



# **BERMUDA MONETARY AUTHORITY**

## **CONSULTATION PAPER**

**Bermuda AIFM Regime**

**December 2015**

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The financial services industry and other interested parties are invited to submit their views on the proposals set out in this paper. Comment should be sent to the Authority and addressed to [policy@bma.bm](mailto:policy@bma.bm) no later than 22<sup>nd</sup> January 2016.

## I. INTRODUCTION

1. Since early 2014, the Bermuda Monetary Authority (the BMA or the Authority) has engaged with domestic and external stakeholders with regard to Directive 2011/61/EU on Alternative Investment Fund Managers (the AIFMD or the Directive) in the European Union (EU) and the appropriate actions for Bermuda to take in response. This ongoing engagement, and the efforts to date by the Authority to develop an appropriate Alternative Investment Fund Manager (AIFM) regime in Bermuda, resulted in the European Securities and Markets Authority (ESMA) selecting Bermuda to be part of its second-wave of assessment on the application of the AIFM passport to non-EU AIFMs and Alternative Investment Funds (AIFs). ESMA has indicated that it intends to publish its advice in relation to Bermuda, and other countries assessed as part of the second-wave process, prior to the end of March 2016.
2. Milestones over the past 12 months relating to the development of a Bermuda AIFM regime include:
  - i. Release of a Discussion Paper in November 2014, at which stage the BMA sought feedback on the proposed direction of the Bermuda AIFM regime and some key concepts that were under development at that time.
  - ii. The BMA responded to ESMA's Call for Evidence on Extension of the Passport to Third Countries on 8<sup>th</sup> January 2015 and provided a further response on 15<sup>th</sup> April 2015 to a subsequent request from ESMA for additional information.
  - iii. In August 2015, the Investment Business Amendment Act 2015 (the Amendment Act) was approved in the House of Assembly and subsequently in the Senate. The Amendment Act establishes the legal basis for an AIFM regime in Bermuda within the existing framework of the Investment Business Act 2003 (the IBA or the Act).
  - iv. ESMA announced during a public hearing of the European Parliament on 15<sup>th</sup> October 2015 that Bermuda would be considered in the second wave of non-EU countries to be assessed regarding extension of the AIFM passport.
3. As noted above, the legal basis for the proposed Bermuda AIFM regime is provided by the IBA generally and the Amendment Act specifically. The recent amendments

include a provision for the Authority to make rules applying to investment providers managing assets held by AIFs, as AIFMs, and it is these rules which provide the detail and substance required to create a Bermuda AIFM regime. A draft version of the Alternative Investment Managers Rules 2015 (the Rules) is attached to this Consultation Paper for comment.

4. A fundamental strategy adopted by the Authority in the development of a Bermuda AIFM regime is that the Bermuda regime should be, to the extent possible, directly aligned with the AIFMD itself. This strategic approach was validated by key policymakers within Government and industry stakeholders. Accordingly, unless otherwise stated, the Rules provide a direct transposition of the Directive into Bermuda law. Although the IBA and the Investment Funds Act 2006 (the IFA) provided the general regulatory framework for a Bermuda AIFM regime, it was necessary to supplement this with specific requirements, such as those relating to the appointment of valuers, risk management, liabilities of depositaries, disclosures and notifications of acquisitions which are consistent with EU requirements.
5. Key stakeholders in Bermuda continue to advocate development of a Bermuda AIFM regime in order to assist marketing activities of Bermuda fund managers and funds, both under current EU provisions for Private Placement and transitioning through to a full AIFM regime. Stakeholder engagement to date has been primarily organised via a sub-group of the Bermuda Business Development Agency (BDA) with whom the BMA have communicated throughout the course of developing this regime.
6. Stakeholders are kindly requested to provide feedback on the overall approach of the BMA and on the specific issues raised in this paper. Please consider, in particular, any text in italics as this indicates a question or discussion point for consideration.

## **II. THE BERMUDA AIFM REGIME**

### **Investment Business Amendment Act 2015**

7. To help provide context as to the overall transposition of the regime, this section outlines the various components of the Amendment Act, which form the legislative basis for the Bermuda AIFM regime. For information, a copy of the Amendment Act is also attached to this Consultation Paper.

