

A large, abstract graphic of a network or sphere made of interconnected blue nodes and lines, positioned in the upper right and center of the page. The nodes are represented by small blue squares, and the lines are thin blue rods connecting them to form a complex, three-dimensional structure.

Bermuda

Regulation

FUNDS AND FUND MANAGEMENT 2009

2.1 Type of funds

The most common entity used for investment funds formed in Bermuda is the open-ended investment company. Other entities used are limited partnerships, closed-ended investment companies and unit trusts.

2.2 Laws

Open-ended investment companies are incorporated as mutual funds under the Companies Act 1981 (as amended) (the Companies Act) as exempted companies. Limited partnerships are formed in compliance with the provisions of the Limited Partnership Act 1883 (as amended) and the Exempted Partnerships Act 1992 if established as an exempted partnership. Unit trusts are governed by their trust deed or other instrument establishing the trust.

The Investment Funds Act 2006 (the Act) is the principal legislation that, together with the Companies Act and the trust deed in relation to unit trusts, principally governs the activities of investment funds operating in or from Bermuda. For the purposes of the Act an investment fund includes unit trust funds, mutual fund companies, and partnerships. It does not include closed-ended investment companies.

An investment fund may apply for authorization under the Act. Requirements for authorization include the appointment of an investment manager, an independent auditor, an administrator, registrar and a custodian. Authorized funds are required to submit a report of activities and performance to the Bermuda Monetary Authority (BMA) on prescribed intervals. Within six months of its financial year end, an authorized fund must submit a statement to the BMA confirming that it has been in compliance with the Act during the preceding year or, in the case that it has not been in compliance, the particulars of the breach.

The Act creates three classes of investment funds that have different requirements. The three classes are: institutional funds, standard funds, and administered funds. Institutional funds are the most lightly regulated class of investment funds and are intended for sale to institutional investors and high net worth individuals, such persons commonly referred to as sophisticated

investors or qualified participants. Standard Funds are more regulated as they are generally intended for products designed more for and available to retail investors who need greater regulatory protection. Administered funds are those that are administered by an administrator that is licensed in Bermuda under the Act.

The Act also allows for exempted and excluded funds.

An investment fund may apply to the BMA for exemption from authorization if it is open only to qualified participants, is administered by an administrator recognized by the authority, has appointed an auditor, and it has a representative resident in Bermuda who has access to the books and records of the fund. The operator of an exempted fund must also notify the BMA annually in writing that the fund continues to qualify for exemption.

The requirement to be authorized or exempt does not apply to funds which are deemed to be private. Such funds are considered as excluded funds. A private fund is one that has 20 or less participants and the interests in the fund are not offered to the general public. The fund must notify the BMA that it is private and qualifies for exclusion under the Act.

The Act includes provisions which specify:

- the content of the fund's constitutional documents and minimum reporting requirements;
- the key service providers that must be appointed - the administrator, custodian, registrar, investment manager, and auditor; and
- the content and other requirements for financial reports.

The appointment of each service provider and any subsequent change in any service provider requires the prior approval of the BMA.

Institutional funds are investment funds offered principally to institutional, high net worth, or sophisticated private investors (qualified participants). Sophisticated investors are generally individuals who have such knowledge and experience in the financial and business matters that they are capable of evaluating the merits and risks of the prospective purchase of securities and in respect of each transaction deals in amounts of USD 100,000 or more. An institutional fund must require a minimum investment of USD 100,000 per investor.

An administered fund must be administered by an administrator which is licensed in Bermuda under the Act and require a minimum investment of USD 50,000 or be listed on a stock exchange recognized by the BMA.

A standard fund is a fund that does not qualify as either an institutional fund or an administered fund.

The Segregated Accounts Companies Act 2000 became effective in 2000 but was originally available only to Bermuda insurance companies for various structures such as rent-a-captive arrangements. The Segregated Accounts Companies Amendment Act 2002 came into effect in June 2002 thereby making the Segregated Accounts legislation available to Bermuda investment companies. The statutory protection the Segregated Accounts legislation provides the assets of one account from liabilities of other accounts are very useful to umbrella funds or investment funds with multiple series of shares. The Segregated Accounts legislation will make it possible to achieve within a single company what previously required several separate companies and should reduce both cost and legal uncertainty.

