



BERMUDA INVESTMENT FUNDS' DEVELOPMENTS

January 2020

The Investment Funds Act 2006 (**IFA**) was amended by the Investment Funds Amendment Act 2019 (**IFA Revision**) which was passed in December 2019 and became operative on 1 January 2020. The IFA Revision introduced some important changes to investment fund regulation in Bermuda with the intention of further strengthening the regulatory framework in Bermuda for funds.

Principal Changes

The principal IFA Revision changes are intended to address economic substance for collective investment vehicles which previously did not require any registration under the IFA or regulation by the Bermuda Monetary Authority (**BMA**) pursuant to the IFA. Consequently, closed-ended Bermuda investment funds and overseas investment funds which are managed or carry on promotion in or from within Bermuda are now required to seek registration or designation with the BMA during a transition period of 6 months. Each new category is considered below together with some supplemental changes under the IFA Revision.

Investment Funds

Prior to the IFA Revision, the IFA only regulated open-ended investment funds. Following the IFA Revision, the BMA now regulates 'investment funds' which means "*any arrangement with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income*". The arrangements must have the following characteristics: -

- the participants do not have day to day control over the management of the property, whether or not they have the right to be consulted or give directions; and
- the contributions of the participants and the profits or income out of which payments are to be made to them are pooled and/or the property is managed as a whole by or on behalf of the operator of the fund.

A Bermuda domiciled investment fund (as defined) will then be regulated under the IFA as either an open-ended investment fund or a closed-ended investment fund which are defined as follows: -

An 'open-ended investment fund' means "*an arrangement in which the participants are entitled to have their units redeemed in accordance with the fund's constitution and offering document at a price determined in accordance with such constitution and offering document*".

A 'closed-ended investment fund' means "an arrangement in which the participants are not, at their election, entitled to have their units redeemed".

The Investment Funds (Definition) Order 2019 (**IFA Exclusion Order**) issued by the Minister of Finance sets out the type of arrangements which are excluded from the IFA and includes arrangements operated otherwise than by way of business, arrangements where all of the participants are in the same group as the operator, arrangements which are holding entities under the Economic Substance Act 2018 (as amended), pension funds, joint ventures, insurers registered under the Insurance Act 1978, securitisation special purpose vehicles, debt issues and digital asset businesses licensed under the Digital Asset Business Act 2018.

Open-Ended Investment Funds

An open-ended investment fund will continue to be required to be classified within the categories of Authorised Fund or Registered Fund as follows:

- Authorised Funds: Institutional Fund, Administered Fund, Standard Fund or Specified Jurisdiction Fund
- Registered Funds: Professional Class A Fund, Professional Class B Fund or Private Fund

Closed-Ended Investment Funds

All closed-ended funds which are not otherwise excluded by the IFA Exclusion Order will need to apply to the BMA for registration, either prior to their launch or, if in existence as at the date of this Memorandum, within a transition period of 6 months expiring 30 June 2020.

Typically, closed-ended funds are used for private equity or master/feeder fund purposes and will seek registration as a closed-ended Private Fund but if the private equity or master fund structure does wish to be registered as an open-ended Private Fund then the IFA Revision will require the appointment of a fund administrator and custodian (though a waiver may be granted from the custodian requirement). Whereas a closed-ended Private Fund is only required to engage a licensed corporate services provider given the closed and private nature of the fund. Like an application for an open-ended Private Fund an offering document will be required for a closed-ended Private Fund which will be in a form reflective of the private nature of the offering and a registration fee will be payable.

A closed-ended fund which is not private should be registered under the new category of Professional Closed Fund which would be where there are or will be more than 20 investors and an intention to offer the units to the public. To qualify for registration as a Professional Closed Fund the following is required:

- it is a closed-ended investment fund;
- it is open only to qualified participants (see revisions to this concept under '[Other Changes](#)' below;
- the operators, officers and service providers of the closed-ended investment fund must be fit and proper to perform their various functions;
- the qualified participants are provided with an investment warning prior to the time of the purchase of the units in an approved form;
- its operator has appointed a licensed Bermuda based service provider (which includes fund administrator or corporate services provider) or another officer, trustee or representative resident to Bermuda who has access to its books and records;
- its operator has appointed an auditor; and

- its financial statements are prepared in accordance with recognised standards (i.e. IFRS or GAAP).

The Professional Closed Fund like the Professional Class A or B Funds will be subject to continuing obligations and required to certify annual before 30 June that it satisfies the applicable provisions of the IFA and this will include information on NAV and underlying assets, a copy of the latest audited financial statements and a statement of material changes to the fund's offering document that may have occurred during the reporting period.

Overseas Investment Funds – Designated category

The IFA Revision introduced a new category of registration namely investment funds which are funds incorporated or established outside of Bermuda but are managed or carry on promotion in or from within Bermuda (**Overseas Funds**). Effective 1 January 2020 a new Overseas Fund will be required to be designated by the BMA as such and if already in existence at the date of this Memorandum will have a 6-month transition period expiring 30 June 2020 to achieve such designation.

