



## The Family Office Bermuda Mutual Fund Segregated Accounts Company: An Innovative Tool in Private Wealth Management



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The benefits and uses of Bermuda segregated accounts companies (“SACs”) to ring-fence assets and liabilities in insurance and investment fund structures are well-known and well-tested. The Bermuda Supreme Court has consistently upheld confidence in, and strength of the statutory segregation and ring-fencing of assets and liabilities in a SAC.

One novel area to explore is the use of an SAC in private client wealth management. In the private client sector an innovative use of a SAC mutual fund company can be a unique add-on feature to the usual combination of trust and corporate entities for wealth management. A private SAC mutual fund solely dedicated to a high net worth family may be established to achieve flexible and diverse investment and inter-generational asset protection objectives while allowing for a greater degree of engagement by family investors.

### Role of The Family Office

A family office is often used by wealthy families to preserve wealth and manage their affairs separate from their business endeavours. With family members and their wealth and interests spread out globally and contending with diverse legal and cultural considerations in their wealth and estate planning, family offices provide an integrated professional and administrative service, navigating through today's highly regulated environment. The family office can be the central focal organ coordinating specialist advisors to determine the best solutions and financial products for the family, taking into account matters the family's (or a patriarch's or matriarch's) philosophy, governance, objectives including strategic philanthropy.

The education of future generations in wealth management and control in accordance with the family's philosophies may also be undertaken by the family office. A chief concern is the need to share the family blueprint with the next generation and to get them involved in the management of their own wealth in a controlled family mutual fund structure. The family office is perfectly positioned to be the fund administrator and coordinator of a private family-run investment fund.

### SAC Fund Structure

The family office, incorporates a “personal” mutual fund company to be registered as a SAC. Segregated Accounts (“Accounts”) are created by the SAC to individually hold diverse investment assets or strategies and redeemable participating shares are issued by each Account to members of the participating family and affiliates, either in their personal capacity or through a blocker entity such as a company, limited partnership or



trust. The investors become beneficial owners of the assets of the Accounts through the participating equity linked to an Account. Separate trusts for different branches of the family may hold Account – linked shares.

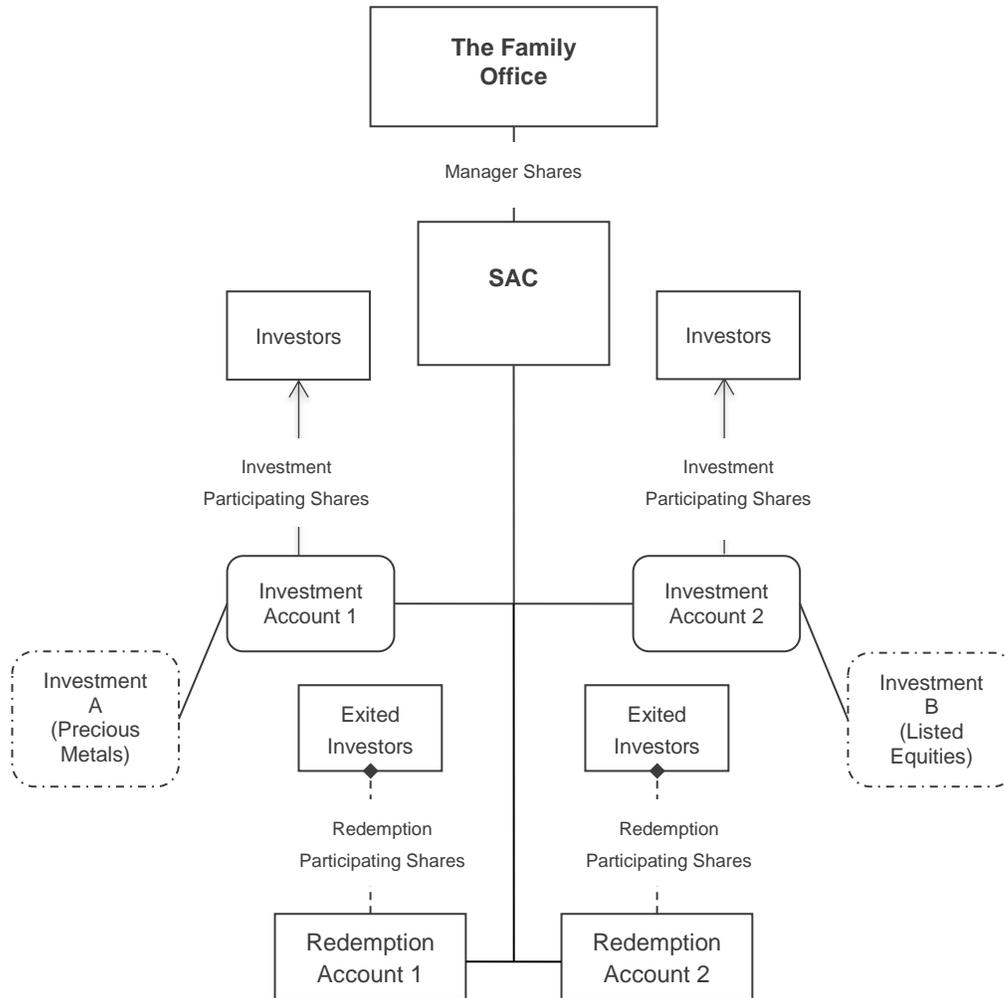


Figure: Pro-forma Open-ended Family Office Segregated Account Company structure

Redeemable investment shares and their associated investments are made available only to family members or their relevant trusts or trustees and would likely be regarded as a qualified private exempted offering.

