

# Recent developments in the Bermuda investment funds industry

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## BERMUDA'S INVESTMENT FUNDS SECTOR

As at the first quarter of 2017, there were about 550 Bermuda funds with net asset value (NAV) of about US\$135.03 billion. The Bermuda Monetary Authority statistics for 2015 stated that Bermuda fund administrator licensees reported an aggregate total of US\$156.2 billion in assets under administration and investment business licensees reported aggregate assets under management of US\$167.6 billion, with an additional aggregate US\$38.5 billion in assets under administration.

Bermuda offers a strong infrastructure including a 400-year old court system, an internationally recognised stock exchange (Bermuda Stock Exchange) and depth of market experience. The jurisdiction continuously modernises its legislation and infrastructure to offer competitive options to fund managers, stakeholders and potential investors in Bermuda.

Bermuda enjoys a reputation as a "blue chip" international business centre and its long-standing position of transparency and co-operation has historically differentiated Bermuda from other jurisdictions. Discerning fund managers and investors are increasingly seeking a sophisticated jurisdiction which offers balanced regulation and is internationally respected as a place in which to invest and conduct business and Bermuda provides this "gold standard".

## INSURANCE-LINKED FUNDS

Bermuda is a world leader in the insurance-linked securities (ILS) market as it continues to lead the way in innovation and product development. ILS funds bring together the investment funds industry and insurance/reinsurance industry creating investment structures specialising in investment in ILS products that include:

- Collateralised reinsurance.
- Catastrophe bonds (cat bonds).
- Sidecars (a financial structure allowing investors to take on the risk and benefit from the return of specific books of insurance or reinsurance business).

The Bermuda Business Development Agency (BDA) recently commissioned a research report that revealed a total economic impact of US\$734 million from Bermuda domiciled insurance-linked funds. The same report revealed that Bermuda is the most popular jurisdiction for ILS fund managers with approximately US\$55 billion in aggregate under management in Bermuda. There were no ILS entities domiciled in Bermuda prior to 2009 which aptly demonstrates the impressive pace of Bermuda's growth in the market as it rapidly became the global leader since inception.

Bermuda's service providers provide a wealth of expertise in the market. They are adept and well suited to serve the specialised ILS industry providing top tier services including legal, fund accounting, valuation, investor services and corporate administration services.

The Bermuda Stock Exchange (BSX) has also been very involved with the continuing development of Bermuda's investment fund market, and the BSX has become the prime listing destination for cat bonds and other ILS products.

In Bermuda, the ILS market generally continues to grow at a rapid pace, innovating and developing new ILS products.

## EXEMPT FUNDS REGIME

Bermuda's investment funds legislation was updated in 2013 to include the establishment of two types of exempt funds, as follows:

- Class A exempt funds (*see below, Class A exempt funds*).
- Class B exempt funds (*see below, Class B exempt funds*).

Following the introduction of these new exempt classes, previously exempt funds under the old regime were given a transition period of three years within which to convert to one of the new classes. The initial transition deadline was 3 October 2016. However, the deadline was recently extended by another year, meaning that the relevant pre-existing exempt funds will have until 3 October 2017 to re-classify as either a Class A or Class B exempt fund under the new regime.

**Class A exempt funds.** In order to qualify as a Class A fund, an investment fund must:

- Only be open to subscription by qualified participants. In respect of both Class A exempt funds and class B exempt funds, a "qualified participant" is a category of investor which is similar to accredited investors in the US or sophisticated investors in the UK. A qualified participant includes individuals who fall within any of the following categories:
  - a high income private investor with personal income in excess of US\$200,000 in each of the two years preceding the current year (the year in which the investment is purchased) or joint income with his/her spouse in excess of US\$300,000 in each of those years and who has reasonable expectation of reaching the same income in the current year;
  - a high net worth private investor who has a net worth in excess of US\$1 million individually or jointly with his/her spouse;
  - a sophisticated private investor being an individual who has such knowledge of, and experience in, financial and business matters, that would enable him to properly evaluate the merits and risks of a prospective purchase of investments;
  - bodies corporate, each of which has total assets of not less than US\$5million, where such assets are held solely by the body corporate or held partly by the body corporate and partly by one or more members of a group of which it is a member;
  - unincorporated associations, partnerships or trusts, each of which has total assets of not less than US\$5 million, where such assets are held solely by such association, partnership



or trust or held partly by it and partly by one or more members of a group of which it is a member;

- bodies corporate, all of whose shareholders fall within one or more of the categories in this list;
- partnerships all of whose members fall within one or more of the categories in this list;
- trusts all of whose beneficiaries fall within one or more categories in this list.
- Appoint an investment manager that either:
  - is licensed by the BMA under the Investment Business Act 2003, as amended;
  - is regulated by a foreign regulator who is recognised by the BMA, such as the US Securities and Exchange Commission or the UK Financial Conduct Authority;
  - manages assets of US\$100 million or more (either individually or as part of a group) and is carrying on business from a jurisdiction recognised by the BMA (for example, the US and the EU).
- Appoint service providers including a fund administrator, registrar, auditor and a custodian or prime broker.
- Appoint an officer, trustee, or resident representative in Bermuda who has access to the books and records of the fund (this service can be provided by the Bermuda based administrator).
- Ensure that the financial statements of the fund are prepared in accordance with International Financial Reporting Standards (IFRS) or Generally Accepted Accounting Principles (GAAP) in Bermuda, Canada, the UK or US or such other GAAP considered appropriate by the BMA.

