

MUTUAL FUNDS IN THE BAHAMAS – A GUIDE FOR INVESTORS

What is a mutual fund?

Under Bahamian law, a Mutual Fund is defined as:

- a unit trust;
- an investment company; or
- a partnership;

that issues or has equity interests, the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risks and enabling investors in the mutual funds to receive profits or gains from the acquisitions, holding, management or disposal of investments.

A mutual fund can be “**open-end**”. This means the fund does not have a fixed number of shares, but issues new shares as it takes in money and redeems them as investors withdraw their funds. This liquidity – the ability for investors to get in and out of the funds easily and at little or no cost – is one of the most important features that this investment vehicle brings to the financial system. A smaller number of funds are “**closed-end**” funds. They raise their capital during offering periods, and once the pool is closed, investors can only get into the fund or out of it by buying or selling the shares on a stock exchange or in the over-the-counter market.

Both types of funds are highly regulated entities, governed by The Mutual funds Act, 1995 and The Mutual Funds Regulations, 1995. As Regulators, we do not dictate investment policy, but we make sure that the administrators and investment managers adhere to prescribed standards of disclosure, record keeping and administration.

Mutual funds, which are subject to the Mutual Fund Act, 1995, and the Mutual Funds Regulation, 1995, are referred to as Regulated Mutual Funds.

How do you create a mutual fund?

- 1) Obtain a Mutual Fund license; and
 - (a) have a registered office in The Bahamas, or
 - (b) have a licensed mutual fund administrator provide its principal office in The Bahamas, and
 - (c) the prescribed annual registration fee has been paid for the fund,and file with the Commission a current offering document and a written synopsis of the mutual fund, unless the Commission has granted an exemption from this requirement.

What is the process to become Registered or Licensed?

- **Mutual fund Registration and Authorization Process**

- ✓ Registered and Authorized funds must be registered by the Commission
- ✓ Notwithstanding anything this provision in the Act these funds may choose to be licensed as indicated below.

There are two possible ways of becoming a Registered and Authorized mutual fund:

- 1) If the minimum investment in the fund is (US) \$50,000.00 or its equivalent in any currency; or
- 2) If the mutual fund is listed on a recognized stock exchange by the Commission.

Mutual fund Licensing Process

There are two possible ways of becoming a licensed mutual fund:

- 1) A mutual fund applies for and acquires a mutual fund license, and
 - ✓ Has a registered office in the Bahamas; or
 - ✓ Holds a unrestricted Bank and Trust license; or
 - ✓ The bank or Trust company has a minimum paid-up capital and non distributable reserves of two million dollars and have a trustee approved by the commission
 - ✓

2) a mutual fund applies for and acquires a mutual fund license and a licensed Mutual fund Administrator provides its principle office in the Bahamas.

Are there any additional requirements?

- Before a fund can be licensed or registered and authorized, the Licensor or registrar must be satisfied that:
 - ✓ The promoter of the fund is of sound reputation;
 - ✓ The funds administrator has sufficient expertise to administer the fund and is also of sound reputation;
 - ✓ If a Mutual Fund Administrator is the Licensor, he provides the principal office and administers the fund (upon starting to provide the principal office for a mutual fund the Mutual fund Administrator must pay a fee of B \$500 and must pay an annual fee of B\$500 before January 31 of each year);

A fund must have its accounts audited annually, and submit its audited accounts to the Licensor or Registrar within our months of the end of the fiscal year.

What are the requirements to become a Regulated Mutual Fund in the Bahamas?

- Complete an application form providing complete details of the find;
- Pay the application fee;
- There are three possible ways of becoming a regulated mutual fund:

- 1) Be licensed by the Commission;
- 2) Be licensed by a Mutual Fund Administrator holding an Unrestricted Mutual Fund Administrators license; or
- 3) Be Registered and Authorized by the Commission.

The first exemption appears in 3(3) of the Act.

A mutual fund may carry on or attempt to carry on business in or from The Bahamas if it is a mutual fund in which:

- (a) the minimum investment is \$50,000, or
- (b) the mutual fund is listed on a recognized stock exchange, and

- (c) there is filed with the Securities Commission the current offering document,
and
- (d) it is registered with the Securities Commission

The second exemption appears in 3(4) of the Act.

