

LEGAL UPDATE:

Licensing Requirements & Obligations of Investment Funds under the new Investment Funds Act, 2019

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I. GENERAL

The Investment Funds Act 2019 (the “new IFA”), brought into force effective September 1, 2019, represents a modern update to the current regulatory regime for investment funds in the Bahamas. The changes apply to all persons currently carrying on investment fund business in and from The Bahamas and those that intend to. The New IFA is set to attract more institutional clients with a focus on investment management. The legislation will also allow Bahamas funds that will be marketed into the EU to comply with the EU’s Alternative Investment Fund Manager Directive (“AIFMD”). The AIFMD compliant regime instituted by the IFA should, subject to the European Securities Market Authority (“ESMA”)

approval of The Bahamas for the extension of a third country passport, allow non European Union (“EU”) alternative investment fund managers and EU investment managers to market Bahamas organized alternative investment funds to professional investors under a single authorization or passport. Presently Bahamas organized funds may be marketed into the EU through the national private placement regimes in effect in most EU countries.

The following is a high-level summary of the new licensing requirements and ongoing obligations of investment funds and fund professionals prescribed under the new IFA.

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II. LICENSING OF FUND

Every investment fund operating from or in The Bahamas must be licensed with the Securities Commission of The Bahamas ("SCB"). Applications are made in the prescribed form and accompanied by the funds constitutive documents, the offering memorandum (where applicable) and any other documentation requested by the SCB to satisfy them that the fund's professionals are fit and proper persons and have the necessary expertise to properly carry out the business of the fund.

Non-Bahamas based funds are exempted from being licensed and are required only to be registered with the SCB. A Non-Bahamas based fund is an investment fund that is incorporated registered or established in a jurisdiction other than The Bahamas but has a nexus to The Bahamas through it being administered or managed in or from The Bahamas.

III. NEW LICENSING REQUIREMENTS AND OBLIGATIONS OF FUND PROFESSIONALS

Investment Fund Manager - Under the new IFA, every fund must appoint an investment fund manager (IFM). The IFM must be licensed or registered with the SCB having submitted the required application and met the prescribed capital and indemnity insurance requirements of the SCB. Under the previous legislation the IFM was not required to be licensed or registered.

Where a fund proposes to offer equity interests in the EU, the fund must appoint an alternative investment fund manager ("AIFM"). An AIFM that holds an EU passport and either (i) markets an investment fund or an alternative investment fund (AIF) in the EU or (ii) manages an EU AIF (irrespective of where it is marketed) must be licensed with the SCB. The AIFM may be either internal or external.

The IFM and AIFM may delegate some of its functions as prescribed in the new IFA subject to approval by the SCB. Both IFM and AIFM have ongoing obligations to disclose the annual financial statements of the fund and material changes in the operation of the fund. However, the AIFM has enhanced disclosure obligations to investors of the fund and enhanced reporting obligations to the SCB. Note, under the new IFA, AIFM licensees in the Bahamas will now be disclosed to European Securities Market Authority ("ESMA") on a quarterly basis.

The new IFA requires the IFM to inter alia: act fairly and in the best interests of the fund and investors, take reasonable steps to avoid conflicts of interests, employ the resources and procedures necessary for proper performance of its business activities, comply with regulations and where a custodian has not been appointed by the IFM carry out the relevant duties as prescribed.

Ongoing obligations of a licensed AIFM are inter alia: to act fairly and in the best interest of the fund and investors, to adopt and maintain adequate internal control policies related to remuneration, mitigate and deal with conflicts of interests, risk management, liquidity management, valuation and appointment of an AIFM custodian (as discussed below). Note that an AIFM is prohibited from acting as custodian of any fund it manages.

Investment Fund Administrator - Similar to the previous IFA, every fund, other than certain SMART Funds, shall appoint an investment fund administrator ("FA"). Such FA may not act on behalf of a fund unless they have been granted an unrestricted or restricted license by the SCB. While, an unrestricted FA may license an unlimited number of funds, a restricted FA may only license those funds specified by the SCB.

An FA may be granted a license upon submission of the prescribed application with the relevant fee and satisfying the SCB that the FA is (i) properly incorporated under the laws of the Bahamas, (ii) has sufficient expertise to administer funds, (iii) has a sound reputation, (iv) will administer the fund in a proper manner, (v) has sufficient officers and directors who are fit and proper persons for those positions, (vi) has a principal office in The Bahamas, (vii) has a CEO and Compliance Officer who are resident in the Bahamas and (viii) complies with the statutory capital and insurance indemnity requirements of the SCB.

The ongoing obligations of FA's include providing the principal office of the fund, payment of annual fees and prescribed statutory reporting to the SCB. Duties of the FA have realigned from the previous IFA such that it is clear that fiduciary obligations in relation to the fund rest with the directors and IFM.

Custodian - Every fund must appoint an independent custodian of its assets (subject to waivers provided by the Commission). General obligations for custodians under the new IFA include: carrying out the sale, issue, redemption and cancellation of equity interests, calculating the value of the equity interests, carrying out the IFM's instructions and remittance of any consideration related to a fund transaction. The new IFA mandates that (i) custodian assets must be kept segregated from the fund's assets and in trust, (ii) all cash must be held separately from the property of the custodian in a designated trust account at a duly licensed bank and (iii) allows a custodian to place a fund's cash in a registered marketplace or clearing facility for the purpose of carrying out or providing collateral for a transaction.

An AIFMD must appoint a single custodian in respect of each fund it manages. The new IFA strictly prohibits an AIFMD acting as AIFMD custodian of the fund

it manages. An AIFMD custodian may be a licensed bank or trust company, a person registered under the Securities Industry Act (SIA), an institution subject to prudential regulation and supervision in an approved jurisdiction or an undertaking authorized by a competent authority in a Member State to carry out functions of an AIFMD custodian. Any changes in the appointment of an AIFMD custodian must be reported to the SCB.

Ongoing obligations of an AIFMD custodian include inter alia (i) to act fairly, honestly professionally and independently (ii) to carry out the activities of the fund while avoiding conflicts of interests between the fund, the investors, the AIFM and itself subject to exceptions, (iii) properly monitor the cash flow of the fund, and (iv) see to the safekeeping of the assets and/or financial instruments of the fund.

IV. CESA REQUIREMENTS FOR IFM'S

Under the Commercial Entities (Substance Requirements) Act ("CESA") Bahamas tax resident companies incorporated, continued or registered under the Companies Act or International Business Companies Act, limited liability partnerships and exempted limited partnerships which conduct relevant activities ("Included Entities") are now subject to certain economic substance requirements in the jurisdiction. Under CESA, an entity which carries on fund management business must be able to demonstrate (i) that its core income generating activities take place in the Bahamas and (ii) direction and management of the IFM is carried out in The Bahamas.

V. CONCLUSION

The industry welcomes the modernization of investment funds in The Bahamas and notes in particular that alignment with international best practices and standards should bode well for the attraction of more institutional funds to The Bahamas.

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Aliya specializes in banking, investment funds, securities, securitisation and capital markets, Technology, FinTech, Blockchain and digital assets. She has written for highly regarded publications co-writing a chapter in Chambers Law and Practice, 2019 on Investment Funds and has released a whitepaper, "The Bahamas' place in a Crypto-Graphic World" which was cited in 2018 by the U.S. Law Library of Congress.

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