

# Re: Consultation: Restricted Investment Accounts

## Industry Comments and Feedback

### Volume 2 All Islamic bank licensees

January 2012

Industry Comments	CBB's Response
<b>Specific comments:</b>	
<b>Proposed amendment to Rule Book:</b>  “With effect from 1 <sup>st</sup> July 2012, banks are no longer allowed to issue or open new profit sharing investment arrangements in the form of ‘restricted investment accounts’ where the bank acts as mudarib or trustee. Any new restricted shari’a profit sharing investment relationships may only be opened in the form of units or shares in a collective investment undertaking and is subject to the Rules and guidance contained in Module CIU (Volume 6) and relevant sections of Module BC Chapter 9 (Volume 2).  All existing restricted Shari’a profit sharing investment accounts may continue to be kept open, however, banks may not accept any new funds into such accounts.”	
Bank's comments	CBB's Response
<p><b>A licensee</b> noted that in case of RIA's, it acts only as fund manager, agent or non-participating mudarib, and is not authorized to mix its own funds with those of investors without prior permission. However, it is recommended that the proposed directive on the subject matter to clearly state the type of collective schemes that will be exempted for the proposed directive such as the followings:</p> <ol style="list-style-type: none"><li>According to CBB directive issued February 18<sup>th</sup> 2009 relating to the establishment of Employee/Occupational Savings Schemes (“OSS”). The Directive requires an OSS, which is set up by a CBB Licensee or in which a CBB Licensee acts as an Asset Manager, Administrator or trustee to be constituted as a Trust under Law No. 23 of 2006 regarding Financial Trusts. As such, the licensee continually accepts new funds into such account.</li><li>According to CBB directive on 10<sup>th</sup> August 2011 relating to participation of Retail Customers/ Investors in Government Securities Issuance. The directive gives the banks the option to act as an</li></ol>	<p>a. Refer to Rule CIU-B.3.4 of the CIU Module of CBB rulebook Volume 6 (Rule CIU-1.2.5 in the CIU Module consultation documents), bullet (e), which excludes OSSs from the definition of CIUs. below is the relevant extract:</p> <p><i>The following arrangements do not fall within the definition given in</i></p>

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<p>agent or trustee of the customer holdings. Therefore it is recommended that the proposed directive on the subject matter clearly states the type of open-ended collective schemes that will not be governed under it.</p>	<p><i>Rule CIU-B.</i> <i>3.1 above:</i> <i>(e) 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 the Kingdom of Bahrain (e.g. GOSI);</i></p> <p>b. Refer to Rule CIU-B.3.4 (Rule CIU-1.2.5 in the CIU Module consultation documents), bullet (e), which excludes holding assets on behalf of customers (whether sukuk or other assets) from the definition of CIUs. Below is the relevant extract:</p> <p><i>The following arrangements do not fall within the definition given in Rule CIUB.</i> <i>3.2 above:</i></p> <p><i>(c) Unilateral arrangements to hold or manage assets on a discretionary basis;</i></p>
<p><b>A licensee</b> noted that this is one of the advantages for banks in Bahrain compared to other jurisdictions.</p>	<p><b>a.</b> At the outset, setting up RIAs as</p>

