

Fund schemes in Bahrain: options and key highlights

Natalia Kumar - Senior Counsel - Banking and Finance
n.kumar@tamimi.com - Manama

Abdullah Rauf Puri - Associate - Banking and Finance
- Manama

Dennis Ryan - Senior Associate - Banking and Finance / Venture Capital and Emerging Companies
- Dubai International Financial Centre

This article discusses the type of funds that may be established in the Kingdom of Bahrain ('Bahrain'). It sets out key highlights of the main differences between types of funds and their legal and regulatory requirements.

The Middle East offers significant opportunities, with sizeable growth in the 'mass affluent', institutional and high net worth individual markets. To service this segment, Bahrain has had a thriving funds industry since the launch of the first Bahrain domiciled fund in 1984. Drawn by Bahrain's proven track-record, formal regulation and disclosure, and constantly developing funds regime, Bahrain is an attractive jurisdiction for international funds managers to build their Middle East operations. Bahrain's 2030 Economic Vision includes an objective of improving the competitiveness of the national economy by continuing to attract business and enhance investment in Bahrain. Some of the key advantages that make Bahrain an attractive funds' jurisdiction include the following:

- strategic location in the GCC;
- ranked in the top positions in the Economic Freedom Index compiled by the Heritage Foundation and the Wall Street Journal that acknowledges Bahrain's commitment to maintaining a business environment considered among the most liberated in the Middle East;
- low costs for rent and utilities;
- an educated and experienced workforce;
- the freedom to repatriate and transfer profits and capital;
- freedom to import and export local and foreign currency;
- no income, capital, real estate, interest or concession rights taxes;
- Bahrain hosts the GCC Commercial Arbitration Centre; and
- permitting foreigners to practise most business activities at a rate of 100 per cent.

The Government of Bahrain seeks to attract investment in a number of sectors, including:

- financial services;
- industrial sector;
- logistics services;
- real estate;
- IT and telecommunications; and
- Fintech.

As of the end of November 2020, there were 2,001 funds registered in Bahrain, 75 of which were Bahrain domiciled and 84 of which were Sharia compliant. The net asset value ('NAV') of funds registered in Bahrain totaled US\$ 7 billion (48 million as of the end of September 2020). US\$ 2.894 billion is invested in Bahrain domiciled funds and US\$ 1.86 billion is invested in Sharia compliant funds.

To further enhance the funds industry in Bahrain, the Protected Cell Companies Law (Law No. 22 of 2016)

was implemented on 13 October 2016 and introduced PCCs in Bahrain and the Investment Limited Partnership Law (Law No. 18 of 2016) was implemented on 4 August 2016. As a result, there are many legal structures available for establishing a fund in Bahrain, including a corporate structure (i.e., joint stock company or PCC); a limited partnership, a trust and contractual arrangements.

The Central Bank of Bahrain ('CBB') and the CBB Rulebook

The CBB is the sole regulator of the financial services sector in Bahrain. The CBB publishes its regulatory requirements in the form of a rulebook ('CBB Rulebook').

Volume 7 (Collective Investment Undertakings) of the CBB Rulebook sets out the CBB's regulatory framework governing collective investment undertakings ('CIUs'), including the requirements of all Bahrain domiciled CIUs and overseas domiciled CIUs.

Collective Investment Undertakings

Under Volume 7 (Collective Investment Undertakings) of the CBB Rulebook, CIUs are defined as follows:

"undertakings: (a) the sole object of which is the collective investment of capital raised from the public or through private placement, including investment seeded by the operator, in financial instruments and other assets and which operates on the basis of risk-spreading as appropriate; and (b) the holdings of which may be re-purchased or redeemed out of those undertakings' assets."

'Holdings' mean the unit of measurement of the beneficial interest of participants in a CIU, by whatever name it is called (including 'units' and, in the case of investment trusts or companies, in the form of shares or units). Each holding (which may be in fractions of a holding) represents a right to the assets of the CIU.

