



Guide to Segregated Portfolio Companies in the British Virgin Islands

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PREFACE

This Guide will explain the concept of the segregated portfolio that became a major feature of the British Virgin Islands' ("BVI") statutory framework following the enactment of the Insurance (Amendment) Act 2002 and the BVI Business Companies Act 2004 (the "BVI BCA") – Part VII of which is dedicated to segregated portfolio companies.

All references in this Guide to "dollars" or "\$" are to the United States dollars.

It is recognised that this Guide will not completely answer the detailed questions that clients and their advisers may have. It is intended to provide a sketch of the BVI's legal and regulatory environment in relation to segregated portfolio companies. The Guide is, therefore, designed as a starting-point for a more detailed and comprehensive discussion of the issues.

Whilst we have made every effort to ensure the accuracy of the statements made herein, we accept no liability for any errors. In all cases expert legal advice from a qualified practitioner of BVI law should be obtained.

Appleby
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INTRODUCTION

The segregated portfolio concept became possible in 2002 with the enactment of the Insurance (Amendment) Act 2002, which was prompted by the competitive demands of the international insurance market, similar legislation in other jurisdictions, as well as a desire to make the existing legislation, the Insurance Act 1994 (now the Insurance Act 2008), more attractive to users by enabling them to achieve the specific business solutions that they requested namely, the ability to register and operate segregated portfolios, and enjoy statutory division between those portfolios.

On 1 January 2005, however, the BVI BCA came into force and provides a comprehensive regime to facilitate the incorporation or registration and operation of segregated portfolio companies (“SPCs”) in the British Virgin Islands. In addition to insurers, Part VII of the BVI BCA allows a person who will operate as a mutual fund under the Securities and Investment Business Act 2010 (**SIBA**) to be incorporated or registered (if it is an existing mutual fund) and operate an SPC. The BVI BCA is now the only legislation governing SPCs in the BVI. For this reason, this Guide looks only at the provisions contained in Part VII the BVI BCA and its subsidiary legislation, the Segregated Portfolio Companies Regulations 2005 (the “2005 Regulations”).

A segregated portfolio (in some jurisdictions described as a “protected cell” or “segregated account”) is an internal account of an SPC to which may be attributed assets and liabilities that are legally separated from the assets and liabilities of the company’s ordinary account, called its “general assets” and also separate from assets and liabilities attributed to the SPC’s other segregated portfolios (if any).

The SPC is a recent and increasingly popular mechanism used to segregate the assets and liabilities of a company. In structuring as an SPC with a potentially vast number of sub-funds (the segregated portfolio), the gains and losses of each segregated portfolio has no impact on the other sub-funds within the company. Accordingly, in many circumstances the availability of an SPC can avoid the need to establish a group company structure to limit creditor exposure.

In practice this means, for example, that where contractual dealings of an SPC are attributed to a particular segregated portfolio maintained on the SPC’s books, a creditor under those contractual dealings will have restricted recourse, and will be entitled to make its recovery, only as against assets attributed and credited to the specific segregated portfolio to which the contract is also attributed. Accordingly, such creditor will not be legally entitled to make recovery against assets attributed and credited to other segregated portfolios of the SPC, or (save to the extent otherwise provided in any relevant contract) against the general assets, being those assets which have not been attributed and credited to any segregated portfolio of the SPC.

Under the BVI BCA, currently only companies licensed as insurers under the Insurance Act 2008 or recognized or registered as funds under SIBA may operate as SPCs. The BVI BCA affirms that a segregated portfolio is not a legal person distinct from the SPC itself. It should be noted that the SPC is a single legal entity and the portfolios are not independent legal entities separate from it but, the recognition in the BVI BCA of the segregation of the portfolios, particularly with respect to creditor recourse, enables the SPC to be used in many circumstances where previously a group structure of various companies may have been required.

An SPC may therefore be used for a variety of insurance purposes, including rent-a-captives, life and annuity companies, transformer vehicles, as well as financial guarantee, securitisation and derivatives structures and special purpose vehicles, not to mention numerous uses in the mutual and hedge fund industries. All references to statutory provisions below are to the BVI BCA, unless otherwise stated.

APPLICATIONS

Advantages of the SPC Concept

The SPC has several advantages over traditional routes to creating legal divisions between portfolios. It is less expensive and less unwieldy than forming numerous subsidiaries. It also avoids issues of time, solvency and perfection in relation to charges.

Most importantly, Part VII of the BVI BCA establishes substantive law governing the application of particular assets in favour of particular portfolios and their respective liabilities. In this regard, it is believed that the substantive provisions contained in the BVI BCA will significantly enhance the prospects for enforceability of transactions in jurisdictions where the assets of a particular segregated portfolio might be situated and, furthermore, the extent to which procedural as well as substantive law provisions may bind third parties.

Range of Applications

The BVI BCA represents a major opportunity for many international businesses. Insurance applications, mutual fund applications as well as some of the other potential applications are considered below.

It is also worth noting that in addition to mutual fund and insurance companies, there have been suggestions that in future the BVI government may allow other entities to be constituted as SPC's, such as for capital markets and securitisation transactions.

i. Insurance

A company that is, or on its incorporation will be, licensed as an insurer under the Insurance Act 2008 may be incorporated as an SPC.

SPCs may be used for a variety of insurance purposes. Among them include rent-a-captives, life and annuity companies, transformer vehicles, as well as financial guarantee, securitisation and derivatives structures, and special purpose vehicles.