8. The IBA has been amended to introduce a new Chapter 1A under Part III to provide for the regulation of AIFMs who apply to be licensed as an “investment provider”, and request to have the provisions of Chapter 1A applied as a condition of their licence. As an investment provider under the Act, an AIFM will be subject to the existing provisions of the IBA in addition to the AIFM rules made in accordance with Chapter 1A.
9. The new sections 19A, 19B and 19C provide substantively for definitions and the context around interpretation and meanings.
10. The new section 19D outlines the scope of application and comprises three elements. The starting point is for applicants to make clear that they are applying for a licence under the IBA to perform the activity of managing investments. Secondly, applicants must differentiate their intention to “manage assets of AIFs” from managing investments more generally. The final element involves verification that the proposed funds to be managed meet the criteria for institutional funds, with investors that, by nature, fall into the most “sophisticated” bracket currently recognised by Bermuda law under the Investment Business (Exemptions) Order 2004, and on which basis the applicant would qualify for exemption from licensing.
11. New sections 19E and 19F outline further specific information with regard to licensing. New section 19G requires AIFMs to notify the Authority of any material change to the conditions on which their licence was granted by the BMA. New section 19H provides rule making powers for the BMA and new section 19I allows for existing IBA licensees to apply to vary the conditions of their existing licence in order to carry out investment business as an AIFM.

### **Key concepts**

12. As noted previously, and stated in the BMA Discussion Paper of November 2014, it is proposed that the Bermuda AIFM regime be structured such that the EU AIFM requirements are transposed into the Bermuda framework. With such an approach, assessment of Bermuda AIFMs by regulatory authorities in the EU may be more efficient, as the underlying regulatory requirements are similar, and regulatory cooperation between the Authority and its overseas counterparts will be facilitated.
13. There are three key founding positions around which the Bermuda AIFM framework is built:

- i. Firstly, applicants who wish to carry on business as an AIFM will elect to be licensed under the IBA. In so doing, they will become subject to all general provisions therein as relevant and the AIFM specific requirements within the Act and the Rules. The two elements would complement each other, and the Authority does not see conflicts between the two.
- ii. Secondly, it will be possible for Bermuda AIFMs to manage a range of AIFs, whether these are authorised or established in Bermuda or elsewhere. In this regard, AIFs under Bermuda law are funds which are limited to high net worth or sophisticated investors, not those which are intended to be marketed to general retail investors. At the time of licensing, AIFMs would be required to submit a list of the AIFs which they intend to manage, accompanied by the business plan and strategy as to how they would be managed. At that point, the BMA would make a judgment as to whether, in cases where funds to be managed are established in other jurisdictions, bilateral cooperation arrangements in place with those jurisdictions were acceptable. Under this regime, the onus is on the AIFM to ensure the funds it manages, and the service providers appointed in relation thereto, comply with applicable requirements. Any material changes to the business arrangements reviewed at the time of licensing must be reviewed by the Authority.
- iii. Thirdly, the scope of investment business activity to be carried out is clear. The Rules require that all AIFMs be capable of performing both risk management and portfolio management, as specified within Annex I(1) to the Directive. AIFMs may also, consistent with Annex I(2) of the Directive, carry on other investment business activities pursuant to the IBA, if so approved at the time of licensing. It will only be possible, of course, for approval to be granted to an applicant to carry on other investment business activities if this does not conflict with the AIFM specific provisions in the Rules. For this reason, an AIFM applicant will need to clearly set out in its business plan the activities it intends to carry out.

### **III. BMA AIFM RULES**

14. Stakeholders should note that the Rules consist of multiple numbered paragraphs, with the paragraphs grouped and presented under relevant titles. In order to facilitate ease of reference between this Consultation Paper and the Rules, relevant paragraph

numbers from the Rules are cited in this paper. Stakeholders should also note that the Rules should be read in conjunction with, and in the context of, the IBA Minimum Criteria for Licensing (MCL), and other statutory and regulatory instruments issued pursuant to the IBA, including the Investment Business Regulations 2004, Supervisory Statement of Principles (SOP) and Code of Conduct. Relevant provisions from the IFA must also be considered in the application of the Rules.

