



# **BERMUDA MONETARY AUTHORITY**

## **CONSULTATION PAPER**

### **SECURING ENHANCED PROTECTION FOR INVESTORS: PROPOSED REVISIONS TO THE INVESTMENT FUNDS ACT 2006**

21st May 2010

## INTRODUCTION

1. The purpose of this Consultation Paper is to set out the Bermuda Monetary Authority's (the Authority's) proposals for amendments and additions to the Investment Funds Act 2006 and to seek feedback from interested parties. In this paper, the term "investment fund" includes all funds authorised or exempted by the Authority under Section 13(1) or Section 7(1) of the Investment Funds Act 2006 ("the Act") and the term "fund administrator" includes all fund administrators licensed by the Authority under section 43(1) of the Act.
2. The Authority has been working with industry to review the Act in light of our collective experience of applying its provisions in the three years since it was enacted. The review process started in 2008 and has involved regular discussions first with Bermuda International Business Association's ("BIBA"'s) IFA Review Sub-Committee and latterly with the Fund Administrators Committee of Business Bermuda (formerly BIBA). The Authority is grateful for the contributions made by industry representatives. The proposals set out in this paper, however, represent the views of the Authority and are not necessarily those of the industry.
3. The proposed amendments and additions are designed primarily to align the regulatory framework for funds and fund administrators more closely with the requirements that exist in other regulatory legislation in Bermuda, while ensuring that the framework overall remains risk-based and recognises the unique nature of the funds industry locally. In making these proposals, the Authority has sought to preserve an appropriate balance between securing the appropriate degree of protection for investors, most of whom are institutional or may be presumed to have a high degree of financial sophistication, while not imposing an undue regulatory burden on the industry.
4. The views of fund operators and other interested persons on the proposals set out in this paper are invited. Comments should be forwarded to the Authority on the Summary of Consultation Comments form which is available with this document. The form can be emailed or mailed to the attention of Leanne Alami-Merrouni: at [lalami-merrouni@bma.bm](mailto:lalami-merrouni@bma.bm) or BMA House, 43 Victoria Street, Hamilton HM12. The deadline for comments is 10 June 2010. The Authority intends to submit the proposed amendments to the Act for legislative approval in Parliament in mid July 2010.

## DETAILED PROPOSALS

5. The draft amendment bill is attached as Appendix I, i.e. the Investment Funds Amendment Act 2010. The changes proposed are as follows:

### **(1) DEFINITION OF SERVICE PROVIDER**

It is proposed to amend the current definition of "service provider" to include auditors appointed to a fund. The existing definition of "service provider" means a fund's custodian, fund administrator, investment manager and registrar (and includes any person to whom a service provider has delegated part or all of his functions), but does not

mention auditors. As auditors provide a vital role in servicing a fund's statutory requirements, we are proposing to amend the definition to include auditors in the list of service providers. Auditors of authorised and exempted funds will then be brought within the fit and proper test under sections 14 and 7 respectively of the Act.

The proposed amendment is outlined as item 3 in the attached Appendix I, the Investment Funds Amendment Act 2010.

## **(2) SERVICE PROVIDER DISCLOSURE FOR EXEMPTED FUNDS**

Section (7)(1)(b) of the Act requires that the Authority be satisfied that the operator of an exempted fund and its service providers are fit and proper persons to act as such. In section 9 of the Act, which sets out the criteria for exempting funds from the requirement of authorisation, one of the conditions is that the fund should have the following: a recognised fund administrator, an auditor and a Bermuda resident officer or trustee or resident representative who has access to the books and records of the investment fund. There is, however, no explicit requirement that an exempted fund should appoint a custodian, investment manager or registrar as is the case for authorised funds. We propose, therefore, to amend the Act to insert the following to the existing Section 9 (1)(c) criteria for exemption “, investment manager, registrar ,a custodian and/or prime broker”.

At the point of application, as provided for under section 7(1)(b), all the specified service providers would be vetted against the same fit and proper test as occurs for authorised funds.

