



BERMUDA MONETARY AUTHORITY

THE INVESTMENT BUSINESS ACT 2003

GUIDANCE FOR PROSPECTIVE

APPLICANTS

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1.0 INTRODUCTION

This material has been issued by the Bermuda Monetary Authority (the “Authority”) to provide information and guidance for prospective applicants regarding the statutory provisions of the Investment Business Act 2003 (the “Act”), and the supervisory process which the Authority will apply. It will be updated as necessary and revised versions published from time to time. The Guidance reflects the Authority’s understanding of the legal provisions affecting investment providers and explains the Authority’s regulatory approach. However, interpretation of the statutes is ultimately a matter for the Bermuda courts and the Authority cannot provide definitive views.

It should be noted that the Authority has also published a Statement of Principles and Codes of Conduct, as provided for under the Act. The Statement of Principles provides guidance on the Authority’s approach in interpreting the minimum criteria and in exercising its power to grant, revoke or restrict a licence and in exercising its power to obtain information, reports and to require production of documents. The Codes of Conduct provide guidance on the duties, requirements, procedures, standards and sound principles to be observed by persons carrying on investment business. Copies of these documents can be found on the Authority’s website (www.bma.bm).

2.0 REGULATORY SCOPE

The Investment Business Act 2003 is the statutory basis for regulating investment business in Bermuda. The Act provides for a licensing regime for any person or entity (unless otherwise exempted) engaging in investment business, as defined by the Act, either in or from Bermuda.

Section 3 of the Act defines investment business as “engaging in one or more investment activities by way of business”.

Part 2 of the First Schedule to the Act defines investment activity as:-

1. Buying, selling, subscribing for, or underwriting, investments, or offering or agreeing to do so, either as principal or agent.
2. Making or offering, or agreeing to make -
 - (a) arrangements with a view to another person buying, selling, subscribing for or underwriting a particular investment, being arrangements which bring about or would bring about the transaction in question;
 - (b) arrangements with a view to a person who participates in the arrangements buying, selling, subscribing for or underwriting investments.
3. Managing or offering, or agreeing to manage, assets belonging to another person where those assets consist of or include investments.

4. Giving or offering, or agreeing to give, to persons in their capacity as clients or potential clients, advice on the merits of their purchasing, selling, subscribing for or underwriting an investment, or exercising any right conferred by an investment to acquire, dispose of, underwrite or convert an investment.
5. Safeguarding and administering or arranging for the safeguarding and administration of assets belonging to another where -
 - (a) those assets consist of or include investments falling within any of paragraphs 1 to 8 of Part 1 of the First Schedule to the Act; or
 - (b) the arrangements for their safeguarding and administration are such that those assets may consist of or include investments and the arrangements have at any time been held out as being arrangements under which investments would be safeguarded and administered.

Section 4 of the Act states that a person carries on investment business in or from Bermuda if such person-

- (a) carries on investment business from a place of business maintained by such person in Bermuda; or
- (b) engages in an investment activity the doing of which constitutes the carrying on by such person of investment business in or from Bermuda under an order made by the Minister of Finance.

A person maintains a place of business -

- (a) in the case of an individual who is a sole trader, if he carries on investment business from premises that he occupies for that purpose;
- (b) in any other case, if it carries on investment business from premises it occupies for that purpose, at which it employs staff and pays salaries and other expenses in connection with that business.

Part 3 of the First Schedule to the Act sets out those activities excluded from the definition of investment activity under the following headings:-

1. Groups, Firms and Joint Enterprises
2. Sale of Goods and Supply of Services
3. Employee Share Schemes
4. Sale of Body Corporate
5. Trustees and Personal Representatives
6. Advice Given or Arrangements Made in Course of Legal Profession
7. Advice Given in Newspapers and Broadcasting Services

The Investment Business (Exemptions) Order 2004 provides for a number of exemptions including:-