15. The Authority would welcome feedback on precise requirements outlined in the Rules in addition to the points in italics within this Consultation Paper.

### **Interpretation (Paragraph 2)**

16. Paragraph 2 introduces the key terms upon which the framework is built. Definitions have, wherever possible, been adopted from the Directive. In some instances, however, comparable Bermuda-specific definitions had to be developed including:
  - i. Constitution – Refers to the formation documents of a fund in the Bermuda context. As the fund prospectus is not considered to be a formation document, it is referenced separately when required.
  - ii. Depositary – Recognises the differences in scope between the function performed by a custodian under Bermuda law and the role of a depositary under the Directive.
  - iii. Financial instrument – The Authority is of the view that it is appropriate to rely on the definition of an investment set out in Part 1 of Schedule 1 to the Act, rather than have to reference other EU Directives.
  - iv. Governing body – The intention was to retain flexibility given the differing nature of entities which might be entailed.
  - v. Issuer – Essentially means a listed company, but as this entails issuing shares for trading on a regulated market, a separate definition for the latter term is then included.
  - vi. Prospectus – Encompasses the definition of a fund prospectus under the IFA, but also references the comparable document under the laws of jurisdiction where the AIF is established.
17. The BMA discussed in some detail the issue of “control” and the various different contexts in which it emerges in the draft Rules. Ultimately, control is dealt with by Section 5 of the IBA which mirrors the equivalent provision within the EU from the 7<sup>th</sup> Council Directive on Consolidated Accounts (83/349/EEC). A definition is introduced for “close links”, under which a reference to section 5 of the IBA is

introduced. Finally, a new definition for “control” in the context of “Acquisition of Control” at the level of AIFs is introduced, which reflects principles of takeover “control” in relation to listed companies.

18. Feedback is requested on:

- a) *The content of paragraph 2 of the draft Rules and any perceived challenges with implementation. This feedback can also be provided in response to any of the titles or paragraphs that follow.*

#### **Application for a licence (Paragraphs 3 - 4)**

19. Paragraph 3 introduces the requirement for additional qualitative and quantitative information on the AIFM itself and on each AIF it manages. It is intended that the information outlined in this paragraph would supplement (in free format) information already required from all applicants pursuant to the existing IBA licence application process. If the applicant is already licensed under the IBA, and is seeking a variance in its licence to carry on business as an AIFM, the Authority will focus on AIFM specific requirements when reviewing the application.

20. The information outlined in this paragraph addresses Article 7 of the AIFMD regarding the ‘application for authorisation’ and elements of Article 8 of the Directive which pertain to ‘conditions for granting authorisation’. For instance, the provision from Article 8 stipulating that any shareholders or members of the AIFM that have qualifying holdings (causing them to be considered shareholder controllers in the Bermuda context) be suitable to ensure sound and prudent management of the AIFM is addressed here. A template for the application form will be issued by the BMA.

21. By setting out the information to be provided upon application by an AIFM, this paragraph also serves, in conjunction with section 19G of the Act, to establish obligations of notification and prior approval of the BMA with regard to ‘material change’. In this respect, requirements to provide the Authority with the following have been included:

- i. In the case of an external AIFM, confirmation as to whether it intends to perform asset management on a discretionary basis for other clients.
- ii. Details of appointment of a depositary;
- iii. Evidence of how the AIFM fulfils capital and liquidity obligations;
- iv. Identification of the person performing the independent valuation function;



- v. Arrangements on, and identification of, any delegates or sub-delegates;
  - vi. Information on leverage and risk limits adopted by the AIFM.
22. The Directive makes it clear (at Recital 21) that applicants should never be authorised to provide portfolio management without also providing risk management or vice versa. Accordingly, as part of the licensing requirements, the Rules impose, via paragraph 4, a licensing prerequisite that AIFMs must demonstrate their ability to perform both the functions of portfolio management and risk management.
23. In addition to addressing each of the specific items outlined under paragraph 3, AIFM applicants will be required to provide other information on themselves and the AIFs to be managed by completing the Reporting Templates presented as Schedule II to the Rules.
24. The Authority proposes to supplement the existing SOP to emphasise and clarify relevant issues relating to the application for, and granting of, authorisation including matters addressed within the IBA Minimum Criteria for Licensing (MCL).