Rent-a-captives

In the BVI and in relation to insurance, an SPC is typically a variation of a “rent-a-captive”. A rent-a-captive is a risk financing solution in which the sponsor (such as a captive manager) establishes and licenses a captive insurance company and “rents” the core capital, licence and corporate capacity of the vehicle to program participants, thus providing participants with the many benefits of captive risk financing without the attendant administrative and capital costs associated with a pure captive. Rent-a-captive programs have lowered the cost of establishing one's own captive, opening this solution to smaller corporations and other entities for which ownership of a captive would otherwise be too expensive.

In a rent-a-captive structure which does not offer legal segregation of accounts, participants agree among themselves to keep the gains and losses of each program separate from the others. These internal agreements would not generally be effective against third parties such as creditors of the

rent-a-captive in the event of liquidation. By taking advantage of the BVI legislation, in a segregated portfolio rent-a-captive, each participant's program is legally segregated from the other, thus making the separation between participants in the rent-a-captive unassailable in the event of liquidation. The segregated portfolio rent-a-captive offers "fire walls" between program participants which should withstand the claims of third party creditors of another participant. Participants need not be concerned that the underwriting losses of an imprudent participant may bring the whole facility down.

Life and Annuity Companies

Legal segregation of accounts (portfolios) also has application in the insurance industry outside of the group captive context. Insurers underwriting long-term risks, such as life, disability, pension plan or annuity programs can take advantage of the legal segregation of reserves among different programs and products.

Transformer Companies

So-called "transformer" companies are those engaged in the transformation of insurance risk into capital markets products and vice-versa. In cases where a single company enters into multiple arrangements of this kind, it will often be desirable to do this through segregated portfolios.

ii. Mutual Funds

A company that is, or on its incorporation will operate as a mutual fund under SIBA may be incorporated or registered (if an existing mutual fund) as an SPC.

In the field of investment funds, traditionally the need to have efficient structures whereby investors could access different trading strategies or other differential features through a single vehicle led to the development of 'multi class' and 'umbrella' funds. In the case of a corporate multi-class fund there is typically a single entity offering various classes of shares designated according to, say, the intended investment strategy with 'pools' or portfolios of assets relating to that strategy expressed to be attributable to a relevant particular share class.

In the event of the winding up of a multi-class fund, however, the segregation breaks down with distributions being made in the liquidation to creditors generally and there is also the possibility of a creditor attaching an asset without regard to its attribution to a particular class in the fund. Properly organised corporate umbrella funds involving a feeder fund with subsidiary trading entities address this problem of 'cross-class liability' and achieve the desired segregation of assets but with the cost and complication of a group structure.

The SPC legislation therefore provides an attractive alternative and gives the SPC, through a single legal entity, the ability to operate in a way analogous to a corporate group comprising parent and subsidiaries.

The 2005 Regulations apply solely to mutual fund SPCs (see section 9 of this Guide below).

Although not yet clear what will be contained in any future Regulations, it is hoped that they will facilitate the legislation to be used for other types of transactions, which could easily

go on and will hopefully be bounded only by the imagination and creativity of clients and their professional advisors:

iii. Capital Markets and Securitisation Transactions

In capital markets and securitisation transactions, the ability to limit recourse of a creditor holding a particular class or series of the issuer company's debt securities to specific underlying assets in an efficient way, through use of segregated portfolios, is attractive.

iv. Companies Owning Real Estate, Ships, Aircraft or Other Assets

Traditionally, certain businesses holding multiple assets eg real estate, ships or aircraft companies are structured such that within the group a separate subsidiary company is used to hold individual (or groups of individual) underlying assets. An SPC, however, may provide a more efficient and economic alternative where each asset is owned by a separate segregated portfolio.

v. Business Divisions

Similar considerations may apply where a business is operated on the basis of several discrete divisions within a single company or group.

In certain cases an SPC may be a convenient and effective structure for joint venture arrangements, for example, where a particular party to the venture is to retain effective indirect ownership of a given asset or income stream within the joint venture structure.

vi. Ring-fencing in Special Cases

There are potential applications for SPCs in the context of corporate rehabilitation and reorganization. For example, where there are multiple parties participating in a rescue of a business in financial difficulty it may be appropriate for them to do so with the benefit of liability segregation which can be efficiently achieved through an SPC.

vii. Trust Applications

Employee benefit schemes and other arrangements where a trust might otherwise be used lend themselves to the idea of an SPC structure.

Where a trustee operates numerous trusts for unrelated beneficiaries the assets and liabilities of each trust are already legally separated. Nevertheless, at least for administrative purposes, it may be appropriate to reinforce the division between the assets and liabilities of each trust, and between those and the trustee's own assets and liabilities, by using an SPC as the trustee. Special licensing as a trustee company may also be required in addition to registration as an SPC.

REGISTRATION UNDER THE BVI BCA

Application Procedure

Prior to the incorporation or registration of an insurer or mutual fund as an SPC, an application in prescribed form accompanied by relevant supporting documents must be submitted to the Financial Services Commission (the “**Commission**”) seeking the Commission’s approval for the insurer or fund to be incorporated or registered as an SPC (§136(1)).

