



BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

REGULATION OF CORPORATE SERVICE PROVIDERS

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Objective

- 1) The objective of this paper is to provide an outline for the effective regulation of providers within the Corporate Service Industry, (“CSPs”) in Bermuda.

Background

- 2) The subject of regulation of the CSPs has been under discussion in Bermuda and elsewhere for over a decade. Recently, the discussion has become linked to the regulatory practices already in place in relation to corporate registration and share transfers. There was widespread concern within the business community that these practices made Bermuda uncompetitive with other jurisdictions.
- 3) The international development of Anti-Money Laundering (AML) obligations, which do not currently apply to CSPs in Bermuda, has added additional relevance to the debate, especially after the publication of the Offshore Group of Banking Supervisors *Statement of best Practice for Trust and Company Service Providers* in 2002; the Financial Action Task Force Paper “*The Misuse of Corporate Vehicles including Trust and Corporate Service Providers*” in 2006; and the publication by Caribbean Financial Action Task Force/ Financial Action Task Force in 2010 of the typologies paper “*Money Laundering Using Trusts and Company Service providers*” in October 2010. It is noted that Bermuda’s National Anti-Money Laundering Committee (NAMLC) chaired the project team responsible for the FATF typology paper.
- 4) The 2010 report noted that “Trust and Company Service Providers” (TCSPs) play a key role in the global economy as financial intermediaries, providing an important link between financial institutions and many of their customers. They provide often invaluable assistance to clients in the management of their financial affairs and can therefore significantly impact transactional flows through the financial system. It was also highlighted in that report that “TCSPs can play a significant role in facilitating money laundering”. The Report further goes on to state that “although TCSPs may play marginally important roles in some larger jurisdictions, they do play a significant role in the economies of many smaller jurisdictions where the financial services industry is a key source of income. In these jurisdictions TCSPs are significant in that they introduce international business to the jurisdiction and facilitate a smoother journey into and through these business relationships”. Thus, in jurisdictions such as Bermuda, CSPs would have to be considered to be a high risk sector. It should also be noted that, under the FATF 40 +9 Recommendations, it is expected that the nature of the supervisory regime for a sector will reflect the level of Anti-Money Laundering/Anti-Terrorist Financing (AML/ATF) risk to the jurisdiction of the activities being carried out by the relevant financial institution or Designated Non-Financial Business and Profession (DNFBP).
- 5) Although there are no internationally-defined standards relating to the regulation of CSPs, it would seem there was general consensus in the various reports that:

- a. There is a need for effective regulatory supervision over CSPs
- b. CSPs represent an area of risk for money laundering and terrorist financing
- c. There is a need for management and staff with expertise, knowledge and understanding of key matters to ensure CSPs do not promote or facilitate illegal activities
- d. There is a need for a “fit and proper” requirement in relation to the mind and management of CSPs in high risk jurisdictions

The risks relating to lack of information about the beneficiaries and the intended purpose of the corporate structure were also identified as significant areas of concern.

- 6) It has been widely acknowledged that some form of regulation of CSPs in Bermuda is necessary. However there were different views regarding the form and structure of that regulation. In the recent course of the debate, three principal options were reviewed:
 - 7)
 - a. *Regulation by the Barristers and Accountants AML/ATF Board with oversight by an independent body.* The joint Board has a regulatory role over the members of the Bar and accountants for AML purposes and the majority of the CSPs are, in fact, owned or controlled by members of the Bar.
 - b. *Regulation by the Financial Intelligence Agency.* This Agency will have AML regulatory obligations in relation to other sectors of the Bermuda economy, most particularly the High Value Retail and Real Estate sectors, although those obligations have not yet come into force.
 - c. *Regulation by the Bermuda Monetary Authority (the Authority).* The Authority already has responsibility for regulating most of the financial sector in Bermuda, and for supervision of compliance with AML regulation by that sector. The Authority has for some time made it clear that it would be reluctant to accept a role in the supervision of CSPs which did not involve prudential regulation of the CSPs, given the level and nature of risks identified in the sector.
- 8) In June 2011 the options were considered by the Bermuda Government (the Government) based on recommendations proposed by NAMLC, and it was decided that option 3 above was the appropriate option to creating a regime that was effective and efficient for Bermuda, and would meet international requirements. Coincidentally, the Authority had begun exploratory consideration of whether or not prudential regulation of the industry was viable, given the nature of its regulation over the rest of the financial sector and the need for consistent standards across the entire regulated sector. It was recognised that the Authority’s responsibilities in relation to AML compliance provided certain synergies with the regulation of this industry.

