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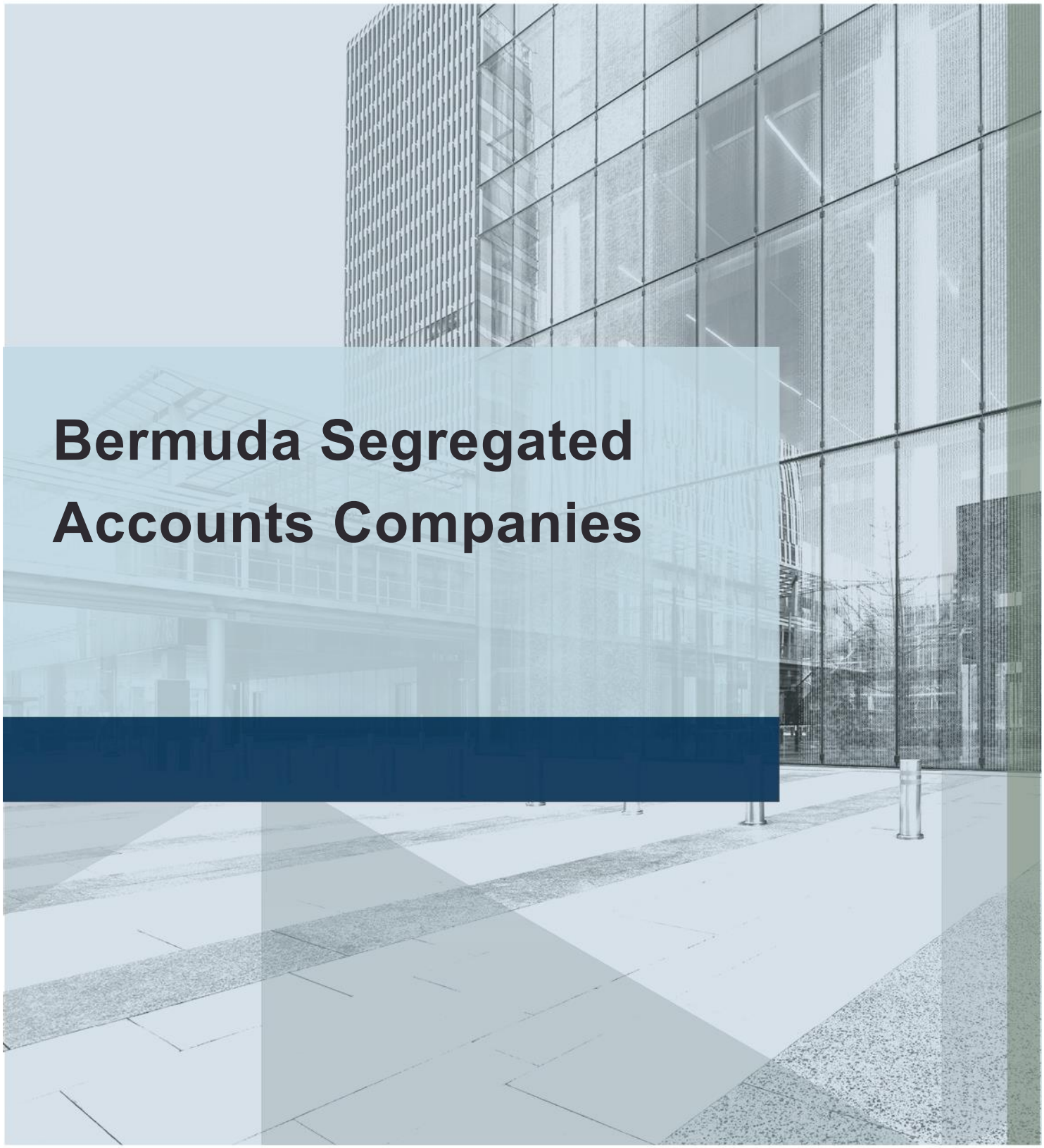

Bermuda Segregated Accounts Companies

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Preface

This publication has been prepared for the assistance of anyone who is considering establishing a segregated accounts company in Bermuda. It deals in broad terms with the requirements of Bermuda law. It is not intended to be exhaustive but merely to provide general information to our clients and their professional advisers.

We recommend that our clients seek legal advice in Bermuda on their specific proposals before taking any steps to implement them.

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1. INTRODUCTION

A segregated accounts company ("**SAC**") is a company which is granted the statutory power to create 'segregated accounts' in order to legally segregate the assets and liabilities attributable to a particular segregated account from those attributable to other segregated accounts and from the SAC's general account (which comprises the assets and liabilities that are not otherwise linked to a segregated account).

