BERMUDA MONETARY AUTHORITY

DISCUSSION PAPER

Proposed Enhancements To Investment Business, Investment Funds and Fund Administration Regimes

March 2018

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Stakeholders are kindly requested to submit feedback, to policy@bma.bm, no later than 7th May 2018.

I. INTRODUCTION

1. The mission of the Bermuda Monetary Authority (the BMA or the Authority) is to "protect and enhance Bermuda's reputation and position as a leading international financial centre", in part by providing "effective and efficient supervision and regulation".

2. At present, the Investment Business Act 2003 (the IBA) and the Investment Funds Act 2006 (the IFA) (collectively the Acts) form the foundations of Bermuda's regimes for regulating and supervising investment providers, investment funds and fund administrators.

3. The international standards against which Bermuda's regimes are assessed continue to evolve. In the aftermath of the 2008 financial crisis, there is heightened awareness of the financial stability impact that the asset and fund management sectors can have on the markets. In response, amongst other things, financial stability-related reporting expectations increased commensurately. Further, there is increased focus on the regulation of conduct, not just of prudential matters. The pace of change in the investment industry is now such that Bermuda must be able to respond promptly and appropriately in order to ensure appropriate regulatory oversight, including with respect to anti-money laundering and anti-terrorist financing considerations, and investor protection. While the Acts have been subject to amendment over time, the amendments have tended to address specific issues. A recent example includes revisions made to the IBA in 2016 as a first step in positioning Bermuda to respond appropriately to the European Union's Alternative Investment Fund Managers (AIFM) Directive.

4. Based on the preceding factors, it is prudent and timely that a comprehensive review of the Acts be performed to ensure that Bermuda's investment business and investment funds regimes remain fit for purpose.

5. In the above context, the purpose of this Discussion Paper is to seek feedback from stakeholders within the financial services sector on a number of proposals to revise Bermuda's investment business and investment funds regimes. It is intended to facilitate discussion between the Authority, relevant government representatives and industry.

6. The Discussion Paper focuses on issues which the Authority proposes to act upon, along with those on which additional information is sought in order to facilitate further consideration and decisions.

II. BACKGROUND

7. In its 2017 Business Plan the BMA committed to publishing a Discussion Paper proposing enhancements to the investment business and investment funds regimes to reflect new international standards for the supervision and regulation of the respective sectors.

8. Given the above, key elements of the development of the Discussion Paper were an analysis of Bermuda's existing regimes against relevant international standards and expectations, including those promulgated by the International Organisation of Securities Commissions (IOSCO) and the Financial Stability Board (FSB) and the application of same in other relevant jurisdictions.

9. The focus within the Discussion Paper is intentionally on the substance of enhancements to be pursued rather than the form by which the enhancements should be achieved.

10. Notwithstanding the above, the Discussion Paper does recognise that there will need to be both legislative amendments and changes to associated regulatory/supervisory instruments.

11. The issues noted within the Discussion Paper essentially fall into two categories:

    - those arising because of "gaps" between Bermuda's existing legislative/regulatory provisions and international standards/expectations which may be required to be imposed on the investment business, investment funds and fund administration sectors in Bermuda; and

    - those which need to be considered if Bermuda's regimes are to be fit for purpose in the future based on emerging expectations and trends.

III. INVESTMENT BUSINESS RELATED ISSUES TO BE ADDRESSED

i. Investments and investment activities

12. Fundamental to the existing IBA regime is the prohibition imposed on a person carrying on investment business in or from Bermuda without being licensed or exempted. At the core of this provision is the definition of carrying on investment

business, and central to this is what constitutes an "investment" and an "investment activity".

13. While the Authority is of the view that the existing list of investments is comprehensive and clear, it is also mindful of both international and local developments in the financial services sector, including in respect of virtual currencies and exchanges established to facilitate trading of same. Accordingly, consideration is being given to whether additional types of investments should form part of the regulatory and supervisory regime. In the same context, thought is being given to proposing revisions to the existing definitions of investment activities, both to ensure that these better reflect current industry terminology and that the current exclusions are still relevant.

