



# Collective investment undertakings (CIUs) in Bahrain

## Overview

The Central Bank of Bahrain (CBB) has promulgated regulations which form the module (the **CIU-R Module**) of the CBB Rulebook (the Rulebook) relating to collective investment undertakings (CIUs). The CIU-R Module became effective on 1st June 2007 and repealed all existing legislation (primary or subordinate) relating to CIUs, then in force. It also forms the first part of Volume 6 of the Rulebook, which is intended to cover all capital markets related activities undertaken in the Kingdom of Bahrain (Bahrain).

CIUs are defined in the CIU-R Module as undertakings:

- the sole object of which is the collective investment of capital raised from the public in financial instruments or other assets and which operates on the basis of risk-spreading, and
- the holdings of which are re-purchased or redeemed, directly or indirectly, out of those undertakings' assets.

The definition of CIUs recognises both open-ended funds and closed-ended funds, unit trusts, investment trusts, mutual funds, SICAV and collective investment schemes. CIUs may be constituted under contract law (as common funds managed by management companies), trust law (as unit trusts) or under statute (as investment companies).



Source: iStock photos

The Rulebook applies to all CBB licensees and 'relevant persons' (defined below) who undertake capital markets activities. CBB licensees that are members of the Bahrain Stock Exchange are also subject to the membership and operating rules of that exchange.

## Relevant persons

**Relevant person** is defined in CIU-R Module as any person who is:

- acting as the operator, manager, administrator or custodian of a CIU, or
- offering CIU holdings to investors resident in Bahrain.

Relevant persons must be acceptable to the CBB in order for a CIU to be authorised. Relevant persons must maintain proper standards of market conduct and must comply with all applicable legal or regulatory requirements.

## Administrator and custodian

The administrator and custodian functions of a CIU must be undertaken by one or more CBB licensees which are acceptable to the CBB for the role, and who must:

- be independent of the CIU's operator
- act solely in the interests of the CIU's participants
- have sufficient financial and other resources to properly undertake its function, and
- accept liability to the CIU and its participants for any loss suffered as a result of its unjustifiable failure to perform its obligations.

In applying this rule, the CBB will allow "hub and spoke" arrangements whereby the actual operations of the administrator / custodian are undertaken outside of Bahrain, provided that a suitably licensed office is maintained in Bahrain.

Also, pursuant to this role, the custodian may appoint sub-custodians, provided the custodian

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retains ultimate responsibility for the CIU's assets and ensures that suitable outsourcing arrangements have been put in place.

## Operators

Operators of CIUs authorised or registered under Module CIU must:

- ensure compliance of the CIU with Module CIU, the instrument constituting the CIU, and of its prospectus
- take all reasonable steps to rectify any failure to comply
- not withdraw as operator of the CIU except upon the appointment of a new operator and subject to the prior approval of the CBB, and
- accept liability to the CIU and its participants for any loss suffered as a result of its unjustifiable failure to perform its obligations adequately.

Operators of CIUs who have introduced seed capital into a CIU must not seek redemption or buy back the seed capital without prior approval of the CBB.

## Classes of CIU

The CIU-R Module sets out requirements relevant to all CIUs that are domiciled in Bahrain irrespective of the jurisdiction in which they are offered (**Bahrain domiciled CIUs**) and CIUs that are domiciled in an overseas jurisdiction and offered to investors resident in Bahrain (**Overseas domiciled CIUs**). No person may offer holdings in a CIU unless that CIU is either authorised by, or registered with, the CBB.

Where a CIU is structured as a series of separate offerings, such as an umbrella fund with a series of sub-funds, whereby each is a separate offering and financially independent of the other funds established within the same legal vehicle, each sub-fund will be treated by the CBB as a separate CIU. The consequence of this, is that each sub-fund will require a separate authorisation or registration.

## Overseas domiciled CIUs

To avoid supervisory duplication, the CIU-R Module provides that overseas domiciled CIUs which are already approved by its 'home' regulator in certain 'recognised jurisdictions' are simply required to register with the CBB, prior to being marketed in Bahrain. The list of 'recognised jurisdictions' includes all European

Economic Area member states, the USA, the Cayman Islands and British Crown dependencies.

## Bahrain domiciled CIUs

The CIU-R Module provides for three classes of CIUs: retail CIUs, expert CIUs and exempt CIUs.

### Retail CIUs

Retail CIUs are open to all investors and are subject to detailed regulation and supervision by the CBB. They are subject to restrictions on diversification and on the types of financial instruments or assets that can be held by the fund.

A retail CIU must be authorised by the CBB.

### Expert CIUs

Expert CIUs may be offered only to **expert investors**, which are individuals or institutions which have financial assets of at least US\$100,000. The minimum investment is set at US\$10,000 or equivalent. Expert CIUs have greater flexibility than retail CIUs. Notably, they are able to utilise higher aggregate and individual exposure limits and they may invest in a wider range of asset classes, including, amongst other things, real estate, commodities, unlisted securities and hedge funds.

