

# CONYERS

A photograph of a modern glass skyscraper with a grid-like facade, viewed from a low angle. The building is partially obscured by a semi-transparent blue overlay. The foreground shows a paved plaza with a pattern of light and dark tiles. A dark blue horizontal bar is positioned below the main text.

## Investment Business in Bermuda

## Preface

This publication has been prepared for the assistance of those who require information about the Investment Business Act 2003. It deals in broad terms with the requirements of Bermuda law and it is not intended to be exhaustive but merely to provide information which we hope will be of use to our clients. We recommend that our clients seek legal advice in Bermuda on their specific proposals before taking steps to implement them.

Copies of the Investment Business Act 2003 and any other legislation referred to herein are available upon request.

**Conyers Dill & Pearman**

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## 1. PRELIMINARY

The Investment Business Act 2003 (the “**IBA**”) came into operation on January 30, 2004. It replaced the Investment Business Act 1998 to effect a new but similar financial services regime in Bermuda and brought Bermuda’s regime more in line with international standards. The IBA is administered by the Bermuda Monetary Authority (the “**BMA**”).

## 2. LICENCE REQUIREMENT

Pursuant to Section 4 of the IBA, any persons carrying on investment business in or from Bermuda must hold an investment business licence issued by the BMA, unless they qualify for exemption from this requirement. A person carries on investment business in or from Bermuda only if that person carries on such business from a place of business maintained by him in Bermuda or if he engages in an activity deemed to be carrying on investment business in or from Bermuda pursuant to an Order made by the Minister of Finance (the “**Minister**”).

The following types of service providers carrying on investment business from a place of business in Bermuda are required to apply for a licence (unless qualifying for exemptions from the requirement), although this list is not exhaustive:

- (a) investment managers;
- (b) investment advisers;
- (c) market makers;
- (d) broker/dealers;
- (e) market intermediaries.

## 3. MEANING OF “INVESTMENT BUSINESS”

The IBA contains a wide definition of “investment business” which includes carrying on any of the following activities by way of business:

- (a) Dealing in investments: buying, selling, subscribing for, or underwriting, investments, or offering or agreeing to do so, either as principal or agent. However, a person will be “dealing” with respect to a particular transaction only if he continuously holds himself out as carrying on that business or the transaction is a result of him continuously soliciting members of the public (eg persons other than licensed or exempted persons).

‘Dealing’ also does not include:

- (i) dealing by a company, in its own shares, by a unit trust in its own units, or by a partnership in its own partnership interests; or
- (ii) accepting or transferring an instrument acknowledging or creating indebtedness in respect of any loan, etc, by a person in respect of an instrument which he has made.

- (b) Arranging deals in investments: making or offering, or agreeing to make:
- (i) 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; or
  - (ii) arrangements with a view to a person who participates in the arrangements buying, selling, subscribing for or underwriting investments.

'Arranging' does not include:

- (i) arrangements made by a person with a view to a transaction to which he himself will be a party as principal or agent;
  - (ii) arrangements, the purpose of which is to provide finance to enable a person to buy, sell, subscribe for or underwrite investments;
  - (iii) arrangements for the introduction of persons to licensed or exempted persons, or persons not unlawfully carrying an investment business in Bermuda, where such introduction is made with a view to the provision of independent advice or independent exercise of discretion in relation to investments; or
  - (iv) arrangements with a view to a person accepting or transferring an instrument creating or acknowledging indebtedness in respect of any loan, etc., which he has made.
- (c) Managing investments: managing or offering, or agreeing to manage, assets belonging to another person where those assets consist of or include investments.
- (d) Investment advice: 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.
- (e) Safeguarding and administering investments: safeguarding and administering, or arranging for the safeguarding and administration, or offering or agreeing to safeguard and administer, or to arrange for the safeguarding and administration of certain assets which may consist of or include investments where such arrangements have been held out as being arrangements under which investments would be safeguarded and administered.

'Safeguarding and administering' does not include: safeguarding and administering investments, or agreeing or offering to do so, by a person under arrangements where another person permitted under the IBA to provide such a service is responsible for and operates such arrangements in the course of carrying on such activities in Bermuda.