14. One area of focus in this regard is whether there would be merit in reflecting "managing investment funds" as a separate activity, distinct from the existing activity of "managing investments". In the process of making the previously referenced AIFM-related amendments to the IBA in 2016, consideration was given to whether such an activity, or even an "alternative investment fund management" activity, should be adopted. Ultimately, this approach was not pursued, with reliance instead placed on the existing "managing investments" activity. The Authority now considers it appropriate to revisit the issue.

ii. ***Application for licence***

15. At present, an applicant for an investment business licence is, amongst other things, required to submit a business plan which sets out the "nature and scale" of investment business which it proposes to carry on. In turn, any licence issued by the Authority may be "subject to such limitations ….. as the Authority may determine to be appropriate having regard to the nature and scale of the proposed business".

16. Notwithstanding the above, under the existing regime, the vast majority of obligations to which licensed entities are subject are the same regardless of the investment activities they are performing. The BMA considers that it would be appropriate for such obligations to be more aligned with the specific nature of, and potential risks posed by, the different activities being conducted. One example of this is reporting obligations. While the Authority is of the view that the reporting obligations within the existing regime would benefit from enhancement generally, receiving relevant additional information from persons "managing investments" relating to the nature and scope of such investments is an area of particular focus.

17. In order to achieve the proposed alignment referenced above, one approach being considered by the Authority is to introduce different classes of licence, with the

activities a provider is permitted to conduct, and the corresponding requirements to which it is subject, being determined by the class of licence it holds. Such an approach is already incorporated within certain other regulatory/supervisory regimes in Bermuda and in the investment business regimes of some other jurisdictions.

iii. ***Exemptions***

18. As a full member of the International Organisation of Securities Commissions (IOSCO), it is important that the Authority adheres to the IOSCO principles. In this vein, the exempted person's requirements within the investment business regime should be responsive to IOSCO Principle 6[1] and Principle 7[2].

19. The current investment business regime allows persons to be exempted from the requirement to obtain a licence. Specifically, the Investment Business (Exemptions) Order 2004 (the Exemption Order) provides exemptions for persons specified therein to be exempted from the requirement to hold a licence under the IBA. Such persons include, but are not limited to, those who provide services exclusively to certain classes of undertakings, including the following:

    (i) High income private investors;
    (ii) High net worth private investors;
    (iii) Sophisticated private investors;
    (iv) Collective investment schemes approved by the Authority, under the Investment Funds Act 2006;
    (v) Bodies corporate, with assets not less than five million dollars;
    (vi) Unincorporated associations, partnerships or trusts, each of which has assets not less than five million dollars;
    (vii) Bodies corporate, whose shareholders fall within one or more items above except (iv);
    (viii) Partnerships, whose members fall within one or more items above except (iv); and
    (ix) Trusts, whose beneficiaries fall within one or more items above except (iv).

20. A definition is provided within the Exemption Order for each of the first three investor types above. The definitions, however, including the monetary threshold values contained within each of them, have not been updated since the Exemption

[1] The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.

[2] The Regulator should have or contribute to a process to review the perimeter of regulation regularly.

Order was initially made. In this context, the Authority is aware, for example, that the net worth monetary threshold used in some other jurisdictions as a qualification for "high net worth private investors" (or the equivalent thereof) is double the existing $1,000,000 threshold currently specified in the Exemption Order.

21. To ensure consistency with international standards and to reflect risks for the types of investors now accepted as appropriate, the nature and quantum of the monetary thresholds cited in the Exemption Order will be reviewed to ensure they are appropriate for "high income", "high net worth" and "sophisticated" private investors.

22. A separate issue being reviewed in respect of exemptions is the fact that under the existing regime the only obligation imposed on an exempted entity is to provide the Authority with a one-time declaration asserting that it qualifies for exemption and citing the relevant basis for such exemption. Given current international expectations of regulatory authorities, particularly those of a shadow banking nature emanating from the work of the Financial Stability Board, the BMA is considering whether it would be appropriate in certain cases to impose conditions on an exempt person in relation to the regulated activity it proposes to conduct.

23. Further to the above, the Authority is contemplating introducing the requirement for an exempted person to be granted exemption via an application process, rather than notification, and requiring exempted persons to submit an annual return, providing appropriate prudential reporting.