### **Capital and liquidity requirements (Paragraphs 5 - 9)**

25. The provisions within the Rules under this title serve to introduce general and specific capital and liquidity requirements for AIFMs. In this regard, the Authority noted considerable alignment between the provisions in the Directive dealing with capital and “own funds” (a term which is not utilised within the Rules) and the provisions in the IBA SOP relating to “minimum net assets” and “adequate liquidity”. Given this, the Rules seek to build upon, and formalise, the current provisions in the SOP.
26. In addition to establishing a minimum capital requirement, a separate total capital requirement, linked to the value of the portfolios of AIFs managed by the AIFM, is introduced, along with associated provisions. The Rules also set out a process regarding restitution of relevant capital and liquidity levels in the case that the requirements specified in the Rules are breached. AIFMs will also be required to address the issue of professional liability risk, either by holding additional funds or a professional indemnity insurance policy.
27. With regard to minimum capital, the BMA seeks to achieve maximum convergence with the EU regime by quoting the limits outlined in AIFMD itself, with AIFMs to hold an equivalent in a ‘locally accepted currency’. Reference in the Amendment Act

allowing the BMA to reference “monetary amounts in foreign currencies” makes this possible. Accordingly, the Rules make reference to “minimum capital that is the equivalent of” EUR 300,000 (in the case of an internal AIFM) or EUR 125,000 (in the case of an external AIFM).

28. Where the total value of the portfolios of AIFs managed by an AIFM exceeds the equivalent of EUR250 million, the AIFM must provide additional capital equal to 0.02% of the amount in excess of the equivalent of EUR250 million, subject to the proviso that the total capital need not exceed the equivalent of EUR10 million.
29. Maintaining the approach of having the Rules build upon and formalise the SOP, the Rules address the AIFM liquidity requirements from the Directive by reiterating the existing provision in the SOP whereby investment providers are required at all times to maintain adequate liquidity equivalent to at least three months’ expenditure.
30. *Feedback is sought with regard to:*
  - a) *In the case that the equivalent capital is held in a currency other than Euro, what is the currency that AIFMs in Bermuda would mostly likely seek approval of?*
  - b) *Where and in what form do stakeholders anticipate holding such capital?*

### **Organisational requirements (Paragraph 10)**

31. Under this title, the Rules broadly set out requirements regarding safeguards and controls to be undertaken by the AIFM. At present, such obligations are generally imposed on investment providers via the MCL, but the Authority has determined that it is appropriate to expressly assert these requirements within the Rules to underscore the obligations to which AIFMs will be subject.
32. Feedback is requested on:
  - a) *The content of paragraph 10 of the draft Rules and any perceived challenges with implementation.*

### **Operating conditions (Paragraphs 11 - 16)**

33. The requirements under this title are split across six paragraphs, dealing with General Operating Conditions, Remuneration, Conflicts of Interest, Risk Management, Liquidity Management and Investment in Securitisation Positions. The starting point under the IBA regime for General Operating conditions, Conflicts of Interest and

Risk Management, can be broadly sourced from the MCL, Code of Conduct and Corporate Governance Policy. These Rules seek to elaborate on the current IBA regime with more explicit requirements being outlined in the legislative text. The provisions relating to Remuneration, Liquidity Management and Investment in Securitisation Positions are more detailed for this particular sector, however, the BMA is of the view that a sufficient legal basis exists in the IBA regime at present for the provisions proposed within the Rules as they are essentially enhancements of areas which are supervised at present.

