

## Alert

### Important Changes to the Bermuda Investment Funds Act 2006

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Following on our firm's 2019 alerts, industry will be aware of developments in relation to the Economic Substance Act 2018 with the Economic Substance Amendment (No. 2) Act 2019 and the Economic Substance Amendment (No.3) Regulations 2019 coming into force on 24 December 2019. At the same time, the Investment Funds Amendment Act 2019 ("IFA Amendments") was passed and became operative 1 January 2020, introducing several important changes to the Investment Funds Act 2006 (IFA). The IFA Amendments are intended to further enhance Bermuda's regulatory framework, primarily in relation to categories of investment funds that previously did not require any registration or regulation in Bermuda.

In particular, operators of **closed-ended Bermuda investment funds** and operators of **overseas (non-Bermuda) funds managed or carrying on promotion in or from within Bermuda** should have regard to these important amendments to the IFA that will require action by such funds to seek to be designated or registered with the Bermuda Monetary Authority (BMA).

This alert deals solely with certain key amendments to the IFA. For information on the broader implications of the Economic Substance Act for Bermuda entities, please refer to the separate Conyers alerts on Economic Substance.

#### Closed-ended investment funds – requirement to register

Closed-ended investment funds, popular vehicles amongst our private equity clients, are brought within scope of the IFA for the first time with a requirement to register with the BMA. It is expected most will choose to register as "Professional Closed Funds", although all the various categories of authorised and registered funds are available, as applicable.

The term "investment funds" means any arrangements 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 to 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 certain characteristics, including:

- (a) 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
- (b) 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 "closed-ended investment fund" means an arrangement in which the participants are not, at their election, entitled to have their units redeemed. Funds can include companies, partnerships or unit trusts. The Minister of Finance may, by order, exclude certain arrangements and has just published the Investment Funds (Definition) Order 2019 that excludes, among others, 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, securitization special purpose vehicles, debt issues and digital asset businesses licensed under the Digital Asset Business Act 2018.

The amendments generally seek to increase BMA oversight of these entities, which previously were outside the scope of the IFA, and will bring them more in line with the BMA's oversight of authorised and registered open-ended funds currently caught by the IFA.

Going forward, all closed-ended investment funds (which are not otherwise excluded by operation of the Minister's order) will need to apply to the BMA for recognition and registration prior to launch. All existing affected closed-ended funds will need to

register under the new regime within the six month transition period expiring at the end of June 2020.

### **New requirements and ongoing obligations**

In addition to the need for registration referred to above, there are some new requirements and obligations that are worth highlighting. Professional Closed Funds must:

- be open only to “qualified participants” (see definition under General below)
- appoint a Bermuda-based licensed service provider or resident representative with authority to access the books and records of the fund. While there is flexibility on the nature of this service provider (e.g. fund administrator, licensed corporate service provider), most funds will likely find it convenient to satisfy this new requirement through the appointment of a corporate service provider (providing registered office and director services) as most will have such an arrangement in place already.
- provide an investment warning to its participants prior to the time of purchase of units in a form approved by the BMA
- appoint an auditor
- prepare audited financial statements in accordance with IFRS or recognised GAAP

The application for registration by a Professional Closed Fund must:

- be submitted before 30 June 2020
- include (i) a certification that the requirements for registration are satisfied; (ii) a copy of the offering document complying with certain content requirements set out in the IFA; (iii) details on the service providers to satisfy the BMA they are fit and proper; and (iv) the applicable fee

Professional Closed Funds will have a new obligation (much as currently exists for other categories of authorised and registered funds) to file an annual certification to the BMA that the fund continues to satisfy the relevant requirements for registration and which 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 terms of offering that may have taken place during the reporting period.

### **Overseas (non-Bermuda) investment funds – requirement to be designated**

Overseas (non-Bermuda) investment funds are also brought within scope of the IFA for the first time with a requirement to be designated by the BMA as “Overseas Funds” before they can be managed or carry on promotion in or from within Bermuda. For the definition of “investment funds”, see above under “Closed-Ended Investment Funds”.

Going forward, all operators of applicable overseas investment funds will need to notify the BMA prior to the overseas

investment fund being managed or promoted in or from within Bermuda and such notification will be in such form and contain such information as the BMA may require. All existing affected overseas funds will need to notify the BMA under the new regime within the six month transition period expiring at the end of June 2020.

