

Why More Chinese Businesses Are Choosing the BVI for Offshore Investment: A Move To Quality

The last few years have seen a steady flow of Chinese businesses choosing to incorporate entities in the British Virgin Islands (BVI), and Chinese lawyers seeking knowledge on the uses and advantages of BVI structures for their clients' transactions. Ashley Davies, partner, corporate & finance Group, of Campbells, discusses what has perked the Chinese interest in the BVI.

By Ashley Davies

Published: Feb 21, 2019

Over the last few decades, it is increasingly widely known that there has been a steady flow of Chinese businesses choosing to incorporate entities in the British Virgin Islands (BVI). And in tandem with the growing interest from Chinese enterprises looking to build businesses using the BVI, we are increasingly seeing more legal professionals based in China looking to become more knowledgeable about the uses and advantages of BVI structures for their clients' transactions.

According to the United Nations Conference on Trade and Development World Investment Reports, the BVI was the second largest investor in China from 2006 to 2012, providing \$7.72 billion of inward foreign direct investment in 2012 alone. What's more, according to recent research by London-based economics consultancy Capital Economics, approximately two-fifths of all BVI business companies in 2017 had operations in mainland China, Hong Kong and Macau. Mainland Chinese and Hong Kong-based companies accounted for more than 40% of the \$1.5 trillion in assets mediated through the BVI, according to the Vistra 2020 report *The Disruption Advantage*. But why have Chinese businesses chosen the BVI?

A Warm Relationship

The BVI and China have developed a close relationship over the last few years. This is because, in part, the BVI has developed itself as a world leader in offshore business incorporation. Quite simply, its legislative framework has made it quick, inexpensive and easy to set up a business company offshore. At the same time, participants in the rapidly growing Chinese economy have sought more ways to be able to do business with the rest of the world, and many have found incorporating companies offshore an excellent way of facilitating the flow of finance and transfer of assets effectively in and out of China and around the globe.

The BVI was aware of this growing demand early on and has purposely crafted an international business framework that provides a number of features attractive to international businesses, not least those in China. For example, the BVI was one of the first offshore jurisdictions to enable Chinese character names to appear on company certificates of incorporation. This wasn't a significant innovation from a legal perspective, but culturally it was huge – Chinese businesses were being welcomed with open arms to the BVI.

And that relationship has continued to blossom. It's not an exaggeration to say that there are likely more lawyers advising on the BVI law aspects of international transactions in Hong Kong today than there are in the BVI itself. And the BVI has become virtually synonymous in China with the very concept of an offshore company. The infrastructure is on the ground and in the right time zone for Chinese entrepreneurs, who know they can easily contact a professional in their time zone to arrange a new BVI company incorporation, speaking to the relevant experts in Chinese and dealing with paperwork that is for the most part conveniently available in their native language.

A Transparent System

As China continues to develop as a key player in global business, there is a growing demand worldwide for more transparency to facilitate more international investment, reduce money-laundering and tax evasion, and generally enhance economic growth. The BVI has publicly committed to work with international organizations to meet international standards in this regard, which is becoming increasingly important as Chinese enterprises seek both to gain more trust from, and place more trust in, their global partners, investors, customers and suppliers.

Much is reported on the supposed “secrecy” of the BVI, but the reality couldn't be more different. For example, the constitutional documents of a BVI company are publicly available, which is an important consideration for those who wish to carry out independent due diligence checks on the BVI company and get a sense of its

authorized business activities. Chinese businesses who wish to build international partnerships are often the first to highlight this aspect of their BVI structures.

The BVI also provides a publicly searchable system for the registration of security interests, whereby lenders are able to register, or ensure that their client registers particulars of a charge granted by a BVI company. A summary of the assets that have been charged or mortgaged in favor of lenders can then be obtained through a company search. Again, this is a layer of transparency that attracts Chinese businesses and their international partners to the BVI.

The Benefits of a system based on English Common Law

Another attractive aspect of the BVI legal framework is the fact that the law of the BVI is a combination of common law and statute, and is based heavily on English law. Principles of English common law and equity have been explicitly extended to the BVI by statute. The English common law is widely regarded as one of the most user friendly and acceptable systems of laws for doing international business across borders.

The English common law is widely understood and respected. And while the BVI courts have developed their own increasingly well-known body of common law jurisprudence, the BVI courts will still look for precedential value to decisions of the English courts which, while not formally binding on the BVI courts, are of significant persuasive authority.

In addition, given the large number of BVI companies that have been incorporated over the years, it should come as no surprise that the statutory framework underpinning BVI vehicles has been well-tested in the courts. This gives international business lawyers and their clients in other jurisdictions confidence in the predictable and robust nature of the BVI legal system.