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<p>The proposed total abolishment of the accounts to be replaced with CIUs will render the system to be less competitive and time consuming.</p> <p>The licensee is cognizant of the need to protect the end investors but the abolishment is too drastic as an approach to take. Not all investments made under RIAs need prospectus to be re-issued. For example:</p> <ol style="list-style-type: none"><li>RIAs for clients wishing to invest in Sukuks. CBB may strengthen the rule by forcing the banks managing such RIAs to make the Sukuk prospectus of Information Memorandum (IM) documents mandatory to be furnished to the clients not only fully understand the risk that they are facing in making the investment, but also the disclosure is as much as the regulatory bodies prescribed under the IM/ prospectus.</li><li>RIAs are short term placements. CBB may give exemption to the clients who instruct the bank managing its funds in short term placement market i.e. in the interbank deposit market. Using CIUs in this case is clearly ineffective and unnecessary.</li></ol> <p>Accordingly, CBB may restrict the use of RIA to only short-term interbank placements (deposits) and also to investments where it has been seasoned (secondary market trading) with publicly available prospectus/ IMs.</p> <p>The licensee does not have any comments on Collective Investment Undertakings.</p>	<p>CIUs will add many forms of advantages to the end investor not only transparency as regards with the prospectus on the outset; for example, strong corporate governance, ongoing obligation of reporting, proper legal separation of the underlying assets from the bank's assets, etc. However, the specific question regarding sukuk is addressed in Rule CIU-B.3.4 of the CIU module (extract is above).</p> <p><b>b.</b> The <b>licensee</b> has a point here. It would be costly and un-feasible to structure such short term investments as CIU. RIAs should be allowed for those investments initiated by the investor at his own discretion specifying what he wants to invest into at what time (discretionary asset management), including short term investments in interbank market. Therefore, the text will be revised accordingly.</p>
<p><b>A licensee</b> noted the following:</p> <ol style="list-style-type: none"><li>At the outset, the CIU Consultation paper is sufficiently covering rules for RIA and other types of offerings. The consultation paper on CIU clearly states that RIAs will be regulated as part of the CIU rules. This consultation on RIA has the effect of redefining the rules for CIU.</li><li>Under the CIU-Consultative-Documents, licensees are allowed to act either as Operator (i.e.</li></ol>	<ol style="list-style-type: none"><li>The CIU Module <u>does not</u> state that RIAs are regulated as part of CIUs. In addition, this consultation says that institutions can no longer offer new RIAs, and cannot accept additional funds in</li></ol>

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mudarib) or trustees whereby this letter is restricting “Islamic Banks” from taking on these roles. This may give a wrong signal to the market/investors that Islamic funds are riskier than conventional ones. This will hurt the overall business of Islamic banks.

- c. As a result of the above, conventional banks will have advantages on Islamic banks resulting into an “unfair market condition”;
- d. This may also have associated Sharia issues: If Islamic banks cannot act as “Mudarib” then how can they justify their profit sharing and / or fees?

existing RIAs. Any new investments can only be accepted in properly structured CIUs, taking into consideration all the requirements of the CIU module.

b. There is no conflict between the Module and consultation paper. The bank can act as a trustee or mudarib, but the arrangement must be in the form of a CIU. However, to act as a trustee under the CIU module, the institution has to be “eligible” to undertake such activity, and be governed by the Financial Trust Law. The restriction to RIAs will have to apply to conventional banks with Islamic windows as well in order not to place Islamic banks at a competitive disadvantage.

c. The proposed consultation will improve the customer safety net and will therefore increase customer confidence in the market and will add positively to the competitiveness of Islamic banks. Such migration will implicate the proper application of corporate governance, transparency, segregation of functions, audit by a

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	<p>third party auditor and maintenance of separate books and records, for the interest of the investors. The bank can still act as a mudarib but through other types of products, not RIAs,</p>
<p><b>A licensee</b> noted the following:</p> <ul style="list-style-type: none"><li>a. More clarification is required on the impact of the said amendments on our other geographical entities (subsidiaries if any), as they have a separate RIA program approved separately by their local regulators;</li><li>b. The <b>licensee</b> only deals with accredited investors, hence, the exempt CIUs rules apply to the licensee. However, the CBB does not regulate the CIUs and only requires their registration. In the light of the above, can the bank still open RIAs whereby the licensee acts as a trustee or mudarib? (since it is an exempt CIU where the CBB does not review the proposed structure and operations, and the CIUs are not subject to any restrictions on their investment policies); and, are there any fees applicable on the licensee on our current portfolio?</li></ul>	<p><b>a.</b> RIAs structured outside Bahrain by licensees domiciled in other jurisdictions are subject to the regulations set by the local regulators in those jurisdictions. However, those cannot be <b>marketed</b> to residents in Bahrain, because it entails account opening and can be viewed as offering regulated activities by non licensed entities.</p> <p><b>b.</b> Even though exempt CIUs only require registration, they will still have to be subject to some “light touch” review and regulations.</p> <p>The bank may offer CIUs instead of RIAs and the bank may act as a trustee or mudarib subject to the CIU applicable rules.</p> <p>The fees applicable on the bank are only the ones applicable to the CIUs.</p>

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