The application for approval to incorporate or register as an SPC shall be accompanied by such documentation as shall be prescribed. The Commission may require other documentation or information that it considers necessary to determine the application (§136(2)). The requirements to be satisfied in an application for approval of an SPC that is a mutual fund company are set out in the 2005 Regulations (see section 9 of this Guide below).

The test the Commission will apply in determining whether to give its approval will be satisfied if “the company has, or has available to it, the knowledge and expertise necessary for the proper management of segregated portfolios”. However, such approval may be coupled with such conditions as the Commission considers appropriate (§137(1)) and the Commission may at any time vary, revoke or impose such conditions to which the approval was given (§137(2)).

The BVI BCA is clear in that the Commission can only approve the incorporation of a company, or the registration of an existing company, as an SPC if the company is, on its incorporation, licensed as an insurer under the BVI Insurance Act 1994 (now Insurance Act 2008); or recognised as a professional or private fund or registered as a public fund under the Mutual Funds Act (now the Securities and Investment Business Act) (§135(2)).

Registration

Once the written approval of the Commission has been given for an insurer or mutual fund to be incorporated or registered as an SPC, the company may apply to the Registrar of Corporate Affairs (the “**Registrar**”) to be incorporated or, registered (if an existing insurer or mutual fund) as an SPC (§135(1) and (2)). The Registrar will not register a company as an SPC until such written approval has been given by the Commission (§ 135 (3)) .

The Nature of Segregated Portfolios

Once registered, an SPC may create one or more segregated portfolios for the purpose of segregating the assets and liabilities of the company held within or on behalf of a segregated portfolio from the assets and liabilities of the company or not held within or on behalf of any segregated portfolio (§138(1)).

The Commission has the power to direct a company to change the name of a segregated portfolio if it considers the name, identification or designation of the portfolio to be misleading or undesirable (§8(1) of the 2005 Regulations). In addition, each segregated portfolio must be separately identifiable and such identification must also include the words “Segregated Portfolio” (§138(3)).

The BVI BCA confirms that an SPC is a single legal entity and that a segregated portfolio does not constitute a legal entity separate from the SPC (§138(2)). This is so even though some of the features of a segregated portfolio are similar to features of legal persons. For example, section 142 provides that any

contract which is to be binding on the segregated portfolio must be executed by the SPC on behalf of the relevant portfolio, which must be identified in writing. The SPC therefore acts as agent to the contracting portfolio to which the contract is binding on, which entails that the segregated portfolio may sue and be sued for debts, obligations or liabilities contracted or incurred by the SPC in respect of a particular segregated portfolio. Accordingly, the segregated portfolio may exercise the same rights of setoff (if any) as between portfolios as apply under the general law in respect of companies, including, on an insolvent liquidation of the company, the same rights of set-off which arise in an insolvent liquidation of a company.

MANAGEMENT AND ADMINISTRATION

Registered Agents and Functionaries

Like ordinary BVI companies, an SPC must have a registered agent in the BVI (§91(1)) and the directors of the company will manage its business and affairs (§109(1)).

There are no further requirements of an insurance company by virtue of it being an SPC. However, a mutual fund that is an SPC must also appoint various functionaries including an *inter alia*, administrator and a custodian (see 9.b of this Guide, below).

Management Duties

The BVI BCA and the 2005 Regulations set out a number of duties that the SPC, a director or functionary each have to fulfil. While these are described elsewhere in this Guide, some key duties are outlined below.

i. Directors and Functionaries

In addition to their duties to the company that are imposed by statute and the common law by virtue of their position as directors, the directors of an SPC are also under a statutory duty to establish and maintain (or cause to be established and maintained) procedures to keep segregated portfolio assets segregated and identifiable from both the general assets of the SPC and the assets of other segregated portfolios (§143(5)(a) and (b)), and to prepare financial statements showing this to be the case (see below at 3.b.iii).

A functionary has duties towards the SPC to which it is appointed; these will be set out in the instrument of appointment (see 9.b below).

ii. Contracts with Third Parties

The BVI BCA provides that any act, matter, deed agreement, contract, instrument under seal or other instrument or arrangement which is to be binding on a segregated portfolio(s) must be executed by the SPC. In addition, the contracting segregated portfolio must be identified in the contract and it must also be indicated that the execution of the contract is in the name of, or by, or on account for the segregated portfolio (§142).

The BVI BCA also provides that a number of terms will be implied into a contract regarding the creditor enforcement rights over portfolio assets (see below at 5.e).

iii. Accounts, Records and Registers

Just like a BVI company, an SPC is required to keep financial records, which are sufficient to show and explain the company's transactions and will, at any time, enable the financial position of the company to be determined with reasonable accuracy (§98). The financial statements of an SPC, however, must take into account the segregated nature of the company and must include an explanation of (§148):

- the nature of the company;
- how the segregation of the assets and liabilities of the company impacts upon members of the company and persons with whom the company transacts; and
- the effect that any existing deficit in the assets of one or more segregated portfolios of the company has on the general assets of the company.

The rules that apply to an SPC in relation to its records and registers are the same as those that apply to a BVI company. For more information, please refer to the 'Guide to Companies in the British Virgin Islands' which is available from the Appleby website.

iv. Offences under the BVI BCA relating to SPCs

The BVI BCA only creates one direct offence relating to SPCs. If an SPC is required by the Regulations to obtain the approval of the Commission prior to creating segregated accounts and fails to do so, then it will be liable to a fine on summary conviction of \$10,000 (§138(5)). The 2005 Regulations make this a requirement only for mutual fund companies at this time.