The proposed amendment is outlined as item 4 in the attached Appendix I, the Investment Funds Amendment Act 2010.

## **(3) CHANGES IN CONTROL FOR FUND ADMINISTRATORS**

It is proposed that the following new provisions will be added to the Act:

- fund administrators to notify the Authority in advance when there is a prospective change in control
- the Authority to have powers to object to a change in control to prevent it happening or to object to existing controllers where the Authority concludes they are no longer fit and proper to be controllers

These proposals are designed to do no more than mirror the provisions that already exist for other licenced entities including banks and investment businesses. The Authority believes the same requirements should be extended to fund administrators so that appropriate oversight can be exercised over those corporate entities or individuals who exercise significant control.

The wording for the proposed new sections 45A, 45B, 45C, 45D and 45E is included as item 5 in the attached Appendix I, the Investment Funds Amendment Act 2010. In addition the required amendment to the existing related section 55 is also attached as item 7 in the Appendix.

## RIGHTS OF APPEAL

It is proposed for section 55 of the Act to be amended to provide that where the Authority has objected to a change of controller, in accordance with the notification of new or existing controller provisions under section 45, the person who is the subject of such an objection may appeal against the Authority's decision to a Tribunal constituted in accordance with section 56. This amendment ensures that proper judicial review of the exercise of the Authority's powers in accordance with section 45 is provided for under the Act.

### **(4) THE "FOUR-EYES" CRITERION FOR FUND ADMINISTRATORS**

The concept that business should be directed by at least two individuals is a standard regulatory requirement based on sound corporate governance standards that aims to prevent one individual exercising excessive control over the affairs of a licensed entity. The Authority is proposing this criterion be added to the existing Schedule- Minimum Criteria for Licensing to the Act to extend this principle to fund administrators.

The new provision is detailed as item 8 in the attached Appendix I, the Investment Funds Amendment Act 2010. In the first instance, the question as to how the "four-eyes" criterion is met will be for each fund administrator to assess in the light of its business and the Authority recognises that the arrangements are unlikely to be the same for every company. It may, for example, be possible for the criterion to be met without both pairs of eyes being resident full-time in Bermuda. The Authority will expect a fund administrator to be able to explain how its own arrangements satisfy this criterion.

### **(5) FUND OFFICERS TO BE FIT AND PROPER**

The Act currently requires a mutual fund company to notify the Authority of persons appointed as directors of the company. However, the Act does not provide that such persons are required to be fit and proper to act as such. Accordingly, the Authority proposes to amend clause 14 (1) to provide for any officers of a fund to be fit and proper at the time of authorisation which shall ensure that the business of the fund is being conducted in a prudent manner.

The Authority is also proposing to properly align paragraphs (a) and (b) under subparagraph (d) (iii); and properly list subparagraphs "(c) (d) and (e)" as "(e) (f) and (g)".

The proposed amendment is outlined as item 6 in the attached Appendix I, the Investment Funds Amendment Act 2010.

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**APPENDIX I**

**A BILL**

**entitled**

**INVESTMENT FUNDS AMENDMENT ACT 2010**

ARRANGEMENT OF SECTIONS

1	Short title and commencement	6	Section 14 amended
2	Interpretation	7	Section 55 amended
3	Section 2 amended	8	Paragraph 1 of minimum criteria amended
4	Section 9 amended		
5	Sections 45A, 45B, 45C, 45D and 45E added		

WHEREAS it is expedient to make new provision for [increased regulation of investment funds and fund administrators; and for connected matters].

Be it enacted by The Queen's Most Excellent Majesty, by and with the advice and consent of the Senate and the House of Assembly of Bermuda, and by the authority of the same, as follows —

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**Short title and commencement**

1 This Act may be cited as the Investment Funds Amendment Act 2010 and shall come into operation on 2010.

**Interpretation**

2 In this Act, the “principal Act” means the Investment Funds Act 2006.

**Section 2 of principal Act amended**

3 Section 2(1) of the principal Act is amended in the definition of “service provider” by inserting “auditor” before “custodian”.