#### 4. MEANING OF “INVESTMENTS”

The IBA defines “investments” in quite broad terms. In addition to items such as shares, bonds and warrants, the definition also includes such things as options to acquire or dispose of any investment, rights under any contract, the purpose of which is to secure a profit by reference to fluctuations in the value or price of property, and rights under any contract constituting long-term insurance business (as defined in the IBA).

However, Part 3 of the First Schedule of the IBA outlines certain activities which are expressly excluded from the definition of investment business. Among these excluded activities are:

- (i) certain activities carried on between members of the same group, firm or joint enterprise;
- (ii) certain activities carried on for the purposes of, or in connection with, the sale of goods or the supply of services;
- (iii) operating employee share or savings schemes;
- (iv) a sale of a body corporate involving the disposal and acquisition of at least fifty per cent of the voting rights, or where the object of the transaction is to acquire day-to-day control of the affairs of the body corporate;
- (v) certain activities carried on by a trustee or personal representative, provided additional remuneration is not received for doing so; and
- (vi) general advice given in a periodical publication or broadcast.

#### 5. MEANING OF “IN OR FROM BERMUDA”

For the purposes of the IBA, a person carries on investment business ‘in or from Bermuda’ only if that person (a) carries on investment business from a place of business maintained by such person in Bermuda; or (b) engages in an investment activity deemed to be carrying on investment business in or from Bermuda pursuant to an Order made by the Minister.

A person ‘maintains a place of business’ (a) in the case of a sole trader, if that individual carries on investment business from premises that he occupies for that purpose; or (b) in any other case, if that person 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.

The Minister may, after consultation with the BMA, make an order amending the meaning of maintaining a place of business or specifying the circumstances in which an otherwise unlicensed person would be regarded as carrying on investment business in or from Bermuda.

#### 6. EXEMPTIONS FROM LICENSING

Persons carrying on investment business will be exempted from the requirement to hold a licence under the IBA if their activities are limited as described below. Such exempted persons may still apply to be licensed if they wish.

The following persons are exempt from the requirement to hold a licence under the IBA:

- (1) persons, other than market intermediaries, who provide investment services exclusively to one or more of the following classes of undertakings:
  - (a) high income private investors;
  - (b) high net worth private investors;
  - (c) sophisticated private investors;
  - (d) investment funds approved by the Authority under the Investment Funds Act 2006;
  - (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; or
  - (g) bodies corporate, partnerships and trusts all of whose shareholders, members or beneficiaries fall within one or more of the subparagraphs above, except subparagraph (d);
- (2) investment funds;
- (3) persons who provide investment services to not more than twenty persons at any time, as long as such services are not provided to, and investment business is not solicited from, the public;
- (4) persons who are registered under the Insurance Act 1978 to carry on insurance business (within the meaning of Section 1(1) of that Act), but only in connection with investment services provided in connection with the insurance business for which those persons are registered under that Act;
- (5) persons registered under the Insurance Act 1978 as insurance managers, brokers, agents, salesmen, or members of an association of underwriters, but only in connection with investment services in connection with the business for which they are registered under that Act; and
- (6) the Government of Bermuda, the Bermuda Monetary Authority or other Public Authorities established in Bermuda.

Where a person seeks to rely on exemptions (1) or (3) described above, that person must submit a declaration to the BMA confirming this.



## **7. UNSOLICITED CALLS**

As well as prohibiting the carrying on of investment business in or from Bermuda without a licence (unless otherwise exempted), the IBA also establishes an unsolicited calls regime prohibiting persons from entering into an investment agreement with an individual in the course of or in consequence of an unsolicited call. Contracts entered into as the result of an unsolicited call shall not be enforceable against the person on whom the call was made and that person shall be entitled to recover any money or other property paid or transferred by him under the agreement, together with compensation for any loss sustained by him as a result of having parted with it.

## **8. REGULATION OF UNLICENSED PERSONS**

Under the IBA, the BMA has several methods of regulating unlicensed persons, including powers of investigation and the ability to seek various types of court order.

If the BMA has reasonable grounds for suspecting that a person is carrying on investment business in contravention of the requirement to be licensed, it may, by written notice, require that person or any other person to provide such information, and/or produce documents which may reasonably be required for the purpose of investigating the suspected contravention. In such circumstances, the BMA may also require the person under investigation or any other person who is connected to the person under investigation to attend an interview and answer questions relevant for determining whether such contravention has occurred. Officers, servants or agents of the BMA may, with a warrant, also enter premises for the purposes of seeking information or documents, asking questions or making copies of documents.