- 9) It was also agreed by Government that, if an effective regulatory regime could be developed then “double vetting”, (where the Authority conducts certain verification processes in relation to corporate registrations), and authorisation of issue and transfer of securities by the Controller under the Exchange Control Act 1972, (where Authority as the Controller is required to approve certain share transfers), would be discontinued.
- 10) Following the Authority’s review and given the approval of the Minister for Justice the Authority has developed this Consultation Paper which outlines its current perceptions on how the form of regulation, if administered by the BMA, would appear.

Scope of Proposed Regime

- 11) **Definition of Scope of Regulated Activity.** It is intended that the industry be regulated under an Act of Parliament, underpinned as needed by Regulations, Statements of Principles and Guidance similar to the legislative framework in place for regulation of financial services.
- 12) Consideration has been given to the scope of activities for corporate service providers that fall within the regulatory remit of two broadly similar jurisdictions, Cayman and Guernsey. In tabular form the activities regulated can be identified as follows:

<u>Cayman</u>	<u>Guernsey</u>
Acting as Company formation agent	Acting as Company formation agent
Providing registered office or business address	Providing registered office address
Providing correspondence, accommodation or admin address	Providing, accommodation address
Filing statutory forms, resolutions, returns	“
Arranging for the acceptance of process	“
Acting or arranging for another person to act as company officer	“
Acting as nominee shareholder	Acting or arranging for another person to act as company officer
Acting or arranging for another person to act as Director or alternate Director	Acting as nominee shareholder
Acting or arranging for another person to act as Secretary etc.	Acting or arranging for another person to act as Director or alternate Director
Acting or arranging for another person to act as Authorised custodian	Acting or arranging for another person to act as Secretary etc
Providing corporate services involving control of whole or part of company assets	
Other services specified in Regulations	Acting as Trustee, Corporate Trustee, Protector
	Other services specified in Regulations

There is useful guidance also to be gained from the Corporate Services Tax Act 1995, which defines corporate services in the following terms:

- a. the provision of corporate administrative services;
 - b. the provision of corporate management services;
 - c. the provision of corporate secretarial services;
 - d. the provision of a registered office;
 - e. the performance of functions in the capacity of director where that director is an owner, officer or employee of a business which is a provider of corporate services;
 - f. the performance of functions in the capacity of resident representative for the purposes of the trade or business carried on by the exempted undertaking; and
 - g. subject to subsection 2(b), the provision of accounting and financial services.
- 13) The common elements in the three alternatives would seem appropriate to delineate the scope of the regulation. It is not intended that accounting or financial services be caught by this legislation, nor that it be limited to services provided to exempt undertakings under S2 of the Companies Act, as is the Corporate Services Tax Act. It is also intended to limit the regulation of directorship activities to those provided as part of wider corporate services. The overall object is to regulate those entities which are directly involved in the business of incorporation, structuring and management of companies.
- 14) It is noted that, in addition to the above activities, there is significant activity in the formation, registration and management of partnerships and overseas companies in Bermuda and it is possible these activities would be included in the final definition of the activities which would be regulated. The activities in **bold** would not be included as they are either already dealt with in other legislation elsewhere, or do not currently apply to Bermuda.
- 15) It should be recognised that it is intended only to license those companies or persons which carry out the above activities as a commercial activity, i.e. services provided to independent third parties for profit. Thus, for example, a CSP which manages companies within a group of which it is a member would not be required to be regulated.
- 16) As noted, the scope of activities carried on by CSPs will be based on general definitions used by other jurisdictions as well as the definition under the Corporate Services Tax Act 1995. However, there may be arrangements by which service providers jointly provide corporate service functions. Under such circumstances, the

Authority would review the structure and determine whether all or only some of the parties should be licensed.