The definition of CIUs recognises both open-ended funds and closed-ended funds: unit trusts, investment trusts, mutual funds, société d'investissement à capital variable ('SICAV') and collective investment schemes are all examples of CIUs.

The following arrangements do not fall within the CIU definition set out above:

- (a) a contract of insurance, insurance linked investment products or investments managed as part of a takaful contract of insurance;
- (b) unrestricted investment accounts offered by Islamic bank licensees;
- (c) restricted investment accounts offered by Islamic bank licensees prior to the effective date of Volume 7 (Collective Investment Undertakings);
- (d) unilateral arrangements:
 - i. or a licensee to hold or manage assets on a discretionary basis;
 - ii. to hold or manage assets on behalf of a client on a non-discretionary basis (i.e. at the discretion of the client and not the bank or other licensees);

- (e) arrangements entirely between bodies corporate who are members of the same group, or entirely between family members;
- (f) pension, annuity and other employee benefit products, organised and managed for the benefit of employees or for another corporate body, which are governed by separate laws of Bahrain (e.g. the Social Insurance Organisation commonly known as GOSI);
- (g) structured products;
- (h) cash savings schemes;
- (i) special purpose vehicles used to issue debt securities; and
- (j) the issue of securities by companies whether publicly or by private placements for the purpose of raising their own capital.

Bahrain domiciled CIUs are undertakings where:

- (a) the legal form of the CIU is established under the laws of Bahrain; and
- (b) the CIU documents and contractual agreements are governed by the laws of Bahrain, unless otherwise agreed with the CBB.

Bahrain domiciled CIUs may be constituted either as:

- (a) common CIUs, established under the law of contract;
- (b) trusts, established under the Trusts Law (Law No. 23 of 2016); or
- (c) corporates established under the Commercial Companies Law (Law No. 21 of 2001 as amended).

Each Bahrain domiciled CIU must have its separate legal vehicle.

Overseas domiciled CIUs are undertakings that are established in and regulated by Australia, Bermuda, Canada, Cayman Islands, European Economic Area, the GCC, Guernsey, Ireland, Isle of Man, Jersey, Luxembourg, New Zealand, Singapore, South Africa, Switzerland, United Kingdom and United States of America ('Recognised Jurisdictions') or other jurisdictions acceptable to the CBB.

Types of CIUs

Bahrain domiciled CIUs are categorised as retail CIUs, expert CIUs, exempt CIUs. Private investment undertakings ('PIUs') and Bahrain Domiciled Real Estate Investment Trusts are also recognised in Bahrain.

Retail CIUs

Retail CIUs may be offered to all types of investors and there is no prescribed minimum investment threshold. The requirements in Volume 7 (Collective Investment Undertakings) of the CBB Rulebook are framed such that retail CIUs are subject to relatively detailed requirements, including restrictions on the types of financial instruments or other assets that may be held by the CIU, in order to limit risks to the general investor.

Expert CIUs

Expert CIUs are CIUs that may be offered only to 'expert investors'. Expert investors are: (a) individuals holding financial assets (either singly or jointly with their spouse) of US\$100,000 or more; (b) companies, partnerships, trusts or other commercial undertakings, which have financial assets available for investment of not less than US\$100,000; or governments, supranational organisations, central banks or other national monetary authorities, local authorities and state organisations.

The minimum initial investment is US\$10,000 (or its equivalent in any other currency). This means that the first payment made by an investor into the CIU must be at least US\$10,000 (or its equivalent in any other currency). Subsequent investments may be for smaller amount.

Expert CIUs are subject to less restrictive requirements than retail CIUs, specifically, expert CIUs have greater investment flexibility, notably in terms of asset classes and risk concentration limits. They, therefore, potentially offer higher risks and are only suitable for expert investors, who are better able to assess those risks than less sophisticated investors.

Exempt CIUs

Exempt CIUs are lightly regulated CIUs that may be offered only to 'accredited investors'. Accredited investors are: (a) individuals holding financial assets (either singly or jointly with their spouse) of US\$1 million or more; (b) companies, partnerships, trusts or other commercial undertakings, which have financial assets available for investment of not less than US\$1 million; or (c) governments, supranational organisations, central banks or other national monetary authorities, and state organisations whose main activity is to invest in financial instruments (such as state pension funds).

