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BVI LPs enjoy strong year-on-year growth

Interview with Eric Flaye

Discipline is one of the key traits of any successful fund manager – sticking to the core investment strategy and avoiding style drift. And in some respects, the same is true of offshore jurisdictions.

Over the years, rather than try to compete for mega-funds with the Cayman Islands, the BVI industry has instead focussed its efforts in carving out a reputation as the natural home for mid-sized and emerging managers across both the hedge fund and PE/VC fund space.

Relative market positioning is difficult to quantify in the unregulated PE/VC space, as offshore regulators do not maintain statistical data for unregulated funds, but as Eric Flaye, head of Conyers' BVI funds practice in London, observes: "Anecdotally, we have seen a lot of activity and interest in private equity fund formation and related transactional matters in the BVI during the past 18 months or so, and industry practitioners in the BVI seem quite bullish about BVI's prospects and growth trajectory in the near term."

In June 2019, BVI Finance reported that the BVI enjoyed an 81 per cent increase in the number of new limited partnerships formed in Q1, citing figures from the BVI Financial Services Commission, the BVI's financial regulator. Overall, some 56 new limited partnerships were established, compared to 31 in Q1 2018. In total, the number of active limited partnerships is fast approaching 1,000 (977 in June 2019). This growth can be attributed, at least in part, to the new BVI Limited Partnership Act, which was enacted in December 2017.

"The new Act has proven immensely popular and a great success for the BVI and its funds industry in a very short period of time," says Flaye. "The situation in the BVI was quite unusual in that prior to the introduction of the new Act we had a number of private equity clients who would use company structures as closed-end funds, rather than more conventional limited partnership structures, which was less than ideal on many counts."

The new Limited Partnership Act was drafted in collaboration with industry practitioners by essentially cherry picking what were considered the best aspects of legislation in other onshore and offshore jurisdictions. It was also front of mind that Delaware is one of the most common onshore jurisdictions seen by offshore law firms. As such, the legislation is designed such that when Conyers receives partnership fund documents from US counsel based on Delaware law, the team can efficiently turn them into equivalent documents for an offshore BVI fund.

"The new limited partnership legislation represents the culmination of industry efforts to create a state of the art limited partnership act which is highly attractive, in particular, to private equity and venture capital funds. For example, it includes provisions facilitating capital call (subscription) financing, expressly permits forfeiture of partnership interests of defaulting limited partners (thereby addressing uncertainty regarding the enforceability of 'penalty clauses' at common law) and adopts certain corporate law concepts such as the ability to merge, consolidate or migrate a BVI limited partnership, and minority squeeze-out provisions, all of which are innovative and add additional structuring flexibility. The new legislation has proven incredibly popular since its enactment in late 2017 and we fully expect this to continue in the months and years to come," adds Flaye.

One of the many attractive features of BVI limited partnerships, which can help managers keep a lid on costs, is the ability to appoint an onshore entity as the general partner (rather than having to form or register an additional entity offshore). This is often particularly attractive in master-feeder structures. "For example, with a master-feeder structure you could have the same Delaware LLC act as the general partner of both the Delaware fund and also the BVI fund," confirms Flaye.

It is also important to note that under the new BVI Economic Substance legislation, which was enacted in late 2018, BVI limited partnerships that do not have legal personality are expressly out of scope of the legislation.

In any event, under the new BVI Economic Substance legislation, collective investment vehicles are, generally speaking, out of scope unless they conduct some other category of 'relevant activity' such as 'holding business' or 'financing business' (e.g. direct lending/credit strategies or alternative finance strategies).

Broadly equivalent economic substance regimes have also been introduced in the Channel Islands, Cayman and Bermuda.

These new economic substance rules have been the main regulatory issue occupying offshore practitioners' minds this year and are the latest continuation of a trend towards greater regulatory compliance and the costs that come with it.

A lot of these new requirements disproportionately hit smaller fund managers, as often they don't have the in-house capabilities to deal with such matters.

"The point of concern is that compliance costs keep rising, globally across all major onshore and offshore funds jurisdictions, and it puts a real squeeze on emerging managers who are basically investment market entrepreneurs. This is unwelcome, as it risks stifling innovation and market competition and limiting returns, and many new global compliance requirements are, quite frankly, inappropriate for private fundraising as opposed to retail offerings. That said, the BVI has always been and remains very attractive from this perspective, with a regulatory regime which is robust but appropriate for private fundraising globally," remarks Flaye.

To reaffirm this article's opening statement on discipline, in Flaye's opinion the BVI's key value proposition has always lay in its compelling combination of ease, speed and cost-effectiveness of formation, and

significant flexibility in terms of structuring and governance.

"Traditionally, this has been especially appealing to small to mid-cap managers. Playing to these core strengths, we expect BVI to continue to gain market share in the near term, especially as fund formation and maintenance costs and compliance burdens continue to increase markedly in many other offshore jurisdictions," says Flaye.

Looking ahead, as the BVI continues to evolve and adapt to changing market dynamics, Flaye believes that fund subscription (or 'capital call') finance may be a key potential growth driver. Over recent years this particular segment of the BVI market has been under-developed, in part due to the BVI's historical focus on emerging managers.

But as Flaye concludes: "The BVI legal system is creditor-friendly and well-adapted for subscription financing, so there are certainly no impediments from a legislative perspective. And the new Limited Partnership Act includes various provisions which were designed to optimise debt financing by BVI limited partnerships. We have observed some traction in this space in recent times and expect that momentum to continue as the BVI funds industry matures and continues to capture more market share in the mid to large-cap space." ■

Eric Flaye
Associate, Conyers

Eric Flaye is an Associate in the Corporate department of Conyers in London. Eric has a broad corporate practice with particular expertise and interest in private investment funds, mergers and acquisitions, and joint ventures. Eric has represented many notable PE/VC sponsor groups and family offices, with extensive experience in acting as lead counsel and managing all legal aspects of offshore fundraising, restructuring and other significant corporate transactions.