If the manager of a prospective fund does not satisfy the above requirements for a Class A exempt fund they may consider, in the alternative, a Class B exempt fund.

**Class B exempt funds.** This fund is available for managers who are not authorised or licensed by, or in a jurisdiction recognised by, the BMA. In order to qualify as a Class B fund, an investment fund must:

- Only be open to subscription by qualified participants (as defined above).
- Appoint an investment manager (but there is no requirement with the Class B fund for the manager to be regulated).
- Appoint service providers including a fund administrator, registrar, auditor and a custodian or prime broker who must, in the BMA's view, be fit and proper to perform the respective functions of their office.
- Appoint an officer, trustee, or resident representative in Bermuda who has access to the books and records of the fund (this service can be provided by the Bermuda based administrator).
- Ensure that the financial statements of the fund are prepared in accordance with IFRS or GAAP in Bermuda, Canada, the UK or US or such other GAAP considered appropriate by the BMA.

**Applications for Class A and Class B funds.** Applications for both Class A and Class B funds are fairly simple and any continuing obligations are not onerous.

The Class A fund can be launched by submitting an exemption form to the BMA that the fund satisfies the requirements for exemption from authorisation (that is, a self-certification form), accompanied by the fund's offering memorandum.

A Class B fund exemption (including the fund's offering document) must be submitted to the BMA to enable the BMA to vet the service

providers to ensure that they are fit and proper for the proposed investment strategy. After filing has occurred, the BMA has ten days to revert with any issues or approval, failing which the Class B exemption is automatically granted.

## THE LIMITED LIABILITY COMPANY (LLC)

The Limited Liability Company Act 2016 (LLC Act) introduced the LLC vehicle for the first time in Bermuda. The Bermuda LLC Act was specifically modelled on, and is more closely aligned with, Delaware law, unlike LLC legislation in other offshore jurisdictions. The introduction of the LLC framework in Bermuda was a direct response to the requests from US stakeholders for such a vehicle.

The LLC is a hybrid entity which merges characteristics of both a limited partnership and a company limited by shares. It is a very flexible vehicle which provides a useful alternative structuring option to complement the existing choice of vehicles available in Bermuda.

The LLC has potential applications in a variety of areas including investment funds, asset holding, special purpose vehicles, joint ventures, general corporate transactions, venture capital and private equity structures.

## PARTNERSHIPS

Bermuda's Limited Partnership legislation was extensively updated in 2015 and further honed since then. The amendments benefit Bermuda's asset management sector and improve the jurisdiction's product offering. The recent changes grant partnerships additional rights enjoyed by exempted companies and include the following updates:

- Greater flexibility for internal governance.
- Extension of the list of "safe harbour" activities which a limited partner can carry out without taking part in the management and whilst preserving its limited liability status.
- Clarification that, unless provided otherwise in partnership agreement, a limited partner of a limited partnership does not owe any fiduciary duty in exercising any of its rights or authorities or otherwise in performing any of its obligations under the partnership agreement to the limited partnership or any other partner.
- Ability for conversion of a limited partnership to an exempted company and vice versa, allowing for ability to change an entity's status.
- The establishment of a register of charges for partnerships with separate legal personality.
- Continuance and discontinuance procedures.

## CONTRACTS (RIGHTS OF THIRD PARTIES) ACT

The Contracts (Rights of Third Parties) Act 2016 (Rights of Third Parties Act) was recently brought into force in Bermuda, and was substantially modelled on the UK equivalent. The Rights of Third Parties Act allows parties to vary the common law doctrine of "privity of contract" so that third parties can enjoy the benefits and enforce the provisions of a contract (including indemnification and exculpation provisions). This is only the case if the third party is expressly identified in the contract and the contract expressly provides that the third party can enforce the contract's terms.

The Rights of Third Parties Act is appealing to Bermuda's investment funds industry because fund documents regularly include indemnities in favour of third parties. It is also attractive to third party service providers, advisors and consultants.

## REGISTER OF DIRECTORS

Under Bermuda law, director and officer registers as well as shareholder registers of Bermuda companies are required to be made available to the public at a company's registered office. Recent amendments to Bermuda's company legislation mean that companies are now also required to file current director

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information with the Registrar of Companies (RoC) to be held in a central database that is open to the public.