The definition of "accredited investors", compared to that of "expert investors", not only imposes higher liquid asset thresholds, but also prevents local authorities, as well as state organisations whose main activity is not related to investing in financial instruments, from investing in exempt CIUs. Investors that satisfy the definition of accredited investor also satisfy the definition of expert investor.

The minimum initial investment is US\$100,000 (or its equivalent in any other currency). This means that the first investment made by an investor into the CIU must be at least US\$100,000 (or its equivalent in any other currency). Subsequent investments may be for smaller amounts. Subscriptions on commitment basis must be at least US\$100,000 (or its equivalent in any other currency).

PIUs

PIUs are defined as follows:

"investment undertakings/funds that are registered with the CBB and may be initiated by or offered to high net worth individuals or institutional investors, and impose a minimum initial investment/participatory interest of US\$3 million (or equivalent in any other currency)."

High net worth individuals or institutional investors are:

(a) individuals holding financial assets (either singly or jointly with their spouse) of US\$25 million or more; and

(b) companies, partnerships, trusts or other commercial undertakings, which have financial assets available for investment of not less than US\$25 million; or governments, supranational organisations,

central banks or other national monetary authorities, and state organisations whose main activity is to invest in financial instruments (such as state pension funds).

PIUs are structures that have been created to facilitate private investments with a capacity to fit the criteria of such schemes. Unlike a CIU, the role of the CBB is limited to processing the registration of PIUs and to subsequently gather statistical information related to PIUs, for the purpose of monitoring developments in the financial services sector only. PIUs are not subject to the CBB's ongoing supervisory requirements.

Bahrain Domiciled Real Estate Investment Trusts (B-REITs)

B-REITs are defined as CIUs the objectives of which are acquiring, holding, administering, managing and selling income generating local and foreign real estate properties, either directly or indirectly. A B-REIT is required to be constituted as a trust, established under the Trusts Law and in accordance with a trust deed or a trust instrument.

A B-REIT may be established in the form of a Bahrain domiciled retail CIU or a Bahrain domiciled exempt CIU and must be authorised or registered by the CBB prior to being offered to eligible investors.

Bahrain Domiciled CIU

To establish a CIU in Bahrain, the CIU must be authorised or registered with the CBB. Bahrain domiciled retail CIUs and Bahrain domiciled expert CIUs must be authorised by the CBB prior to being established. Bahrain domiciled exempt CIUs are only required to register with the CBB.

Bahrain Domiciled CIU authorisation and registration

Retail and expert CIUs

Bahrain domiciled retail CIUs and expert CIUs must be authorised by the CBB prior to being offered to investors. An application for authorisation may only be made by the operator of the CIU. In the cases where the operator is not a CBB licensee, an application for authorisation will only be considered if:

a) the operator:

- (i) is duly authorised to operate similar CIUs in its home jurisdiction;
- (ii) is supervised by an overseas regulatory authority acceptable to the CBB;
- (iii) has a sound track record and/or experienced management team;
- (iv) is financially sound according to home country regulatory requirements; and
- (v) is a reputable financial institution.

b) the operator has identified appropriate institutions licensed by the CBB, with which it would enter into

service agreements in order to satisfy the administration and custody requirements; and

c) the operator has submitted an acceptably worded undertaking to the CBB, stating that it will abide by the CBB Law (Law No. 64 of 2006, as amended) and the provisions of Volume 7 (Collective Investment Undertakings) of the CBB Rulebook.

Applicants for authorisation must fill in the requisite form and submit the complete form with supporting documents with the CBB. To be granted authorisation, an applicant must demonstrate compliance with the applicable requirements of Volume 7 (Collective Investment Undertakings) of the CBB Rulebook. The authorisation may be subject to additional conditions being met. The CIU must be launched within a period not exceeding six months from the date of authorisation.

