Proposed Changes to Module PCD Chapter 4 concerning Special Purpose Vehicles and Shari'a Compliance For Islamic Retail Banks

Industry Comments and Feedback
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Industry Comments		
General Comments:	**Ref**	**CBB's Response**
A bank noted that they humbly submit that additional regulations imposed will put Islamic Banks operating in the Kingdom at a further disadvantage compared to their conventional peers. They are concerned that having to seek Shari'a Supervisory Board ("SSB") approval on new SPVs prior to seeking CBB written approval will result in longer turnaround times leading to Islamic banks being less competitive in the market place. Therefore, they urge the CBB to consider providing conditional approval for establishing new SPVs parallel to obtaining SSB approval.	GR1	SSB approval must be obtained first. No changes to be made to the rules. New wording to be used in PCD-4.1.3(f): (f) A copy of the Bahraini Islamic bank licensee's Shari'a Supervisory Board approval of the initial investment or financing structure involving the use of the concerned SPV(s).
A bank noted that they would also like to highlight some challenges they may face during the implementation: 1. At the time of seeking SSB approval for an investment structure, the SPV may not have been incorporated hence, SSB approval may not refer to the specific SPV by its name. 2. Transactions where Banks are providing financing to third parties at arms-length, it may not be practical to stipulate Shari'a compliant borrowings especially, where such financing is not readily available at competitive market rates. Currently, SSB takes this factor into account on a case by case basis when approving such financing.	GR2	Designate names may be given. In case of new acquisition or investment after the date of issuance of these rules, when conventional borrowing exists, it should be replaced by Islamic financing asap and in no case later than 12 months from the date of investment. This is extendable subject to SSB approval. SSB opinion and Shari'a solution must

		be considered. -
A bank noted that CBB is assured that it has adequate procedures in place to ensure Shari'a compliance in all its activities including establishing SPVs to hold Bank's investments. While they recognize the need to uphold Shari'a compliance at all levels in the conduct of Islamic Banks, non-compliance may be the exception and not the rule. Therefore, they believe that currently there are sufficient regulations to govern Islamic banks and further regulation will only make the industry less competitive.	GR3	Disagree- The introduced rules will enhance Shari'a compliance.

Specific Comments:			
Reference to the draft Directive:	**Comments**	**REF**	**CBB's Response**
PCD-4.1.3 The CBB requires any locally incorporated bank associated with an SPV to confirm the following points in any request for approval under Paragraph PCD 4.1.2: **(a) The purpose of the SPV;** **(b) The nature of the relationship between the bank and the SPV (e.g. originator, sponsor, manager, investor, controller etc.);** **(c) The bank management's proposed consolidation/accounting treatment of the SPV in relation to the concerned bank both for**	A bank noted that the Bank is fine with the requirements from (a) to (e) however, they are of the opinion that the Sharia Advisor's approval is sufficient rather than seeking the approval of the SSB.	SP1	The SSB is the ultimate authority and should have the final say at the start of the relationship.
	A bank suggested that item (f) would be reworded as follows: **(f) That the whole Shari'a Supervisory Board of the Bank has approved the whole investment or financing structure involving the use of the concerned SPV(s) and an explanatory written copy of such SSB approval must be submitted with the notification.**	SP2	**New wording:** The CBB requires any Bahraini Islamic bank licensee associated with an SPV to confirm the following points in any request for approval under Paragraph PCD-4.1.2: **(f)** A copy of the Bahraini Islamic bank licensee's Shari'a Supervisory Board approval of the initial investment or financing structure involving the use of the concerned SPV(s).

PIR and audited financial statements' purposes and the bank should agree the treatment of the SPV with its external auditor and confirm the same to the CBB; **(d) The availability of financial and other information relevant to the SPV and access to its business premises and records; and** **(e) Whether the bank is providing any guarantees, warranties or financial/liquidity support of any kind to the SPV.** **(f) That the Shari'a Supervisory Board of the Bank has approved the whole investment structure involving the use of the concerned SPV(s) and a written copy of such SSB approval must be submitted with the notification.**			
PCD-4.1.3A In addition to the points noted in PCD-4.1.3 above, banks which are involved with SPVs in any of the relationships described in PCD-4.1.2 must not allow such SPVs to obtain any conventional financing to fund	A bank suggested that the paragraph would be reworded as follows: **PCD-4.1.3A In addition to the points noted in PCD-4.1.3 above, banks which are involved with SPVs in any of the relationships described in PCD-4.1.2 must not allow such SPVs to obtain any conventional financing to**	SP3	New suggested wording and guidance: PCD-4.1.3A In addition to the points noted in PCD-4.1.3, <u>Bahraini Islamic bank licensees</u> which are involved with SPVs in any of the relationships described in Paragraph PCD-4.1.2 must not allow such SPVs to