24. In summary, the Authority is considering the following proposals with respect to enhancing the investment business exemption regime:

    a) Amending the current exempted persons' definitions to ensure continued appropriateness.

    b) Making provision for an 'Exempted Persons Register' whereby relevant persons would register or apply annually to be exempted based on satisfaction of updated exemption criteria (as determined in a) above). Such an approach would permit a more efficient policing of our investment business perimeter and facilitate improved adherence to IOSCO Principles 6 and 7.

    c) In the context of the establishment of the above-noted register, introduction of a registration fee to cover the regulatory cost associated with reviewing relevant registrations or applications.

    d) Further to proposal b) (above), and as embedded in some other regimes internationally, making provision for the Authority to have access to certain information from entities on the 'Exempted Person Register' and that such entities be required to file an annual return with the BMA which would

provide appropriate statistical reporting and notification of any material changes to its operations, along with an updated business plan, where appropriate, to verify whether the existing exemption should continue to apply.

iv. ***Carrying on business in or from Bermuda***

25. As noted previously, fundamental to the existing IBA regime is the prohibition to a person carrying on investment business in or from Bermuda without being licensed or exempted. This licensing requirement necessitates that two determinations be made. Firstly, whether the activity being conducted constitutes "investment business" as defined in section 3(1)(b) and, secondly, whether the activity is being carried on "in or from Bermuda".

26. Within the above context, central to the determination of whether an activity is being carried on in or from Bermuda is whether the person conducting the activity "maintains a place of business in Bermuda", with that term defined at section 4(6).

27. Periodically, the Authority becomes aware of situations where Bermuda-incorporated companies are conducting activities which would constitute "investment business" as defined in section 3(1)(b) of the IBA, but because they operate in a manner which does not involve "maintaining a place of business in Bermuda" (which entails having premises in Bermuda, employing staff and paying business expenses) they fall outside the scope for licensing under the IBA.

28. In instances of the sort described above, the Bermuda incorporated entity is often conducting its investment operations in another jurisdiction. If such a Bermuda entity is not licensed in the overseas location(s) in which it operates, issues can arise with regard to international regulatory cooperation expectations and, ultimately, adverse reputational implications may result for Bermuda as a financial services jurisdiction.

29. The Authority is of the view that, in the future, entities of the sort described above must be included in Bermuda's oversight regime. One option under review is to revise the criteria which must be met in order for an entity incorporated or established in Bermuda to be viewed as "maintaining a place of business" in Bermuda, such that these are less focused on physical premises and more reflective of today's less traditional operating models. Another approach, employed by some other jurisdictions, would be to require that any Bermuda entity which is conducting investment business in or from within a country outside of Bermuda be licensed in that country and/or Bermuda.

v. Enforcement-related considerations

30. Similar to the regimes in a number of other jurisdictions, the IBA provides the Authority with general enforcement powers, including but not limited to restricting and revoking an investment business license.

31. Such powers are formally set out in section 20 (Restriction of licence) and 21 (Revocation of licence). After the Authority issues a warning notice as stipulated in section 22 of the IBA, the formal process set out in these provisions may be followed. In cases of urgency, the warning notice is not required to be issued.

32. Although these formal proceedings for restriction and revocation are important, there are instances where the prolonged nature of the process can limit the effectiveness of supervisory oversight and the management of risk.

33. A number of peer jurisdictions have embedded express provisions requiring the filing of various prudential returns and notifications within prescribed times. While the IBA contains some requirements of this nature, failure to comply with them does not directly attract any penalties.

34. The Authority is of the view that more specific sanctions are warranted for failure to lodge relevant returns, reports, certificates, applications and notifications in order to enhance the Authority's knowledge of the entities it regulates, the level of compliance of those entities with their obligations and the overall effectiveness of regulation and mitigation of systemic risk to the financial market.

35. While the existing enforcement powers are adequate in most respects, the Authority believes they can be enhanced and, in this context, is:

    e) Considering the introduction of administrative fines, to address various minor and habitual offences, including failure to file prudential returns and notifications in a timely manner.

    f) Assessing the potential to achieve additional clarity by more effectively consolidating enforcement powers in one location, either the legislation or the accompanying Statement of Principles.

vi. Rule-making power

36. Stakeholders will be aware that, amongst other things, the Investment Business Amendment Act 2015 provided the Authority with a general rule making power, but

only in respect of persons to whom Chapter 1A of Part III of the IBA (namely, Alternative Investment Fund Managers) applies. Utilising this power, the Authority issued the Investment Business (Alternative Investment Fund Managers) Rules 2016, although they are yet to be brought into operation.