The Executive Council may, on the advice of the Commission, make regulations to provide for further fees and penalties for an SPC (§159(2)(e)).

v. Effect of Infringement of the BVI BCA

The legislation does not state that a transaction or interest in a segregated portfolio becomes ineffective by reason only that the SPC fails to comply with, or is in breach of, any provision of the BVI BCA. Accordingly, and subject to the standard rules of capacity, power and constructive notice, a transaction or interest in a segregated portfolio will be effective notwithstanding the fact that the company may not be registered to create segregated portfolios. However, the SPC may be liable to a fine (as described above at 3.b.iv).

The intention is to ensure that if a breach of the BVI BCA occurs, the consequences should be as set out in the legislation, rather than generally rendering business transactions ineffective, which could sometimes produce absurd results. For example, if a mutual fund created segregated portfolios without the permission of the Commission, the consequence of that is that the company commits an offence and may be subject to a fine. In some circumstances it could cause unfair hardship to the company or the third party if either of them were able to terminate the transaction.

GOVERNING INSTRUMENTS AND CONTRACTS

As noted above (3.b.ii) SPCs are subject to particular rules in relation to execution of contracts etc. Apart from this, the rules in the BVI BCA that apply to companies generally in relation to contracts apply equally to SPCs. For example, a company may enter into valid and binding contracts in writing under the common seal of the company (or in some cases without a common seal) and signed on behalf of the company by a person acting under the express or implied authority of the company, or orally by or on behalf of the company by a person acting under the express or implied authority of the company (§103).

Persons who enter into a contract in the name of, or on behalf of, a company before it has been incorporated under the BVI BCA are personally liable under the contract unless the contract specifically provides otherwise or the company, within a reasonable time after incorporation, expressly or impliedly adopts the contract (§104(1) and (2)). If a company adopts a contract in this manner after incorporation, then the company is deemed to be bound by and is entitled to the benefits of the contract as if it had been a party to it at the date of the agreement (§104(3)).

Contracts (Shareholders)

An SPC may issue shares (including shares in one or more classes or series) attributable to a particular segregated portfolio (see 6.a). Accordingly, the holders of such shares have an ownership right in the SPC and indirectly in the relevant segregated portfolio. This right is governed by the articles of association of the SPC or by a specific contract contained in the terms of issue of such shares. The BVI BCA and the 2005 Regulations do not specify any requirements on the nature of the contract or what must be specified in such a contract with respect to shareholder's rights, interests or obligations.

Contracts (Counterparties)

The BVI BCA provides that any act, matter, deed agreement, contract, instrument under seal or other instrument or arrangement which is to be binding on a segregated portfolio(s) must be executed by the SPC. In addition, the contracting segregated portfolio must be identified in the contract and it must also be indicated that the execution of the contract is in the name of, or by, or on account for the segregated portfolio (§142).

The BVI BCA also provides that a number of terms will be implied into a contract regarding the creditor enforcement rights over portfolio assets (see below at 5.e).

SPC and Management Duties to a Segregated Portfolio, Shareholder or Counterparty

In an SPC, the directors have a duty to establish and maintain (or cause to be established and maintained) procedures to segregate, and keep segregated, segregated portfolio assets separate and separately identifiable from general assets; to segregate, and keep segregated, segregated portfolio assets of each segregated portfolio separate and separately identifiable from segregated portfolio assets of any other segregated portfolio; and, where relevant, to apportion or transfer assets and liabilities between segregated portfolios, or between segregated portfolios and general assets of the company (§143(5)). It is to be noted, however, that directors of an SPC do not breach their duties by reason only that they cause or permit segregated portfolio assets or general assets, to be collectively invested or collectively managed by an investment manager, provided that the assets remain separately identifiable (§143(7)).

Contracts (Internal Transactions)

There are no explicit provisions in the BVI BCA with respect to the ability of portfolios to contract with each other or the general portfolio. However, section 143(5) expressly allows a director, where relevant, to apportion or transfer assets and liabilities between segregated portfolios, or between segregated portfolios and general assets of the company.

ASSETS AND LIABILITIES

Application of Assets and Liabilities

The BVI BCA provides that assets of an SPC must be either ‘segregated portfolio assets’ or ‘general assets’, but not both (§143(1)). The segregated portfolio assets comprise assets representing the consideration paid or payable for the issue of segregated portfolio shares and reserves attributable to the segregated portfolio, as well as all other assets attributable to or held within the segregated portfolio (§143(2) and (4)). Accordingly, the general assets of the SPC comprise the assets of the company which are not segregated portfolio assets (§143(3)), eg income, receipts and other assets or rights acquired by the SPC that are not otherwise attributable to any segregated portfolio (§147(2)).

The directors of an SPC are under a statutory duty to establish and maintain (or cause to be established and maintained) procedures to keep segregated portfolio assets segregated and identifiable from both the general assets of the SPC and the assets of other segregated portfolios (§143(5)(a) and (b)), and to prepare financial statements showing this to be the case (see above at 3.b.iii).

Pursuant to section 145, segregated portfolio assets will only be available and used to meet liabilities to the creditors of the SPC who are creditors in respect of that segregated portfolio and who will therefore be entitled to have recourse to the segregated portfolio assets attributable to that segregated portfolio for such purposes, ie a creditor will be afforded restricted recourse, and will be entitled to make recoveries, only as against assets attributed and credited to the specific segregated portfolios to which their respective contracts are also attributed (§145(a)).