For decades Bermuda companies have operated "separate accounts" or "segregated accounts" in the form of companies acquiring segregated accounts powers by Private Act granted by the Bermuda Legislature. A Private Act is specific legislation applicable to the petitioner which has the effect of modifying Bermuda law as respects the petitioning company.

In response to the increasing number of Private Act applications being submitted to the Bermuda Parliament for approval, the Government of Bermuda enacted the Segregated Accounts Companies Act in 2000 (the "**SAC Act**") to enable companies to achieve segregated accounts powers more quickly and without the expense associated with petitioning the Bermuda legislature to enact private legislation.

While it is still possible for companies to petition the Bermuda Legislature for a Private Act, it has become uncommon given the ease and cost efficiency of registration under the SAC Act. Indeed, Private Act companies have the option of registering as an SAC to take advantage of the robust framework established under the SAC Act. Private Act companies are beyond the scope of this memorandum.

2. RATIONALE FOR ESTABLISHING A SEGREGATED ACCOUNTS COMPANY

2.1. Segregation of Assets and Liabilities

Under the SAC Act, an SAC is permitted to create and operate segregated accounts. Unless otherwise provided, the assets linked to a segregated account are available only to meet liabilities to the account owners and creditors of that segregated account and are not available, and may not be used, to meet liabilities to, and shall be protected from, the general shareholders and from the creditors of the company who are not creditors with claims linked to that segregated account.

Accordingly, the assets of the general account of the SAC shall only be available to meet the liabilities of the SAC's general account that are not linked to a segregated account.

A segregated account is not a separate legal entity but a record or a collection of records detailing transactions relating or linked to each other. The SAC Act therefore enables a statutory segregation of accounts within a single company that could otherwise only be achieved by incorporating subsidiaries or by Private Act or by creating trusts.

Within the investment funds industry, the ability to use an SAC is particularly beneficial for fund managers wishing to establish master-feeder fund structures, structures providing for multiple classes of shares or any structure for different investor classes or strategies or terms where the statutory segregation of assets is desired.

SACs are also useful in the insurance industry, particularly suitable for 'rent-a-captives' which are captive insurance companies established and licensed by a sponsor who then 'rents' its capital, its insurance licence and its capacity to operate to various participants. Insurance companies also find SACs useful for legally separating reserves among different insurance products, particularly long-term business such as life and disability programs.

Companies incorporated to hold significant assets (for example, aircraft or ships) may also find it beneficial to have each asset attributed to a separate account.

Other types of companies may also benefit from the segregated accounts structure and specific advice should be sought to determine whether on the facts of each case an SAC is the best available option.

2.2. Flexibility

Each segregated account can be tailor-made to best serve the interests of the individual account owners and the company at large. In particular, SACs can be designed to streamline and simplify administration for investment funds, insurance companies, asset-holding companies and companies carrying on separate and distinct business ventures.

2.3. Cost

The standard annual government fees for Bermuda companies apply similarly to an SAC and are set on a sliding scale calculated on the basis of the company's assessable (or in the case of an investment fund, authorised) capital. Annual government fees for exempted companies presently range from $2,095 to $32,676 per company.

One of the primary benefits of an SAC is that it renders it unnecessary to incorporate subsidiaries to conduct separate businesses or hold different assets; instead one SAC with minimal assessable capital can be created, administering any number of segregated accounts each individually ring-fenced. There are no limits on the number of accounts that an SAC may establish.

The initial registration fee to establish an SAC is $295 and thereafter the current annual fee is $295 for each segregated account operated by the SAC subject to a maximum of $1,180 per annum.

Therefore, by way of example, an SAC with minimal share capital operating 10 segregated accounts will attract an annual government fee of $3,275. At today's rates, ten separate companies with minimum share capital would attract $20,950 in government fees each year. Leaving aside the considerable savings in legal and incorporations fees and ongoing secretarial fees, which are usually payable per company, the cost benefit of operating segregated accounts can be considerable.

3. SETTING UP A SEGREGATED ACCOUNTS COMPANY

Any new company seeking to operate segregated accounts must be incorporated under the Companies Act and registered under the SAC Act. While these are two separate and distinct processes, they can be performed simultaneously so that the date of incorporation of the SAC can be the same as the date of SAC registration. Subject to the satisfaction of certain conditions, existing Bermuda companies, including those operating separate accounts under a Private Act, may register to become a SAC under the SAC Act.