A mutual fund where 15 or less investors who are capable of appointing or removing the operator of the fund hold the equity interests is not required to register with the Securities Commission. Such mutual funds are called “Exempt mutual funds

The third exemption appears in 3(6) of the Act.

A mutual fund, which has already been licensed in a jurisdiction prescribed by the Commission, is not required to register with the Securities Commission. Such mutual funds are called “Exempt mutual funds”.

What is Mutual Fund Administration?

- There are 4 definitions of Mutual Fund Administration under the Mutual Funds Act, 1995:
 - 1) To manage or to administer a mutual fund;
 - 2) To provide the principal office of a mutual fund in the Bahamas;
 - 3) To provide an operator to a mutual fund;
 - 4) To provide administration services for a mutual fund including the accounting, valuation or reporting services.

What is needed to be a Mutual fund Administrator in the Bahamas?

- In order to carry on business as a Mutual fund Administrator in or from the Bahamas a person must have a mutual Fund Administrator’s License **UNLESS**
the Commission gives an exemption.

Are there any exemptions from obtaining a license?

- An exemption may be granted if 2 criteria are met:
 - 1) A restricted mutual fund license would otherwise be granted;
 - 2) No more than one fund will be administered.

Are there different types of Mutual Funds Administrators Licenses?

- There are two different types of Mutual Fund Administrators Licenses:

1) **Unrestricted Mutual Fund Administrator License**

The holder of this license may administer an unlimited number of regulated mutual funds.

2) Restricted **Mutual fund Administrator License.**

The holder of this license may administer regulated mutual funds specified in the license. **ALSO**

The holder of this license must have a registered office in the Bahamas

What is the procedure to apply for a license?

- The applicant must fill out the prescribed form with ALL the relevant information required;
- Pay the prescribed fee of \$5,000.00 for an unrestricted Mutual Fund Administrator's License, and \$2,000.00 for a restricted Mutual Fund Administrator's License.

Are there any additional requirements for obtaining a license?

- There are some additional requirements that an applicant must be aware of:
 - ✓ The applicant must have sufficient expertise to administer mutual funds;
 - ✓ The applicant must be of sound reputation and must administer mutual funds in a proper manner.
- There are some additional requirements for obtaining Unrestricted Mutual Fund Administrator License:
 - ✓ The applicant must have at least \$500,000.00 paid-up capital; **OR**

If the applicant is a company, it must have at least \$150,000.00 paid-up capital **AND** liability insurance coverage of at least \$350,000.00;
 - ✓ The applicant must have a place in The Bahamas which will be its principal office;

- ✓ The applicant must have two individuals resident in the Bahamas to be its agent in The Bahamas

- ✓ Notwithstanding this provision in the Act, these funds may choose to be licensed.

- ✓ Licensed funds may be licensed by the Commission or by a Mutual Fund Administrator holding an unrestricted Mutual Funds Administrators license.

Cost, Fees and Expenses

When acquiring the shares/ownership of a mutual fund, certain fees can and may be incurred. The following are a few examples: -

Redemption Fee

A number of funds, especially no load funds, charge a small fee at redemption. The fee is usually charged if redemption occurs within six (6) months of the purchase date. The fee is meant to discourage short-term trading of no load fund shares.

Administration Cost

These are the costs of operating the fund. Sometimes they are borne by a management company but they are usually paid from the income of the fund. Examples of this expense are administrative and clerical salaries, office supplies, legal fees, office rental and other such expenditure. When these expenses are charged against the fund as an expense, they reduce the value of the investor's holdings.

Management Cost

An important expense incurred by all investment companies is the fee charged by the Investment Management Company. The Fund has contracts the Investment Management Company to perform the investment functions, perform analysis of the markets and of the shares, buy and sell the securities; the management fees usually range from 1-3 % of the NAV. The fee is charged regardless of whether the fund is a load or no load fund.

Brokerage and Custodial Costs

Brokerage fees are the same for mutual funds as they are for any investor transacting business in the securities market. Investment managers must use brokers to transact trades, as must the individual investor.

Types of Mutual Funds

Investors purchase funds for a number of reasons. Portfolios are usually classified according to their objective as outlined in their respective prospectuses.