themselves or any transactions that they enter into. Shari'a compliance must be written into the memorandum and articles of association of such SPVs so that entry into structures or transactions that are not Shari'a compliant is ultra vires.	**fund themselves or any transactions that they enter into unless the Shari'a Supervisory Board has given its prior approval for such conventional borrowing. Shari'a compliance must be written into the memorandum and articles of association of such SPVs so that entry into structures or transactions that are not Shari'a compliant is ultra vires.**		obtain any conventional financing to fund themselves or any transactions that they enter into. PCD-4.1.3AA For purposes of Paragraph PCD-4.1.3A, in case of new acquisition or investment after the date of issuance of these rules, when conventional borrowing exists, it should be replaced by Islamic financing as soon as possible and in no case later than 12 months from the date of investment. In case of existing investments before the date of issuance of these rules, where conventional borrowing exists, it should be replaced by Islamic financing as soon as possible and in no case later than 12 months from the date of issuance of these rules. Both cases are extendable subject to SSB approval.
	A bank noted that although they 100% support this direction , however, In the event of investing or acquiring an SPV which already has conventional financing, there should be a grace period (AAIOFFI and their Sharia usually allows 3 years for rectification).Furthermore, the conventional financing should not exceed 30% of net assets (as per AAIOFFI) . The Bank may	SP4	See answer under SP3.

	acquire shares in SPVs which were initially established under a conventional banking framework.		
PCD-4.1.3D Banks which are involved with SPVs in any of the relationships described in PCD-4.1.2 must not transfer non-performing or impaired assets from their own balance sheets to such SPVs or vice versa.	A bank is of the opinion that non-performing or impaired assets to be transferred from the bank's balance sheet to an SPV at its carrying value should be acceptable provided that sufficient provisions have been made and there is transparency on this regard such as disclosures in the financials.	SP5	Disagree: This is contradictory to the proposal.
PCD-4.1.4 Where the SPV is consolidated into the accounts of a locally incorporated bank, the bank must provide separate accounting information on the SPV to the CBB on a quarterly basis. Furthermore, the annual audited financial statements of all consolidated SPVs must be submitted to the CBB within 3 months of the year end of the concerned SPV.	A bank is of the opinion that a materiality threshold should be defined as it would be difficult for management and external auditors to complete the audit within three months for such SPVs. The Rulebook must clearly state that the banks are allowed to prepare the consolidated financial statements based on the latest management accounts, and if the auditor judges that the SPV is not significant or risky (E.G. single asset or the auditor can assess risks as they are the auditors of the SPV and the Bank.)	SP6	Quarterly reporting on SPVs is based on management accounts. Only annual reporting is based on audited accounts and must be submitted within 3 months of SPV's year end.
PCD-4.1.5 Where a locally incorporated bank has a controller or majority ownership relationship with an	A bank is of the opinion that "Significant Events" should be clearly defined. Moreover, the reporting / approval process of the companies with its own	SP7	The accounting term 'material' will be used instead. This is in IAS1.7. The note to the definition states '*users are assumed to have a reasonable knowledge of business*

SPV, or acts as sponsor, the bank must obtain the prior written approval of the CBB for any changes to the capital, ownership, management or control of the SPV. All locally incorporated banks must also notify the CBB of any significant events in relation to the SPV. If necessary, the CBB may require that formal information exchange arrangements are put in place (e.g. a memorandum of understanding) if the SPV is located in a foreign jurisdiction and its activities are not supervised locally.	management and Board should be excluded from this requirement or specifically detailed.		*and economic activities and accounting…'.* . Disagree. We should not differentiate between SPVs and operating companies/ bank subsidiaries under bank's ownership.