3.1. Incorporation

Bermuda law distinguishes between "local" companies (which are owned predominantly by Bermudians) and "exempted" companies (which are owned predominantly by non-Bermudians). Generally, exempted companies may only carry on business from Bermuda in connection with transactions and activities which are external to Bermuda. The vast majority of companies incorporated in Bermuda are exempted companies. The focus of this part is on the incorporation of an exempted company and its registration as a SAC.

The Bermuda Monetary Authority (the "**BMA**") must approve the incorporation of all Bermuda exempted companies. The identity of the ultimate beneficial owners of the company must always be disclosed and, in general, all ultimate beneficial owners holding 10% or more of the shares of the proposed company must sign a personal declaration attesting to his or her good standing and provide verification documents. Generally, an "account owner" of individual segregated accounts does not typically need to be vetted by the BMA if the "account owner" does not hold voting shares in the SAC.

Full particulars of the incorporation process, together with a description of the constitutional documents, local requirements and the ongoing regulation of a Bermuda exempted company can be found in our publication entitled "Bermuda Exempted Companies," copies of which are available on our website or on request.

3.2. Registration

In order to be registered as an SAC, a company is required to file a statutory notice (the "**Form 1**") with the Registrar of Companies (the "**Registra**r"). The Form 1 must describe the nature of the business as well as contain a statement that the company is able to comply with the accounting procedures set out in the SAC Act. When making such a statement, it is usually sufficient for the company's directors or other applicants to confirm that the company's accountant or administrator has been directed to account for segregated accounts in the manner set out in the SAC Act.

Where the company has conducted business prior to its application to register as an SAC, a copy of the Form 1 must be sent to all persons currently doing business with the company who will become account owners and to the company's known creditors at least contemporaneously with the filing of the Form 1 with the Registrar. Further, the company must include with the Form 1 for filing with the Registrar evidence that seventy five percent in number of the account owners and the creditors have consented in writing to the registration of the company as an SAC and a statutory declaration made by at least two directors (the "**Statutory Declaration**") stating, among other things, that on registration the company and each segregated account will be solvent and (i) no known creditor of the company will be prejudiced and (ii) the known creditors have consented in writing to the company's registration or adequate notice has been given and no creditor objects to the registration otherwise than on grounds that are frivolous or vexatious.

The process used by the company to determine that the known creditors will not be prejudiced, or to obtain their consent to registration, must be described and verified by its directors as part of the Statutory Declaration.

The company is also required to notify the Registrar of any material changes to the information set out in the Statutory Declaration between the date of the notice filed and the date of registration.

The application and documents submitted to the Registrar and the BMA do not form part of the public record of the company. Once registered under the SAC Act, the name of the SAC will, however, be included in the Register of Segregated Account Companies which is maintained by the Registrar and is available to public inspection.

4. TIMESCALE FOR INCORPORATION AND REGISTRATION

A mutual fund SAC can usually be incorporated within two to three full business days of submission to the BMA of the completed application together with all of the supporting information on the ultimate beneficial owners and any required personal declarations. An insurance SAC may take a little longer because of the additional review carried out by the BMA Insurance Department. The Registrar may require a business plan with respect to the proposed activities of the SAC and the rationale for operating segregated accounts and it may be beneficial for applicants (particularly for non-mutual fund companies) to prepare a brief business plan to support the application. In order for contemporaneous registration under the SAC Act, all documentation must be completed in full and be correct.

5. MAIN PROVISIONS OF THE SAC ACT

5.1. Nature of Segregated Account/Application of Assets and Liabilities

The establishment of a segregated account does not create a legal person distinct from the SAC.

Any asset which is linked by the SAC to a segregated account shall be held by the SAC as a separate fund which is not part of the general account of the SAC and shall be held exclusively for the benefit of the segregated account owners and any counterparty to a transaction linked to that segregated account. Assets linked to a segregated account are available only to meet liabilities to the account owners and creditors of that segregated account and are not available and may not be used to meet liabilities to, and shall be protected from, the general shareholders and from the creditors of the company who are not creditors with claims linked to segregated accounts.

The assets recorded in the general account shall be the only assets of the SAC available to meet liabilities of the SAC that are not linked to a segregated account.

Liabilities arising from a transaction or matter relating to a particular segregated account may only be satisfied out of the assets linked to that segregated account and creditors, in respect of that liability, are not entitled to have recourse to the assets linked to any other segregated account or the general account of the SAC.

Where a liability arises otherwise than in respect of a particular segregated account, that liability may only be satisfied out of the assets linked to the general account and creditors, in respect of that liability, are only entitled to have recourse to the general account assets.

