Start-up investment managers – what are the benefits of the BVI's incubator funds regime?

Insights - 02/05/2023

For many aspiring start-up investment managers, finding the most appropriate jurisdiction to domicile their first fund may feel a daunting prospect – but it does not need to be, as start-up investment managers have long found solutions for their needs in the British Virgin Islands (**BVI**), by utilising BVI domiciled fund vehicles for their fund offerings[1].

Offshore fund structuring is not a matter of one-size-fits-all and to reflect this, the BVI has a range of funds products to suit all investment managers. For aspiring start-up investment managers, the BVI's incubator funds regime is particularly popular, in that it provides a cost effective solution appropriate for the nature and size of the proposed investor audience. This enables an aspiring investment manager to set-up and launch a fund without having to simultaneously resource a substantial middle and back office function to support its fledgling front office investment management operations.

What are the features of the incubator funds regime?

The BVI's incubator funds regime is appealing to aspiring start-up investment managers for a number of reasons.

- Type of investors: incubator funds are available for offerings to "sophisticated private investors" only and, for these purposes, a "sophisticated private investor" is a person invited to invest
- Minimum investment: US$ 20,000
- Maximum number of investors in the fund: 20
- Aggregate maximum investments: not exceeding US$ 20 million (or its equivalent in another currency)

- Time limit for taking advantage of incubator fund status: two years, with a possible further 12 month extension available at the discretion of the BVI regulator, the Financial Services Commission (**FSC**)
- Private placement memorandum: there is no formal requirement for a formal private placement memorandum. However, where no formal private placement memorandum is prepared, the regulatory requirement is for investors to each be given a written investment warning. From our experience, most incubator funds opt to go further than this minimum requirement and offer fund interests to investors through a short form term sheet. The ability not to have a formal private placement memorandum is particularly suitable for funds likely to initially raise money from friends and family, such investors not needing the benefit of detailed disclosures in relation to a potential investment in the fund in evaluating whether or not to invest
- No audit requirement: rather, incubator funds are only required to prepare and file unaudited financial statements each year with the FSC. However, at the time of their future conversion into a private fund or a professional fund, an audit of (i) the fund's current financial position (such audit being an independent determination of the status of the fund's finances as opposed to an audit of its financial statements); and (ii) its compliance with the requirements of the incubator funds regime, will be required
- No mandatory requirement for a third party fund administrator: however, notwithstanding that it is not mandatory for an incubator fund to appoint a third party fund administrator, a number of our clients voluntarily elect to engage a third party fund administrator, so as to (i) assist it with discharging its anti-money laundering obligations and automatic exchange of information reporting obligations under FATCA/CRS; and (ii) enable it to have an independently calculated NAV, making it easier to market the fund's track record to future prospective investors

The ability to utilise an incubator fund structure is not restricted to aspiring start-up investment managers and we often also see more established investment managers opt to structure subsequent funds for their portfolio as incubator funds, where there may be commercial or operational advantages for doing so (eg to test a particular investment thesis to a restricted group of investors).

For investment managers seeking alternative solutions, other categories of BVI funds to consider might be either a private fund, professional fund or approved fund. Of these three alternatives, approved funds are the most similar fund product to incubator funds, with the exception of being able to be utilised for an indefinite period, with a higher cap on maximum investments of US$100 million and a requirement to appoint a third party fund administrator. Private funds and professional funds are more regulated fund products, with mandatory service providers and a requirement to be audited. Professional funds also are only available to "professional investors", all of whom must make an initial investment of at least US$100,000. By contrast, private funds, have no investor suitability requirements, but to be a private fund must either have no more than 50 investors or be marketed on a private basis only.

All food for thought for an aspiring start-up investment manager.

[1] *As at 31 December 2022, there were 1,959 active funds licensed with the BVI's Financial Services Commission*

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