Common Types of Mutual Funds

Equity Funds

Equity funds invest most of their money in equities, but they occasionally invest in short-term government securities and commercial paper. The management of the equity fund can be defensive or aggressive, depending on the condition of the stock market, growth or income and the discretion of management.

Balanced Funds

A fund comprised of both equities and fixed income securities (debt instruments such as bonds and debentures), usually at some predetermined percentage relationship. The main objective of balanced funds is to minimize the risk without sacrificing long-term growth.

Money Market Fund

Portfolio of these funds consists solely of short-term money market instruments, such as bank certificates of deposit, commercial paper etc.; .The advantage of this type of funds is its high yield, liquidity and safety.

Bonds Funds

The main objective of Bond funds is income and safety of principal. Bond funds invest only in debt instruments, usually either corporate bonds or government bonds.

Specialized Funds

Specialty funds frequently invest in equity stock of one industry, in one geographic location, or producers of specific products etc., The main objective of these Funds is long-term capital growth.

Professionals involved in the operation of Mutual Funds:

Custodians

Mutual funds are required by law to protect their portfolio of securities by placing them with a Custodian. Most mutual funds use qualified bank custodians. The Commission requires that the Administrator and Custodian be separate entities to avoid conflict of interest and for the sake of proper accountability.

Transfer Agents

A Transfer Agent is employed by a mutual fund to conduct record-keeping and related functions. The transfer agent maintain records of the share-holders i.e. shareholders register, calculate and disburse dividend payments and prepare and mail share-holder account statements and any shareholder notices as is necessary. Transfer agents also are responsible for mailing statements and confirming shareholder transaction and account balances.

Promoters

The Promoters are the principal underwriters of a fund. Most mutual funds continuously offer new shares to the public at a price based on the current net asset value of the fund plus any sales/service charges. Mutual funds usually distribute their shares through principal underwriters/promoters, who are regulated as brokers-dealers and are subject to National of Association of Securities Dealers, Inc. (NASD) rules governing mutual fund sales practices.

Directors

A Board of Directors governs a mutual fund. The Directors of a mutual fund have oversight responsibility for the management of the fund's business affairs. Because mutual fund Directors is in essence looking out for shareholders' money, the law holds Directors to a very high standard. They must exercise the care that a reasonably prudent person would take with his or her own business. They are expected to exercise sound business judgment, establish procedures and undertake oversight and review of the performance of the investment adviser, principal promoter and others that perform services for the fund.

Investment Advisers

An Investment Adviser is responsible for selecting investments consistent with the objectives and policies as stated in the mutual fund's prospectus. The Investment Adviser places securities orders with broker-dealers and is responsible for obtaining the best overall execution of those orders.

Administrators

A Mutual Fund Administrator is responsible for overseeing the performance of all the companies that provide services to the fund (service providers such as lawyers, accountants, investment adviser, investment manager, custodian etc.,) and ensuring that the fund's operations comply with the legal requirements of the Commission.

What are some the advantages of mutual funds?

Professional Management – Many investors may not have the time, desire or expertise to manage their own portfolio and may lack funds to obtain professional management. With a mutual fund, you pay a small annual fee to have your investment managed by an experienced professional. The Fund Manager selects individual securities such as stocks, bonds, or money market instruments that should help the fund achieve its particular objective.

Diversification- A diversified portfolio helps reduce risk by offsetting losses from some securities with gains in others. The average investor would find it difficult to construct a portfolio as diversified as that of a mutual fund. The greater the number and variety of holdings within the portfolio, the smaller the impact on the fund's price if a particular holding performs badly. Most funds own anywhere from several dozen to hundreds of different securities – a degree of diversification that could be impractical for an individual to match their own.

Variety of funds – Many different types of funds are sold, which enables investors to meet a wide range of objectives (i.e. from fixed income funds through to aggressive equity funds)

Liquidity- shares of all open-ended mutual funds are very liquid that is they are easy to buy and sell. This is because the fund is continually issuing and redeeming shares.

Potential disadvantages

Unsuitable for short-term investment- Mutual funds other than money market funds are for the most part, considered long-term investments and thus are unsuitable for investors seeking short-term performance. Generally it can take years to benefit.

Professional Management is not infallible

Mutual funds do offer the advantage of professional management, but this management cannot guarantee to outperform the market. A particular fund may do well in any given year, but it may do very poorly in subsequent years.