1. Persons, other than market intermediaries, who provide investment services exclusively to one or more of the following classes of undertakings —
 - (a) sophisticated private investors;
 - (b) high net worth private investors;
 - (c) high income private investors;
 - (d) collective investment schemes approved by the Authority under the Bermuda Monetary Authority (Collective Investment Scheme Classification) Regulations 1998 or any provision of law amending or replacing such Regulations;
 - (e) bodies corporate, each of which has total assets of not less than five million dollars, 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;
 - (f) unincorporated associations, partnerships or trusts, each of which has total assets of not less than five million dollars 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;
 - (g) bodies corporate all of whose shareholders fall within one or more of the subparagraphs of this paragraph except subparagraph (d);
 - (h) partnerships, all of whose members fall within one or more of the subparagraphs of this paragraph except subparagraph (d);
 - (i) trusts, all of whose beneficiaries fall within one or more of the subparagraphs of this paragraph except subparagraph (d);
2. Collective Investment Schemes.
3. Persons who provide investment services to not more than twenty persons at any time, and do not provide investment services to, or solicit investment business from, the public.
4.
 - (a) Persons who are registered or otherwise permitted under the Insurance Act 1978 to carry on insurance business (within the meaning of section 1(1) of that Act).
 - (b) An exemption under this paragraph applies only to investment services that are provided in connection with the business for which insurers are registered or otherwise permitted to carry on under that Act.

5. (a) Persons registered under the Insurance Act 1978 as insurance managers, brokers, agents or salesmen.
- (b) An exemption under this paragraph applies only to persons who provide investment services in connection with the insurance services for which they are registered under that Act.

Persons seeking to make use of the exemptions under paragraphs 1 or 3 above must first so notify the Authority in the manner described in Appendix 7. The effect of the Act is that, within three months of the implementation date, persons exempt from the 1998 Act and seeking similar exemption under paragraphs 1 or 3 of the Investment Business (Exemptions) Order 2004 must re-file an appropriate exemption declaration.

The above is a summary of the relevant provisions of the Act and the Investment Business (Exemptions) Order 2004. Prospective applicants should refer to the applicable provisions for complete particulars of the terms of the Act and of the exemptions and exclusions.

3.0 APPLICATIONS

An application for a licence under the Act may be made by a Local or Exempted Company incorporated under the Bermuda Companies Act 1981 (the “Companies Act”); an Overseas (Permit) Company licensed by the Minister of Finance under the Companies Act to conduct business in Bermuda; a Partnership formed under the Partnership Act 1902 or the Exempted Partnerships Act 1992; an Overseas Partnership permitted by the Minister of Finance to conduct business in Bermuda; and an individual or unincorporated entity seeking to conduct investment business, as defined, in or from Bermuda. Where an applicant is a legal person, it must have the objects and powers in its memorandum of association, articles of incorporation or similar document that enable it to carry on investment business of the type proposed by the applicant.

An application for a licence must be made in the form prescribed in the Regulations and accompanied by such fees as may be prescribed (The schedule of fees appears at Appendix 1). A copy of the application IB Form 1 can be found in Appendix 2 of the Guidance and along with Appendix 1 is also available in electronic form on the Authority’s web site (www.bma.bm).

An applicant must also submit a statement setting out the nature and scale of the investment business that is to be carried on. The details which are to be included in this statement are set out in Appendix 3 of the Guidance and are also available in electronic form on the Authority’s web site (www.bma.bm).

The Authority also requires that an applicant submit completed Institutional or Personal Questionnaires (IB Forms 2 and 3 set out in Appendices 4 and 5) as applicable. Questionnaires are required from each shareholder/controller, director and officer (as defined in section 2 of the Act) responsible for the applicant’s business.

In considering an application for an investment business licence, the Authority may: -

- a) carry out any enquiries which it considers appropriate (eg. approaching other regulators);
- b) ask the applicant, or any specified representative of the applicant, to attend a meeting with the Authority to answer questions and explain any matter(s) the Authority considers relevant to the application;
- c) seek additional information from the applicant;
- d) visit the applicant to review the proposed premises and files pertaining to the business that it is proposed to conduct in the licensed entity;
- e) request any information furnished by the applicant to be verified in such manner as the Authority may specify; and
- f) take into account any other information which it considers relevant in relation to the application.

The Authority will not grant a licence unless it is satisfied that the minimum criteria are met or are capable of being met by the applicant. However, even when so satisfied, the Authority always retains discretion not to grant a licence - notably if it sees reason to doubt that the criteria will be met on a continuing basis or if it considers that for any reason there might be significant threats to the interests of clients or potential clients.

The Act imposes no time limit within which the Authority must reach a decision in respect of an application. In practice the Authority seeks to deal as promptly as possible with applications. The time required to complete its initial enquiries may vary, however, depending on the nature of the issues which may arise and the difficulty or otherwise in obtaining any additional information which may be necessary. Generally, the Authority would not expect an application to remain outstanding for a period in excess of 3 months; and in most cases the timetable will be appreciably less.