37. While the above step was taken specifically to facilitate Bermuda responding appropriately to the European Union's AIFM Directive, it is deemed beneficial for the Authority to have a similar general rule-making power in relation to the regulation and supervision of the investment business sector more broadly.

38. As can be seen in the above-referenced AIFM Rules, in rules issued under other regulatory and supervisory regimes in Bermuda and in rules issued by regulators in other jurisdictions, rules are typically utilised to address matters of a complex or technical nature.

39. Investment business-related matters which lend themselves to being addressed, at least in part, via rules include capital and liquidity requirements, reporting and disclosure obligations and considerations related to outsourcing arrangements and the management of conflicts of interest. Under the existing Bermuda regime, the Second Schedule of the IBA (Minimum Criteria for Licensing), and by extension the Code of Conduct, address some of these matters. While these documents will undoubtedly need to be revised and updated in response to any legislative changes to the regime ultimately proposed, the Authority proposes to undertake this process in conjunction with the development of appropriate rules.

vii. Capital and Liquidity Requirements

40. Regardless of whether it is accomplished by amendment of primary legislation and supporting regulatory documents, or (in keeping with the possibility raised above) in newly developed rules, the Authority believes that the existing capital adequacy requirements need to be reviewed and updated to reflect current norms.

41. In keeping with international best practice, and its mandate as a risk-based regulator, the Authority's approach has been, and remains, that higher levels of risk to customers and the market should proportionately correspond to a higher capital requirement for investment providers, while in cases where there is less risk to customers and markets a lower capital requirement may be applied.

42. At present, the Minimum Criteria for Licensing requires investment providers to maintain "minimum net assets of such amount as the Authority may prescribe or as it

may require in any particular case". Further to this, paragraph 2.7 of the Statement of Principles (the SOP) clarifies that for investment providers acting as principal, minimum net assets of $250,000 must be maintained, while for providers acting as agent, the minimum level is $100,000. In cases where the investment provider is acting as neither principal nor agent, net assets of at least $12,000 are required. These minimum requirements have not been amended for many years.

43. While the SOP highlights that the Authority, via use of its powers under the IBA, has the ability to substitute a higher net asset figure, this power should be exercised only when it is warranted by the nature of a particular business – not relied upon routinely to address an entry-level net asset sum which is no longer viewed as sufficient to provide appropriate redress to customers should the need arise.

44. Under the existing investment business regime, providers must file financial statements annually with the Authority and submit a quarterly Liquidity Statement/Analysis (Appendix 8 from the "Guidance for Prospective Applicants"). Investment providers are not, however, required to submit a capital analysis which could be reviewed by the Authority as part of the process of verifying that adequate capital is being maintained.

45. The Authority is considering the following options as a means to refine the capital requirements of investment providers:

    a) To facilitate an ongoing, up-to-date assessment of whether the capital being maintained by an investment provider is proportionate to its risk, the Authority proposes that capital requirements be reported via a quarterly capital return form similar to the existing Liquidity Analysis template.

    b) To the extent that the licensing of investment businesses is more directly aligned with specific activities (as noted above), ensuring that capital levels correspond to the level of risk associated with such activities. This may require information on underlying assets and may include a reclassification of assets to assess regulatory capital.

46. The time frame within which reporting related to liquidity must be submitted to the Authority is currently specified in the Guidance for Prospective Applicants as "within 21 business days of the calendar quarter" end. The Authority proposes that this same time frame should apply to the submission of any capital return form introduced under law.

IV. INVESTMENT FUNDS RELATED ISSUES TO BE ADDRESSED

i. Definition of Investment Funds

47. Under the existing investment funds regime, an investment fund is defined as "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 arrangement to participate in or 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 be such that the persons who are to participate do not have day-to-day control over the management of the property and are entitled to have their units redeemed in accordance with the investment fund's constitution and prospectus.

    The arrangements must also have one or both of the following characteristics: (a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled; and (b) the property is managed as a whole by or on behalf of the operator of the investment fund.

