



Fund Finance

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Bermuda

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Overview

Bermuda is a major centre in the international offshore investment fund industry with over US\$200bn of fund assets domiciled here. In addition to over 600 investment funds registered in and operating from Bermuda, there are also a significant number of unregulated investment funds, being primarily closed-ended investment companies and limited partnerships that fall outside of the Investment Funds Act 2006. As closed-ended funds are not required to be registered with the Bermuda Monetary Authority (**BMA**), it is not possible to estimate with accuracy the number of such funds domiciled in Bermuda.

The Bermuda fund industry sees investment predominantly from North America and Europe and therefore trends in the Bermuda fund finance market track the major onshore markets. Although there is no overall data reporting service for the fund finance market, anecdotal reports from many of the major facility lenders as well as Appleby practitioners anticipate that there will continue to be a strong period of fundraising through 2017 and into 2018, as well as an increase in demand for bespoke structures, such as funds of one and segregated accounts.

Bermuda as a jurisdiction is highly responsive to evolving market demands and over the past two years key stakeholders, including the government, the financial services regulator (the BMA) and investment industry professionals have collaborated to make legislative changes that serve to cement Bermuda's position as one of the premier offshore jurisdictions for private equity funds. A review of the most significant changes from a private equity fund perspective is set out in the 'Key developments' section below.

Fund formation and finance

(i) Investment funds – overview

The Investment Funds Act 2006, as amended (**IFA**) governs the exclusion, exemption and authorisation of investment funds and contains certain requirements for the formation of investment funds, their operation and the offering of shares or interests of investment funds. An 'investment fund' is broadly defined under the IFA and means any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits and income.

Investment funds are prohibited from being operated in or from Bermuda unless they are authorised or exempted under the IFA. The requirement to be authorised or exempted does not apply to investment funds that are deemed to be private (such as master funds). An investment fund is a private fund (or an excluded fund) if the number of participants is 20 or

less, and if the promotion, communication and offer to participate in the investment fund are restricted and not made to the general public. An operator of an excluded fund is required to serve a notice on the BMA of the fact that the private fund qualifies for the exclusion as soon as practicable following the formation of the fund.

(ii) Regulatory approval

The formation of companies, partnerships and limited liability companies (**LLCs**) is subject to the approval of the Registrar of Companies (**Registrar**) and the BMA (the Registrar and BMA being the principal regulatory bodies). The BMA is the principal body responsible for the regulation of investment funds, including those listed on the Bermuda Stock Exchange (**BSX**). The Registrar is responsible for the registration of companies, partnerships and LLCs and has powers pursuant to, *inter alia*, the Companies Act 1981 (**Companies Act**), the Partnership Act 1902, the Limited Partnership Act 1883, the Exempted Partnerships Act 1992, the Segregated Accounts Companies Act 2000 and the Limited Liability Company Act 2016. While the Registrar and the BMA do not regulate the formation of unit trust funds, a unit trust fund is required to apply to the BMA for authorisation or exemption under the IFA, and must also seek the permission of the BMA under the Exchange Regulations to issue units (as further defined and explained below).

(iii) Anti-money laundering (AML) and anti-terrorist financing (ATF)

The Bermuda AML and ATF framework, set out in the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing, Supervision and Enforcement) Act 2008, requires that AML and ATF regulated financial institutions as well as independent professionals establish policies and procedures to forestall and prevent money laundering and terrorist financing. Such policies and procedures must cover:

- (a) customer due diligence measures and ongoing monitoring;
- (b) reporting;
- (c) record keeping;
- (d) internal control;
- (e) risk assessment and management; and
- (f) the monitoring and management of compliance with and the internal communication of such policies and procedures in order to prevent activities related to money laundering and terrorist financing.

The policies and procedures should be developed using a risk-based approach. The nature and extent of such policies and procedures will depend on a variety of factors, including the nature, scale and complexity of the business; the diversity of its operations, including geographical diversity; and its customer, product and activity profile.