4.0 SUPERVISORY PROCESS

Supervision enables and requires judgements to be made about the nature of an investment provider's business, the quality of its management, the effectiveness of its controls and compliance, the fairness of its treatment of customers and about its financial viability. In order for the Authority to make these judgements, it needs to receive and keep under review information from various sources.

The Authority's regulation of investment businesses involves regular meetings with the senior management of licensed firms, together with scrutiny of financial information on the institution's performance and regular compliance visits to the institution's premises. While the Act provides certain supervisory powers for the Authority to require information from institutions, the Authority expects firms to provide voluntarily and routinely the information necessary for its supervision. Where necessary information is not forthcoming or when concerns arise about the

completeness or timeliness of information provided, the Authority may decide to utilise its formal powers to require information.

The Act also enables the Authority to commission reports on an institution's business from an accountant or other person with relevant professional skills. Such reports can assist with or, on occasion, substitute for part of the on-site element of regulation which is required. In practice the Authority will conduct most reviews of systems and controls directly. Accordingly, reports by auditors on systems and controls will be commissioned only exceptionally, when the nature of the specific business may call for particular skills in order to conduct a more extensive review of the risks involved in the business or where particular concern or difficulties may have arisen in the Authority's normal on-site work. However, the Authority may from time to time commission reports from auditors with a view to obtaining verification of prudential data submitted by investment providers, in order to provide assurance to the Authority of the accuracy and completeness of financial reporting.

4.1 Reporting Requirements

The Act requires that licensed investment providers provide the Authority with financial statements or accounts on an annual basis, submitted not later than four months after the end of their financial year. Where such statements or accounts are required to be audited, an auditor's report thereon should also be provided. Standard financial information (financial statements and liquidity analysis) is required from investment providers quarterly. All investment providers must submit the relevant information within twenty-one business days of each calendar quarter. Sample financial statements and a liquidity analysis report appear at Appendices 8 and 9 respectively and are also available in electronic form on the Authority's web site (www.bma.bm). The Act also requires that, on an annual basis, each investment provider submit a certificate to the Authority confirming that it has complied with the minimum criteria or indicating any failure to do so and where the licence is subject to limitations imposed pursuant to section 17(3) that it has observed such limitations. A copy of the compliance certificate IB Form 4 appears at Appendix 6 and is also available in electronic form on the Authority's web site (www.bma.bm).

In addition to this reporting, the Authority expects to be notified immediately of any significant developments in relation to an investment provider. Matters that should be reported include, but are not limited to, the following:

- (i) any breach of minimum net assets or liquidity requirements or expectation that a breach may be likely. Where the net assets of an investment provider fall below the minimum amount or below the amount specified by the Authority pursuant to paragraph 2.7b of the Statement of Principles, the investment provider shall inform the Authority of the event not later than the first business day after the day that the investment provider becomes aware of its occurrence
- (ii) instances of legal action against the investment provider involving the risk of material financial cost or reputational damage;

- (iii) requests for information or assistance in relation to ongoing inquiries by a foreign regulatory body; and
- (iv) material changes in the business undertaken, including any proposal to undertake non-investment related business.

The Authority would stress that it expects undertakings to be open and proactive in ensuring that the Authority is kept informed of material developments when, or before, they occur.

Where the Authority finds reason to doubt the completeness or accuracy of information provided to it in its routine supervision, it will consider the use of the statutory powers in the Act enabling it to require additional documents or information. Depending on the seriousness of its concerns, it may also have recourse to other information and intervention powers provided in the Act – for example, the appointment of persons to investigate under section 49.

4.2 Off – Site Supervision

Regular prudential meetings provide an opportunity for the Authority to discuss with senior management the development of the investment provider’s business, including past performance and future strategies for the business. Meetings are normally scheduled annually, but may be more frequent when the Authority judges it necessary. Ad hoc meetings will also take place to discuss important interim developments or concerns.

Topics discussed at prudential meetings are likely to include:-

- a) Financial reporting and financial statements (audited, where applicable);
- b) Any planned changes to business strategies;
- c) “Management letters” issued by external auditors (where applicable) and responses thereto;
- d) Material operational changes, changes in investment advisers, managers, custodians, administrators, key staff members, etc;
- e) Adequacy of net assets and liquidity requirements;
- f) Indebtedness between the investment provider and other members of the group to which it may belong;
- g) Internal controls issues;
- h) Adequacy of procedures manuals;
- i) Staff training;
- j) Anti-money laundering procedures and compliance;
- k) Adequacy of insurance coverage;
- l) Disaster recovery planning; and
- m) Scheduling of the Authority’s on-site compliance visits.