**Section 9 of principal Act amended**

4 Section 9(1) (c) of the principal Act is amended by inserting “investment manager, registrar, a custodian and/or prime broker and” before “an auditor”.

**Sections 45A, 45B, 45C, 45D and 45E added**

5 The principal Act is amended by inserting the following sections after section 45 –

*“Objections to controllers*

**Notification of new or increased control**

45A. (1) No person shall become a controller of any description of a fund administrator unless —

- (a) he has served on the Authority a written notice stating that he intends to become such a controller of the fund administrator; and
- (b) either the Authority has, before the end of the period of forty-five days beginning with the date of service of that notice, notified him in writing that there is no objection to his becoming such a controller of the fund administrator, or that period has elapsed without the Authority having served him under section 45B a written notice of objection to his becoming such a controller of the fund administrator.

(2) Subsection (1) applies also in relation to a person becoming a member of a fund administrator which is a partnership.

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(3) A notice under subsection (1)(a) shall contain such information as the Authority may direct and the Authority may after receiving such a notice from any person, by notice in writing require him to provide such additional information or documents as the Authority may reasonably require for deciding whether to serve notice of objection.

(4) Where additional information or documents are required from any person by a notice under subsection (3) the time between the giving of the notice and the receipt of the information or documents shall be added to the period mentioned in subsection (1) (b).

#### **Objection to new or increased control**

45B. (1) The Authority may serve a notice of objection under this section on a person who has given notice under section 45A unless it is satisfied –

- (a) that the person concerned is a fit and proper person to become a controller of the description in question of the fund administrator;
- (b) that the interests of clients or potential clients of the fund administrator would not be in any other manner threatened by that person becoming a controller of that description of the fund administrator; and
- (c) without prejudice to paragraphs (a) and (b), that, having regard to that person's likely influence on the fund administrator as a controller of the description in question the minimum criteria would continue to be fulfilled in the case of the fund administrator or, if any of those criteria is not fulfilled, that that person is likely to undertake adequate remedial action.

(2) Before serving a notice of objection under this section the Authority shall serve the person concerned with a preliminary written notice stating that the Authority is considering service on that person of a notice of objection and that notice—

- (a) shall specify which of the matters mentioned in subsection (1) the Authority is not satisfied about and, subject to subsection (5), the reasons for which it is not satisfied; and

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(b) shall give particulars of the rights conferred by subsection (3).

(3) A person served with a notice under subsection (2) may, within a period of twenty-eight days beginning with the day on which the notice is served, make written representations to the Authority; and where such representations are made the Authority shall take them into account in deciding whether to serve a notice of objection.

(4) A notice of objection under this section shall—

(a) specify which of the matters mentioned in subsection (1) the Authority is not satisfied about and, subject to subsection (5), the reasons for which it is not satisfied; and

(b) give particulars of the rights conferred by section 55.

(5) Subsections (2)(a) and (4)(a) shall not require the Authority to specify any reason which would in its opinion involve the disclosure of confidential information the disclosure of which would be prejudicial to a third party.

(6) Where a person required to give a notice under section 45A in relation to becoming a controller of any description becomes a controller of that description without having given the notice, the Authority may serve him with notice of objection under this section at any time within three months after becoming aware of his having done so and may, for the purpose of deciding whether to serve him with such a notice, require him by notice in writing to provide such information or documents as the Authority may reasonably require.

(7) The period mentioned in section 45A(1)(b) (with any extension under subsection (4) of that section) and the period mentioned in subsection (6) shall not expire, if it would otherwise do so, until fourteen days after the end of the period within which representations can be made under subsection (3).

#### **Objection to existing controller**

45C. (1) Where it appears to the Authority that a person who is a controller of any description of a fund administrator is not or is no longer a fit and proper person to be such a controller of the fund administrator it may serve him with a written notice of objection to his being such a controller of the fund administrator.