(iv) Private equity funds

Closed-ended, private equity funds are typically formed as limited partnerships or companies incorporated with limited liability.

A Bermuda-exempted company (e.g., companies exempted from the provisions of Bermuda law that stipulate that at least 60% of the equity must be beneficially owned by Bermudians) incorporated with limited liability can be established with a single shareholder, any amount of authorised share capital, unrestricted objects, and the capacity and powers of a natural person.

In general terms, the Companies Act restricts an exempted company from carrying on business in Bermuda except to the extent that it has been granted a licence by the Minister of Economic Development. There are certain activities that are expressly excluded from the requirements

of a licence, including doing business with other exempted companies in furtherance of the business of the exempted company that is being conducted outside Bermuda, and dealing in securities of exempted companies or partnerships.

Approval is sought from the BMA for the intended beneficial ownership of those with voting rights in the company. Any information provided to the BMA is treated in the strictest confidence (pursuant to Section 31 of the Bermuda Monetary Authority Act, 1969). Ordinarily, an incorporation can be accomplished within 24 to 48 hours. An exempted company can only commence business or issue shares after it has been organised and the requisite BMA consents have been obtained.

(v) Investment funds

Historically, investment funds have typically been formed as mutual fund companies or limited partnerships, the optimal structure depending on a number of factors including where and to whom the investment opportunity is to be marketed, the nature of the investor base, and the identified portfolio of investment assets.

Mutual fund companies

A mutual fund company is a company incorporated with limited liability, that is incorporated for the purpose of investing the monies of its members for their mutual benefit, having the power to redeem or purchase for cancellation its shares without reducing its authorised share capital, and stating in its memorandum of association that it is a mutual fund. In the case of a mutual fund company, the shares of which are to be sold in overseas markets, an exempted company is the appropriate vehicle. However, shares of a Bermuda mutual fund company, which is an exempted company, may also be offered inside Bermuda to both local and international investors.

Typically, a mutual fund company is incorporated with two share classes: ordinary voting shares (non-participating) held by the investment manager; and non-voting, participating, redeemable shares held by the investors.

The timeline for incorporation of a mutual fund company, after submission of the application to the BMA, is usually 24 to 48 hours. A mutual fund company may only commence business and issue shares after it has been organised and the consents under Bermuda's exchange control regulations (**Exchange Regulations**) and the IFA (if required) have been obtained.

Limited partnerships

Investment funds may also be formed as exempted limited partnerships. A limited partnership consists of one or more general partners (which may be bodies corporate, or general or limited partnerships, formed under the laws of Bermuda or another jurisdiction) and one or more limited partners (namely investors) whose relationship is governed by a partnership agreement. In Bermuda, partnerships (both general and limited partnerships) are not legal entities separate from their partners unless a specific election has been made by the partnership to have legal personality. Nevertheless, a partnership may in any event function as an 'entity', and may sue and be sued and carry on business in its own name. If an election is made by the partnership to have separate legal personality, such election is irrevocable and the partnership will continue regardless of whether all the partners die or are declared bankrupt or if there is a change in its constitution.

General partners are fully liable for partnership debts and obligations. In the case of limited partnerships, the general partners will have such general liability to third parties, while generally speaking, the liability of the limited partners is limited to the value of the money and any property that they contribute (or agree to contribute) to the limited partnership. It

should be noted that the limited partners may forfeit their limited liability status in certain circumstances if they participate in the management of the partnership.

Limited Liability Companies

LLCs are an exciting new development in the Bermuda market and are discussed in more detail in the ‘Key developments’ section below. It is anticipated that the Bermuda LLC will prove to be an attractive alternative in the investment fund arena.