Segregated portfolio assets are therefore not available to meet liabilities, and shall be absolutely protected from, the creditors of the SPC who are not creditors in respect of that segregated portfolio (§145(b)).

For these reasons, where a liability of an SPC to a person arises from a matter, or is otherwise imposed, in respect of a particular segregated portfolio, then such liability will only extend, and that person shall only have recourse, to the assets of the segregated portfolio in question (§146(1)(a)(i)). However, the BVI BCA also provides that where the segregated portfolio’s assets attributable to such segregated portfolio are insufficient to satisfy the liability, and to the extent that the assets attributable to such SPC’s general assets exceed any minimum capital requirements, then the person may also have access to the SPC’s general assets (§146(1)(a)(ii)). In no circumstances will a person be entitled to have recourse to the assets of any other segregated portfolio (§146(1)(b)). Accordingly, where a liability of an SPC to a person arises or is imposed otherwise than in respect of a particular segregated portfolio, then that person shall only have recourse to the SPC’s general assets in respect of that liability (§146(2) and §147(1)).

The segregated portfolio assets attributable to a specific segregated portfolio of an SPC cannot be transferred to a third party except under the authority of, and in accordance with the terms and conditions of, an order of the BVI High Court of Justice (§149(3)). The Court has wide powers (§149(5)),

(6) and (7)). However, the Court is not to make such a “segregated portfolio transfer order” in relation to a segregated portfolio of an SPC, unless it is satisfied that the creditors of the company entitled to have recourse to the segregated portfolio assets attributable to the segregated portfolio consent to this transfer, or those creditors would not be unfairly prejudiced by the transfer (§149(4)).

Apportionment of Assets and Liabilities

Generally, the intention of Part VII of the BVI BCA is to ensure that assets and liabilities of segregated portfolios will not be intermingled with the assets and liabilities of the company. However, in many cases it will be convenient for commercial purposes for an asset, such as a bank account, to be held to the credit of more than one account. The same will sometimes be true of liabilities. Accordingly, the BVI BCA expressly enables the apportionment of assets and liabilities between segregated portfolios and the general assets of the company, and it is the duty of the directors to establish and maintain (or cause to be established and maintained) procedures to this end (§143(5)(c)). The BVI BCA provides, however, that in such instances the assets belonging to the segregated portfolio and the assets belonging to the company must remain separately identifiable (§143(7)).

Notwithstanding the above, the directors of the SPC may permit both segregated portfolio assets and general assets to be held by or through a nominee or a company (§143(6)).

Transfers between Portfolios

As stated above at 5.b, the legislation expressly provides that the directors of an SPC are under a duty to establish and maintain (or cause to be established and maintained) procedures to apportion or transfer assets and liabilities between segregated portfolios, or between segregated portfolios and general assets of the company (§143(5)(c)).

For example, assets of or pertaining to a segregated portfolio may from time to time be temporarily held within the general assets (eg reinsurance recoveries or other inbound payments) en route to the particular segregated portfolio for which they may be earmarked.

Rights of a Shareholder

As noted above, the rights of a shareholder whose shares relate to a specific segregated portfolio will be set out in the articles of association or terms of issue of such shares (including where applicable a prospectus or offering document). The BVI BCA and the 2005 Regulations do not provide any additional requirements in this respect by virtue of the company being registered as an SPC.

Creditor Enforcement Rights over Portfolio Assets

Special provisions are included in the BVI BCA to reduce the likelihood that creditors in respect of a particular segregated portfolio will be in a position to enforce their claims against assets not attributable to that segregated portfolio. The BVI BCA provides that in relation to every transaction entered into by an SPC it shall be implied that the relevant liability will not be paid out of assets other than assets of the segregated portfolio to which the transaction is attributed (§144(2)(a)).

In addition, if any party succeeds in making liable any segregated portfolio assets that are not attributable to that segregated portfolio, then that party shall be liable to the company to pay a sum equal to the value

of the benefit obtained by him (§144(2)(b)). The BVI BCA also provides that any recoveries in breach of the provision are held on trust by the recipient for the company (§144(2)(c)).

The foregoing provisions may, however, be excluded in writing (§144(3)).

In the event of any segregated portfolio assets being taken in execution in respect of a liability not attributable to that segregated portfolio, and in so far as such assets or compensation in respect thereof cannot otherwise be restored to the segregated portfolio affected, the company must procure its auditor, acting as expert (and not as arbitrator) to certify the value of the assets lost and transfer or pay, from another segregated portfolio's assets or general assets to which the liability was attributable to the segregated portfolio affected, assets or sums sufficient to restore to the segregated portfolio affected the value of the assets lost (§144(6)). In such circumstances, and where a segregated portfolio's assets are insufficient to compensate the relevant segregated portfolio's deficit, then the company must, as far as possible, make up the deficiency from its general assets (§144(7)). As stated above and to this end, the directors of the SPC are also under a duty to establish and maintain (or cause to be established and maintained) procedures, where relevant, to apportion or transfer assets and liabilities between segregated portfolios, or between a segregated portfolio's assets and the general assets of the SPC.

These provisions will be particularly useful in cases where assets attributed to a segregated portfolio are located outside of the BVI. In fact, the BVI BCA explicitly states that this section has extra-territorial application (§144(8)).

