BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

SECURING ENHANCED PROTECTION FOR INVESTORS REVISED CODE OF CONDUCT FOR INVESTMENT PROVIDERS

31 MARCH 2010

BERMUDA MONETARY AUTHORITY

INTRODUCTION

1. The purpose of this Consultation Paper is to set out the Bermuda Monetary Authority's (the Authority's) proposals for revising the General Business Conduct and Practice Code of Conduct (the Code) and to seek feedback from interested parties. The existing Code was issued in 2004 under the Investment Business Act 2003 (the Act). In this paper, the term "investment provider" includes all holders of investment business licenses granted under section 17 or issued under section 87(2) of the Act.

2. The Authority embarked on this exercise in an effort to improve practices amongst investment providers for the ultimate protection of investors. The project stemmed from a review the Authority conducted in 2009 into disclosure practices prevalent throughout the industry. The review revealed quite widespread deficiencies which were common to a number of investment providers. It was determined that the Authority should work closely with industry to revise the Code and a Working Group was established comprising representatives of the Authority, the investment industry and the Pensions Commissioner. The exercise broadened to include a review of the entire Code to enable the production of an expanded up-to-date document which reflected international good practice.

3. The current Code provides general guidance to investment providers - whether dealing with personal or institutional investments, including pension funds - as to their conduct in dealing with clients. The Code covers such areas as avoiding misleading or deceptive representations; avoiding or disclosing conflicts of interest; providing periodic information/performance reports; disclosure of remuneration and commissions; and generally helping clients to make informed investment decisions. Consistent with good international practice, the enhanced Code incorporates more explicit guidance in all these areas, and in particular on the form and content of information provided by licensed entities to their clients. Through the use of specific templates, it is envisaged that this will foster greater consistency in reporting and provision of information to investors. The enhanced Code also provides greater clarity about the Authority's expectations in terms of acceptable behaviour from licensed investment providers, whilst ensuring that firms are clear about their obligations and conduct in relation to their clients.

4. The views of investment and pension providers 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. This form can be emailed or mailed to the attention of Betty Dale: bdale@bma.bm; BMA House, 43 Victoria Street, Hamilton HM12. The deadline for comments is 30 April 2010. The Authority intends to publish the final version of the Code by 30 June 2010.

PRELIMINARY

5. The Authority's power to issue a code of conduct is contained in Section 10 of the Investment Business Act 2003. The purpose of such a code is to establish duties, requirements and standards with which all holders of investment business licences granted under section 17 or issued under section 87(2) of the Investment Business Act 2003 must comply. The Authority shall take into account failure to comply with the provisions of the Code in determining whether an investment provider's business is being conducted in a prudent manner, as required by paragraph 5 of the minimum licensing criteria.

The draft revised Code is attached as Appendix 1. Key changes are:

PROFESSIONAL CONDUCT STANDARDS

6. This is a new heading which incorporates the section entitled "Responsible Conduct" from the current Code.

   Detailed guidance on the level of standards expected is designed to encourage investment providers to conduct business in a professional and ethical manner. The Authority expects an investment provider to comply both with the Code and with accepted industry standards in its dealings with investors.

CLIENT RELATIONSHIPS

7. This section has been expanded to provide for better protection of investors by requiring investment providers to create a client risk profile and to provide additional disclosures to clients. The CFA Asset Manager Code of Professional Conduct was used as a reference guide.

   In order to discharge responsibilities to investors, through an exercise known as Risk Profiling, the investment provider will be required to obtain all relevant information regarding a client's financial position and investment objectives. This should also assist investors in understanding inherent risks and enable them to make informed investment decisions.

   It is the duty of an investment provider to make sure that clients are furnished with sufficient information to enable them to make informed investment decisions. Data on performance, for example, should be fair, accurate, timely, relevant, complete and consistent with investment industry standards.

   This section now contains more detailed requirements relating to the disclosure of performance; fees; firm and manager track records; valuation methods and benchmarks.

There is general guidance for all investment providers, together with guidance explicitly for pension providers. Benchmarks used should be closely linked to the investment provider's strategy. Any changes to the benchmark should be communicated together with the reasons for the change. The new Code is explicit on the attributes of a reasonable benchmark.

With respect to performance and track records, the Code highlights the importance of consistency and encourages investment providers to adopt globally recognised industry standards such as the CFA Institute's suggested Global Investment Performance Standards ("GIPS"). Using the same reporting standards across the industry will also enable investors to perform trend analysis of an investment provider's performance and compare results with its peers.

PORTFOLIO MANAGEMENT

8. An investment provider shall use reasonable care and judgment to achieve and maintain independence and impartiality in making recommendations or taking investment action. To this extent, an Investment Policy Statement ("IPS") section has been added to the Code. The IPS must be written and must be provided before monies are invested on behalf of the investor. Specific information on matters such as asset allocation, risk tolerance and liquidity requirements should also be included in an IPS. The IPS holds the investment provider accountable to the instructions contained in the statement.

9. Guidance in relation to asset allocation has also been added to the Code: whether acting on a discretionary or directed basis, an investment provider should seek to adequately diversify a client's portfolio. Where the supply of stock or other investments is inadequate to meet demand, the investment provider must always allocate stock fairly and uniformly.

   Other details added to this section focus on independence; valuation of investments which are not marketable and distribution of transactions among clients.

CONFLICTS OF INTEREST

10. Conflicts of Interest are now covered in a separate section of the Code, which includes guidance on front running; fairness with research or analysis and use of material non-public information.

    Investment Providers must be in a position to identify when conflicts of interest arise and ensure that information is properly communicated to clients. The Investment Provider must not undertake or recommend an investment transaction in which it has material interest without the prior knowledge of the client. A key element in avoiding an actual or perceived conflict of interest is to ensure that a system is in place under which those serving the clients provide full disclosure of any actual or potential conflicts.

TEMPLATES

11. Sample disclosure templates have been added to the Code to provide greater consistency across the industry. These templates provide a prescriptive guideline for the receipt and dissemination of information between the client and investment provider.

    The Terms of Business Document is aimed at empowering clients with information that will assist them in making more informed investment decisions. It includes information relating to the ownership of the investment provider, products, services and fees charged. These disclosures form the basis of ethical and professional conduct.

    The Client Relationships section of the Code compels investment providers to create client Risk Profiles and also provide additional disclosures. The Risk Profile letter is a collection of the customer's personal information, financial standing, investment objectives and performance expectations. The objective of the Risk Profile letter is to enable an investment provider to gather relevant information necessary to fulfil its responsibilities to its clients. It should be completed at the beginning of the relationship and updated regularly.

    The Risk Disclosure Statement is to be signed by clients acknowledging understanding of the risks of investing having regard to their personal financial circumstances. Clients will also confirm that they have not been unduly influenced or received any guarantees of future performance of their investment by the investment provider.

    The Asset Allocation model provides examples of the combination of various asset classes in order to achieve investment objectives.

    In line with good international practice, the enhanced Code together with templates is designed to provide guidance as well as tools for investment providers which also protect investors.