The BMA may also seek orders to restrain or remedy such contraventions, or to restrain the disposal of assets or to require the restitution of profits to persons which have, for example, suffered loss as a result of the contravention.

## **9. ENFORCEABILITY OF AGREEMENTS MADE IN CONTRAVENTION OF THE IBA**

Pursuant to Section 15 of the IBA, an agreement entered into by a person in the course of carrying on investment business in contravention of the requirement to obtain a licence under the IBA shall be enforceable by all parties to that agreement.

## **10. LICENCE APPLICATION**

An application for a licence to carry on investment business must be made in a prescribed form and accompanied by such fees as may be prescribed by the BMA. In addition, at or prior to the time the application is made, the applicant must advertise his intention to apply for a licence in a local newspaper. Among other things, the application for a licence must include a business plan setting out the nature and scale of the business intended to be carried on by the applicant and particulars of the proposed arrangements for its operation. The BMA may not grant a licence unless an applicant meets (or will meet by the time of licensing) the minimum criteria described in the Second Schedule of the IBA.



The BMA published a Statement of Principles and Codes of Conduct, as provided for under the IBA. The Statement of Principles provides guidance on the BMA's approach to interpreting the minimum criteria, 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. The BMA may take into account any failure of an investment provider to comply with any Codes of Conduct issued in determining whether the business of that investment provider is being conducted in a prudent manner as required by the minimum criteria.

In considering an application, the BMA must take account of the minimum criteria specified in the Second Schedule of the IBA. The minimum criteria include the following requirements:

- (a) that 'controllers' and 'officers' of applicants be 'fit and proper' persons to hold the particular position which he holds or is to hold;
- (b) that, if the applicant is a company, a firm, a partnership or an unincorporated association, its business be directed by at least two individuals;
- (c) that, if the applicant is a company, it have sufficient non-executive directors as the BMA considers appropriate in the circumstances;
- (d) that the business of the applicant will be carried out in a prudent manner. In determining whether an investment provider is conducting its business in a prudent manner, the BMA shall take into account whether it (i) maintains sufficient liquid assets; (ii) maintains adequate accounting and other record keeping systems; (iii) maintains adequate in force errors and omissions insurance; and (iv) whether there has been any failure on the part of the investment provider in complying with the IBA, all applicable codes of conduct, any international sanctions in force in Bermuda and Bermuda's anti money-laundering / anti-terrorist-financing legislation;
- (e) that the applicant's position in the structure of any group to which it belongs is not such as to obstruct the conduct of effective consolidated supervision; and
- (f) that the business of the applicant will be carried on with appropriate integrity and professional skill.

The BMA also requires that an applicant submit completed Institutional or Personal Questionnaires as applicable. Questionnaires are required from each shareholder/controller, director and officer (as defined in Section 2 of the IBA) responsible for the applicant's business.

Anti-Money Laundering and Anti-Terrorist Financing policies and procedures should form part of all applications to ensure compliance with the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing) Regulations 2008 (the "**Regulations**"). The name, contact details and relevant qualifications for the appointed Reporting Officer should also be provided in accordance with Regulations 16 and 17.

In considering an application for an investment business licence, the BMA 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 BMA to answer questions and explain any matter(s) the BMA 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 BMA may specify; and
- (f) take into account any other information which it considers relevant in relation to the application.

After considering an application, the BMA may grant, refuse or issue a licence subject to conditions. However, even when so satisfied, the BMA 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. An application may be withdrawn at any time before it is rejected or a licence is granted, but the application fee is not refundable.

The IBA imposes no time limit within which the BMA must reach a decision in respect of an application. In practice, the BMA 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 BMA 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.

## **11. THE LICENCE**

The holder of a licence is referred to in the IBA as an “investment provider”.

It is possible for the limitations on a licence to be varied and for a licence to be restricted or revoked. The IBA establishes a right to appeal a decision of the BMA to vary, restrict or revoke a licence to an appeals tribunal appointed by the Minister.

The licence must be displayed in Bermuda at the applicant’s principal place of business or registered office. The BMA maintains a register of licences available for public inspection. A fee is payable on the grant of a licence and an annual fee is payable thereafter.