Details of Licensing Regime

- 17) While institutions regulated otherwise by the Authority will still be reviewed as they are presently, the removal of the checks and approval described above will substantially change the regulatory environment for corporate registration. It is recognised that there are significant powers under the Companies Act 1981, under which the Minister and the Registrar have powers to investigate, issue fines, and take other steps to monitor high-risk activities. For example, activities under Schedule 9 of that Act are restricted and those listed in Schedule 10 are prohibited. Those powers, however, relate to the specific institutions registered under that Act and do not relate to the responsibilities of the service provider who conducts the registration process. It is considered essential for the reputation of Bermuda as a legitimate and effective corporate centre that the removal of the above controls does not result in the admission of parties who may undermine Bermuda's reputation. A key element of the regulation of the industry will, therefore, be to impose an obligation that individual licensees have a duty to review applicants for suitability and ensure processes are in place to protect the reputation of the jurisdiction.
- 18) As there are a wide variety of business operating as CSPs, a tiered licensing structure, possibly based on volume of business will likely be the most appropriate.
- 19) **Minimum Criteria.** It is not intended to prescribe practices and procedures that must be adopted to satisfy the above requirement. The range of participants in the industry and the variety of their activities, as well as the regulatory environment, make such an option unviable. It is however proposed to develop a set of Minimum Criteria, not dissimilar to those in other regulatory Acts such as the Second Schedule to the Investment Business Act 2003, but which will include an express requirement to have practices and procedures in place to ensure that the activities are carried out in a manner which does not bring Bermuda into disrepute as a financial centre.

Thus, the Criteria will include:

- a. Directors and officers to be fit and proper persons.
- b. Business to be conducted in a prudent manner (which will include an express requirement to introduce and maintain policies and procedures which address all the obligations of the Licensee).
- c. Business to be conducted with integrity and skill (which will require that officers have a satisfactory level of experience and knowledge consistent with their responsibilities, and receive regular training on those obligations).

- d. Business to be conducted in a manner which ensures that Bermuda's reputation as a financial sector is not brought into disrepute. This would normally be seen as part of the obligation to act in a prudent manner but, given the nature of the industry, it is seen as better expressed directly. It will require that the policies and procedures developed as required above include processes to minimise and limit the risk of damage to Bermuda's reputation.
- 20) It is not seen as necessary to impose a "four eyes" requirement or a requirement for independent Directors.
- 21) The usual regulatory tools, to be found in the other regulatory Acts, will also apply to the industry:
- 22) **Licensing:** It is intended that access to the corporate registration process, and the right to conduct the above-specified activities, would be limited to licensees under the Act, and there would be a prohibition on those activities being conducted by unlicensed persons. Licences would be issued with an annual fee. It is envisaged the Licensing provision would be similar to that of section 17 of the Investment Business Act, (the IBA). There would be a provision for revocation of the licence similar to section 21 of the IBA, (including a failure to meet one or more of the minimum criteria) and a prohibition on carrying on the specified activities without a licence, similar to section 12 of the IBA.
- 23) **Fees:** Regarding the fees for supervision, it is expected that there will be different levels of fees depending on the size and scale of business, similar to the approach taken for scaling fees for trust companies.
- 24) **Annual Returns:** The usual practice in the regulatory Acts is for annual returns to be filed recording the nature of the regulated activities carried out in the year. It is anticipated that a similar requirement would apply in this situation, although the content of the return is yet to be settled. It is not anticipated that financial data would be required but some detail on the number of different activities carried out and geographic location of beneficial owners would be useful information. A requirement similar to section 38 of the IBA is envisaged although the contents of the return would be focused on activities rather than financial matters.
- 25) **Records:** Section 39 of the IBA imposes an obligation on licensees to maintain records as specified in the regulation. Given the role of the licensee under this regime, it is seen as desirable that the kind of records to be kept be defined with some precision. Accordingly, it is proposed that a provision similar to section 39 be included with the issue of what records should be maintained defined following further consultation and reference to the Companies Act 1981 obligations.
- 26) **Approval of Change of Directors and Officers:** Given that the licensee will be granted a semi-exclusive right with significant commercial advantage, it is felt desirable that the Authority have the power to approve any change in directors or

senior officers, to ensure that new participants can demonstrate they meet the fitness and suitability criteria in the Minimum Criteria. This would not be materially different to the provisions of sections 28 to 32 of the IBA, for example, and would provide for an obligation to notify the Authority and demonstrate how the proposed new participants meet the criteria, with a requirement that the Authority approve or reject the application within a specified time.