48. Given the above, "opened-ended funds" fall within the scope of the definition of investment fund, while closed-ended funds and certain other non-traditional investment type structures are out of scope. "Closed-ended funds", by their nature, do not provide investors with the right to demand redemption. Rather, redemption takes place only at the end of a pre-determined investment period.

49. The Authority notes that numerous jurisdictions have fund regimes which make provision for the capture of "closed-ended" in addition to "open-ended" funds. Given this, and questions which have arisen in respect of entities falling outside the scope of the Bermuda regulatory regime, the Authority believes that it is an appropriate time to bring closed-ended vehicles within scope of the oversight framework for funds.

ii. Segregated Accounts funds

50. The Authority recognises that section 4 of the IFA, as currently drafted:
    - might be construed as being applicable only to unit trust funds which are permitted to operate segregated accounts (SA), rather than to all investment funds; and
    - does not clearly separate the provisions applicable to the fund operating the SA from the provisions applicable to the SA.

51. It is essential that there be clarity that the Authority's oversight extends beyond the fund level to include any underlying SA.

52. To address any doubt which may exist in the market, and to deliver on its investor protection mandate, the Authority will seek to expand section 4 to affirm that it applies to all investment funds operating segregated accounts, while ensuring that the Authority's supervisory powers are applicable to both an investment fund and its SA.

iii. Incorporated Segregated Accounts Companies

53. Further to the above observations in respect of segregated accounts funds, the Authority is aware of the proposed introduction of legislation which will, for the first time in Bermuda, facilitate the establishment of incorporated segregated accounts companies (ISAC).

54. The Authority accepts that, should the above-referenced legislation become operative, persons may seek to use ISAC structures for various purposes, including for investment funds. Accordingly, the Authority intends to consider what implications this will have for its oversight of the fund sector and what modifications to the existing framework might be necessary in this regard. Feedback which industry practitioners may have to offer in this context would be welcomed.

iv. Excluded Funds

55. Principle 7 of the IOSCO Principles provides that regulators should have or contribute to a process to review the perimeter of regulation regularly.

56. The IFA contains express provisions that allow the Authority to require authorised or exempted funds to provide certain information and documents either on annual periodic basis or at the request of the Authority. These provisions, however, do not extend to private or excluded funds. The ability to obtain information and documents from all investment funds is an important power that allows the Authority to better understand matters relating to the sectors that it regulates and to better satisfy Principle 7.

57. The only IFA requirement imposed on excluded funds is to file a notice on the Authority after registration, informing the Authority of its exclusion from the provisions of the IFA. Section 6 of the IFA does not address regulatory oversight for excluded/private investment funds, thereby limiting the control which the Authority has in respect of such vehicles.

58. Accordingly, and with adherence to IOSCO principles in mind, the Authority considers that section 6 of the IFA may be expanded to include additional minimum obligations, such as:

    a) introduction of an application or a registration process similar to that in place for exempted funds;

b) a requirement that a filing be submitted to the Authority on an annual basis regarding the relevant fund's excluded status; and

c) a requirement to report material changes to the Authority; or

v. Exempted Funds

59. Currently, all the requirements specified under section 6A or section 7 of the IFA must be met in order for a fund to qualify as either a Class A Exempt Fund or a Class B Exempt Fund.

60. Once the operator of a Class A Exempt Fund certifies that all of the specified requirements are met the fund is automatically registered. Conversely, the operator of a Class B Exempt fund must make an application to the Authority for registration and the Authority must grant the application.

61. The Authority holds the view that the existing criteria for exemption set out in section 9 of the IFA needs to be updated. In particular, consideration is to be given to whether the definition for 'qualified participants' should be enhanced. In this regard, the Authority has reviewed global trends and notes that such definitions have evolved in terms of the minimum net worth and total asset values employed when determining 'high net worth' and 'high income' private investors.

62. For example, the net worth and total asset minimums utilised in some jurisdictions are $800,000 and $4 million, respectively, whereas Bermuda's limits are currently $200,000/$300,000 individually/jointly of income and $1 million in net worth.