## 12. REGULATION AND SUPERVISION OF LICENSEES

### 12.1. Adequate Systems and Records

Every investment provider is required to maintain adequate systems and records and must maintain accounts for clients separate from his own. The investment provider is also required to prepare annual financial statements or accounts in respect of all investment business transactions and balances relating to his investment business and shall ensure that the financial statements are laid before the company in general meeting.

### 12.2. Reporting Obligations

The IBA requires that licensed investment providers provide the BMA 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 21 business days of each calendar quarter. The IBA also requires that, on an annual basis, each investment provider submit a certificate to the BMA 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) of the IBA, that it has observed such limitations.

In addition to the foregoing reporting obligations, the BMA 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:

- (a) 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 BMA pursuant to paragraph 2.7b of the Statement of Principles, the investment provider shall inform the BMA of the event not later than the first business day after the day that the investment provider becomes aware of its occurrence;
- (b) instances of legal action against the investment provider involving the risk of material financial cost or reputational damage;
- (c) requests for information or assistance in relation to ongoing inquiries by a foreign regulatory body; and
- (d) material changes in the business undertaken, including any proposal to undertake noninvestment related business.

Where the BMA believes that it is reasonably required in the interests of an investment provider's clients or potential clients, it may appoint one or more competent persons to investigate and report on the affairs of the investment provider. The BMA has power to require any controller, officer, employee, agent, auditor, accountant or barrister and attorney of an investment provider which is under investigation to produce such documents or information in that person's possession, custody or power

which may be reasonably required for the purposes of the investigation. The BMA also has power, in certain circumstances, to enter the premises of an investment provider which is under investigation.

Where an investment provider's licence permits it to hold client assets, the investment provider's accounts must be audited annually by an auditor approved by the BMA. An auditor of an investment provider must also notify the BMA in writing of any fact or matter which he believes is likely to be of material significance for the discharge of the BMA's functions under the IBA with respect to that investment provider.

Under the IBA, the BMA has wide-ranging powers to require an investment provider, a member of its group or partnership, or a controller of that investment provider, to provide such information or documents as the BMA may reasonably require for the performance of its functions under the IBA, including the provision of a report by the investment provider's auditor or other person with relevant professional skill.

### **12.3. Change in "Shareholder Controller"**

No person shall become a ten per cent or majority "shareholder controller" (as defined by the IBA) (i) unless he has served on the BMA written notice of his intention to be a ten per cent or majority shareholder controller; and (ii) a period of ninety days has elapsed without receiving from the BMA a notice of objection (or earlier if the BMA has notified him in writing that there is no objection). An objection may be made on the basis that the person is not 'fit and proper' or if the BMA determines that clients and potential clients may in any other manner be threatened by that person becoming a shareholder controller. Such objections by the BMA are subject to an appeals process.

Where the BMA has determined that a person is no longer fit and proper to be a shareholder controller (or a controller of any description), it has wide powers to restrict the transfer of his shares, the voting rights attached to those shares and may even order the sale of specified shares.

The BMA may also object to existing "controllers" (as defined by the IBA) of any description (including shareholder controllers, managing directors and chief executives) on the grounds that such controller is no longer 'fit and proper'.

A person shall be guilty of an offence if he fails to give the required notice or if he becomes a controller before the end of the specified objection period or where he becomes or continues to be a controller after being served with a notice of objection. However a person shall not be guilty of an offence if he shows that he did not know of the acts or circumstances by virtue of which he became a controller of the relevant description.

### **12.4. Liquidity**

The BMA requires investment providers to maintain adequate levels of liquidity as determined by the BMA (having regard to, among other things, its liabilities and the nature and scale of its operations).

The BMA requires investment providers to maintain minimum liquidity which is equivalent at all times to at least three months expenditure. However, when an investment provider does not act as principal or agent, a minimum one month expenditure test applies. Expenditure is based on the latest annual (or

annualised) financial statements and is calculated as total revenue less profit before appropriations (or, in the case of an investment provider making a loss, plus loss before appropriations). Monthly expenditure is calculated by dividing annual expenditure by 12.

The IBA also imposes certain requirements in respect of the systems, records and documentation to be maintained and produced by investment providers. For example, investment providers are generally required to provide each client with a confirmation note within seven days of carrying out a transaction and must provide clients with portfolio statements on a semi-annual basis. They must also maintain up-to-date accounting records in respect of their business and their clients' affairs and must permit clients to inspect records relating exclusively to them. Any information required to be kept by the investment provider may be recorded and maintained in electronic form (as long as the information is capable of being inspected and being produced in legible form).