- 27) **Power for Regulatory Review:** This is the power which permits the Authority to require documents and information for the purposes of review of compliance with the requirements of the legislation, i.e. on-site and desk-based reviews. It is envisaged the provisions would be similar to those of sections 45, 46 and 47 of the IBA.
- 28) **Power for Investigations:** It is usual to have a power to investigate suspected contraventions of any regulatory Act. A provision similar to sections 49 and 50 of the IBA is envisaged.
- 29) It should be noted that the purpose of both review and investigation is to examine compliance with the Act licensing the participant. It is not intended that these powers would be used to investigate compliance with other Acts, such as the Companies Act 1981 or the partnership legislation under which the licensee may have obligations. It is intended that compliance with the Minimum Criteria, including the requirement that the licensee ensure that the reputation of Bermuda is not adversely affected, would be a matter for which review and investigation could occur.
- 30) **Power for Directions/Conditions:** Most regulatory Acts include a power to give directions to licensees, although this is not the case in respect of the IBA, where conditions are only imposed after licenses are surrendered. At the present time it is not seen as necessary to have two forms of inhibition on the licensees activities, and the capacity to impose conditions on the license is seen as sufficient.
- 31) **Criminal Offences:** This would provide for a penalty for licensees which make false or misleading statements to the regulator and a penalty for conducting business without the requisite licence.
- 32) **Other Regulatory Powers:** In October 2010 the Authority issued a consultation paper on proposed additional powers. It was the stated intent that the powers described therein would be applied to each of the regulated sectors as part of a standardisation of the Authority's powers. Legislation is currently being drafted to amend the regulatory Acts. It is proposed that those provisions would be included in the proposed legislation establishing this regulatory regime. The powers in question are:
 - a. The capacity to impose monetary penalties for specified breaches of the legislation.

- b. The capacity to ban individuals from senior roles in the Industry if found not to be fit and proper.
 - c. The power to seek injunctions.
 - d. The power to seek restitution.
 - e. The power to publish details of regulatory actions.
- 33) The Enforcement Amendment Bill also provides for processes surrounding the exercise of any of the powers which will be similar to those in sections 22 and 23 of the IBA.
- 34) **Appeal:** There will be appeal provisions from any decision under this legislative regime. It is anticipated they will be similar to those under section 33 to 37 of the IBA.
- 35) It is not seen as necessary to have any financial requirements as to minimum capital, or adequate liability insurance, given that no client funds are to be held by the licensee and the anticipated clients are fully capable of looking after their own interests. It follows that there is no need for an auditor or audited accounts to be filed.
- 36) There is no immediate intention to impose regulations under the legislation, apart from specific requirements, for example in relation to records. However as the regulation of the industry progresses and the issue of regulation becomes more apparent, then it is possible regulations may become appropriate. It may be that a code of conduct will be developed, which will be binding on licensees.

Transition

- 37) It is currently proposed that there would be a transition period of 12 months in which CSPs could implement the new requirements and prepare the requisite practices and procedures to ensure effective compliance with the obligations imposed by the legislation.
- 38) It is envisaged that any application would have to be accompanied by a set of the policies and procedures by which the new legislative obligations would be met. Those documents would be evaluated and, if and when found adequate, would form part of the basis for licensing. Compliance with these policies would form the basis of the on-site review process.

Consequential Amendments

- 39) **AML/ATF:** Given that the activities of corporate service providers is a matter of significance for AML/AFT purposes it is anticipated that the AML/ATF legislation will be amended to include licensees under the new regime.

- 40) **Exchange Control Regulations 1973:** While there may be some residual obligations which still need to be maintained it is generally anticipated that provision be made for deemed consent by the Controller for companies which engage licensed corporate service providers.
- 41) **Companies Act 1981:** Consideration will have to be given as to whether there will need to be consequential amendments to the Companies Act 1981 to ensure there is no inconsistency and the Registrar's regulatory obligations are capable of being satisfied. For example the personal declaration form which is filed at the time of incorporation would have to be reviewed.

Conclusion

- 42) Once the framework of regulation is determined then the mechanics under which it operates becomes a relatively straightforward process. The Authority has been moving toward a standard style of regulatory legislation for some time and the continuation of that process, and the importation of identical provisions and processes, lends the regulation of a new activity both legitimacy and consistency.
- 43) The objective is not to introduce overly intrusive regulation or to intrude unduly into the operation of the industry. This has not been the case with the other regulatory Acts, most of which have some of the proposed provisions, nor is it the intent of the Authority. The intention is to provide a demonstrably legitimate level of regulation to a range of activity which is the subject of increasing attention and potential risk and is critical to Bermuda's future and reputation.

Comment is requested on all aspects of this Consultation Paper. Responses should be sent to legal@bma.bm by 28th October 2011.