



BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

PROPOSED AMENDMENT TO THE INVESTMENT FUNDS ACT 2006

13 APRIL 2018

TABLE OF CONTENTS

I. INTRODUCTION.....1

II. BACKGROUND.....1

III. PROPOSED AMENDMENT TO THE ACT.....2

I. INTRODUCTION

- 1 The purpose of this Consultation Paper is to set out the Bermuda Monetary Authority's (the Authority's) proposal to amend the Investment Funds Act 2006 (the Act) whereby a Class A Exempt fund shall be exempt from Section 6A(2)(d)(iv) pertaining to the requirement to appoint a custodian or prime broker if certain criteria prescribed by the Authority is met.

II. BACKGROUND

- 2 The legislation does not allow for any modifications to the requirements applicable to the Class A Exempt fund category. All the requirements under Section 6A of the Act discussing Class A Exempt Fund Qualification must be met in order to register as a Class A Exempt fund. Once the operator of the fund self-certifies that the requirements are met, the fund is automatically registered.
- 3 Insurance-linked securities (ILS) are broadly defined as financial instruments whose values are driven by insurance loss events. The proceeds collected from investors will form the collateral for the insurance loss events. If there is a loss, the proceeds are reduced when the loss is settled; if there is no loss, the proceeds, plus interest, are returned to the ILS investor.
- 4 ILS funds are typically well-aligned with the requirements for Class A Exempt fund registration, however, the ILS market is broad. Securitisation¹ of insurance loss events occurs in many different ways, i.e. swaps, industry-linked warranties, catastrophe bonds, etc.
- 5 Depending on the nature of the ILS transaction, the appointment of a custodian or prime broker may add little to no additional value. In most instances, the proceeds received from the share issuance are deposited into a reinsurance trust account and the trustee appointed to the reinsurance trust account manages the assets in accordance with the terms stated in the agreements governing the ILS transaction (these include but are not limited to the Trust Agreement, Reinsurance Agreement, Investment Guidelines, etc.).

¹ Securitisation is the transferring of underwriting risks to the capital markets through the creation and issuance of financial securities.

III. PROPOSED AMENDMENT TO THE ACT

- 6 Section 6A(2)(d)(iv) requires a Class A Exempt fund to appoint either a custodian or prime broker who is entrusted with the safekeeping of the fund's property. The proposed amendment to the Act will allow a Class A Exempt fund to be automatically exempt from Section 6A (2)(d)(iv) of the Act if the criteria prescribed by the Authority has been met. The Authority will publish on its website a Notice discussing the relevant criteria for the custodian/ prime broker exemption (refer to **Appendix I** for the draft Investment Funds Act Amendment Bill 2018 and **Appendix II** for the draft Notice).
- 7 Exempting the Class A Exempt fund from the requirement to appoint a custodian or prime broker does not expose the investor to any additional risk. The investor proceeds are managed by a trustee in accordance with the terms and conditions of the agreements governing the ILS transaction, reducing the risk of the funds being misallocated or misappropriated. The ILS investor is aware of this arrangement because the offering memorandum provides, amongst other things, an express disclosure to all investors and proposed investors that the proceeds of the share issuance of the Class A Exempt Fund are held in trust for the purposes of collateralising the insurance loss events linked to the securitised insurance transaction. Furthermore, the interconnectedness of the various agreements (Offering Memorandum, Trust Agreement, Reinsurance Agreement, Investment Guidelines, etc.) also self-governs the ILS deal.
- 8 You are invited to comment on the proposal presented in this Consultation Paper. Comments should be emailed or mailed to the attention of Melissa Morton at mmmorton@bma.bm, or BMA House, 43 Victoria Street, Hamilton HM12. The deadline for comments is **4th May 2018**. The Authority intends to submit the proposed amendments to the Act for legislative approval in Parliament as soon as reasonably practical.

APPENDIX I

A BILL

entitled

INVESTMENT FUNDS AMENDMENT ACT 2018

ARRANGEMENT OF SECTIONS

- 1 Short title
- 2 Interpretation
- 3 Inserts section 6B (2A)

WHEREAS it is expedient to make new provision for additional exemption requirements and for connected matters:

Be it enacted by The Queen's Most Excellent Majesty, by and with the advice and consent of the Senate and the House of Assembly of Bermuda, and by the authority of the same, as follows:

Short title

1. This Act may be cited as the Investment Funds Amendment Act 2018.

Interpretation

2. In this Act, 'principal Act' means the Investment Funds Act 2006.

Inserts section 6B (2A)

3. Section 6B of the principal Act is amended by inserting the following paragraph after paragraph (2) –

“6B (2A) An operator of a Class A Exempt Fund shall be exempt from the requirement under section 6A (2) (d) (iv) to appoint a custodian or prime broker where it meets criteria prescribed by the Authority.”.

Investment Funds Amendment Act 2018

Explanatory Memorandum

The purpose of this Act is to introduce provisions for the operator of a Class A Exempt Fund to be exempt from section 6A (2) (d) (iv) requirements.

Clause 1 provides for the short title.

Clause 2 defines 'principal Act'.

Clause 3 inserts a new section 6B (2) in order to introduce provisions for the operator of a Class A Exempt Fund to be exempt from the requirement under section 6A (2) (d) (iv) to appoint a custodian or prime broker where it meets criteria prescribed by the Authority.

APPENDIX II

NOTICE

Section 6A (2) (d) (iv) “Class A Exempt Fund: qualification” Custodian/ Prime Broker Exemption Criteria

1. Pursuant to section 6B (2A) of the Act, at the time of applying to be exempt from authorization in accordance with section 6A, an operator of a Class A Exempt Fund must fulfil the following criteria in order to satisfy the Authority that no custodian or prime broker is required to be appointed in accordance with the requirements of section 6A (2) (d) (iv) to provide custodial or prime brokerage services to the Fund:
 - The Class A Exempt Fund issues or proposes to issue, Insurance-linked securities (ILS) to investors;
 - The proceeds received from the share issuance are held in a trust account, established by the counterparties to the (re)insurance agreement governing the (re)insurance loss event, for the purposes of collateralizing the (re)insurance loss events linked to the securitized insurance transaction;
 - The trustee appointed to the trust account manages the trust assets in accordance with the terms and conditions of the agreements governing the ILS transaction (which includes but is not limited to: the offering memorandum, trust agreement, (re)insurance agreement and any investment guidelines); and
 - The offering memorandum provides amongst other things, an express disclosure to all investors and proposed investors that the proceeds of the share issuance of the Class A Exempt Fund may be used for the purposes of collateralizing the insurance loss events that are linked to the securitized insurance transaction.
2. An exemption from the requirements of section 6A (2) (d) (iv) will only apply to the investment strategy that meets the criterion set out herein; otherwise the requirements of section 6A(2)(d)(iv) must be met.
3. An operator of a Class A Exempt Fund that wishes to be exempted from the requirements of section 6A (2) (d) (iv) after it has been exempted in accordance with section 6A by the Authority, must also meet the criterion set out herein.
4. All operators of Class A Exempt Funds shall be required to confirm to the Authority that they continue to meet this criteria as an ongoing obligation in their annual certificate required to be filed with the Authority pursuant to section 6B (2) of the Act.