



BERMUDA MONETARY AUTHORITY

Islamic Collective Investment Schemes

GUIDANCE NOTES

April 2011

1. Purpose of this guidance note

The purpose of this note is to provide guidance to prospective applicants seeking to establish an Islamic Collective Investment Scheme in Bermuda.

2. Authorisation

As a general rule, an Islamic Collective Investment Scheme would require to be authorised under the Investment Funds Act 2006 ('the Act'). A "level playing field" applies in dealing with fund applications and that extends to Islamic Collective Investment Schemes. All funds authorised by the Authority are subject to the same regulatory framework regardless of country of origin, sector specialisation or any underlying principles, including religious or philosophical principles.

3. Unique considerations for Islamic Collective Investment Schemes

All authorised investment funds are required to comply with the provisions of the Act and underlying rules. However, while Islamic Collective Investment Schemes are not subject to any additional or varied requirements under the Bermuda regulatory framework, certain unique features of such funds and their interpretation under the framework must be recognised.

a. Appointment and role and responsibilities of the 'Shariah Supervisory Board' (SSB)

The Authority will have no supervisory responsibility over the SSB. This responsibility lies with the fund's board of directors or equivalent. The Authority is a secular regulator and it would not be appropriate for the Authority to judge among different interpretations of Islamic financial jurisprudence.

The Authority expects that the members of an Islamic Collective Investment Scheme's SSB will be independent of the fund's board of directors, or equivalent, and investment manager. Moreover, a fund's board of directors, or equivalent, must ensure that any conflicts of interest are recognised and carefully managed. Where there is a potential conflict of interest this must be disclosed in line with the Fund Prospectus Rules 2007.

There is no impediment to an Islamic Collective Investment Scheme's use of an SSB at the fund sponsor level, instead of having a separate SSB at the fund level, provided proper disclosure is made in the prospectus.

b. Further Disclosures

All authorised funds are required to make disclosures as prescribed under the Fund Prospectus Rules 2007. As with any other type of authorised fund, an Islamic Collective Investment Scheme is required to set out in its prospectus the fund's investment policy and investment limitations. Disclosure should include reference to investment restrictions imposed by Islamic financial jurisprudence.

The prospectus shall include a description of the roles and responsibilities of the SSB, SSB composition, competence, and the SSB's contractual agreement with the fund, in the same way that disclosure should be made in relation to any person having significant involvement in the affairs of a fund.

The Fund Prospectus Rules 2007 require the description of a fund's material risks. In meeting this disclosure requirement there is an expectation that an Islamic Collective Investment Scheme would describe in its prospectus how its Board of Directors, or equivalent, and Investment Manager manage fiduciary risk in regards to compliance with Islamic financial jurisprudence (e.g. obtaining certification of compliance with Islamic financial jurisprudence from the SSB prior to the launch of the fund, and on an annual basis thereafter, through periodic internal audits and/or annual 'Shariah audit', etc).

Risk disclosure in the prospectus regarding how the fund will deal with investments which in the opinion of the SSB are no longer compliant with the fund's investment policies may also be required. Such disclosure may need to cover the communication of such non-compliance to investors and the time within which the fund is permitted to liquidate such positions. (Any purification mechanism adopted by the fund, and its impact on the basis of fund valuation, should also form part of the prospectus disclosure).

Where Islamic financial jurisprudence compliance may pose additional risks to the investor, such compliance risk, as well as the liquidation risk associated with disposing of any non-compliant investments should be adequately disclosed in the prospectus.

It should be noted that the competence or otherwise of the members of the SSB and the accuracy or completeness of statements made or opinions expressed with regard to the compliance of a fund with Islamic financial jurisprudence are not prudential matters. The Authority, therefore, does not exercise any prudential oversight over these matters. Where the absence of regulatory oversight of compliance with Islamic financial jurisprudence presents a material risk to the investor, appropriate disclosure should be made in the prospectus.

As a general principle, the Authority seeks to ensure that the prospectus is drafted in such a way that investors are able to clearly understand the basis on which they are investing.

c. Constitution

The Act requires that the constitution of an authorised investment fund must include certain provisions e.g. investment restrictions, where applicable. In the case of an Islamic Collective Investment Scheme the constitution should reflect the particular requirements relating to compliance with Islamic financial jurisprudence.

While, as has already been stated, it is not the Authority's role to interpret Islamic financial jurisprudence, the Authority expects an authorised investment fund to comply with the provisions of its constitution. Under section 26 of the Act, a fund's service providers are required to report to the Authority when the management and investment strategy is not materially in accordance with the constitutional documents.

d. Material changes

Section 25 of the Act requires the operator of an authorised fund to give written notice to the Authority of any proposal to make a material change in the fund's prospectus. A change is deemed to be material if it would, if known, reasonably affect the mind of a prudent participant in deciding whether to participate or continue to participate in the fund. A change in the membership of the SSB would not necessarily in itself be a material change but any change which might impact the fund's ongoing compliance with Islamic financial jurisprudence, e.g. a change in investment restrictions, would be deemed material.