SEGREGATED ACCOUNT
COMPANIES DESIGNATION

1. BACKGROUND

The Segregated Accounts Companies Act 2000 came into force on 1 November, 2000 and was subsequently amended by the Segregated Accounts Companies Amendment Act 2002 (collectively the "**SAC Act**"). It should though be noted that the benefit of segregation as a matter of law has been available in Bermuda for many years but only by way of Private Act and was previously only utlised by insurance companies. The SAC Act provides a public regime for the registration and regulation of a segregated accounts company (**SAC**) and extends this regime to mutual fund companies.

It remains possible for Bermuda companies to seek a Private Act where the company needs to obtain special provisions relative to the constitution and structure of the company which would not otherwise be available under the SAC Act. It is expected that in most cases the SAC Act will provide an effective alternative to the lengthy and expensive Private Act procedure.

2. NATURE OF SACS

Three conceptual definitions are used in the SAC Act in order to provide a clear demarcation between different types of interest namely:

"*account owner*" is a person having an interest in the nature of an equity or residual interest in a segregated account – for example shareholders of a class;

"*counter-party*" is a person who transacts with the segregated account whether as a creditor or debtor; and

"*creditor*" is a person having an unsecured claim against the segregated account (which could include a counter-party unless the counterparty is a debtor).

The most significant aspect of a SAC is that any asset which is linked to a particular segregated account shall be held as a separate fund which is not part of the general assets of the SAC and is held exclusively for the benefit of the account owner of that account and any counter-party to a transaction linked to that segregated account. Assets in such account shall only be available to meet liabilities to the creditors of that segregated account. The SAC Act provides that any asset which attaches to a particular account shall not be available or used to meet liabilities to and shall for all purposes be protected from the general shareholders of the SAC and from the creditors of the SAC who are not creditors in respect of the particular segregated account identified in the governing instrument.

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Thus in the context of an umbrella fund as a SAC, it may issue shares in classes and the proceeds of issue would be included in the assets of the account (i.e. the sub-fund linked to those shares). If shares are issued by a SAC and are not linked to a segregated account then such proceeds would comprise an asset of the SAC's general account.

Segregation is recognised as a matter for statute under Bermuda law. The SAC Act does not with the establishment of a segregated account create a legal person distinct from the SAC. Instead the SAC Act provides for a statutory regime governing record keeping, the manner in which shares are issued and dividends distributed, accounting standards, the appointment of a receiver and winding up of a segregated accounts company.

3. SUMMARY OF KEY PROVISIONS OF THE SAC ACT

Set forth below is a summary of some of the important provisions of the SAC Act:-

- Companies which are subject to the Bermuda Companies Act 1981 may apply to be registered. A company registered as an insurer or mutual fund in Bermuda may apply without any restriction or approval but other companies must first obtain approval of the Minister of Finance (**MoF**).
- The SAC Act sets out detailed information to be provided in connection with an application for registration.
- The Registrar of Companies (**RoC**) is required to maintain a register of SACs which is available for inspection by members of the public.
- The RoC may (though is not obliged to) direct that the name of any company to be designated as a SAC pursuant to the SAC Act must contain the expression "*SAC*".
- The SAC Act sets out the requirements for the removal of companies from the register of SACs.
- Where a company operates segregated accounts by virtue of the authority conferred by a Private Act that company must give notice of that fact in writing to the RoC attaching thereto a copy of the Private Act together with a copy of its most recent financial statements.
- The SAC Act provides that where a Private Act confers authority on a company to operate segregated accounts but also contains other operative provisions not pertaining to the operation of such accounts, those other provisions are not affected by the registration of the company under the SAC Act.
- Nothing in the SAC Act shall be construed as requiring a company which operates segregated accounts under the authority of a Private Act or otherwise to be registered under the SAC Act.
- The SAC Act clarifies that a segregated accounts company is not by reason only of the operation of segregated accounts carrying on trust business in Bermuda.
- A SAC must inform those with whom it deals that it is such a company and identify the particular account to which the transaction relates. A SAC shall include reference to that fact on its letterhead and in all contracts.
- Each SAC must appoint a segregated account representative in Bermuda whose duties are similar to those of the resident representative of an exempted company under the Bermuda Companies Act 1981.
- Governing instruments and (unless otherwise provided) a contract relating to a segregated account must be governed by the laws of Bermuda and are subject to the jurisdiction of Bermuda courts. A governing instrument or contract relating to segregation of assets or liabilities of a segregated account shall be

governed by and construed in accordance with the SAC Act and parties may not contract out of those provisions.

- A SAC may issue securities which track or are linked to the performance of a particular account and may pay a dividend or distribution in respect of securities linked to a segregated account provided certain solvency requirements are met before any dividend of distribution is effected. These provisions are consistent with the Bermuda Companies Act 1981.

- The SAC Act establishes a regime for the conduct of inter-account contracts and transactions. Although a segregated account does not have legal capacity separate from the SAC, the SAC Act permits transactions between accounts as if the transaction had been entered into between the SAC as a company and a third party. Where there is any dispute with respect to such a transaction, the parties may apply to the Supreme Court for resolution or refer the matter to arbitration.

- The SAC Act sets out the requirements governing the keeping of records with respect to each segregated account. An account owner may waive the laying of financial statements or an auditor's report for an indefinite period and such waiver is revocable at the option of the account owner.

- Unless expressly excluded in writing, in every contract and governing instrument entered into by a SAC, terms shall be implied into that governing instrument or contract that only the assets of the account to which the transaction is linked will be liable to meet the claims and any recoveries in breach of this implied term will be held in trust by a recipient.