When it comes to dispute resolution, the international business community is also able to take comfort from the fact that the BVI court system is generally regarded as clear, transparent, principled and predictable. The rule of law is applied impartially and openly in the BVI and in keeping with the jurisprudential norms of other common law jurisdictions such as the U.K. and the countries of the Commonwealth.

Chinese businesses and their advisors also like working with BVI companies because they are able to enter into contracts governed by other laws. So it is common, and no problem, for a BVI company to sign an agreement governed by

Hong Kong law, English law or New York law. And finally, it is worth noting that BVI companies increasingly enter into agreements governed by Chinese law.

BVI Joint Ventures Promote International Investment

The BVI allows for a number of variations of Joint Ventures (JV) and bespoke partnerships that help create a transparent, mutually beneficial agreement that suits all stakeholders. This also allows for more efficient international investment, which is in particular demand today as Chinese companies look to take advantage of the government's Belt and Road Initiative (BRI).

For example, under a JV arrangement, a company headquartered in China is able to set up group-level financing and begin the process of bringing on board investors. The JV can be easily structured using a BVI business company which would generally permit investment by way of debt or equity from both Chinese and non-Chinese sources.

Where the BVI business company is used by a Chinese business and its international partners to form an offshore JV corporation, it is widely regarded as being user friendly in the context of entering into project contracts, government and engineering programs and various other initiatives that facilitate the organization of pan-continental projects. Also, such JV structures can be more efficient when enterprises need to operate at a local level – they can work with the relevant authorities and organisations on the ground, whilst facilitating international investment with minimal disruption.

Bespoke Shareholder Arrangements

The BVI has also become a go-to destination for Chinese business because of its flexibility when it comes to structuring shareholder rights. The powers and duties of directors and shareholders, and the key rights of certain cornerstone investors can be a critical part of a new incorporation. Under BVI law there is considerable flexibility to tailor the rights of participants in a way which matches their commercial objectives. And once such arrangements are put in place, it is relatively easy to make future changes to them without seeking BVI governmental or regulatory approvals.

For example, Chinese businesses entering into BVI JVs often want to create complex sets of rights attaching or related to different classes of shares. This can include enhanced dividend rights for certain classes of preferred shares, put and call options which may be exercised in certain circumstances, and preemptive

rights governing restrictions on the transfer or issue of shares. BVI law has the flexibility to address these issues in a clear and transparent manner that addresses the concerns of the parties from the outset. This can help to preempt problems and by addressing potential issues early, a BVI JV can reduce the likelihood of disputes arising between the various stakeholders.

New BVI Partnership Law

It is worth mentioning that the BVI recently updated its laws to add a new level of accessibility to Limited Partnership (LP) models.

The previous BVI LP statute was based upon English law written in 1907 and it is fair to say that it needed an upgrade. At times BVI lawyers sought to draft rules around the margins of the legislation, resulting in complex agreements that bred uncertainty among partners. The update happened with the passing of the Limited Partnership Act, 2017, and made the model more compatible with the modern investment industry.

The new legislation incorporates elements of the highly successful BVI Business Companies Act that has served so many Chinese investors well over the years. Now, for example, partners can choose whether a limited partnership is formed with or without legal personality, which may be an issue if capital is going to be raised using the vehicle. A charge can also now be publicly registered against an LP with legal personality, and partners now have the ability to merge or consolidate LPs and to migrate existing LPs to and from the BVI. For those Chinese investors looking to create funds in the BVI, the new BVI LP model will be reassuringly familiar.

Move To Quality

Chinese businesses are choosing to set up structures using the BVI because they need to be able to show international investors and partners that their enterprises are transparent, robust, secure and conducive to international business. Being able to use a well-tested and flexible legal system, create bespoke arrangements for shareholders and directors, and demonstrate transparency are key benefits for Chinese businesses looking for cooperation and investment beyond Asia.

It is worth mentioning the positive comments on the attractions and practicalities of Chinese entities using BVI companies contained in the recently published Overseas Development Institute report *International financial centres and development finance*. It contains a number of high-profile case studies – from a

Pakistan bus company to a Chinese state-owned fund for investing in Africa – evincing the success of this Sino-BVI relationship.

As calls for increased global transparency increase, more Chinese enterprises will seek out offshore jurisdictions which have demonstrated that they are committed to international norms. Chinese businesses will increasingly be seeking out a jurisdiction that will enhance their reputation and underline the quality of their business as China continues to become a world leader in international enterprise.

Copyright 2019. ALM Media Properties, LLC. All rights reserved.