A Cautionary Note

An SPC may operate or have assets, or be subject to claims, in jurisdictions that may not recognise the segregation of assets and liabilities. In those jurisdictions, the assets of one segregated portfolio may potentially be exposed to the liabilities of another. This risk is higher in jurisdictions that do not have segregated portfolio type legislation. Currently there is very little, if any, case law in such jurisdictions in which the structure and standing of a BVI SPC has been tested. There is therefore very little guidance to indicate the manner in which the courts will deal with this issue. The BVI legislation with respect to SPCs is substantive as opposed to procedural and this should mitigate the non-recognition risk on the basis that a foreign court, in applying the law of another jurisdiction, more usually respects substantive provisions even though they may apply their own procedure.

The risk is likely to be reduced if the SPC holds its assets in jurisdictions that have segregated accounts legislation, for example the Cayman Islands, Bermuda, the British Virgin Islands, Jersey and Mauritius and if relevant contracts are governed by the law, and made subject to the jurisdiction of the courts of a segregating jurisdiction, such as the BVI. Further protection is gained if contracts contain language that limits the recourse of any potential creditor of a particular segregated portfolio to the assets in the relevant segregated portfolio.

In considering these issues, it is likely that a court (even in a jurisdiction with equivalent legislation) considering a BVI SPC would also have close regard to whether the SPC has in fact been operated in accordance with the requirements of the BVI legislation. Consequently, it is important for this reason (among others) that these requirements are strictly adhered to.

SECURITIES

Issue of Securities by a Segregated Portfolio

The BVI BCA expressly provides that an SPC may issue shares in respect of a segregated portfolio. They may be issued in classes and the proceeds of issue would of course be included in the segregated portfolio assets (§139(1) and (2)). An SPC, however, is not required to state the classes of segregated portfolio shares that it is authorised to issue in its memorandum of association (§139(3)).

The SPC may also issue shares the proceeds of which fall into the SPC's general assets (§140).

Dividends, Distributions and Redemptions

An SPC may pay a dividend or other distribution in respect of segregated portfolio shares (§141(1)). Due to the inherent nature of a segregated portfolio, segregated portfolio dividends and distributions may only be paid by reference to the segregated portfolio assets and liabilities attributable to the segregated portfolio in respect of which the shares were issued (§141(2)).

Accordingly, in determining whether the segregated portfolio satisfies the solvency test, no account may be taken of the assets and liabilities of or attributable to any other segregated portfolio of the SPC or the company's general assets and liabilities (§141(3)).

There are no special rules that apply to a company by virtue of the fact that it is an SPC in respect of redemptions. However, it follows from the segregation requirements (see section 5 above) that redemption proceeds should be paid from the applicable segregated portfolio. For more information on this topic with respect to companies in the BVI, please refer to 'The Guide to Companies in the British Virgin Islands', which is available from the Appleby website.

Reduction of Capital/Capital Transactions

There are no special rules that apply to a company by virtue of the fact that it is an SPC in respect of reduction of capital/capital transactions. Therefore for more information on this topic with respect to companies in the BVI, please refer to 'The Guide to Companies in the British Virgin Islands', which is available from the Appleby website.

LIQUIDATION, PORTFOLIO LIQUIDATION AND ADMINISTRATION

Portfolio Liquidation Orders

A portfolio liquidation order may be made in relation to a segregated portfolio that requires the liquidator to manage the orderly closing down of the business of or attributable to the segregated portfolio; and the distribution of the segregated portfolio's assets attributable to the segregated portfolio to those entitled to have recourse thereto (§152(3)).

A portfolio liquidation order may be made in respect of any number of portfolios (§152(2)) and will be made when the Court is satisfied that (§152(1)):

- the segregated portfolio assets attributable to a particular segregated portfolio of the company (when an account is taken of the company’s general assets, unless there are no creditors in respect of that segregated portfolio entitled to have recourse to the company’s general assets) are or are likely to be insufficient to discharge the claims of creditors in respect of that segregated portfolio; and
- that the making of the order would achieve the orderly closing down of the business of or attributable to the segregated portfolio; and the distribution of the segregated portfolio assets attributable to the segregated portfolio to those entitled to have recourse thereto.

Such an order will not be made, however, if a liquidator is appointed in respect of the SPC and will cease to have effect upon the appointment of a liquidator in respect of the SPC (§152(6)), though in the case of the latter, leave of the Court is required before a resolution may be passed to appoint a liquidator of the company (§152(7)), i.e., the shareholders of an SPC cannot pass a resolution to wind up voluntarily without the consent of the Court, which ensures that such a dramatic step will not take place in relation to an SPC unless the Court is aware.

At the same time as making the order, the Court will appoint an Official Receiver or an “eligible insolvency practitioner” (as defined in the Insolvency Act 2003 (the “Insolvency Act 2003”)) to act as portfolio liquidator (§152(4)). Sections 483 to 485 of the Insolvency Act, ie the provisions relating to the appointment of an overseas insolvency practitioner apply to portfolio liquidation orders (§152(9)).

Creditors of a segregated portfolio that is subject to a portfolio liquidation order are regarded as preferential creditors just as they would be preferential creditors under the Insolvency Act if the segregated portfolio was a company and the portfolio liquidator was an Insolvency Act liquidator (§155(2)). Subject to this premise and any agreement between the SPC and any creditor of the company as to the subordination of the debts due to that creditor to the debts due to the company’s other creditors, the portfolio liquidator must, in the winding up of the segregated portfolio in question, apply the segregated portfolio assets in satisfaction of the company’s liabilities attributable to that segregated portfolio *pari passu* (§155(1)).