A Bahrain domiciled expert CIU must be able to demonstrate that each of its participants falls within the definition of expert investor. This requirement can be met, in practice, by the provision to the CBB of a written confirmation by the participant stating that they satisfy the definition of expert investor and confirming that they understand the higher risks involved in investing in an expert CIU, in addition to the provision of the supporting documentation demonstrating that the minimum net worth / financial assets thresholds have been satisfied.

An expert CIU must be authorised by the CBB.

### Exempt CIUs

Exempt CIUs may be offered only to **accredited investors**, which are individuals or institutions with financial assets with a value of at least US\$1,000,000. The minimum investment is US\$100,000 or equivalent.

Exempt CIUs are only 'regulated' to the extent that they must register with the CBB prior to being offered to investors. They may only be offered to accredited

investors and they are subject only to high level disclosure and reporting requirements. Exempt CIUs are not subject to any restrictions on their investment policies and as a result of this, they may exhibit high risk characteristics, such as, high levels of leverage and the taking of large speculative positions.

The operator of an exempt CIU must be able to demonstrate that each of the participants in that CIU falls within the definition of accredited investor. This requirement can be met in practice by the provision to the CBB of a written confirmation by the participant stating that they satisfy the definition of accredited investor and confirming that they understand the higher risks involved in an exempt CIU, in addition to the provision of the supporting documentation demonstrating that the minimum net worth / financial assets thresholds have been satisfied.

Exempt CIUs must not quote the CBB as the regulator of the CIU and must clearly display a statement of the fact that the CIU is considered exempt for the purposes of the CBB's CIU regulations. In addition, exempt CIUs must disclose all relevant features of the CIU in their offering documentation.

An application for registration must be made by the operator of the CIU or the directors or trustees of the CIU. An application from an overseas operator will only be considered if the overseas operator has a suitable track record in operating CIUs.

In order for an exempt CIU to be registered with the CBB it must meet the exemption conditions. The exemption conditions require that the CIU delegate the administration and safe keeping of their assets to an administrator / custodian. These functions must be undertaken by one or more licensed institutions acceptable to the CBB for the role.



Source: Corbis, Architectural details

The CBB would normally expect the administrator / custodian CIU to be a CBB licensee, and whilst 'hub and spoke' arrangements are permitted, in the case of an exempt CIU, the CBB will consider non-CBB licensees on a case by case basis and only where there is strong rationale for doing so (e.g. prime broking arrangements for hedge funds).

Bahrain domiciled CIUs registered with the CBB are subject to an annual fee of BD 2,000.

## Shari'ah compliant CIUs

The CIU-R Module makes special provision for Shari'ah compliant CIUs (which apply to Expert and Retail CIUs only). The operator of the CIU must appoint two or more Shari'ah advisers. All Shari'ah CIUs must ensure that their offering documentation contains provisions describing the Shari'ah compliant nature of the CIU, the process for achieving such compliance and the names of the Shari'ah advisers. The CIU must comply with all applicable standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (**AAOIFI**). The operator of the CIU must ensure that the operations and investments are subject to compliance reporting and monitoring by its Shari'ah advisers in accordance with applicable AAOIFI standards. The annual report must contain a report and opinion from the CIU's Shari'ah advisers.

## Rules applicable to Bahrain domiciled CIUs

### Prospectus

The CIU must keep the prospectus up to date. Once authorised, prior approval must be obtained from the CBB for any subsequent material changes to the prospectus. Material changes include: changes in the CIU's manager, administrator or custodian, a change to the investment strategy or a change in fees.

### Valuation and record keeping

A CIU must ensure that:

- an independent, fair and regular valuation of the CIU's assets is carried out, which must be documented in a valuation policy and agreed with the CBB
- records are maintained for five years
- a register of holdings is maintained, which must be kept up to date, and

- all applicable anti-money laundering and financing of terrorism requirements are complied with.

## Reporting and auditors

A CIU must publish, and file with the CBB, annual and semi annual financial statements, prepared in accordance with International Financial Reporting Standards or, as appropriate the standards promulgated by AAOIFI. The annual and semi annual financial statements must be published and distributed to CIU participants within four and two months respectively of the period end. The annual financial statements must be audited by an independent auditor resident in Bahrain and acceptable to the CBB. The semi annual statements must be subject to an independent review by the same qualified auditor. The CIU must also file a quarterly statistical return with the CBB.



Source: Corbis, Business tools

A CIU must publish the issue, sale, repurchase or redemption price of its holdings each time it issues, sells, repurchases or redeems its holdings and at least twice a month.

The Bahrain office of Trowers & Hamlins has an extensive track record of involvement in the structuring and documentation of funds domiciled in Bahrain and approved by or registered with the CBB.

We have acted as lead, international counsel for sponsors and managers of Bahrain domiciled funds which have utilised both conventional and Shari'ah compliant structures and have focussed on asset classes in infrastructure (including investments in the power & water, petrochemicals, oil & gas, airports and transportation and aggregates industries) and in the real estate, private equity, telecoms, healthcare and education sectors.

We also continue to be active in advising and assisting clients in implementing and exiting from investments.

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