Security package in fund financings

A key consideration in any fund financing transaction (whether it be a capital call facility, subscription facility or equity bridge facility) is the collateral package which the lender can secure. Typically security will be granted over the rights to call for contributions from investors, with the security interest in uncalled capital commitments perfected by the delivery of a notice of the assignment of such capital commitments to the investors. Additionally, the lender will want security over the account into which investors’ capital contributions are funded.

There is no Bermuda law requirement that the collateral account be a local one (although of course, the local banks are very familiar with such requirements should it be preferable to secure a local account).

Bermuda law does not stipulate that the security package must be governed by Bermuda law, and most frequently we see the security agreements mirroring the governing law of the applicable credit facility. Bermuda as a jurisdiction is very familiar with New York law as the preferred governing law for US facilities, and English law for European facilities. Of primary concern therefore, from an offshore perspective, is to review the validity and priority of the offshore-based security.

Bermuda recognises the concept of a security agent and there are no restrictions under Bermuda law on the enforcement of rights or security interests solely because those rights or security interests are held by an agent. An agent is treated in the same way as any other secured party and is subject to any applicable Bermuda law. It should also be noted that there are no Bermuda law restrictions on granting security to foreign lenders and that it is not necessary under Bermuda law for a security agent to be registered, licensed or otherwise qualified in Bermuda in order to enforce any of its rights.

There are no restrictions under Bermuda law on a company or partnership making payments to a foreign lender under a security document, guarantee or loan agreement, and exempted companies and partnerships are designated by the BMA as “non-resident” for exchange control purposes, which means that they are free to deal in any currency of their choosing, other than “resident” Bermuda dollars.

The Stamp Duties (International Businesses Relief) Act 1990 abolished stamp duty on most documents executed by exempted undertakings (including exempted companies and partnerships, and this also applies to limited liability companies).

Following execution of the security document, lenders will want to ensure that their security package is appropriately registered. Charges over the assets of Bermuda companies in Bermuda (except charges over real property in Bermuda or ships or aircraft registered in Bermuda) which are granted by or to companies incorporated outside Bermuda, are capable of being registered in Bermuda in the office of the Registrar of Companies, pursuant to the provisions of Part V of the Companies Act. Registration under the Companies Act is not compulsory and does not affect the validity or enforceability of a charge, and there is no time limit within which registration of a charge must be effected. However, in the event that questions of priority fall to be determined by reference to Bermuda law, any charge registered

pursuant to the Companies Act will take priority over any other charge which is registered subsequently in regard to the same assets, and over all other charges created over such assets after 1 July 1983, which are not registered.

Partnerships which have elected to have separate legal personality can also register with the Registrar of Companies and therefore ensure priority in a similar way to the regime for companies, as discussed further below.

Key developments

Amendments to partnership legislation

During 2015 and the first half of 2016, Bermuda implemented a series of innovative changes to the existing partnership legislation. These changes were driven by industry demand and following consultation with key stakeholders, led to a renewed focus from the regulators and the legislature on the partnership products offered in Bermuda.

The amendments introduce a register of charges to be maintained by the Registrar of Companies, which register can be used by and in relation to partnerships which have elected to have separate legal personality. The creation of a register of charges, and therefore statutory priority, provides increased certainty and operational efficiency, as this is the same regime that has been in place for companies for some time. Any person (including the partnership itself) who is interested in a charge created on the assets of such a partnership can apply to have that charge registered. Any charge registered on or after the effective date of the new legislation will have priority based on the date that the charge is registered (and not on the date of its creation) and will have such priority over any unregistered charges.

Charges created prior to the effective date of the new legislation will continue to have the priority they had previously, although these charges can also be registered and will continue to have the priority they had prior to such registration.

Much like with the registered security regime for companies, the Registrar of Companies has the statutory ability to both amend the register of charges and to correct the register of charges in prescribed circumstances. Traditionally, the ability to take security in Bermuda over partnership assets has been unnecessarily different from companies, and this amendment is certainly a welcome change to practitioners and clients that deal frequently with secured financings.