- The SAC Act provides that a receiver may be appointed for an account even where the account is not insolvent such as where the general account is insolvent and it is considered that there is a need for alternative management of an account.

- The test of insolvency to be applied when a SAC is wound up, shall be that specified in section 162 of the Bermuda Companies Act 1981 or in the case of an insurance company, as specified in section 33 of the Insurance Act 1978.

- The SAC Act enables the Supreme Court to make a receivership order in respect of a segregated account where it is satisfied that the assets are unlikely to be sufficient to discharge the claims of creditors relative to that account.

- The SAC Act details the requirements relating to the winding up of a SAC. In particular, the SAC Act makes express provision for a liquidator to observe the segregation of accounts and apply the assets as intended by the parties.

- The SAC Act contains an important section that provides that no transaction or interest in a segregated account shall be void or voidable by reason only that at the relevant time the SAC fails to comply with, or is in breach of, any provision of the SAC Act. This provision is important to ensure that the failure of a company to comply with the provisions of the SAC Act will not defeat the segregation of assets in a segregated account.

4. REGISTRATION PROCESS

Mutual funds that are structured as unit trusts or partnerships are not companies and therefore are not able to register as SACs. A mutual fund company that wishes to provide investors with the protections of the SAC Act will have to register as an SAC.

An application for registration to operate segregated accounts must be made by filing a notice and certain

documents as stipulated in Section 5 of the SAC Act with the Registrar of Companies in Bermuda. The statutory noticed to be filed by an applicant for registration must include:

- The name of the company (the Registrar of Companies retains discretion to require that a SAC has the letters “SAC” in its name);
- A statement that the company intends to operate segregated accounts;
- The registered office of the company;
- The name and address of the segregated account representative of the company;
- The nature of the business of the company;
- Its date of incorporation; and
- A statement that the company has made provisions to account for segregated accounts in the manner set out in s. 16 of the SAC Act.

Where the company has carried on business prior to registration, the application must be supported by a statutory declaration made by the at least 2 directors setting out the assets and liabilities of the company and any pending material transactions. The declaration must also describe the segregated accounts the company intends to operate and the assets and liabilities which the company proposes to assign to each of those segregated accounts. The statement must affirm that the company and each segregated account will be solvent and that no known creditor of the company will be prejudiced, or they have consented in writing to the company proceeding to register, or they have been given notice and have been given notice and not objected. Where the company has carried on business prior to the application, the application must also attach evidence of the consent to registration in writing of 75% of those who would, on the registration of the company, be the account owners of the segregated accounts of the company, and 75% of those who would, on the registration of the company, be creditors.

The SAC Act also provides, in Sections 5(4) to 5(7) (inclusive), an avenue for people to object to the registration of the company under the SAC Act by application to the Supreme Court of Bermuda. The application to object must be made within 28 days of the registration of the company.

The RoC is required to maintain a register of SACs and may register the company as an SAC on payment of the prescribed fee, if the Registrar is satisfied that the company is capable of complying with the SAC Act. Additionally, as a mutual fund company is a regulated financial institution, the Bermuda Monetary Authority (**BMA**) must also approve the SAC registration application.

From the point of registration, shareholders of the mutual fund company who are ‘linked’ to a segregated account are defined as ‘account owners’, and third parties transacting with the company and similarly linked are called ‘counterparties’. In order to ensure that third parties dealing with SACs will be aware of that fact, third parties must be informed that they are dealing with a SAC and, where the transaction is with a particular segregated account, that segregated account must be identified or specified. In addition, the letterhead of the company and all contracts it enters into must make reference to the fact that the company is registered under the SAC Act.

A SAC must appoint a segregated account representative who must be approved by the Minister of Finance. A body corporate, or an individual, may be appointed. The segregated account representative is required to make a report to the RoC when he or she becomes aware of a reasonable likelihood that the general account or a segregated account has become insolvent, or that it is in breach of certain provisions of the SAC Act.

Section 26 of the SAC Act enables the MoF to direct that certain provisions of the SAC Act will not have effect in relation to a particular SAC (or shall have effect but subject to modifications).

The sections of the SAC Act in relation to which a direction may be made are:

- Section 5 (requirements in relation to application to become registered under the SAC Act)
- Section 7 (removal from the register of SACs)
- Section 11 (requirements in relation to governing instruments and contracts)
- Section 16 (accounts, records and registers)

In support of such a direction, the company must submit a statutory of declaration made by at least 2 directors affirming that no creditor will be affected or that the creditors have consented.

A SAC may be removed from the register of SACs maintained by the RoC, with the effect that the SAC Act would no longer apply to the company. This may be done either at the instance of the company itself, or at the instance of the RoC (either on his own initiative or on the request of an account owner or counterparty). The application may be made by the company and must be supported by 75% of account owners and counterparties who are creditors, and be accompanied by a statutory declaration from the directors stating that no creditors will be prejudiced or that the known creditors have consented. The declaration must also include a statement of assets and liabilities, and describe any material transactions since the date of the statement. The declaration must also enumerate the segregated accounts of the company and indicate the assets and liabilities linked to each. The RoC may require additional information and documentation.

5. FEES

In addition to the application fee for registration or designation under the SAC Act, there is also provision for the payment of an annual fee of $280 in respect of each segregated account operated by a SAC subject to a maximum annual fee of $1,120 in the aggregate.

6. CONCLUSION

The foregoing review of the SAC Act is only intended to offer a brief overview. A detailed consideration should be undertaken of the requirements of the SAC Act and potential exemptions and modifications there from with respect to the relevant mutual fund company seeking to apply for registration as a SAC.

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