### **12.5. "Adequate Insurance"**

Investment providers face a wide variety of potentially major financial risks in their business. Rather than requiring investment providers to hold capital against all these risks, the IBA requires businesses to hold adequate insurance cover. Relevant types of insurance include the following:

- errors and omissions/professional indemnity;
- directors and officers liabilities;
- fidelity and forgery;
- loss of property;
- computer crime;
- computer damage;
- business interruption; and
- office contents.

In judging the adequacy of insurance cover, the BMA looks to be satisfied that the scope and scale of cover in place is such as to provide reasonable assurance of the ability of the investment provider to continue to trade in the event that it should face either major damage to its infrastructure or material claims from clients or third parties for loss and damage sustained. It is in the first instance for those directing the business to assess the level of risk they face in the business and to determine the extent of coverage appropriate for that business.

The BMA will review the adequacy of cover in place, having regard to the scale, composition and complexity of the business and to the size of the deductible in relation to the investment provider's net asset position. However, in all cases, minimum insurance cover of \$250,000 is required, and at least \$500,000 where client assets are held. Higher amounts may be required having regard to the nature and scale of the business.

## 12.6. Offences

Any person that fails to comply with any requirement or contravenes any provision by or under the IBA shall be liable to a civil penalty and/or public censure. The BMA shall not impose a civil penalty where it is satisfied that the person concerned took all reasonable steps and exercised all due diligence to ensure the requirements of the IBA would be complied with. If the BMA proposes to impose a civil penalty or make a public censure, it must first give the person concerned a warning notice. The BMA's decision to make a public statement may be appealed to the appeals tribunal. If the BMA determines that an individual is not a fit and proper person to perform his function or carry out certain activities on behalf of the investment provider, it may make a prohibition order in respect of the regulated person or activity.

The BMA may seek a court order to wind up a company or dissolve a partnership which has carried on investment business in contravention of the IBA. The BMA may also apply to the Bermuda courts for an injunction to restrain an investment provider from contravening any relevant requirement of the IBA (including to prevent the investment provider from disposing of, or otherwise dealing with, any assets of his which it is satisfied he is reasonably likely to dispose of or otherwise deal with). It may also seek a court order to require the restitution of profits to persons which have, for example, suffered a loss as a result of a contravention of a relevant requirement.

The IBA provides for restriction on the disclosure of non-public information by the BMA and other persons receiving information relating to the business or affairs of any other person. One exception to this restriction is the provision for information-sharing gateways between the BMA and regulatory bodies of other jurisdictions.

## 12.7. Off-Site Supervision

The BMA may request regular meetings to enable the BMA 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 BMA judges it necessary. Ad hoc meetings may also be required if necessary to discuss important interim developments or concerns.

Topics discussed at annual 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 BMA's on-site compliance visits.

These meetings can take place at the BMA or at the investment provider's own premises.

### **12.8. On-Site Supervision**

The BMA has the power to request an on-site meeting at the offices of the investment provider. The purpose of on-site meetings is to enable the BMA 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 meetings at an investment provider's offices involves the BMA interviewing a range of management and staff and as well as reviewing a selection of documentation and files. A review of compliance with "know your customer" and record keeping requirements, in relation to the Regulations, forms part of all of the BMA's visits. On-site visits are usually scheduled on a three-year rolling basis. However, the frequency of on-site visits also reflects the BMA'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 BMA has material concerns for the interests of clients or about the financial position of the investment provider) the BMA may conduct a visit at short or even no notice. The BMA will normally write to the investment provider approximately four to six weeks ahead of an on-site visit, requesting pre-visit information and providing more details regarding how the BMA intends to structure the visit.

The pre-visit information requested would generally include:

- (a) a staff chart for the investment provider with brief job descriptions for key personnel;
- (b) a completed response to the BMA's questionnaire on the investment provider's compliance with the Regulations;
- (c) copies of procedures manuals;
- (d) copies of staff training plans; and



(e) copies of disaster recovery plans.

While the IBA provides powers for the BMA 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.

*This publication should not be construed as legal advice and is not intended to be relied upon in relation to any specific matter. It deals in broad terms only and is intended merely to provide a brief overview and give general information.*

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