By creating individual Accounts with different investment strategies, this private and personal investment fund enables the family to mix and match investment portfolios by investing in the respective Accounts through equity subscriptions.

For example, a SAC may create an “Investment Account 1” to hold precious metals or other commodities, “Investment Account 2” to hold publicly traded securities to be managed by a licensed US broker-dealer and a more speculative “Investment Account 3” to invest in renewable energy resources in Japan. Each Account is segregated and ring-fenced from the others in terms of liabilities and a particular investor may choose to invest in all three Accounts in any combination he desires. Further, the shares may be gifted or held for the next generations as a nest egg in one or more trusts.



A Bermuda mutual fund SAC with less than 20 participants will generally qualify as an excluded private fund under the *Investment Funds Act, 2006* and will therefore be excluded from regulation by the Bermuda Monetary Authority. Certain investment funds are eligible for exemption and will have minimal reporting obligations. Audited financial statements for each Account may be prepared but may also be waived by the investors collectively.

Unlike unlimited partnerships, investors may also participate actively in the supervision of the investment by appointing themselves or their advisors to investment committees with respect to specific Accounts without losing their status as limited liability investors.

## **Beneficial Features of the SAC Fund**

### **Separation and Protection**

A SAC affords greater protection against risks, losses and insulates investments without the need to establish corporate entities. Failure of one Account will not affect the solvency or viability of another Account unless the latter has undertaken to underwrite the former.

The SAC structure permits the diversity of the portfolio and at the same time insulates risk from each strategy. Each investment is ring-fenced from another and compartmentalized in respect of access to Account reports and information. .

In a trust structure there's an obligation to act in the overall interest of every beneficiary but in a SAC investors/beneficiaries get to choose which Account to invest in according to their personal risk profile and diversification strategy, as each investment is separately owned and maintained. If an investor (i.e. a family member or a related trust for their benefit) wishes to exit an investment strategy they are able to redeem their shares, which is a more flexible than a trust where beneficiaries wishing to realise their beneficial interest prematurely or act without the consent of all other beneficiaries can result in disputes and increase the risk of costly litigation.

By law, the investors of an Account may not be inspected by third parties with no interest in the Account, potentially offering a wall of confidentiality from exited investors or other family members.

### **Individualised Dividends, Distributions and Audits**

The Account need only be commercially solvent when paying dividends and distributions. There is no requirement for all the Accounts or the SAC itself to be solvent before a dividend/distribution may be declared and paid from the assets of a healthy Account.

Each Account may be individually audited or, alternatively, for each of its investors or account owners to collectively waive the required auditing and presentation of financial statements and accounts indefinitely.

### **Inter-Account Support**

With investors' consent, the SAC structure allows for one Account to transfer assets or give financial support to another Account, when an Account has a strategy that is best served by centralising obligations and liabilities in one Account backed and cross-collateralised by the assets of another Account. For example, an Account may enter into derivative contracts like currency calls or put options with another Account providing collateral support to the first Account. The supporting Account is insulated against any direct claim by the trading



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counterparties of the first Account.

### **The Offshore Benefit**

In some instances there could be tax and other legal advantages of legitimately deferring income tax on dividends or capital gains tax from realisation of overseas investment assets including arising from the redemption of the shares by a SAC that is managed offshore.

A unique add-on feature of the family offshore SAC is for each “Investment Account” to be accompanied by a dedicated and separate “Redemption Account” which sole purpose is to receive the redemption proceeds following the redemption of shares of the Investment Account without repatriating the proceeds back to the home jurisdiction, and thereby incurring a taxable event. Please see Figure. The investors would be exchanging their participating shares in the Investment Account for similar type shares in the Redemption Account effectively exiting an investment strategy and parking their proceeds in a ring-fenced fund held by the same SAC. Proceeds in the Redemption Account may subsequently be deployed for reinvestment in any other Investment Account of the SAC or to other external investments.

### **Costs and Economies of Scale**

As mentioned, family offices often utilise a number of companies and trusts to diversify their assets and give benefit to certain family members from certain assets. The administration of separate trust and corporate entities can be costly. A SAC can have any number of Accounts and at a lower per capita “fund” cost while centralising administrative control in the same entity.

The family office can potentially take on some of the role and functions of the investment manager or advisor, to the SAC and charge a fee/commission to defray its own administration costs as well as fund worthwhile family-oriented goals and projects. A family office/investment manager does not have to be licensed or regulated in Bermuda if not operating within Bermuda.

### **Incorporated Segregated Accounts Companies**

Bermuda has been exploring the potential for Incorporated Segregated Accounts Company (“ISAC”). ISACs are segregated accounts companies which create incorporated Accounts with separate legal identity providing the advantage of being severable from the ISAC core entity. This may be an attractive feature for members looking to create legally distinct governance for their Accounts to own and run their own separate incubator businesses or projects, but still sharing back-office functions and costs with the core ISAC until they are ready to take it to the next level whereby an Account can be spun-off into separate companies.

### **Conclusion**

Following the banking crisis, many wealthy families and their family office have moved away from reliance on bank-affiliated advisors and taking greater charge and control finding it more effective to assemble their own team of specialists to service their own investment vehicles. A bespoke SAC provides a great tool to hold diverse investment assets with minimal regulation and maximum flexibility for family or close-knit investors to chart their own financial course.



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