63. In light of this, it is proposed that the definition for 'qualified participants' be amended in respect of the threshold values employed to enable an alignment with current global practice.

vi. Authorised Funds

64. The BMA may authorise funds in one of four classes, being institutional, administered, specified jurisdiction or standard funds. Regardless of the class in question, it is important that oversight of them satisfies international best practices and expectations. One of these is that relevant regulatory bodies have access to information on the nature and scale of operations by investment funds within their jurisdictions in order to, amongst other things, facilitate financial stability and foster appropriate international cooperation. In this context, the Authority believes that steps must be taken to enhance the reporting requirements for authorised funds, in order to secure for its regulatory review: current, adequate and timely information concerning the activities of these funds.

65. The Authority believes that the data and information collected at present to measure, understand and address relevant risks that may arise with respect to authorised funds could be improved.

66. With regard to specific risks, the Authority recognises that it must continuously work towards promoting stability within the financial services sector. Therefore, it is looking to broaden its powers to collect the appropriate data from investment funds to facilitate better measurement and understanding of stability risks within the financial sector, and in turn better mitigation of such risks. Examples of the type of data required from investment funds could include:
    - Leverage limits
    - Liquidity
    - Exposures
    - Maturity limits

67. The Authority takes the view that periodic collection from funds of data as identified above would enhance not only its regulatory oversight of investment funds but the financial sector more broadly.

68. In relation to the supervision of standard funds, the Authority recognises that they are typically vehicles for retail investors. However, section 11(7) of the IFA states that a fund qualifies for classification as a standard fund when it does not fall within any of the other three classes of funds. Accordingly, the Authority is considering the possibility of amending the existing classification basis to ensure that it is more directly aligned with nature, scale, complexity and risk considerations.

69. The Authority is also assessing "Specified Jurisdiction Funds", to determine whether this class is still appropriate and relevant.

vii. Notice of Material Change

70. Section 25 of the IFA sets out the requirements for giving notice to the Authority in respect of material changes. Pursuant to this section, operators of relevant funds shall "forthwith give written notice to the Authority" of various proposed changes. Currently, there is no express provision enabling the Authority to object to the replacement of an existing director or the appointment of an additional director of a mutual fund company. The same applies to the replacement or addition of a trustee of a unit trust fund or the replacement of a general partner in a partnership fund in cases where the funds are classified as either institutional or administered funds.

71. A similar situation exists with respect to the Authority's ability to approve or object to a reconstruction, amalgamation or winding up of funds classified as either institutional or administered funds.

72. The Authority believes that these limitations restrict its ability to oversee the investment funds industry in a manner consistent with international expectations and best practice.

73. It is therefore proposed that the material change notification provisions in the IFA relating to directors, general partners, trustees and reconstruction, amalgamation and winding up arrangements be extended to include an approval process for all registered funds.

viii. Reports to the Authority

74. Pursuant to section 26 of the IFA, authorised funds are required to file with the Authority a Statement of Compliance on an annual basis. In addition, the Authority may request an activity report at such intervals and in respect of such period as may be required. Notwithstanding the latter capability, however, the Authority believes that the scope of the existing annual filing requirement is insufficient in relation to emerging standards in the area of fund-related regular reporting.

75. Given the above, the Authority intends to enhance the provisions of section 26 to require additional data to be filed by all registered funds via the submission of an annual return. This will enable the Authority to better identify and monitor the nature and scale of the industry, thereby assisting it to better anticipate and address any potential risks.

76. Specifically, additional data which the Authority believes could usefully form part of an annual filing by a fund are those relating to its liquidity profile/limits, leverage limits, maturity, exposure, redemption gates, suspensions of redemptions, redemption fees, side pockets and stress pockets, etc.

77. The following are amendments which the Authority proposes in respect of Section 26 of the IFA:

    a) making the annual statement of compliance more detailed, with information to be contained to include, but not be limited to, details on liquidity profile/limits, leverage limits, domestic vs. non-domestic assets, etc.;

    b) requiring a filing of the fund's annual financial statement;

    c) enhancing the requirements applying to service providers (by expanding the duty to report and the content of what is to be reported); and

    d) mandating that the Authority be notified of the liquidation of a fund.

ix. Revocation and winding up

78. Currently, the process for revocation under the IFA applies only to Authorised Funds. There are no provisions within the IFA which allow for deregistration of exempted and excluded funds. Therefore, even after such funds cease trading they still exist on the Authority's records as investment funds. This means that, amongst other things, these funds continue to incur fees levied by the Authority.