Exempt CIUs

Bahrain domiciled exempt CIUs must be registered with the CBB prior to them being offered to investors. Bahrain domiciled exempt CIUs are not subject to the CBB's authorisation or ongoing supervisory requirements. The registration requirement is to allow the CBB to monitor developments in the financial services sector. An application for registration may only be made by the operator of the CIU where:

a) the operator:

- (i) is duly authorised to operate similar CIUs in its home jurisdiction;
- (ii) is supervised by an overseas regulatory authority acceptable to the CBB (if applicable);
- (iii) has a sound track record and/or experienced management team;
- (iv) is financially sound according to home country regulatory requirements; and
- (v) is a reputable financial institution.

b) the operator has identified appropriate institutions licensed by the CBB, with which it would enter into service agreements in order to satisfy the administration and custody requirements; and

c) the operator has submitted an acceptably worded undertaking to the CBB, stating that it will abide by the CBB Law and the provisions of Volume 7 (Collective Investment Undertakings) of the CBB Rulebook.

Applicants for registration must fill in the requisite form and submit the complete form with supporting documents with the CBB. To be registered, an applicant must demonstrate compliance with the applicable requirements of Volume 7 (Collective Investment Undertakings) of the CBB Rulebook. The authorisation may be subject to additional conditions being met. The CIU must be launched within a period not exceeding six months from the date of authorisation.

Overseas domiciled CIU

Overseas domiciled CIUs must be authorised by the CBB prior to being offered to investors in Bahrain, unless they are domiciled in a Recognised Jurisdiction, in which case retail CIUs are required to register with the CBB, and expert CIUs are required to be filed with the CBB. Overseas domiciled exempt CIUs domiciled in Recognised Jurisdictions are required to be filed with the CBB, while those domiciled in other jurisdictions are required to be registered with the CBB.

Overseas domiciled CIU authorisation, registration and filing

The CBB's review of applications for registration is mainly limited to satisfying itself that the applicant satisfies the conditions specified in the relevant rules pertaining to the category of scheme it falls under (i.e. retail CIU, expert CIU or exempt CIU). This may require seeking confirmation of the CIU's regulatory status from its home regulator, and reviewing the CIU's documentation (such as promotional material and its prospectus). The CBB does not however review the proposed structure or operations in detail, although it reserves the right to seek appropriate confirmations or additional information or documentation from the applicant.

The CBB's review of applications for authorisation is mainly limited to satisfying itself that the CIU for which authorisation is sought has an equivalent structure to Bahrain domiciled CIUs falling under the same category. The CBB reserves the right to seek appropriate confirmations or additional information or documentation from the applicant.

The CBB's review of applications for filing is mainly limited to satisfying itself that the applicant has done its due diligence to ensure the suitability of the CIU to the profile of the targeted investors (i.e. expert or accredited investors). The supporting documents are submitted to the CBB for filing purposes only. The CBB relies solely on the due diligence process undertaken by the applicants, however, the CBB reserves the right to seek appropriate confirmations or additional information or documentation from the applicant.

Conclusion

Bahrain's reputation as one of the most progressively regulated financial centres in the region has helped Bahrain earn a reputation as a leading funds' jurisdiction in the Middle East. The funds' regime in Bahrain is well established and provides various options of fund types. Applicants may establish a retail CIU, an expert CIU, an exempt CIU, a PIU or a B-REIT. Each type of scheme is subject to different levels of regulatory requirements. Bahrain continues to demonstrate to the global investment community that it is open for business with progressive legislation and an investment environment that positions itself as a world class funds' regime.

For further information, please contact [Rafiq Jaffer \(r.jaffer@tamimi.com\)](mailto:r.jaffer@tamimi.com), [Natalia Kumar \(n.kumar@tamimi.com\)](mailto:n.kumar@tamimi.com), [Dennis Ryan \(d.ryan@tamimi.com\)](mailto:d.ryan@tamimi.com) or [Abdullah Puri \(a.puri@tamimi.com\)](mailto:a.puri@tamimi.com).