The Act also includes provisions to permit unit trust funds to operate segregated accounts. This allows for the identification of a pool of assets and liabilities of a unit trust fund that are segregated from other assets and liabilities of the unit trust fund.

2.3 Managers, trustees, and custodians

The administrator and investment manager of an investment fund may be an individual or company. Administrators must be licensed under the Act.

The Investment Business Act 2003 requires investment managers carrying on investment business in or from within Bermuda to be licensed, unless they qualify for exemption from this requirement (see 2.13). This however should affect few investment funds because only a small percentage of investment advisers operate from Bermuda and for those that do there is a specific exemption for persons providing investment services exclusively for investment funds approved by the BMA under the Act.

The administrator and investment manager must demonstrate his/her expertise and experience to the satisfaction of the BMA who must then approve his/her appointment. Any change in the administrator, investment manager, or other key service provider must be approved by the BMA.

The auditor and custodian must be independent of the directors of a mutual fund company or the partners of a partnership, as applicable.

The custodian must, if incorporated in Bermuda, be licensed under one of the Bermuda financial services acts or, if not incorporated in Bermuda, be subject to equivalent regulation. The appointment of a reputable prime broker as the custodian is generally acceptable.

There are no limits imposed on the fees that the administrator, investment manager, registrar, trustee, auditor, or custodian may charge.

2.4 Investment restrictions

The Act imposes no investment restrictions on investment funds. Instead the emphasis is on demonstrating to the BMA the promoter's expertise in the area of investment selected. The BMA review concentrates on approval of the promoter/sponsor, the custodian, and the investment manager when the fund is established rather than on detailed monitoring of subsequent activities. The promoter and the key service providers must be fit and proper persons to act as such

2.5 Borrowing

Investment funds may borrow if this is allowed by their constitutional documents. The Act does not contain provisions that prohibit borrowing or place any restriction on borrowing by investment funds. However, these investment funds may specify in their constitutional documents that they are prohibited from borrowing or that they are restricted in their borrowing ability. Such restrictions are established by the investment fund and its directors, as applicable, rather than being imposed by law.

2.6 Accounts and prospectus

Investment funds are required to prepare and distribute annually to investors a financial report. This shall include financial statements prepared in accordance with generally accepted accounting principles and audited in accordance with generally accepted auditing standards. An investment fund is not obligated to publish their financial statements or to file them with the BMA. Investment funds are expected to supply the BMA with regular details on net asset values, subscriptions, and redemptions.

In addition, the operator of an investment fund (that is, the trustee, directors, or general partner, respectively), within six months of its financial year end, must submit to the BMA a statement that the fund has been in compliance with the provisions of the Act throughout the year or, in the case of non compliance, a statement setting out the breach.

The Act requires all three classes of investment funds to prepare and distribute a prospectus which must comply with the applicable content requirements of the Act and the Fund Prospectus Rules 2007. In addition, the investment fund's prospectus must comply with the prospectus requirements of the Companies Act, unless the investment fund is to be listed on the Bermuda Stock Exchange (BSX) or another approved stock exchange that has accepted the prospectus as listing particulars for the purpose of the listing. The initial prospectus prepared when the investment fund is formed is submitted to the BMA as part of the approval process. The prospectus must also be filed with the Bermuda Registrar of Companies. To make this filing, the investment fund's legal counsel must certify that the prospectus complies with the prospectus content requirements of the Companies Act and the auditor must consent to its issue

unless the investment fund is to be listed on the BSX or another approved stock exchange that has accepted the prospectus as listing particulars for the purpose of the listing. An investment fund that continues to sell shares/units after the initial offering period must file an updated/amended prospectus with the BMA when there is a material change in any of the particulars such as replacing a service provider, changes in trustees or the number of trustees, changes in the general partner, or changes in the corporate structure. Any such material change also requires the prior approval of the BMA. If there are no material changes it is not necessary to re-file the prospectus annually. The prospectus must contain the most recent financial statements and the auditors' report thereon, as applicable.

2.7 Supervision

The supervisory authority in Bermuda is the Bermuda Monetary Authority (BMA) located at 43 Victoria Street, Hamilton, Bermuda (www.bma.bm).

2.8 Fund ownership

There are no restrictions on the percentage of shares/units of an investment fund that may be owned by one person or group of related persons. However, an investment fund may specify in its by-laws restrictions with regard to certain classes of persons such as that its shares/units are not available to U.S. persons (because of the potential tax consequences to the fund), however, this same fund that restricts investment by taxable U.S. persons may offer shares/units to U.S. tax exempt entities.

