

BVI Incubator and Approved Funds – when and how to convert

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In 2015, the Financial Services Commission (**FSC**) of the British Virgin Islands (**BVI**) introduced two new fund regimes to provide an efficient route for start-up managers to establish a track record and for smaller funds with friends and family money to establish open ended funds, being the Incubator Fund regime and the Approved Fund regime respectively. Given their nature, both regimes contain hard-wired provisions providing for those fund types to be converted into the more established fund categories offered by the BVI, once certain trigger events occur. The new fund categories have proved popular with many new managers and, thanks to their growing asset bases, many of these managers are now reaching the threshold limits for conversion.

By way of background, the Securities and Investment Business (Incubator and Approved Funds) Regulations, 2015 (the **Regulations**) provided for the regulation of an appropriate fund as either an "Incubator Fund" or an "Approved Fund". Such funds benefited from certain derogations from the requirements that the more established funds had, including dispensing with the need for an offering memorandum, an annual audit or a custodian separate from the administrator. Their attributes, while similar, differ in certain key ways:

Incubator Fund

- maximum of 20 investors; and
- aggregate maximum investments in the Fund not exceeding US\$20 million (or its equivalent in another currency);
- subscription is limited to sophisticated private investors who are investing at least US\$20,000
- limited to two years in duration with a possible further 12 month extension available at the discretion of the FSC.

Approved Fund

- maximum of 20 investors;
- aggregate maximum investments not exceeding US\$100 million (or its equivalent in another currency);
- no minimum subscription; and
- evergreen duration.

Trigger Events

Incubator Fund

The key trigger for conversion is when the Incubator Fund comes to the end of its incubation period, which is 24 months, or 36 months if extended by the Commission following an application made within one month of the expiry of the initial 24 month period (called the **Validity Period** in the Regulations).

In addition, an incubator Fund will be required to convert if it has more than 20 investors or if its assets exceed US\$20 million for any consecutive period of 2 months or more.

Approved Fund

The triggers for the Approved Fund are if the fund has more than 20 investors or if its assets exceed US\$100 million for any consecutive period of 2 months or more.

Both Approved Funds and Incubator Funds can, in any event, choose to convert at any time prior to a trigger event.

Conversion process

Whilst the conversion processes for Incubator Funds and Approved Funds are not dissimilar, there are differences to note.

Incubator Fund

On the occurrence of a trigger event, an Incubator Funds must either:

- convert to become recognised as a Private Fund, a Professional Fund, or an Approved Fund;
or
- commence the process for a voluntary liquidation under the BVI Business Companies Act, 2004; or
- restructure and amend its constitutional documents so as to cease to be a fund under section 40(1) of the Securities and Investment Business Act, 2004 and remove all references from its constitutional documents to being an incubator fund. It should be noted that, in

such a scenario, the structure will almost certainly need to be regulated as a Private Investment Fund under Part IIIA of the Securities and Investment Business Act, 2010, unless it is restructured so as to also fall outside the definition of a Private Investment Fund in section 63A.

In the absence of expressly doing either (a), (b) or (c) upon the expiration of the Validity Period, the FSC will automatically cancel a fund's Incubator Fund status.

If it is intended that the Incubator Fund intends to continue to operate as a fund after a trigger event, it must undertake the following steps:

- a. update its fund documents and file an application to either be recognised as a Private Fund or a Professional Fund or be approved as an Approved Fund;
- b. if converting to either a Private Fund or a Professional Fund, prepare and submit with the application an audit of its current financial position (as opposed to an audit of its financial statements) and compliance with the Regulations. This audit must be conducted by either an auditor approved by the FSC under the Securities and Investment Business Act, 2010 or the Regulatory Code, 2009 or, if not an approved auditor, by a person independent of the fund and whose normal duties include the performance of such an independent audit function (such credentials needing to be demonstrated with the audit submission).

For Incubator Funds converting to Professional Funds, as it relates to existing investors, the requirements for all investors in a Professional Fund to be a professional investor and to have invested at least US\$100,000 do not apply for such existing investors, such that these requirements only apply going forwards for new investors coming into the fund. It was intended that this provision would lead to Incubator Funds more naturally converting to Professional Funds.

Approved Funds

Following a trigger event, an Approved Fund must either:

- a. convert to become recognised as a Private Fund or a Professional Fund which process would include it updating its documentation and appoint an auditor and custodian accordingly; or
- b. commence the process for a voluntary liquidation under the BVI Business Companies Act, 2004; or
- c. restructure and amend its constitutional documents so as to cease to be a fund under section 40(1) of the Securities and Investment Business Act, 2004 and remove all references from its constitutional documents to being an incubator fund. It should be noted that, in such a scenario, the structure will almost certainly need to be regulated as a Private Investment Fund under Part IIIA of the Securities and Investment Business Act, 2010, unless it is restructured so as to also fall outside the definition of a Private Investment Fund in section 63A.

Unlike the position for Incubator Funds, in filing a conversion application for an Approved Fund, there is no equivalent statutory requirement for an audit of its current financial position and compliance with the Regulations to accompany the application.

Where an Approved Fund converts to a Professional Fund, there is no statutory equivalent to the grandfathering of incubator fund sophisticated private investors and, as such, all investors will need to demonstrate that they are professional investors and will need to have an investment of at least US\$100,000 in the fund. For this reason, it is often more likely that Approved Funds would convert into Private Funds.

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