79. On occasion, the Authority receives enquiries regarding winding ups of an exempted or excluded fund, but at present there are no mechanisms within the IFA to wind up such funds. These funds are normally wound up based on the provisions of the Companies Act 1981, or the funds' legal documents, if not a company. Regardless, there are no requirements for such a fund to notify the Authority of its pending liquidation.

80. The Authority is, therefore, giving consideration to appropriate approaches whereby the provisions in the IFA relating to revocation and winding up of authorised funds could be extended to apply to exempted and excluded funds.

x. Fund Rules/Fund Prospectus Rules

81. Section 37 of the IFA grants the Authority the power to make fund rules, while Section 38 enables it to make prospectus rules. Pursuant to these powers, the Authority issued the Fund Rules 2007 (the Fund Rules) and the Fund Prospectus Rules 2007 (the Fund Prospectus Rules). Currently, the Fund Rules apply only to funds authorised as standard funds, while the Fund Prospectus Rules 2007 apply to all authorised funds.

82. While there is no intention to bring exempted or excluded funds fully within scope of the IFA, the Fund Rules or the Prospectus Rules, the Authority is exploring options which would enable it to require operators of such funds to include certain disclosures in their prospectus.

83. The Fund Rules require a standard fund to appoint either a Bermuda licensed fund administrator or a Bermuda licensed custodian. It is not intended that this obligation be removed, but the Authority believes that it would be more appropriate for it to be imposed via a provision in the IFA itself. One reason for this proposed change would be to achieve consistency with the approach taken in respect of appointment of service providers for Administered funds in addition to Class A Exempt and Class B Exempt funds.

84. Accordingly, the Authority proposes that the Fund Rules 2007 be amended to remove Rule 3, with the corresponding provision being incorporated directly into the IFA, either within the aforementioned section 11 or section 14 (Requirements for authorisation).

85. On a separate front, Rule 6 of the Fund Prospectus Rules addresses disclaimers to be included in the prospectus relating to authorised funds. Because the Fund Prospectus Rules do not extend to exempted funds, however, there is no obligation in respect of inclusion of disclaimers in such funds.

86. The Authority believes that, for the sake of transparency, an appropriate disclaimer should be required of exempted funds, making it clear (notwithstanding the fact that the investors are "qualified participants"), that the funds have not been authorised by the Authority.

V. FUND ADMINISTRATION RELATED ISSUES TO BE ADDRESSED

i. Fund Administrators

87. For some time there have been discussions surrounding the appropriateness of utilising the IFA as the legislative basis for regulating fund administrators in addition to overseeing investment funds. Specifically, there have been questions as to or whether it would be appropriate to introduce separate legislation focusing exclusively on fund administrators in order to enhance the Authority's supervisory and regulatory oversight of this important sector. The Authority believes that such a legislative change may be beneficial and intends to further explore this initiative via a separate formal consultation process over the course of the remainder of the year.

88. A core element of the current regime is its prohibition of a person carrying on or purporting to carry on fund administration business in or from Bermuda unless such person is licensed to do so.

89. The IFA does not contain a definition of "carrying on the business of a fund administrator in or from Bermuda". Unlike the IBA, the IFA does not include criteria which a person would need to satisfy in order to be "maintaining a place of business in Bermuda". Accordingly, the Authority believes that the existing prohibition is appropriately wide.

90. Notwithstanding the above, the Authority intends to provide additional clarity on what constitutes carrying on fund administration business in or from Bermuda.

91. Another aspect of the IFA which the Authority has under review is the prohibition against fund administrators holding "client monies or any other client assets". It has been suggested that there would be benefit in allowing fund administrators to hold non-financial assets such as agreements, etc., on behalf of their clients.

92. The Authority is aware that certain other jurisdictions make no reference in their legislation or regulations to a prohibition on fund administrators holding client

monies or any other client assets, while others have provided instructions regarding segregation and separation of fund assets from the assets of service providers.
Following dialogue which occurred with industry in the context of the proposed AIFM regime for Bermuda, the Authority is considering the possibility of enabling Bermuda-licensed fund administrators to hold non-financial assets.