34. *Feedback is requested on:*

- a) *The content of paragraphs 11 to 16 of the draft Rules and any perceived challenges with implementation.*

### **General operating conditions**

35. Paragraph 11 introduces general principles regarding the good conduct of AIFMs. There is a specific requirement for those who would perform portfolio management on a discretionary basis, preventing them from investing all or part of their client's portfolio in any unit or shares of an AIF it manages without receiving prior approval of their client and notifying the BMA as such.

36. *Feedback is requested on:*

- a) *The extent to which stakeholders envisage carrying out general IBA activities in addition to acting as an AIFM, under one licence.*

### **Remuneration**

37. Paragraph 12 introduces general principles relating to remuneration, and the basic requirement for AIFMs to establish remuneration policies. More detailed principles and quantitative requirements pertaining to remuneration are addressed within Schedule I to the Rules. While this is a new requirement for the industry in Bermuda, following industry feedback to the Discussion Paper issued in November 2014 the BMA understands that this is an accepted part of the proposed AIFM regime.

38. *Feedback would be welcomed on:*

- a) *The precise titles of the persons whose professional activities have a material impact on the risk profile of an AIFM and who would, as such, fall under scope of paragraph 12(3) i.e., "chief executive officers, senior executives, or any employees who carry out a risk related activity and whose remuneration puts them in the same bracket as those persons".*

- b) The content and perceived implementation challenges of the Schedule I Remuneration Policy.*

### **Conflicts of Interest**

39. Paragraph 13 introduces relevant principles relating to conflicts of interest and the basic requirements in terms of their management. The Rules reflect the Authority's understanding that conflicts of interest cannot in every case be prevented and that, by way of mitigation, AIFMs should take reasonable steps to ensure that conflicts of interest can be identified, monitored and managed so that they do not reach levels which are detrimental to the AIFs and their investors.

*40. Feedback would be welcomed on:*

- a) Factors related to an AIFM's operating environment and conditions which could give rise to material or systematic conflicts of interest.*

### **Risk Management**

41. Paragraph 14 introduces relevant principles relating to the risk management function and the basic requirements of AIFMs in this regard. The Authority recognises that certain elements of this structure will be new for the Bermuda industry, such as the requirement for functional and hierarchical separation of risk management and portfolio management from the rest of the operating units, the establishment of maximum limits for risk and leverage and mandatory stress testing.

42. An AIFM would be required to notify the Authority if it ceases to operate within its risk and leverage limits. As these limits would have been considered by the Authority as part of its initial licensing decision, any breach of them would be analogous to the AIFM establishing new limits, which would be considered a material change and require notification to, and non-objection from, the Authority.

*43. Feedback is requested on the following points:*

- a) The BMA interprets "functional and hierarchical separation" to mean that the functions in question should not report in to the same person/decision maker. Confirmation would be welcomed on whether stakeholders share this interpretation and, if not, what other options are envisaged to ensure compliance with this requirement.*

- b) *While the requirement to perform stress tests is mandatory “on an ongoing basis” (paragraph 14(10)), feedback would be helpful on how frequently stakeholders envisage performing stress tests in order to measure and manage the risk associated with each investment position of the AIF.*

### **Liquidity Management**

44. Paragraph 15 introduces general principles relating to liquidity management and the basic requirements imposed on AIFMs to monitor and manage liquidity of the AIFs in this area. While this is a new requirement for the industry in Bermuda, based on industry feedback provided in response to the Discussion Paper issued in November 2014, the BMA understands that this is an accepted part of the proposed AIFM regime.

45. Feedback would be welcomed on:

- a) *What conditions would be considered as “normal and exceptional conditions” respectively, in terms of monitoring the liquidity risk of AIFs.*

### **Investment in Securitisation Positions**

46. Paragraph 16 introduces relevant principles relating to investment in securitisation positions and the basic requirements of AIFMs in this context. The BMA notes the initiative of the European Commission with regard to the proposal for a regulation laying down common rules on securitisation and the fact that this proposal would repeal Article 17 of AIFMD. The BMA intends to discuss this matter with ESMA and EU Policymakers.