Subject to the memorandum or articles of association, any surplus must be distributed among the holders of the segregated portfolio shares (or other persons entitled to the surplus), according to their respective rights and interests in or against the company (§155(3)). Where there are no segregated portfolio shares and no persons otherwise entitled to the surplus, then the surplus goes to the general assets of the company (§155(4)).

The Court will not discharge a portfolio liquidation order unless it appears to the Court that the purpose for which the order was made has been achieved, substantially achieved or is incapable of achievement (§156(1)). On hearing such an application, the Court may make such order as it considers appropriate (§156(1)).

Where the Court discharges a portfolio liquidation order on the ground that the purpose for which the order was made has been achieved (or substantially achieved), then the Court may direct that any payment made by the portfolio liquidator to any creditor in respect of that portfolio shall be deemed full satisfaction of the liabilities of the company to that creditor in respect of that portfolio, thereby extinguishing that particular claim (§156(3)). This does not, however, affect any right or remedy a creditor may have against any other person, including any surety of the SPC (§156(4)).

Application Procedure

An application for a portfolio liquidation order in respect of an SPC may be made by the company itself, the directors, any creditor or shareholder in respect of the relevant segregated portfolio, or the Commission (§153(1)). Notice of such an application must be served upon the SAC, the Commission and such other persons (if any) as the Court may direct, each of whom will have an opportunity to make representations to the Court before any order is made (§153(2)).

The Court, on hearing such an application for a portfolio liquidation order (or for leave to pass a resolution appointing a liquidator) may make an interim order or adjourn the hearing conditionally or unconditionally (§153(3)).

The Court may make a portfolio liquidation order subject to such terms and conditions as it considers appropriate (§153(4)).

The Portfolio Liquidator

Pursuant to the BVI BCA, the portfolio liquidator has all the powers of the directors in respect of the business assets attributable to that portfolio for the purpose of achieving (§154(1)):

- the orderly closing down of the business of, or attributable to, the segregated portfolio; and
- the distribution of the portfolio assets attributable the segregated portfolio to those entitled to have recourse thereto.

Accordingly, during the period of operation of a portfolio liquidation order, the powers, functions and duties of the directors of the SPC continue but are subject to any directions of the portfolio liquidator (§154(6)). The portfolio liquidator is therefore the agent of the SPC and the BVI BCA provides that the portfolio liquidator does not incur personal liability except to the extent that he is fraudulent, negligent, reckless or acts in bad faith (§154(3)).

In addition, the BVI BCA stipulates that during the period of operation of a portfolio liquidation order, no proceedings may be instituted or continued by or against the SPC and no steps may be taken to enforce any security in respect of the business or segregated portfolio assets, in relation to the Portfolio in respect of which the order was made (§154(5)).

The remuneration of a portfolio liquidator will be fixed by the Court (in accordance with the principles set out in section 432 of the Insolvency Act) and are payable in priority to all other claims from the segregated portfolio assets in respect of which the portfolio liquidator was appointed and from the general assets (where the segregated portfolio assets are insufficient) (§157). Under no circumstances will the portfolio liquidator be remunerated from assets attributable to any other segregated portfolio.

Stay of Proceedings

The BVI BCA provides that the Court may make a portfolio liquidation order subject to such terms and conditions as it considers appropriate, which may include a stay of proceedings (§153(3) and (4)). Accordingly, in the event of the insolvency of a segregated portfolio, the Court may order the stay of any legal actions relating to a SPC in respect of that segregated portfolio.

A stay of proceedings comes into force automatically when the SPC goes into a compulsory liquidation and the court may order a stay in a creditor's voluntary winding-up. In those circumstances, the stay of proceedings is meant to give the insolvent company and its liquidator a "breathing space" during which the company and the liquidator may consider their options. As, the provisions relating to portfolio liquidation orders in the BVI BCA may come into operation when a segregated portfolio becomes insolvent, despite the solvency of the SPC, a stay of proceedings might be just as appropriate in the event of the insolvency of a segregated portfolio as it is in the event of the insolvency and liquidation of the general assets.

Winding Up of an SPC

The general provisions of the BVI Insolvency Law 2003 as to winding up apply equally to SPCs but, notwithstanding the provisions of Part XII of the Insolvency Act, or any other statutory provision or rule of law to the contrary, in the liquidation of an SPC the liquidator (as defined in the BVI BCA) is under a duty, pursuant to the BVI BCA, to deal with both the general assets and segregated portfolio assets in the same fashion that a director is under a duty to deal with the general assets and the segregated portfolio assets (§151(1)(a)), and as described above at 5.a).

Accordingly, in the discharge of the claims of creditors of the SPC, the liquidator must apply the company's assets to those entitled to have recourse thereto in conformity with the provisions of Part VII of the BVI BCA, in other words the assets and liabilities that are attributed to each segregated portfolio may only be available and be used to meet liabilities to the creditors of the SPC who are creditors of that segregated portfolio and shall not be available or be used to meet liabilities to, and shall absolutely be protected from, the creditors of the SPC who are not creditors in respect of that segregated portfolio, and who accordingly shall not be entitled to have recourse to the segregated portfolio assets attributable to that segregated portfolio (§151(1)(b)).