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(2) Before serving a notice of objection under this section the Authority shall serve the person concerned with a preliminary written notice stating that the Authority is considering service on that person of a notice of objection and that notice shall—

- (a) subject to subsection (5), specify the reasons for which it appears to the Authority that the person in question is not or is no longer a fit and proper person as mentioned in subsection (1); and
- (b) give particulars of the rights conferred by subsection (3).

(3) A person served with a notice under subsection (2) may, within a period of twenty-eight days beginning with the day on which the notice is served, make written representations to the Authority; and where such representations are made the Authority shall take them into account in deciding whether to serve a notice of objection.

(4) A notice of objection under this section shall—

- (a) subject to subsection (5), specify the reasons for which it appears to the Authority that the person in question is not or is no longer a fit and proper person as mentioned in subsection (1); and
- (b) give particulars of the rights conferred by section 55.

(5) Subsections (2)(a) and (4)(a) shall not require the Authority to specify any reason which would in its opinion involve the disclosure of confidential information the disclosure of which would be prejudicial to a third party.

#### **Contraventions by controller**

45D. (1) Subject to subsection (2), any person who contravenes section 45A by—

- (a) failing to give the notice required by subsection (1) (a) of that section; or
- (b) becoming a controller of any description to which that section applies before the end of the period mentioned in subsection (1)(b) of that section in a case where the Authority has not served him with a preliminary notice under section 45B(2);

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shall be guilty of an offence.

(2) A person shall not be guilty of an offence under subsection (1) if he shows that he did not know of the acts or circumstances by virtue of which he became a controller of the relevant description; but where any person becomes a controller of any such description without such knowledge and subsequently becomes aware of the fact that he has become such a controller he shall be guilty of an offence unless he gives the Authority written notice of the fact that he has become such a controller within fourteen days of becoming aware of the fact.

(3) Any person who—

- (a) before the end of the period mentioned in section 45A (1) (b), becomes a controller of any description to which that subsection applies after being served with a preliminary notice under section 45B (2);
- (b) contravenes section 45A by becoming a controller of any description after being served with a notice of objection to his becoming a controller of that description; or
- (c) having become a controller of any description in contravention of that section (whether before or after being served with such notice of objection) continues to be such a controller after such a notice has been served on him;

shall be guilty of an offence.

(4) A person guilty of an offence under subsection (1) or (2) shall be liable on summary conviction to a fine of \$25,000.

(5) A person guilty of an offence under subsection (3) shall be liable—

- (a) on summary conviction to a fine of \$25,000 and in respect of an offence under paragraph (c) of that subsection, to a fine of \$500 for each day on which the offence has continued;
- (b) on conviction on indictment to a fine of \$50,000 or to imprisonment for two years or to both.

#### **Restriction on and sale of shares**

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45E. (1) The powers conferred by this section shall be exercisable where a person—

- (a) has contravened section 45B by becoming a shareholder controller after being served with a notice of objection to his becoming as such controller;
- (b) having become such a controller in contravention of that section continues to be one after such a notice has been served on him; or
- (c) continues to be a shareholder controller after being served under section 45C with notice of objection to his being such a controller.

(2) The Authority may by notice in writing served on the person concerned direct that any specified shares to which this section applies shall, until further notice, be subject to one or more of the following restrictions —

- (a) any transfer of, or agreement to transfer, those shares or, in the case of unissued shares, any transfer of or an agreement to transfer the right to be issued with them, shall be void;
- (b) no voting rights shall be exercisable in respect of the shares;
- (c) no further shares shall be issued in right of them or in pursuance of any offer made to their holder; or
- (d) except in liquidation, no payment shall be made of any sums due from the investment provider on the shares, whether in respect of capital or otherwise.

(3) The court may, on the application of the Authority, order the sale of any specified shares to which this section applies and, if they are for the time being subject to any restrictions under subsection (2), that they shall cease to be subject to those restrictions.

(4) No order shall be made under subsection (3) in a case where the notice of objection was served under section 45B or 45C —

- (a) until the end of the period within which an appeal can be brought against the notice of objection;

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(b) if such an appeal is brought, until it has been determined or withdrawn.