93. Should the existing outright prohibition of fund administrators holding any client assets be amended along the lines described above, it could prove beneficial for products such as Insurance Linked Securities (ILS) funds and private equity funds, the assets of which might typically be held in contracts and/or leases. It could also potentially enable fund administrators to act as depositaries under any future Bermuda AIFM regime pursuant to accepted "depo-lite" provisions. To be clear, the Authority is not in favour of fund administrators being permitted to hold financial assets such as cash or securities. Additionally, it is important to note that any ability for fund administrators to act as depositories would need to be accompanied with corresponding appropriate enhancements to the obligations to which they would be subject, including the nature and frequency of the reporting requirements to be met.

94. In the context of the previously referenced potential introduction of separate legislation focused exclusively on fund administrators, the Authority anticipates that the process relating to the application for a fund administration licence will be enhanced and clarified. It is expected that this objective would be accomplished by not only legislative provisions but also accompanying regulatory documents such as the Code of Conduct (the Code), the Statement of Principles (the SOP), etc.

ii. Transfer of Administrator

95. The IFA grants the BMA the authority to issue Codes of Conduct which set out the standards to be complied with by a fund administrator. Pursuant to the Code, a fund administrator must cooperate in ensuring a smooth and timely transfer of records or other relevant information when its role is transferred to a new fund administrator.

96. The Authority is aware of instances where the handover of information to a new fund administrator pursuant to the Code has not taken place in an efficient or timely manner.

97. In order to resolve this issue, the Authority believes that the requirement to ensure a smooth and timely transfer to a new administrator should be imposed in the primary legislation, rather than addressed in the Code. Additionally, it is proposed that the requirement should include a timeline. Such an approach would place responsibility for the transfer of all records relating to a fund in the hands of the Operator (as defined in the IFA), including the transfer of historic information. The Authority intends to ensure that enforcement powers relating to non-compliance with this obligation are also provided for under the IFA.

iii. Statement of Compliance

98. Section 47 of the IFA requires fund administrators to submit an annual statement of compliance to the Authority. The requirements to be met when making such submissions, however, are general in nature. Based on its supervisory experience, and in order to achieve better alignment with international best practice in this area, the Authority proposes to expand, and make more specific, the requirements of the Statement of Compliance. The enhancements may include:

    a) Requiring senior management (e.g. CEO/CFO) or those responsible for the entity's governance to review and execute the statement of compliance.

    b) Introducing more extensive confirmation requirements on the self-certification, including a possible requirement for filing of annual audited financials.

    c) Providing the Authority with a power to allow a filing extension under limited circumstances (subject to payment of an appropriate fee) and to impose fines for late filings or failure to file.

iv. Minimum Criteria for Licensing

99. The minimum criteria for licensing of fund administrators are set out in the Schedule to the IFA. It establishes the baseline for supervisory expectations, setting out the requirements fund administrators must fulfill to obtain and retain their licence and, via the SOP, identifying where enforcement action may occur if requirements are not met. The Schedule also sets out the criteria to be fulfilled by individuals who control or wish to hold certain senior posts in the licensed entity.

100. When considered in the context of international best practice, the BMA believes that the existing minimum criteria may be enhanced such that they better capture the breadth and depth of factors necessary to enable the Authority to properly carry out its regulatory and supervisory functions in respect of licensed fund administrators.

101. In light of the above, and without prejudice to other potential changes, the Authority expects to revise, directly or indirectly, the "Business to be conducted in a prudent manner" obligation imposed by the Schedule in order to provide additional detail and clarity regarding requirements in certain areas. These areas may include, but not be limited to, the following:

    a) Outsourcing

    b) Record retention

    c) Risk management framework

d) Business continuity management

VI. CONCLUSION

102. The views expressed and proposals presented in this paper are intended to initiate dialogue regarding potential legislative and regulatory changes.

103. The Authority seeks input from our industry partners on the issues which have been raised regarding the oversight of investment businesses, investment funds and fund administrators. The Authority welcomes views on the points presented, as well as on other related issues which the reader may deem appropriate.

Stakeholders are kindly requested to submit feedback, to policy@bma.bm, no later than ***7th May 2018.***