Subject to the above, an SPC is wound up, as far as possible, just like an ordinary company, i.e. the winding up is governed by Part XII of the Insolvency Act (§151(2)). However, Part XII of the Insolvency Act will be subject to such modifications as are necessary to give effect to Part VII of the BVI BCA and, in the event of any conflict, Part VII of the BVI BCA will prevail.

REMOVAL FROM THE REGISTER

The Registrar does not maintain a separate register of SPCs. The general rules in the BVI BCA with respect to removal of defunct companies from the Register apply equally to SPCs.

Should a Court direct that a particular segregated portfolio be dissolved (on such date as the Court may specify), following the discharge of a portfolio liquidation order in respect of a segregated portfolio (§156(5)), then the company may not undertake business or incur liabilities in respect of that segregated portfolio (§156(6)). The fact of this matter may not, however, be necessarily registered on the public registry.

MUTUAL FUNDS – THE SEGREGATED PORTFOLIO COMPANIES REGULATIONS 2005

The 2005 Regulations applies solely to SPCs that are mutual funds.

Application Procedure

In order to be constituted as an SPC, a company that is, or on its incorporation will be, a mutual fund must apply to the Commission for approval to be incorporated or registered as an SPC (§3 of the 2005 Regulations). The application must include *inter alia*, the following information:

- the name of the company;
- details of the person(s) who will be appointed as administrator(s) of the company;
- a list of the initial segregated portfolios that it is intended will be created, including the name, identification or designation of each segregated portfolio; and
- in respect of each of the initial segregated portfolios that is intended to be created, details of the functionaries who will be appointed by the company to act in respect of that portfolio.

The application will serve as the application for recognition or registration of the fund under the Securities and Investment Business Act and must be accompanied by certified true copies of the company's memorandum and articles and the offering documents for each of the segregated portfolios that is intended to be created. For more information, please refer to the contact details at the end of this Guide.

Functionaries and Auditors

A “functionary” with respect to a mutual fund is a manager, administrator, investment advisor or custodian (§2 of the 2005 Regulations). The 2005 Regulations provide that a mutual fund SPC must at all times have at least one administrator, manager and custodian, and may appoint one or more investment advisors (§4(1) of the 2005 Regulations).

A functionary must be appointed by instrument that specifies in respect of which portfolio(s) the functionary is appointed, and his responsibilities and duties in respect of each such portfolio (§4(2) of the 2005 Regulations).

A mutual fund SPC must also have an auditor (§5(1) of the 2005 Regulations) and must maintain annual audited financial statements in respect of each financial year of operation. The audited financial statements must be filed with the Commission within 6 months of the end of its financial year (§5(2) of the 2005 Regulations).

Creation of additional segregated portfolios

A mutual fund SPC will require written permission from the Commission before it can create or authorise an additional segregated portfolio (§6(1) of the 2005 Regulations). In the case of professional and private funds, however, the prior approval of the Commission is not required by an SPC for the creation of an additional segregated portfolio where each of the persons who will be appointed by the SPC to act as functionaries of the new segregated portfolio (i) are the same persons as the functionaries notified to the Commission on the application for approval to incorporate or register as an SPC or in any subsequent notification of change of functionary or (ii) have their principal place

of business in a recognised jurisdiction for the purposes of SIBA (see §6 of the 2005 Regulations for details).

Where the prior written approval of the Commission is not required for the creation of an additional segregated portfolio, the mutual fund SPC must nevertheless notify the Commission of the creation of the additional segregated portfolio within 14 days of the creation of a segregated portfolio. Such notification shall be made in the approved form containing (§7(1) of the 2005 Regulations):

- the name of the SPC;
- details of the segregated portfolio that has been created, including the name, identification or designation of the portfolio;
- details of the functionaries who have been appointed by the company to act in respect of the segregated portfolio; and
- the date of the creation of the segregated portfolio.

In addition, a mutual fund may not create a segregated portfolio unless it has previously issued an offering document with respect to the portfolio and a copy of the offering document must be submitted with the notice (§7(2) of the 2005 Regulations).

Change in Information

In almost all circumstances, a mutual fund SPC is required to notify the Commission of any change in information that it is required to be submitted to the Commission under the 2005 Regulations (§9 of the 2005 Regulations).

GENERAL

The BVI BCA contains a general and fairly standard provision enabling the Executive Council to make regulations in connection with the BVI BCA (§159). Regulations would deal with such things as fees payable under the BVI BCA and the 2005 Regulations and the prescription of standard forms and documents to use for the purposes of the BVI BCA.

CONCLUSION

The legislation pertaining to SPCs therefore represents a major opportunity for many international businesses in the insurance and mutual fund industries, to name but a few. Rather than forming numerous subsidiaries, it creates an inexpensive and less unwieldy system to the traditional route of creating legal divisions between accounts.

Most importantly, however, Part VII of the BVI BCA establishes substantive law governing the application of particular assets in favour of particular accounts and their respective liabilities. In this regard, it is believed that the new substantive provisions will significantly enhance the prospects for enforceability of transactions in jurisdictions where the assets of a particular segregated account might be situated, and furthermore, the extent to which procedural as well as substantive law provisions may bind third parties.

For more specific advice on Segregated Portfolio Companies in the British Virgin Islands, we invite you to contact one of the following:

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