

Compliance with Economic Substance Rules

Rafiq Jaffer - Partner, Banking & Finance
(Bahrain, KSA and UAE) - Banking and Finance
r.jaffer@tamimi.com - Dubai International Financial Centre

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

Abdullah Rauf Puri - Associate - Banking and Finance
- Riyadh



The Central Bank of Bahrain ('CBB') issued Directive No. OG/499/2018 concerning the economic substance requirements for certain financial institutions (defined as the 'Relevant Entities' below) in the Kingdom of Bahrain ('Bahrain') that came into force on 1 January 2019 ('Economic Substance Directive') pursuant to Article 38 of the CBB and Financial Institutions Law No. 64 of 2006 ('CBB Law').

The CBB recently published guidance notes in relation to the Economic Substance Directive and the report that is to be submitted by certain financial institutions (defined as the 'Relevant Entities' below), with the aim of serving as a preliminary guide to these Relevant Entities on the scope and application of the Economic Substance Rules (the 'Guidance Notes'). In this article we provide an overview of the Economic Substance Directive and the Guidance Notes.

Relevant entities

The Economic Substance Directive applies to all CBB licensed:

1. conventional and Islamic (wholesale and retail banks);
2. financing companies;
3. insurance companies;
4. investment business firms (Categories 1 and 2 only); and
5. fund administrators,

in Bahrain (collectively hereinafter referred to as the 'Relevant Entities' and individually a 'Relevant Entity').

The Economic Substance Directive

The Economic Substance Directive prescribes the requirements to be met by the Relevant Entities in Bahrain in terms of confirmations and notifications that must be submitted to the CBB on various matters on an annual basis (the 'Rules'). These requirements are in addition to the existing requirements under the CBB Law and the regulations and do not replace or supersede any existing provisions of the CBB Law or regulations. In addition, any applicant applying to the CBB for a licence to become a Relevant Entity is also required to submit a written confirmation to the CBB that they will comply with the requirements of the Economic Substance Directive.

Some key requirements under the Economic Substance Directive

The Relevant Entities are required to submit a report to the CBB on an annual basis within three months of the Relevant Entity's financial year end confirming (to the extent applicable to the Relevant Entity based on its licence category), amongst other things:

1. the Relevant Entity is directed and managed in Bahrain including confirmation that:
 - the meetings of the board of directors of the Relevant Entity are frequently held in order to enable it to discharge its duties and responsibilities effectively. At least half of all the meetings are to be held in Bahrain. The Relevant Entity must specify the total number of such meetings held within the financial year and specify how many such meetings are held in Bahrain;
 - strategic decisions of the Relevant Entity are set out at meetings of the board of directors as well as the board of directors' committees and the minutes of the meetings should reflect those decisions;
2. all 'approved persons' (as defined in the CBB rulebook) of the Relevant Entity possess the necessary knowledge and expertise to discharge their duties and meet the 'fit and proper' criteria prescribed by the CBB;
3. the Relevant Entity's core income-generating activities (i.e. those principle functions and activities that drive business value, rather than exclusively or mostly administrative support activities) ('CIGA') are being undertaken by the Relevant Entity in Bahrain. Where a CIGA is outsourced (if permitted by the CBB rules), the Relevant Entity is deemed to have complied with all CBB outsourcing rules and requirements as set out in the CBB rulebook. If a Relevant Entity is carrying on more than one CIGA then it is required to satisfy the economic substance requirement for each CIGA);
4. the Relevant Entity has proportionate to the activities of the Relevant Entity:
 - an adequate level of key decision-makers from the executive management;
 - a sufficient number of qualified employees resident in Bahrain. The Rules contain guidance on how the CBB will determine the adequacy of qualification and how full-time equivalent qualified employees is calculated;
 - the Relevant Entity has adequate physical premises in Bahrain; and
 - the Relevant Entity has in place an adequate set of internal policies and controls with respect to its operations, compliance, corporate governance and risk management. These policies are reviewed on a regular basis to ensure that they remain appropriate, relevant and in line with any standards set out by the CBB.

Penalties for non-compliance

Failure of a Relevant Entity to comply with any of the provisions of the Economic Substance Directive may result in enforcement action being imposed by the CBB.

What should you do next?

If you are a Relevant Entity, it is important for you to:

1. understand the Economic Substance Directive requirements and the obligations to be adhered to in order to ensure that your business is compliant;
2. undertake a 'health check' on your existing level of economic substance in Bahrain; and
3. ensure to file the required annual report in the CBB prescribed form within the designated timeframe (within three months of a Relevant Entity's financial year end).

Al Tamimi & Company's [Banking & Finance team](#) regularly advises on regulatory matters and is well placed to assess the impact of the Economic Substance Directive on your organisation. For further information please contact [Rafiq Jaffer](mailto:r.jaffer@tamimi.com) (r.jaffer@tamimi.com), [Natalia Kumar](mailto:n.kumar@tamimi.com) (n.kumar@tamimi.com) or [Abdullah Puri](mailto:a.puri@tamimi.com) (a.puri@tamimi.com).