47. *Feedback is requested on:*

- a) *In the case that the content of this paragraph is edited so as not to contradict with future provisions of EU regimes, it would be helpful to receive view on what parts of the text could be retained.*

### **Independent Valuation (Paragraphs 17 - 21)**

48. The requirements under this title are split across five paragraphs dealing with: Valuation; Appointment of Valuers; Qualifications of a Valuer; Duties of a Valuer; Valuation: Liability of AIFM.

49. The Rules require that at least once per year an AIFM must, for each AIF it manages, ensure that an independent valuation of assets is performed. Additionally, the Rules require the AIFM to ensure that the net asset value per share or unit of each AIF it manages be calculated and disclosed to investors. The Rules also establish who can and cannot perform the valuation function. Specific provision is made for the valuation function to be performed by the AIFM itself but only if conditions are met which would ensure that the valuation task is functionally independent. Similarly, in the case the valuation function would be performed by an external party, the requirements on an AIFM regarding their external appointee are set out.
50. The Rules prescribe that the above-referenced valuation and calculation be done “in accordance with the Rules; the constitution and prospectus of the AIF and the law of the jurisdictions where the AIF is authorised or established”. This differentiation is made in order to reflect that AIFMs in Bermuda may manage a range of AIFs, including Bermuda authorised and exempted funds and funds established outside of Bermuda, all of which would be subject to different legislative requirements.
51. The explicit requirement that an independent valuation be performed is not presently stated under the IFA, but is standard practice in the Bermuda fund sector. At the time of authorisation, funds are required to appoint an investment manager, an auditor, a fund administrator and a custodian. In the BMA’s view, the auditor and fund administrator are the two entities who most similarly perform these activities in the domestic market at present. The existing duty, however, is on the fund to appoint and not the manager. Given this, the BMA Rules direct that the AIFM must ensure the appointment is made for every fund it manages.
52. The appointment of the valuer is effectively approved by the Authority at the time of licensing, as the applicant must confirm arrangements made for the independent valuation of assets. As such, any change thereafter shall be considered material and section 19G of the Act shall be triggered.
53. Amongst other provisions related to valuers and the valuation process, the Rules establish the liability of the AIFM for the proper valuation of AIF assets. Furthermore, the Rules state that this liability to the AIF and its investors is not affected by the appointment by the AIFM of an external valuer. The BMA proposes to rely on its powers to restrict or revoke a licence, pursuant to Section 20 and 21 of the IBA respectively, should it be necessary to take action against AIFMs in this regard.

54. *Feedback is requested on:*

- a) *The content of paragraphs 17 to 21 and any perceived challenges with implementation.*
- b) *In respect of paragraph 18(1)(a), any potential issues pertaining to persons who may be considered to be “linked by control” as per paragraph 2(1) of the draft Rules.*

#### **Delegation of AIFM’s functions (Paragraphs 22 - 25)**

55. The title is split into four paragraphs dealing with: General Provisions; Appointment of a Delegate; Sub-Delegation; Liability following Delegation. The Authority recognises that certain provisions introduced under this title will be new for the industry, as the IBA does not presently establish specific requirements with regard to delegation of duties or outsourcing. Rather, it is standard practice at present for investment providers to notify the BMA of such changes to their arrangements as this is considered to be a “significant development” in the meaning of section 4.1 of the IBA Guidance Note.

56. The provisions under this title introduce requirements for the AIFM when delegating functions, including the activity of further sub-delegation. Two key elements of these provisions are as follows: 1) the AIFM will not be able to delegate both their portfolio and risk management functions; 2) the AIFM must not delegate to the extent to which it becomes a ‘post office box entity’ within the meaning of the Bermuda Companies Act 1981 in that it cannot merely have a post office box presence in Bermuda. It is accepted to have the same meaning as the EU term ‘letter-box entity’ reference. Ultimately, an AIFM should not delegate more than they retain.

57. Any appointment of a delegate is effectively approved by the Authority at the time of licensing, as the applicant must provide details of its arrangements on delegation and sub-delegation, including identification of any delegates or sub-delegates. Accordingly, any change thereafter shall be considered material and section 19G of the IBA shall be triggered.

