

Unit Trusts in Bahrain

Introduction

A **unit trust** is a special kind of investment vehicle which is subject to the law governing mutual funds or Collective Investment Undertakings (“CIU”), as they are defined in the Central Bank of Bahrain (“CBB”) CIU regulations (revised and amended in 2007). A unit trust is also subject to the Bahrain Financial Trust Law (2006) and accordingly has features in common with all trusts.

A unit trust is registered as a trust in Bahrain and is also registered as a CIU according to CBB regulations which regulate all CIU established in or operating from the Kingdom of Bahrain.

A unit trust is a type of mutual fund defined by the CBB to mean a trust established by one or more settlers (typically the promoter) which, for valuable consideration, issues trust units giving rights to the profits or gains arising from the acquisition, holding, management or disposal of investments by the trustee of the trust, the proper law of which is the law of the Kingdom of Bahrain.

Unit trusts, according to Bahrain regulation, need to have a Bahrain based and licensed trustee and need to be administered by a licensed CIU Administrator. **Ohad Trust BSC (c)** can be appointed for both roles on any unit trust.

All CBB licensed mutual funds, including unit trusts, are regulated by the CBB.

Advantages of Bahrain unit trusts

No taxation

There is no taxation in the Kingdom of Bahrain in relation to income or capital gains, in respect of a unit trust, or in relation to distributions to unit holders or capital gains on redemption or sale of units.

No exchange control

There is no exchange control in Bahrain and thus investments may be made and realised in unit trusts without any governmental consent.

Worldwide investments

Provided the trustee is permitted to do so by the instrument governing the unit trust, investments of any type may be made anywhere in the world, subject always to the restrictions of local laws of any applicable jurisdiction.

Local regulations and legislation

Other than the CBB requirements outlined below relating to regulated CIU, there are no additional governmental approvals or consents which need to be obtained in Bahrain, nor any statutory requirements to be complied with in relation to the issue of units by a Bahrain unit trust or the circulation of the offering documentation.

Advantages and differences between a unit trust and other forms of Bahrain CIU

CIUs can be in a number of forms such as companies, limited partnerships, foundations and unit trusts. Bahrain regulations have in the past permitted only corporate based CIUs, but now the Bahrain trust law is also enabling the establishment of unit trusts.

Bahrain unit trusts are new concept and as yet there is little practical experience of their use in Bahrain.

The theoretical difference is that a unit trust is established as a trust and subject to trust law (as well as CIU regulations). A corporate based mutual fund is subject to company law (as well as CIU regulations). In principle the establishment of a unit trust is easier as it does not involve the formation of a company and does not have to comply with company law requirements (e.g. registered office premises and separate audit of the company as well as the fund).

A unit trust can have more flexible terms than a corporate fund structure

A Bahrain unit trusts

What is a unit trust?

The unit trust is established by a trust instrument (also referred to as a deed). All assets of a unit trust are vested in a trustee under the trust instrument which divides the beneficial ownership into a number of units which are usually (but not necessarily) freely transferable and redeemable. The rights and obligations of the trustee and the unitholders, the terms of redemption and valuation rules are all set out in the trust instrument.

A subscription agreement will contain the contractual provisions between the trustee and the unitholders. The contractual provisions governing the relationship between the trustee and other advisers to the trustee will be set out in agreements between the trustee and the service provider(s).

There are two basic types of unit trust: open ended and closed ended CIUs.

Open ended unit trust

In an “open ended” unit trust, the fund is divided into a number of units, each unit representing a proportion of the assets held by the trustee. Units may be issued and/or redeemed from time to time as indicated by the provisions of the trust deed and offering document at the relevant net asset value.

Closed ended unit trust

In a “closed ended” unit trust, as opposed to an “open ended” one, the subscription is only allowed for a limited period of time, at the beginning of the investment period, when the units are “offered for sale”. There might be more than one “closing”, but usually no new holders are allowed in the fund, except through a financial compensation mechanism. The capital raised is blocked for a certain period of time, during which the unit trust may or may not make some interim distributions of profits and redeem part of the capital funds. Typically units are redeemed at the very end of the investment period in one bullet payment and the trust dissolved.

Registration of the trust as a CIU

Any Bahrain registered unit trust is regulated by the CBB under the CIU regulations as are any other collective investment undertakings, such as mutual funds issued as “instruments” of fund companies incorporated in the form of Bahrain Stock Companies (closed) or “BSC (c)”.

In addition to being registered as a CIU, unit trusts must also be registered at the CBB in the “Register of Trusts”; this is the only additional administrative regulatory requirement made by the CBB for a unit trust.

In the case of a unit trust, there is no need to incorporate a company, as opposed to the requirement to incorporate a company if a BSC (c) route is used.

Types of Bahrain CIU

There are three main types of CIU as per Bahrain CBB regulations, namely retail, exempt and expert CIU.

Retail CIU

This category is the most regulated category; the requirements are fairly heavy and should be discussed with legal advisers in detail. These CIU are designed for the retail market and investing in such mutual funds is accessible to anyone.

Expert CIU

Expert CIUs may only be offered to “**expert investors**”. The CBB imposes a minimum investment of USD 10,000 to such investors. These funds are subject to less restrictive requirements than retail CIUs. They do have greater investment flexibility, notably in terms of the asset classes in which these funds can invest. The regulatory framework is also less stringent with regards to the risk concentration limits allowed.

The CBB gives the following definition of an “**Expert Investor**”:

- Individuals holding financial assets of USD 100,000 or more;
- Companies, partnerships, trusts or other commercial undertakings, which have financial assets of USD 100,000 or more;
- Governments, supranational organisations, central banks or other national monetary authorities, local authorities and state organisations.

Exempt CIU

Exempt CIUs are largely unregulated CIUs that may be offered only to “**accredited investors**” and impose a minimum initial investment of USD 100,000.

These are regulated to the extent that they need to be registered with the CBB prior to being offered to “accredited” investors. There are only high-level disclosure and regular reporting requirements, on an annual (audited financials), semi-annual (reviewed financial statements) and quarterly (limited information) basis.

Investment policies are not restrictive and, as a result, such funds are offered only to a restricted investor base, i.e. those defined as “accredited investors”.

The CBB gives the following definition of an “**Accredited Investor**”:

- Individuals holding financial assets of USD 1,000,000 or more;
- Companies, partnerships, trusts or other commercial undertakings, which have financial assets of USD 1,000,000 or more;
- Governments, supranational organisations, central banks or other national monetary authorities, local authorities and state organisations whose main activity is to invest in financial instruments.

Investors that satisfy the definition of accredited investor also automatically satisfy the definition of expert investors.

The definition of accredited investor imposes higher liquid assets thresholds. It also prevents local authorities, as well as state organisations whose main activity is not related to investing into financial assets from investing in exempt funds.

Operators

For a unit trust to operate two or three functionaries are normally required: a trustee (which should be a Bahrain licensed trust company, such as **Ohad Trust BSC (c)**), a promoter and an asset manager. A unit trust's documentation normally provides certain safeguards whereby each of the trustee/custodian or promoter/asset manager is able to remove the other for certain specified causes. The unit holders usually have the power to remove the custodian or manager and, in certain circumstances, the trustee.

The trustee (or custodian)

The functions of the trustee or custodians are to:

- act as custodian of all the assets, including cash, of the trust fund;
- collect distributions and other payments due in respect of the unit trust's securities;
- act as registrar, transfer agent in relation to the issue, transfer, redemption of certificates for all units issued by the trustee and to maintain the appropriate registers; and
- make distribution and redemption payments.

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