### **New requirements and ongoing obligations**

In addition to the need for notification referred to above, there are some new requirements for designation and obligations that are worth highlighting. Overseas Funds must:

- comply with applicable rules and requirements of the overseas regulatory authority in the country or territory in which it is incorporated or established
- comply with the IFA provisions in section 5 relating to overseas funds and any conditions that may be imposed on it by the BMA

The notification for designation by an Overseas Fund must:

- be submitted before 30 June 2020
- include (i) details of any regulatory approval given by, or notification given to, the overseas regulatory authority in the country or territory of incorporation or establishment; (ii) a copy of the offering document; (iii) the applicable notification fee

Overseas Funds will have a new obligation (much as currently exists for other categories of authorised and registered funds) to file with the BMA an annual certification on or before 30 June in every year that the fund continues to satisfy the relevant requirements for designation and which will include a statement of material changes to the fund's terms of offering that may have taken place during the reporting period, a statement confirming compliance for the preceding year with the applicable rules and requirements of the overseas regulatory authority in the country or territory in which it is incorporated or established; a statement confirming that the fund continues to comply with the relevant provisions of the IFA.

Finally, operators of overseas funds should note that they must, within 14 days of the winding up of the fund, notify the BMA in writing.

Bermuda-based fund managers should examine their stable of funds to determine which of their overseas fund entities may be caught by this new requirement to be designated by the BMA and call to discuss with their usual Conyers lawyer.

It is an offence to operate a fund in contravention of the requirement under the IFA to be designated as an Overseas Fund. Penalties on conviction include fines of \$50,000 to \$200,000, imprisonment for two to five years, or both, depending on whether the conviction is summary or on indictment.

The BMA's general powers of intervention applicable to authorised and registered funds under the IFA have been extended to designated funds (Overseas Funds) as well.

## General

### Minimum Criteria for Licensing

Certain IFA Amendments were made to ensure that the operators, officers and service providers of authorised, registered, and designated funds (including Professional Class A, Class B and Professional Closed Funds) are fit and proper to perform their various functions. Through issuing minimum criteria, the BMA has expanded on what it requires for this purpose and that it will have regard to a person's probity, competence and soundness of judgment for the responsibilities of the position and to the diligence with which such person is fulfilling, or is likely to fulfil, those responsibilities. 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 laws, codes of conduct and international sanctions in force in Bermuda.

### Qualified Participants

The definition of "Qualified Participants" has been updated by the IFA Amendments. The definition is relevant to investor eligibility criteria for Professional Class A and Professional Class B Funds as well as to Professional Closed Funds and authorised Institutional Funds.

In particular, Qualified Participants include, among others, "high net worth private investors". A high net worth private investor is defined as 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, and net worth means the excess of the total assets at fair market value over total liabilities. The change introduced by the IFA Amendments is to specify that this calculation of net worth must exclude the value of that person's residence and any benefits or rights under a contract of insurance.

### Fund Rules and Codes of Conduct

Operators of both registered and authorised investment funds (including open-ended and closed-ended) should take note that the BMA has issued Investment Fund Offering Document Rules and Investment Fund Rules both effective 1 January 2020. These rules do not apply to Designated Funds (Overseas Funds).

The Fund Offering Document Rules make provision requiring the preparation of an offering document by every registered or authorised fund which is to be submitted to the BMA and approved by it before being used for the offering of units to potential participants. Certain minimum content requirements for offering documents are set out in these rules.

The Investment Fund Rules make provision as to (i) prudential requirements of the fund and obligations of the fund operator with respect to its service providers; (ii) obligations with respect to depositary functions and safekeeping obligations; (iii) obligations with respect to valuations; and (iv) additional

requirements related to reports to the BMA, reporting to investors, public disclosure and disclosure to investors. In particular, in relation to Professional Closed and Private Funds, there is a requirement for operators to designate responsibility for segregated and safekeeping 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 (generally this would be expected to be through disclosure in the offering document).

Further, the Investment Fund Rules make general provision for all registered and authorised funds to carry out valuations with particular minimum frequency depending on the category of fund (annually for Professional Class A and Class B Funds and for Professional Closed 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). The operator should ensure the valuation function is performed by: (i) an external valuer; (ii) the investment manager, provided that the valuation task is functionally independent from portfolio management with mitigation for conflicts of interest and prevention of undue influence upon employees; or (iii) a fund administrator with systems that provide for timely and accurate generation of NAVs. Where external valuers do not perform the valuation function, the fund should have its procedures or valuations, or both, verified by an external valuer or, where appropriate, by its auditor.

Finally, the BMA may issue codes of conduct providing guidance on the duties, requirements and standards to be complied with and the procedures and sound principles to be observed by operators of, or service providers to, an investment fund.

Conyers will provide further details on the introduction of new or amended fund rules and codes of conduct as they are drafted and published.

### What action to take now

The IFA Amendments have brought into force some significant changes, as summarised here, which require close review. The changes overall are intended to enhance Bermuda's investment fund regulatory framework to better align with developing global standards. Many clients will find that they are reasonably placed with their existing structures to comply with the new requirements.

Our closed-end fund clients and Bermuda-based managers who manage or promote overseas funds in or from within Bermuda are encouraged to discuss these developments at the earliest opportunity with their usual Conyers lawyer.

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