The register of shareholders or partners is private and not open to public inspection.

2.9 Fund structure

Hedge funds, funds of funds, umbrella funds, and various master/feeder structures are permitted under Bermuda law which makes no distinction between these types of investment funds.

2.10 Stock exchange

The Bermuda Stock Exchange (BSX) is a member of World Federation of Exchanges and an affiliate member of the International Organization of Securities Commissions (IOSCO). The United States SEC has recognized the BSX as a designated offshore market for Reg. S securities and the U.K. FSA has recognized the BSX as a designated investment exchange.

The Bermuda Stock Exchange has developed listing rules specifically for funds formed under the laws of Bermuda and other jurisdictions. These rules are

comparable to those of stock exchanges in other offshore centers. The listing requirements for funds are not onerous.

2.11 Bank secrecy

Bermuda's anti-money laundering regime includes several acts, regulations, and guidance notes relating to the proceeds of crime and anti-money laundering. The guidance notes contain useful advice on how a fund can comply with the money laundering legislation including suggested verification procedures for subscriptions. Criminal tax fraud is now included among the crimes covered by Bermuda's money laundering legislation.

2.12 Fund set-up

It takes approximately five working days to have an investment fund approved by the BMA. This time period can be compressed where the fund is one of a series of already established funds or is being established by promoters well known to the BMA. Where promoters are not previously known to the BMA or the investment fund has novel or unusual features, approval could take longer. Applications by institutional funds are fast-tracked and usually take less than five working days.

Formation of an investment fund, preparation or review of its prospectus, and obtaining BMA approval for the fund to sell its shares is normally done by Bermuda lawyers. The largest Bermuda expense associated with the launch of a fund is legal fees for the preparation of the BMA application, preparation/review of the prospectus and byelaws, and reviewing the various related material contracts. The amount of Bermuda legal fees is dependent upon the complexity of the fund but typically is between USD15,000 and USD 30,000. Factors that may impact on legal fees are:

- whether it is a fund with a new promoter unknown to the BMA;
- the familiarity of the promoters with preparing a prospectus;
- the number and extent of major drafting changes made to the prospectus and other documents; and
- the extent to which non-Bermuda lawyers unfamiliar with the Bermuda regulations draft the fund documents

2.13 Foreign funds

The Investment Business Act 2003 requires any person carrying on investment business in Bermuda to have a license unless their activity falls within one of the specific exemptions. The Investment Business Act is aimed mainly at the activities of investment advisers, investment managers, market makers, and broker dealers but the Investment Business Act defines investment business very widely. The practical effect is likely to be that the person or organization

through which funds established outside of Bermuda are sold to persons resident in Bermuda will need to be licensed under this act unless they qualify for exemption from this requirement. To obtain a license a person must, among other things, show to the satisfaction of the BMA that they have adequate knowledge, skill and experience, have adequate capital and insurance and have sufficient record keeping systems and controls.

2.14 Bearer shares

An investment fund may not issue or sell shares/units in bearer form.

2.15 Use of the internet

Offshore investment funds such as those formed under the laws of Bermuda are typically sold in private transactions to institutions and high net worth individuals. Generally they are not marketed to a broad group of potential investors. As a result the Internet is generally not used to market investment funds. Offshore investment funds typically want to sell shares/units to offshore investors because selling shares to onshore investors requires compliance with securities laws of the onshore jurisdiction(s). Most offshore funds will not wish to do this. If information or offering documents are available on a website the site must be available only to pre-authorized/pre-screened potential investors using a password or other mechanism. Failure to adequately restrict access to a Web site may result in the investment fund inadvertently offering shares to onshore investors in contravention of securities laws of certain jurisdictions. The comments in this paragraph are not intended to be advice on how to market an offshore investment fund over the internet. This is a complex topic that is beyond the scope of this publication.

Although marketing an offshore fund using the internet involves complex issues, fund administrators are increasingly using it to communicate with existing shareholders/unitholders. Administrators send out net asset values and investment adviser newsletters to shareholders and allow shareholders to purchase additional shares or redeem shares using the internet. It is likely that greater use will be made of the internet in the future to communicate with existing investors and provide them with information rather than to market the fund. However, concerns about confidentiality and data security persist so most funds have to use the Internet cautiously.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.