### **THE COMMON REPORTING STANDARD AND COUNTRY-BY-COUNTRY REPORTING**

Bermuda is on the OECD's "white list" of co-operative and compliant jurisdictions and is a leading country in terms of tax transparency and global compliance standards. Bermuda is an early adopter of the OECD's Common Reporting Standard (CRS) and financial institutions in Bermuda have been required to comply with the CRS regime since 1 January 2016.

In April 2016, Bermuda became the first British Overseas Territory to sign up to the Country-by-Country (CbC) reporting regime which is a component of the OECD's base erosion and profit shifting (BEPS) project. It became the 33rd signatory of the Multilateral Competent Authority Agreement for CbC reporting. Multinational groups based in Bermuda that satisfy the criteria requiring submission of a CbC report will need to submit information for financial years starting on or after 1 January 2016.

Bermuda's transparency system is extremely effective and Bermuda remains at the forefront of financial crime prevention. Bermuda's Government, Regulator (Bermuda Monetary Authority), and industry representatives ensure that the country responds to market evolution and global trends in a way that is efficient, considered and sensibly regulated.

#### ***EU Solvency II and NAIC Designation***

In 2016, the EU awarded Bermuda equivalency with its own EU Solvency II insurance regime as only one of two non-EU countries awarded that distinction (the other country is Switzerland). Similarly, in the US, the National Association of Insurance Commissioners (NAIC) has designated Bermuda a "qualified"

jurisdiction. This highlights Bermuda's strong, mature and proficient regulatory environment.

### **AIFMD AND THE FUTURE OF BERMUDA INVESTMENT FUNDS**

On 19 July 2016, the European Securities and Markets Authority (ESMA) issued advice regarding the possible extension of the AIFMD passport to non-EU countries, including Bermuda. In relation to Bermuda, ESMA confirmed that it saw no significant obstacle to extend the passport in the following areas:

- Competition.
- Market disruption.
- Monitoring of systemic risk.

This leaves investor protection and effectiveness of enforcement as the two areas that are yet to be confirmed for Bermuda in respect of the ESMA assessment criteria. Bermuda has in fact already undertaken some of the outstanding work noted in ESMA's report including the following:

- Issuing the Order by the Minister of Finance to bring the Investment Business Amendment Act 2015 into force.
- Publication by the Authority of the AIFM Rules.
- Passing of the Investment Funds Amendment Act 2016.

This will strengthen the BMA's enforcement powers and enhance investor protection capabilities. However, until Brexit is resolved it seems unlikely that ESMA will progress the designation of third country status for non-EU countries beyond the current jurisdictions which were previously assessed.

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**Non-professional qualifications.** Postgraduate Diploma in Legal Practice (Distinction), BPP Law School, UK; Graduate Diploma in Law, BPP Law School, UK; BA in Psychology, University of Waterloo, Canada

**Languages.** English

### Professional associations/memberships

- Bermuda Bar Association.
- Chair of Bermuda Government-Industry FATCA/CRS Committee.
- Member of 100 Women in Finance, Bermuda.
- Member of Restructuring and Insolvency Specialists Association of Bermuda.

### Publications

- *Bermuda's Sophisticated International Transparency and Regulatory Environment*, HFM Special Report on Bermuda 2017, July 2017.
- *Mergers & Acquisitions 2017, Bermuda Chapter, Getting the Deal Through*, 2017 Edition
- *M&A in Bermuda*, Lexology, May 2017.
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- *The OECD Base Erosion and Profit Shifting (BEPS) Project*, Multinational Enterprises and CbC Reporting, IFLR 1000 Insight, July 2016.
- *Bermuda – A Sophisticated Leader in International Business*, IFLR1000 Financial & Corporate Guide to the World's Leading



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### Professional associations/memberships

- Bermuda Bar Association.
- Director of the Board of the Bermuda Monetary Authority.
- Member of the Asset Management Group, Committee of the Bermuda Business Development Agency.
- Former chair of a Bermuda investment funds committee.
- Member of the BSX Listing Committee.
- Member of 100 Women in Finance, Bermuda.
- Member of Restructuring and Insolvency Specialists Association of Bermuda.
- Director of the publicly listed fund, The China "A" Fund Limited and a number of privately owned companies.

### Publications

- *The Art of Negotiation: A Global Review of the M&A Deal Process*.
- *The Bermuda Angle: Structuring Energy and Infrastructure M&A offshore*, IFLR1000, June 2016.
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- *Investment Funds*, Lawyer Monthly, December 2013.
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- *10 Things to Know about Mergers and Acquisitions in Bermuda, IFLR 1000, May 2016.*
- *Bermuda and the International Transparency Drive Parts 1 and 2, Royal Gazette, May 2016.*
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- *Establishing Ethical Parameters For An Offshore Legal Practice, Offshore Commercial Law in Bermuda.*