Types of risks

All investments involve some form of risk. Consider these common types of risk and evaluate them against potential rewards when you select an investment.

- **Market Risk.** Also known as systemic risk. At times the price or yield of all the securities in a particular market rise or fall due to broad outside influences. When this happens, the stocks of both an outstanding, highly profitable company and a fledging corporation may be affected.
- **Inflation Risk.** Sometimes referred to as "loss of purchasing." Whenever inflation sprints forward faster than the earnings on your investment, you run the risk that you'll actually be able to buy less, not more. Inflation risk also occurs when prices rise faster than your salary.
- **Business Risk.** Changes in the earning power of a company may result in a loss in income or capital to the investor. This inability of a company to maintain its competitive position and the growth or stability of its earnings, either temporarily or permanently, is referred to as business risk.
- **Interest Rate Risk.** The loss of principal brought about by changes in interest rates. Investors are reminded that "predicting", which way rates will go is rarely successfully. A diversified portfolio can offset these changes.
- **Currency Fluctuations.** As the dollar rises in value, the value of overseas investments will decline, and vice versa. But, in this era of globalization, you don't have to invest in foreign securities to gain or lose from currency movements.
- **Political Risk.** At home and abroad, uncertainty due to the possibility of major political or economic change in the country where the investment is made may encourage or discourage those who want to invest. This is also a consideration when investing outside the Bahamas.

Investigate before you invest

Mutual funds are no different from any other investment. Two of the biggest mistakes people make are failing to match their goals, and failing to inquire into the performance and reputation of the fund manager. Before you choose a fund, establish your own financial goals, decide how much risk you can afford to take and consider the cost, services and track records of the mutual fund.

It is important to obtain and read the fund's prospectus. Mutual funds are required by law to provide prospectuses. Most include a description of the general nature of the fund, a summary of the financial structure and operation, description of fund assets, the management structure, salaries of officers, the expenses of the offering, specific uses of the fund proceeds.

The Mutual Funds department of the Securities Commission registers mutual funds and licenses the people who sell them. Before you invest, be sure that the fund you have selected and the person selling you the fund are properly registered with the Commission. Registration is no guarantee against loss; it does however assure that certain minimum standards have been met.

Regulation of Funds

In the Bahamas mutual funds are part of a highly regulated industry. Financial entities must comply with the Mutual Funds Act/Regulations, 1995, which is administered by the Securities Commission. The Act imposes restrictions not only on mutual funds, but also on their investment advisers, promoters, officers, directors and employees of the Mutual Fund Administrator. Moreover, investment companies must provide periodic financial reports and disclose their investment policies to its investors. Regulation does not guarantee success of the investment company but it does offer the investor reasonable protection against gross mal-practices and ensures the dissemination of accurate and adequate information.

Remember

Professional management, convenience and efficiency all help to explain the growth of mutual funds. They can help you realize your financial objectives – but only if you invest in funds that are suitable to your particular needs and circumstances. Before investing, review your objectives and your tolerance for risk. Be sure to read the prospectus and any other literature supplied by the fund before you become a stakeholder. Mutual funds are as risky or as safe as the financial assets they purchase. They therefore must be analyzed in the same way as a single financial asset. The advantage of mutuals is the diversification of assets they purchase and the ability of the investor to buy small amounts at regular intervals. Their long-term orientation makes them excellent investments to buy and hold.

What is an investment?

An investment may be defined as the purchase of an asset that produces a return proportional to risk over some future period. The investments available for purchase are typically financial assets, but real or tangible assets may be included among the alternative investments. The investor can be an individual, a government, or a corporation.

What is a mutual fund?

An investment company that pools money from shareholders and invests in a variety of securities, including stocks, bonds, and money market instruments. A mutual fund ordinarily redeems its shares at their current net asset value, which would normally depend on the market value of the fund's portfolio of securities at the time.

What is a prospectus?

A prospectus can be described as

The prospectus also contains the investment objectives of the fund. The success of the fund is measured by how well the fund achieves its stated objectives.

What is a capital market?

Capital markets are a complex of institutions and mechanisms through which funds for purposes longer than a year are pooled and made available to business government and individuals and through which instruments already outstanding are transferred. Because capital markets deal with the long- term investment, they play a key role in the economy's capital formation process.