(5) Where an order has been made under subsection (3) the court may, on the application of the Authority, make such further order relating to the sale or transfer of the shares as it thinks fit.

(6) Where shares are sold in pursuance of an order under this section the proceeds of sale, less the costs of the sale, shall be paid into court for the benefit of the persons beneficially interested in them; and any such person may apply to the court for the whole or part of the proceeds to be paid to him.

(7) This section applies —

(a) to all the shares in the investment provider of which the person in question is a controller of the relevant description which are held by him or any associate of his and were not so held immediately before he became such a controller of the investment provider; and

(b) where the person in question became a controller of the relevant description as a result of the acquisition by him or any associate of his of shares in another company, to all the shares in that company which are held by him or any associate of his and were not so held before he became such a controller of that investment provider.

(8) A copy of the notice served on the person concerned under subsection (2) shall be served on the investment provider or company to whose shares it relates and, if it relates to shares held by an associate of that person, on that associate.

(9) In this section, “associate” has the meaning given in section 7(9) of the Investment Business Act 2003.”.

**Section 14 amended**

6 Section 14 (1) of the principal Act is amended by—

(a) inserting in subparagraph (c) “,its officers” after “fund”;

(b) indenting “(a) and (b)” in subparagraph (d) (iii); and

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- (c) re-listing subparagraphs “(c), (d) and (e)” as “(e), (f) and (g)”.

**Section 55 amended**

7. Section 55 of the principal Act is amended by inserting the following subsection after subsection (4) –

“(4A) Any person on whom notice of objection is served under section 45B or 45C may appeal to a tribunal constituted as aforesaid against the decision of the Authority to serve the notice; but this subsection does not apply to a person in any case in which he has failed to give a notice or become or continued to be a controller in circumstances in which his doing so constitutes an offence under section 45 (1), (2) or (3).”.

**Schedule amended**

8 The Schedule to the principal Act (“Minimum criteria for licensing”) is amended by inserting the following paragraph after paragraph 1 –

**“Business to be directed by at least two individuals**

1A. At least two individuals shall effectively direct the business of the fund administrator.”.



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## **INVESTMENT FUNDS AMENDMENT ACT 2010**

### **EXPLANATORY MEMORANDUM**

The main purpose of this Bill is to enhance the regulatory framework for the supervision for investment funds and persons engaged as fund administrators. The Bill also makes provision for controllers of any description to appeal a decision of the Authority in connection with an objection by the Authority.

Clauses 1 and 2 deal with preliminary matters.

Clause 3 seeks to amend section 1(1) by inserting “auditor” in the definition of “service provider” in the interpretation section.

Clause 4 seeks to amend section 9 to provide that persons must also appoint an “investment manager, registrar, custodian and/or prime broker and” in addition to an auditor in order to satisfy criteria for exemption.

Clause 5 seeks to add new sections 45A, 45B, 45C, 45D and 45E as follows: section 45A seeks to provide for notification to the Authority of new or increased controller of any description of a fund administrator; section 45B provides for the objection by the Authority to any new or increased controller of any description; and section 45C provides for objection by the Authority to any existing controller of any description. Section 45D provides for offences to the contravention of sections 45B or 45C; and section 45E seeks to provide the power for the Authority to restrict the sale of any voting shares of a fund administrator.

Clause 6 seeks to amend clause 14 (1) to provide for any officers of a fund to be fit and proper at the time of authorisation; to properly align paragraphs (a) and (b) under subparagraph (d) (iii); and properly list subparagraphs “(c) (d) and (e)” as “(e) (f) and (g)”.

Clause 7 seeks to provide an amendment to section 55 for a controller of any description to appeal an objection by the Authority in relation to new sections 45B and 45C.

Clause 8 seeks to amend the minimum criteria for licensing under the Schedule to the principle Act by providing that a fund administrator shall be directed by at least two individuals. This adoption of the 'four eyes' principle by fund administrators shall assist the Authority in determining whether the fund administrator's business is being conducted in a prudent manner.