5.2. The Governing Instrument and Contracts

The rights, interests and obligations of the segregated "account owners" are evidenced in a governing instrument which is binding on the account owners and the SAC in respect of the relevant segregated account. Among other things, the governing instrument will usually set out the requirements for becoming an account owner, voting rights, if any, that may be exercised by the account owner, the methods by which the accounts will be managed, the mechanics for the payment of profits, and the distribution of assets upon a winding up of the segregated account.

The rights, interests and obligations of all counterparties to transactions entered into for and on behalf of any segregated account must be evidenced in contracts.

All governing instruments and contracts are deemed to be governed by the laws of Bermuda and the parties thereto shall be deemed to submit to the jurisdiction of the courts of Bermuda.

Unless otherwise expressly agreed in writing by the parties, any contract pertaining to a transaction linked to a segregated account shall be deemed to contain a statement that the rights of the counterparty shall not extend to, and the counterparty will not have recourse to, the assets which are linked to any other segregated account or to the general account of the SAC.

Any provision of a contract or governing instrument relating to the segregation of assets or liabilities of a segregated account shall be governed by and construed in accordance with the SAC Act, and the parties may not contract otherwise in such regard.

5.3. Segregated Account Representative

In addition to the ongoing requirements imposed by the Companies Act on all Bermuda exempted companies (as detailed in our publication entitled "Continuing Requirements of the Companies Act of Bermuda"), an SAC is required to appoint and maintain a segregated account representative ("**SAR**") in Bermuda who must be approved by the Minister of Finance. The particulars of the SAR are required to be included in the SAC's Directors and Officers Register which is open to public inspection.

The SAR has a statutory duty to make a written report to the Registrar within thirty days of (a) the SAR reaching the view that there is a reasonable likelihood of a segregated account or the general account of the SAC becoming insolvent; or (b) it coming to the SAR's attention, or the SAR having reason to believe, that certain failures to comply with the SAC Act have occurred or that the SAC has become involved in any criminal proceedings in Bermuda or elsewhere.

5.4. Internal Transactions

While the default position is that assets and liabilities of a segregated account are self-contained and ring-fenced within the same account, an SAC may elect to apportion an asset or liability among two or more segregated accounts and the general account of the SAC if agreed to by the SAC and the account owner(s) and provided for in the governing instrument.

Where an SAC has apportioned an asset or liability, the extent to which the asset or liability is linked to a segregated account shall be clearly indicated in the contract or governing instrument effecting the apportionment, particularly in the case of a mutual fund SAC where additional formalities will apply.

If not otherwise prohibited, a segregated account within an SAC may contract with one or more other segregated accounts of the SAC (subject to some restrictions designed to protect creditors from improper transactions made between different accounts). In addition, an SAC acting in respect of its general account may enter into transactions with one or more other segregated accounts operated by the SAC.

Transfers from the general account to a segregated account are only allowed if, on the date the transfer is to take place, and taking into account such transfer, the general account is solvent and all the shareholders and creditors of the general account on that date have given their written consent to the transfer. In the event a transfer breaches these provisions, such transfers can be voided upon application to the court by any person adversely impacted by the transfer.

5.5. Accounts, Records and Registers

The SAC must inform its counterparty that it is a segregated accounts company and include reference to such on its contracts and letterhead stationery. It must also identify the segregated account to which it is contracting on behalf of in all its transactions. The SAC shall maintain financial records in accordance with generally accepted accounting principles used in the preparation of the financial statements of the company prepared in accordance with the Companies Act, or other accounting principles so that such records clearly set out the assets, liabilities, income and expenses etc. that are linked to each segregated account. In addition, the SAC must maintain a record of each transaction entered into by the company and maintain a general account which records all of the assets and liabilities of the company which are not linked to a segregated account and which discloses any assets intended by the parties to be applied to a risk of any nature, and which therefore exposes such assets to liability or loss.

The records maintained with respect to any segregated account may be inspected by the owner of that segregated account but the owner of that account has no right to inspect the records relating to any other segregated account or the general account of the SAC.

Unless waived in writing by the account owner, the SAC shall prepare or cause to be prepared financial statements in respect of each segregated account which shall be audited and presented to the members in general meeting.

Subject to the foregoing, a copy of the financial statements of a segregated account shall be made available to the account owner at such intervals and for such periods as may be agreed by the SAC and the account owner, such period not to be less than once in each financial year.

The SAC shall maintain a register of account owners setting out their respective interests in any segregated account. The register of account owners is not open to public inspection.

