Looking back on a year of economic substance changes in the BVI

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With the BVI continuing to invest in its regulatory regime, Ogier partner Simon Schilder looks back on one year of economic substance in the jurisdiction. His comments first appeared in an article in a Hedgeweek special edition on BVI Hedge Fund Services.

The BVI's economic substance law came into effect 1 January 2019, with the first draft of guidance notes issued in April and updated in early October to become the Rules on Economic Substance in the British Virgin Islands

Economic substance requirements are imposed on British Virgin Islands companies and limited partnerships that are not tax "resident" in countries outside the BVI and carry on "relevant activities".

Simon told Hedgeweek recently: "There are nine relevant activities but the business of being an investment fund is not one of these relevant activities.

"While being a fund is not a relevant activity, depending on what funds are doing, they may become in scope through virtue of their underlying investment strategy; credit strategies are one example of this, because a fund which makes available credit facilities and derives income from this could be considered to be undertaking financing and leasing business, which is a relevant activity."

In such an instance, the fund would need to have economic substance in the BVI: by being directed and managed from the BVI, having adequate employees and premises in the BVI and undertaking core-income generating activities in the BVI.

"Potentially feeder funds which are used solely to hold shares in the master fund could also come in to scope on the basis of undertaking holding business. However, entities undertaking holding business are subject to less onerous economic substance compliance obligations, in that they are not required to be directed and managed from the BVI or undertake core-income generating

activities in the BVI. If it is just passive holding, which is what a feeder fund typically does, the only obligations are to comply with the statutory obligations of the BVI Business Companies Act and having adequate employees and premises could be limited to having a registered agent (and authorised representative) in the BVI and registered office in the BVI, which is something all BVI funds have to have anyway.

“If you are a Category 3 investment business licensee, and doing fund management activities, then you will be in scope. However, if you are an approved manager, as the law currently stands, you will be out of scope,” explains Simon.

Another regulatory development has been the BVI Business Companies Act amendments (Oct 2018) in relation to segregated portfolio companies. Under the amendments, SPCs are now permitted for use by unregulated private equity and VC funds.

Simon confirms that in terms of fund formation work in 2019, “one of the things that typifies the work we’ve done is that sizeable amounts of new business has been for non-traditional areas of the alternative asset space; such as private debt strategies and hybrid strategies using a mix of liquid and illiquid assets in closed-ended structures.”

One of these hybrid strategies specifically sought to avail of the SPC structure.

“SPCs are used in the marketplace for a couple of reasons. Firstly, for the manager to pursue different investment strategies and risk profiles and ring fence those strategies in individual cells. And secondly, where managers are trying to design customised investment products either for specific investors or groups of investors, where everything is housed within one investment fund vehicle. It is a way to avoid having to set up multiple funds,” he says.

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