Introduction of Limited Liability Companies

Key among the recent legislative changes is the introduction of the Limited Liability Company Act (**LLC Act**), which came into force on 1 October 2016. A limited liability company or “LLC” is a hybrid legal structure allowing the contractual and operational flexibility of a partnership to be housed within a corporate entity. Like a Bermuda-exempted company, an LLC has separate legal personality and the liability of its members is limited. Whilst members of a Bermuda company receive shares, members of a Bermuda LLC will each have an interest in a capital account in a similar way to partners in a partnership. Under the Bermuda LLC Act, parties can create bespoke vehicles, having the contractual freedom to set out in the LLC agreement the terms of operation and management of the LLC as well as expressly agreeing the allocation of profits and timing of distributions amongst its members. A Bermuda LLC may be managed by one or more members (a “managing member”), or a manager may be appointed who may or may not be entitled to share in the profits of the LLC.

Whilst the LLC vehicle may be utilised by clients in a broad range of sectors, the Bermuda LLC is an attractive structuring option for operators of investment funds and, in particular,

closed ended private equity funds, as the flexible corporate governance structure allows “managing members” to manage the fund (in a similar way to a general partner) but without unlimited liability for such members in respect of the fund’s losses. At the moment it is not yet clear what the lender collateral package will look like in respect of LLC funds, although arguably use of LLCs as opposed to partnerships may serve to simplify the security package, as security would only have to be granted by the LLC itself and not its manager.

Register of Directors

In keeping with the global trend towards increased transparency, it is now a requirement under the Companies Act 1981 that a Register of Directors of every Bermuda company be lodged with the Registrar of Companies, where it will be publicly available for inspection. The Register of Directors must contain the following information with respect to each director of a Bermuda company: (i) if an individual, her present first name, surname and address; or (ii) if a company, its name and the address of its registered office. Whilst there is a requirement to disclose the identity of the directors, there is no requirement for such directors to be registered or licensed with a governing body or to satisfy any additional disclosure or regulatory requirements.

Anti-money laundering and anti-terrorist financing

Amendments to Bermuda’s anti-money laundering and anti-terrorist financing regulations also came into effect on 1 January 2016. These changes, which ensure Bermuda achieves compliance with the 40 recommendations of the Financial Action Task Force, serve to further strengthen the regulatory oversight in Bermuda, ensuring that the jurisdiction continues to have a “gold standard” regulatory framework.

The year ahead

We are seeing an increase in the number of tailored investment structures and single-investor vehicles being utilised in Bermuda. These “fund of one” structures are especially popular with funds of funds (**FoF**), in which the investor, in this case the FoF, is the sole investor in a specific vehicle or fund. These structures allow the FoF to create a bespoke investment rather than investing in a target fund as an ordinary limited partner. As ‘fund of one’ structures continue to grow in popularity, we anticipate that the subscription credit market will also look to expand its offering to facilitate lending to these types of structures. Another innovative legal structure which Bermuda offers and where there is increasing interest, is the segregated accounts company. Under the provisions of the Segregated Accounts Companies Act 2000, a mutual fund company may be registered as a segregated accounts company, enabling it to create different share classes, each representing a segregated portfolio of assets. Accordingly, where a multi-class structure is desired with a separation of liability between classes, it is not necessary to incorporate multiple companies in an umbrella form. Instead, a single segregated accounts company may be incorporated with segregated accounts representing each share class. Such accounts enjoy a statutory division of liability, effectively ring-fencing each segregated account from the general liabilities of the company, and from other segregated accounts. Bermuda segregated accounts can invest in other segregated accounts in the same company creating a master/feeder structure, making it possible to invest and redeem without the capital leaving the company and creating a capital transfer.

Bermuda will continue its commitment to developing new and innovative products and we will continue to see a ‘collaborative effort’ by regulators, government and industry professionals to ensure Bermuda continues to provide innovative fund products and maintains its position as a leader in the offshore funds world.

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