5.6. Issue of Shares/Dividends

It is not a requirement of the SAC Act that an account owner be issued shares in respect of his or her interest in the segregated account (he or she may instead rely on the contractual provisions of the governing instrument); however, where shares linked to a particular segregated account are issued, the proceeds of such issue shall be included in the assets linked to that segregated account and the issue

of the security shall be identified as being linked to that segregated account in the accounts, books and records that are required to be prepared and maintained by the SAC.

An SAC may pay a dividend or make a distribution in respect of any class of shares linked to a segregated account (provided it is solvent) whether or not a dividend or distribution is declared on any other class of shares linked to the same or any other segregated account or any other shares issued by the SAC. The SAC Act stipulates its own solvency test for the declaration of dividends and distributions for segregated accounts, which takes into account the solvency of the segregated account in question, rather than the solvency of the company itself.

5.7. Account Owner Protections

Except where specifically excluded, there shall be implied in every contract and governing instrument entered into by an SAC a term that:

- No party shall seek, by any means, to establish an interest in or recourse against any asset linked to any segregated account to satisfy a claim or liability not linked to that segregated account;
- If any party succeeds in establishing an interest in or recourse against any asset linked to any segregated account of the SAC in respect of a liability not linked to that segregated account, that party shall be liable to the company to pay a sum equal to the value of the benefit thereby obtained by him; and
- If any party shall succeed in seizing or attaching or otherwise levying execution against any assets linked to any segregated account of the company in respect of a liability not linked to that segregated account, that party shall hold those assets or their proceeds on trust for the company and shall keep those assets or proceeds separate and identifiable as such trust property. The equitable remedy of tracing is permitted.

In the event that any assets attributable to a segregated account are taken in execution in respect of a liability not attributable to that segregated account, and in so far as those assets cannot otherwise be restored to the segregated account affected, the SAC shall procure that its auditor shall certify the value of the assets lost and, in priority to all other claims against the account, transfer or pay out of the account for which the liability was attributable sufficient assets or sums to restore to the affected segregated account the value of the assets lost.

5.8. Application of Assets on Insolvency

The consent of the Registrar of Companies is required for winding-up an SAC. When winding up an SAC, the liquidator is required to deal with the assets and liabilities which are linked to each segregated account only in accordance with the SAC Act and he shall ensure that the assets linked to one segregated account are not applied to the liabilities linked to any other segregated account or to the general account, unless an asset or liability is linked to more than one segregated account, in which case he shall deal with the asset or liability in accordance with the terms of any relevant governing instrument or contract.

6. SEGREGATED ACCOUNTS COMPANIES AND OTHER JURISDICTIONS

The SAC has become a very popular and effective vehicle not just in Bermuda but in other jurisdictions as well, including Jersey, Guernsey, the Cayman Islands and several U.S. States and has gained international industry acceptance.

The SAC Act has been considered by the Bermuda Supreme Court on several occasions and the Court has consistently upheld the ring-fencing of the segregated accounts in the face of insolvency and ensured that the assets of an individual segregated account are only available for the creditors and account owners of that particular segregated account.

It is possible that courts in other jurisdictions may not be prepared to accept that creditors in respect of a particular segregated account are prevented from gaining recourse to the assets of other segregated accounts, or that general creditors of the SAC as a whole do not have recourse to those assets specifically designated as segregated account assets, although we are not aware of any cases where applying Bermuda law, the SAC Act has not been accepted.

Similarly, if a liability (for example a fine or tax) is imposed by an authority of another jurisdiction, it is not known how the courts of Bermuda (or indeed other jurisdictions) might impose or distribute that liability as among the general account of the SAC and the various segregated accounts.

As the concept of segregated accounts (or “protected cell structures” as they are sometimes known) becomes more commonplace, so too should investor comfort with the effectiveness of such structures.

7. TAXATION

There is no Bermuda income or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by a Bermuda exempted company or its shareholders, other than by shareholders who are ordinarily resident in Bermuda.

A Bermuda exempted company may apply for, and is likely to receive, from the Minister of Finance (under the Exempted Undertakings Tax Protection Act 1966) an assurance that if the Bermuda legislature adopts any legislation imposing tax computed on profits or income, or computed on any capital assets, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then such taxes shall not apply to the company until at least March 2035.

No stamp duty is payable in respect of any instrument executed by a Bermuda exempted company or in respect of an instrument relating to an interest in a Bermuda exempted company. Stamp duty may, however, be payable in respect of transactions involving Bermuda property.