58. *Feedback is requested on:*

- a) *The content of paragraphs 22 to 25 and any perceived challenges with implementation.*

*b) Based on current activities under the IBA, what activities are most frequently delegated, to whom, and where are the delegates located?*

**Depositaries (Paragraphs 26 - 35)**

59. The requirements under this title are split across ten paragraphs covering requirements on: General Provisions & Appointments; Conflicts of Interest; Cash Flow Monitoring; Safekeeping of Financial Instruments; Safekeeping of Other Assets; General Compliance; Delegation of Functions; Liability for Loss of Financial Instruments; Liability for Other Losses; Liability & Overseas Depositaries.

60. Broadly, under this title of the Rules, AIFMs must ensure that they appoint a depositary which would be responsible for holding and safeguarding the assets of the AIF whilst retaining responsibility/liability towards the investors of the AIF. Under the Directive, only those institutions which are compliant with Basel III and the EU Markets in Financial Instruments Directive (MiFID) standards would be eligible for appointment as a depositary. For the purposes of establishing a Bermuda AIFM regime, the Authority proposes to limit such appointments to Bermuda authorised banks or credit institutions or investment firms authorised by a competent authority in the EU to carry out a depositary function.

61. The Bermuda IFA regime has similar requirements for holding of third party assets. The IFA requires that Bermuda authorised funds appoint a custodian. Exempted funds must also appoint a custodian in order to meet one of the criteria for exemption under the IFA, Going forward, the provisions of the IFA will be interpreted along with the AIFM Rules, and the Authority will require AIFMs and those Bermuda AIFs managed by them to appoint custodians in accordance with the Rules. As previously noted, any change to an appointed depositary is a material change under section 19G of the Act.

62. Amongst all of the important obligations imposed on depositaries under the draft Rules, one point of focus will be on the requirement relating to liability. In the case that the depositary is a licensed bank in Bermuda then it will already be bound by the Minimum Criteria for Licensing under the Banks and Deposit Companies Act 1999 and the requirements therein to operate in a prudent manner and comply with all legal requirements under Bermuda law. Should the depositary be an overseas undertaking, however, the Authority will expect to verify that the contract via which the depositary is appointed contains appropriate liability provisions and will make use of regulatory cooperation agreements it has in place with relevant overseas competent authorities to ensure that these provisions are honoured.



63. *Feedback is requested on:*

- a) *The content of paragraphs 26 to 35 of the draft Rules and any perceived challenges with implementation.*
- b) *What other entities in Bermuda should, in the longer term, be eligible to act as a depositary?*
- c) *Whether, in the longer term, it should be possible to appoint a depositary other than a Bermuda bank or an EU authorised credit institution or investment firm, upon approval of the BMA? In case such an option is eventually taken up, what kind of entity is contemplated and in which jurisdiction would these entities be domiciled/originate?*

#### **Transparency requirements (Paragraphs 36 - 38)**

64. This title introduces transparency requirements on AIFMs in relation to their annual report and disclosure to investors. The title is split into three paragraphs dealing with: Annual Report; Disclosure to Investors and Prescribed Information (Disclosure to Investors).
65. At present under the IBA regime, investment providers are required to produce an annual report pertaining to their licensed business. Further, if the provider holds assets its financial statements must be audited and published within four months of the financial year end. These AIFM Rule requirements are, however, targeted at each AIF under the management of the AIFM in question. Under the Rules, the AIFM must ensure that for each AIF it manages an annual report is submitted to the Authority within six months of the financial year end. The Rules enumerate the information to be included within the annual report, with one element relating to the remuneration paid by the AIFM.
66. Under the Bermuda regime at present, requirements to disclose information to investors are outlined in the fund prospectus rules, however these Rules are only directed at funds authorised under the IFA. The approach to be adopted under the AIFM regime would be for managers to have more flexibility in terms of the portfolio that they manage. The BMA will not seek to prescribe the exact contents of a fund prospectus, other than Bermuda authorised funds, however it is expected that, at a minimum, the prescribed information outlined in paragraph 38 would be detailed. For Bermuda authorised funds, it should be understood that the IFA fund prospectus rules

represents a starting point and if the requirements in paragraph 38 give rise to additional requirements, these would be included and identified as such. Notably, there is a provision which imposes an obligation on an AIFM to inform investors, before they invest in an AIF, of any arrangements made by the depositary to contractually discharge itself of liability.