The criteria for designation as an Overseas Fund by the BMA are that it: -

- complies with the applicable rules and requirements of the overseas regulatory authority in the country in which it is incorporated or registered; and
- complies with the requirements of Section 5A(2) of the IFA with respect to Overseas Funds and any conditions imposed on it by the BMA.

The operator of an Overseas Fund must notify the BMA in writing prior to managing or promoting the fund in or from within Bermuda and submit:

- details of any regulatory approval given by or notification given to the overseas regulatory authority in the country or territory of incorporation or establishment;
- a copy of the offering document; and
- the applicable fee.

An Overseas Fund will also be required (like other categories of authorised and registered funds) to file with the BMA an annual certification on or before 30 June that the Overseas Fund continues to satisfy the relevant requirements for designation and which will include a statement of material changes to the funds' terms of offering which occurred during the reporting period and a confirmation that the fund has at all times during the preceding financial year been in compliance with the IFA. The Overseas Fund will also need to confirm compliance with the applicable rules and requirements of the overseas regulatory authority in the country or jurisdiction in which it is incorporated or established.

In the event of winding up of the Overseas Fund, the operator of it must notify the BMA in writing within 14 days of the same occurring.

The IFA Revision defines promotion as meaning the following activities:

- advertising;
- issuing an offering document, application form or proposal form and stating the method of issue;
- circulating or making available promotional material, including describing the general nature of the material and the persons to whom, and the manner in which, it is to be circulated or made available.

No definition is provided as to what constitutes management in the context of the IFA but guidance could be taken from the circumstances under the Companies Act 1981, as amended, where an overseas company which carries on business in Bermuda, is required to obtain a permit.

Other Changes

The IFA Revision also made a number of other changes to the IFA which include the following:-

- *Minimum Criteria for Licensing* – the operators, officers and service providers of authorised, registered, and designated funds (including Professional Class A, Class B and Professional Closed Funds) must be fit and proper to perform their various functions. In this connection, the BMA will have regard to a person’s probity, competence and soundness of judgment for fulfilling the responsibilities of the position and to the diligence with which such person is fulfilling, or is likely to fulfil, those responsibilities. Similarly, the BMA requires that operators, officers and service providers carry on business in a prudent manner and, in determining that, the BMA may take account of any failure to comply with the IFA, any other law including AML/ATF laws, codes of conduct and international sanctions in force in Bermuda.
- *Qualified Participants* – this definition in Section 9 of the IFA is relevant to investor eligibility criteria for Professional Class A, Professional Class B Funds, Professional Closed Funds and authorised Institutional Funds. The IFA revision substitutes the following definition of a ‘high net worth private investor’ as meaning “an individual whose net worth or joint net worth with that person’s spouse in the year in which he purchases an investment exceeds \$1,000,000, (excluding the value of that person’s residence and any benefits or rights under a contract of insurance) and net worth means the excess of the total assets at fair market value over total liabilities”. The change introduced by the IFA Revision is to specify that this calculation of net worth must **not** include the value of that person’s residence and any benefits or rights under a contract of insurance.
- *BMA Website* – the BMA will maintain a list of all investment funds that are authorised, registered or designated.
- *Unit Trusts* – the scope for unit trusts to operate segregated accounts is widened to include all authorised and registered investment funds.
- *BMA Powers of Intervention* – have been expanded to enable the authority to give directions to authorised and registered funds where the circumstances do not justify revocation of an authorisation or registration or where desirable to do so to protect the interests of participants in an investment fund.

In addition to the IFA Revision, the BMA revised and issued the following effective 1 January 2020:-

- Investment Fund Offering Document Rules 2019; and
- Investment Fund Rules 2019.

Pursuant to the Investment Fund Offering Document Rules, every registered or authorised fund must file with the BMA an offering document which complies with certain minimum content requirements for offering documents as set out therein.

The Investment Fund Rules make provision for:-

- prudential requirements of the fund and obligations of the fund operator with respect to its service providers;
- obligations with respect to depository functions and safekeeping obligations;
- obligations with respect to valuations; and

- additional requirements related to reports to the BMA, reporting to investors, public disclosure and disclosure to investors.

In particular, it should be noted that for Professional Closed and closed-ended Private Funds, there is a requirement for operators to designate responsibility for segregation and safekeeping of the investment fund property to a fit and proper person to act as such, based on the nature of the investment property. These safekeeping arrangements must be disclosed to the BMA and to investors which would be achieved through disclosure in the offering document.

The Investment Fund Rules also require all registered and authorised funds to carry out valuations with particular minimum frequency depending on the category of fund (annually for registered funds). Valuation and pricing methods are to be disclosed to investors in the offering document and consistently applied (unless change is desirable in the interests of investors). These Rules further provide that the valuation function should be performed by an external valuer, the investment manager or fund administrator subject to requisite safeguards being in place to maintain functional independence, mitigate conflicts of interest and prevent the exercise of undue influence upon employees. In the absence of an external valuer, then the valuation procedures or valuations or both must be verified by an external valuer or, as applicable, its auditor.

Assistance

If you have any queries on your existing or prospective regulation under the IFA following the IFA Revision, then please do not hesitate to contact the BeesMont team members below who are able to assist with your queries or your usual contact at BeesMont.

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