million or US\$100 million, as applicable
 - The fund is not subject to supervision by the Commission and that the requirements considered necessary for the protection of investors that apply to public funds do not apply to an incubator or approved fund, as applicable
 - An investor is solely responsible for determining whether the fund is suitable for his or her investment needs
 - Investment in an incubator or approved fund may present a greater risk to an investor than investment in a public fund
 - The incubator fund is limited to an initial period of two years and may, thereafter, unless it decides to terminate its business, apply to the Commission to be recognised as a private or professional fund or approved as an approved fund

Application process

The applicant must submit an application in the approved form to the Commission and provide the following:

- A copy of the applicant's constitutional documents which must state that the applicant is an approved or incubator fund
- A copy of the applicant's offering document which must include the investment warning and a description of the applicant's investment strategy. Where there is no offering document, the investor warning and description of the applicant's strategy must be provided separately
- A copy of the applicant's subscription agreement
- Details of the money laundering reporting officer of the applicant
- A resume or curriculum vitae for each director of the applicant or of the applicant's general partner (as appropriate) as well as for the money laundering reporting officer
- A copy of the applicant's valuation policy
- A copy of the applicant's anti-money laundering and countering the financing of terrorism policies and procedures
- The application fee of US\$2,000 (including the fee for obtaining an original certificate of recognition from the Commission)

The applicant is deemed to be an incubator or approved fund upon submission of a complete application and may commence business two business days after receipt by the Commission of the application.

If the Commission considers the application to be incomplete, it will advise the applicant within two business days of receipt of the application and will outline any further requirements. The applicant will then have seven days (subject to any extension being granted by the Commission) to provide the further information, after which time the application will be considered abandoned.

Regulatory considerations

Incubator and approved funds also have the following regulatory obligations under BVI law:

- **MLRO:** Appoint a single money laundering reporting officer in accordance with the fund's obligations under the British Virgin Islands Anti-Money Laundering Regulations 2008 and the British Virgin Islands Anti-Money Laundering and Terrorist Financing Code of Practice 2008 (as amended). This person is often one of the directors or a representative of the administrator who is conducting the onboarding of investors on behalf of the fund.
- **FATCA & CRS:** Register with and report to the BVI International Tax Authority (*ITA*) to meet the fund's automatic exchange of information obligations under FATCA and CRS.
- **Investor AML:** For incubator funds, put in place procedures for investor on-boarding which address typical investor identification requirements and the reporting of suspicious activities to the BVI Financial Investigations Agency, and documenting how the fund complies with BVI anti-money laundering procedures. For approved funds this will typically be done by the administrator.

Conversion of an incubator or approved fund

An incubator or approved fund may continue as such for so long as it remains within the relevant thresholds under the Regulations. An incubator fund is subject to a validity period of two years, unless extended with approval from the Commission by a maximum of 12 months.

If an incubator or approved fund exceeds the restrictions in relation to the value of its net assets or the number of investors for two consecutive months, within seven days of the end of the second month (unless at the time of notification it no longer exceeds the threshold), the fund must choose whether to:

- Apply for recognition as a private or professional fund
- In the case of an incubator fund, apply for approval as an approved fund
- Take steps to amend its constitutional documents to remove its redemption provisions and references to being an incubator or approved fund and cease to operate as a mutual fund
- Commence the process of liquidating the fund

An application for recognition as a private or professional fund must be accompanied by an audit of the fund's current financial position and its compliance with the Regulations.

If any of the restrictions in relation to the value of its net assets or the number of investors are exceeded by the fund in contravention of the provisions of the Regulations (ie proper notice is not provided to the Commission and/or the fund does not voluntarily take the steps outlined above), the Commission may require the fund to take one of the steps outlined above.

Ongoing obligations

Incubator and approved funds must:

- Have an authorised representative in the BVI at all times
- Have at least two directors (one of whom must be an individual) at all times
- In the case of an approved fund, have an administrator at all times
- Pay an annual fee of US\$1,200 to the Commission for renewal of its approval as an incubator or approved fund
- Submit financial statements (which do not need to be audited), approved and signed by a director or the general partner of the fund (as relevant), to the Commission within six months of the end of the financial year to which they relate

- Submit to the Commission, no later than 31 January in each year, a statement that it is not in breach of the requirements of the Regulations that allow it to continue as an incubator or approved fund
- Incubator funds must submit to the Commission a semi-annual return no later than 31 January and 31 July in each year for the periods ending 31 December and 30 June respectively, containing the following information:
 - 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

Approved funds are required to submit the same information to the Commission, but on an annual basis only, by 31 January for the previous calendar year.

- Notify the Commission:
 - Immediately if the authorised representative ceases to represent the fund and take necessary steps to replace the authorised representative within 21 days of the date that the authorised representative ceased to act for the fund
 - Immediately if the number of directors falls below two and take necessary steps to bring the number of directors to two within 21 days from the date that the requirement was not complied with
 - Of any change to the information provided to the Commission with its application, including a written declaration stating whether the change complies with the requirements of the Regulations, within 14 days of any such change occurring
 - Of any matter related to the conduct of the business activities or affairs of the fund which may have a material impact on the fund (for example, a suspension of redemptions or the fund becoming subject to any legal or regulatory proceedings)



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