67. *Feedback is requested on:*

- a) *The content of paragraphs 36 to 38 of the draft Rules and any perceived challenges with implementation.*
- b) *With regard to disclosure requirements, the BMA has taken on board the EU drafting in terms of referencing frequency in terms of “periodic” and “regular”. The industry is requested to examine the content surrounding each of the requirements and comment on what should be interpreted as “ad hoc” and “systematic” along with the perceived appropriate frequencies and deadlines.*

#### **Supervisory reporting (Paragraphs 39 - 41)**

68. This title introduces specific systematic supervisory reporting requirements for AIFMs which are intended to supplement the Reporting Templates outlined in Schedule II. Within the title are three paragraphs dealing with: Reporting Obligations to the Authority and to other competent Authorities; AIFMs Managing Leveraged AIFs; Limits on Leverage.

69. At present under the IBA, investment providers are required to submit various documents to the BMA, including a copy of their annual accounts, a liquidity analysis report and a copy of their business plan. The Rules seek to elaborate on these existing IBA supervisory reporting obligations, with additional and more explicit requirements being established. Under the IFA, funds are required to report to the Authority, at specified intervals, on various matters. As the BMA position is that the Bermuda AIFM regime would allow AIFMs to manage funds other than Bermuda funds, all reporting requirements are outlined in these Rules. As has been the case with other aspects of the draft Rules, the requirements pertaining to supervisory reporting will supplement, rather than replace, existing reporting obligations to which managers or funds are subject.

70. The recently added provision in the IBA allowing the BMA to make reference to monetary amounts in foreign currencies makes it possible to reference the original Euro thresholds as outlined in the EU texts in relation to the reporting deadlines.

71. The Authority recognises that the reporting requirements for AIFMs managing AIFs which employ substantial leverage are new for Bermuda managers, however they are consistent with the development of key risk indicators in the general financial stability framework. It should be noted that the Authority proposes that leverage be considered to be employed on a substantial basis when the exposure of the AIF exceeds three times the value of the AIF's net asset value. It should also be noted that the Rules, at paragraph 40, enable the Authority to use its powers, under section 20 and 21, to impose leverage limits that are different from those set by the AIFM.

72. *Feedback would be welcomed in respect of:*

- a) The content of paragraphs 39 to 41 of the draft Rules and any perceived challenges with implementation.*
- b) The content and perceived implementation challenges of the associated Schedule II reporting.*
- c) Any perceived challenges associated with having essentially three separate reporting structures i.e. IBA, IFA and AIFM Rules.*
- d) Potential leverage limits for any AIFs currently under management?*

**Obligations for AIFMs managing AIFs which acquire control of non-listed companies or issuers (Paragraphs 42 - 47)**

73. This title introduces requirements for AIFMs when an AIF that they manage acquires control of a listed (issuer) or non-listed company. This title is split into six further paragraphs: Ways of Acquiring Control of Shares; Notification of the Acquisition or Disposal of Major Holdings and Control of Non-Listed Companies; Disclosure in the Case of Acquisition of Control; Additional Disclosure when Control is Acquired of Non-Listed Companies; Annual Report of AIFs Exercising Control of Non-Listed Companies; Asset Stripping. The objective of these paragraphs is to monitor acquisition of companies by AIFs and to impose obligations to make disclosures to relevant stakeholders, including the Board and the employees of such entities. Control is defined for non-listed companies as 50%. For issuers (i.e. listed companies), it would be determined by the applicable take-over provisions under the laws of the jurisdiction where the issuer is established. This reflects the EU text, which refers to the Takeover Bids Directive (2004/25/EC), and the actions required to be taken, or information required to be transmitted, under this title in the Rules relate to the effective operation of that regime.

*74. Feedback is requested on:*

- a) The content of paragraphs 42 to 47 of the draft Rules and any perceived challenges with implementation.*