Prudential discussions can take place at the Authority or at the investment provider’s own premises.

4.3 On – Site Supervision

The purpose of on-site supervision is to enable the Authority to review compliance with policies and procedures (e.g. record keeping, segregation of assets etc.), as well as the processes that management has put into place to monitor and control key risks in the business. On-site supervision involves structured visits to an investment provider's offices when, typically, the Authority interviews a range of management and staff and reviews a selection of documentation and files. A review of compliance with "know your customer" and record keeping requirements, in relation to the Proceeds of Crime Act, forms part of all of the Authority's visits. On-site visits are usually scheduled on a three-year rolling basis. However, the frequency of on-site visits also reflects the Authority's assessment of the degree of risk in the business and the effectiveness of the investment provider's personnel, systems and controls for monitoring risk. Investment providers can normally expect to be pre-notified at the beginning of the respective calendar year in which a visit will take place. In exceptional cases (e.g. where the Authority has material concerns for the interests of clients or about the financial position of the investment provider) the Authority may conduct a visit at short or even no notice. There will not usually be a need for a separate off-site prudential discussion in a year when an investment provider is scheduled for an on-site visit, unless significant recommendations emanate from the on-site visit.

The Authority will normally write to the investment provider approximately four to six weeks ahead of a visit, requesting pre-visit information and providing more details regarding how the Authority intends to structure the visit. The pre-visit information requested would generally include:

- i) A staff chart for the investment provider with brief job descriptions for key personnel;
- ii) A completed response to the Authority's questionnaire on the investment provider's compliance with the Proceeds of Crime Act;
- iii) Copies of procedures manuals;
- iv) Copies of staff training plans; and
- v) Copies of disaster recovery plans.

While the Act provides powers for the Authority to formally require the production and submission of such information as it may reasonably require, on-site visits are normally conducted without recourse to formal powers.

4.4 Communication With Auditors

The provisions set out in the Act reflect the importance of ensuring proper dialogue between supervisors and auditors and accountants in order to reinforce the effectiveness of prudential regulation. It is inherent in the nature of the auditing task that the auditors must assess and make judgments about the quality of the internal control environment within investment providers, including conducting detailed testing of systems and controls. The results of such work can also be highly relevant to the judgments which must be reached by the prudential regulator: contact between

regulators and auditors therefore strengthens the regulatory framework. Recognising that auditors and accountants perform functions that can assist regulators, the Act provides specifically for the Authority to be able to disclose information to them in certain circumstances, and to be able to commission reports from them. It also provides for auditors and accountants to communicate in good faith with the Authority, notwithstanding any duties of confidentiality that may be owed to clients. In addition, sections 42 and 45 of the Act specify circumstances in which auditors and accountants are obliged to give the Authority written notice of certain facts or matters.

4.5 Disclosure of Information

The Act includes strict provisions governing the circumstances in which the Authority may disclose confidential information received by it in the course of its regulatory responsibilities. Certain “gateways” apply, including for the purpose of enabling or assisting the Authority to discharge its functions under the Act or under the Bermuda Monetary Authority Act, or for the purpose of enabling or assisting the Minister, another authority in Bermuda or a foreign regulatory body exercising functions corresponding to those of the Authority to discharge its regulatory functions.

In fulfilment of established international norms and standards, the Authority is committed to ensuring effective liaison and cooperation with foreign regulatory bodies in circumstances in which there is a shared regulatory interest in an investment provider - for example because it (or another member of its group) is licensed or otherwise subject to regulation in another jurisdiction. In order to disclose information to a foreign regulatory body the Authority must first satisfy itself that the body is subject to restrictions on further disclosure at least equivalent to those imposed under the Act.

4.6 Consolidated Supervision

Although the Authority licences specific individuals or entities, it also needs to have regard to relationships with any wider group to which an entity may belong or with other persons closely linked to the investment provider, which may have implications for the licensed investment business. The Authority reviews these aspects in the course of its routine supervision. In this regard, it may seek relevant information in relation to other group companies from time to time. In particular cases, where relevant, the Authority may also take on a wider role of consolidated supervisor in relation to the investment provider and the group to which it belongs, involving a need for more regular information on the wider group.