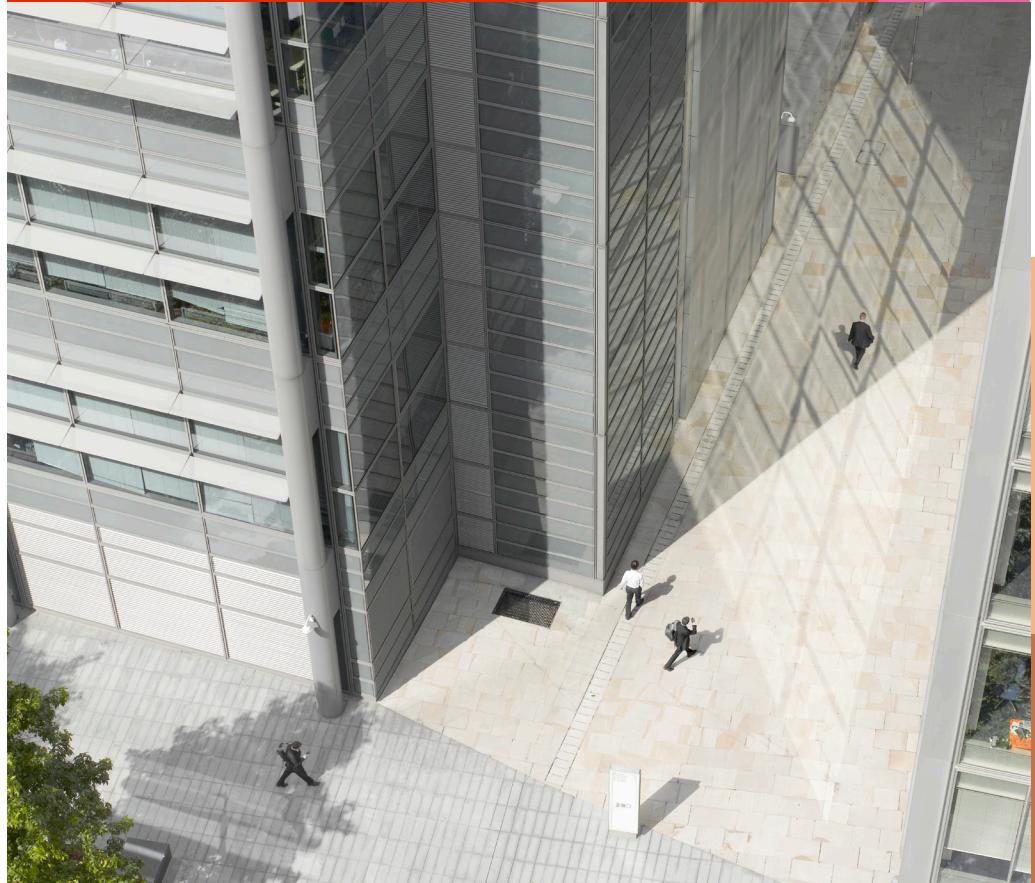


## *Islamic finance in Bermuda*

*Bermuda: Islamic  
finance hub  
in the western  
hemisphere*





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*Note*

The term 'Shariah-compliant' in this document refers to financial products and structures that are compliant with Islamic financial principles.

## ***Bermuda: Islamic finance hub in the western hemisphere***

The Bermuda Government welcomes Islamic finance.

The Bermuda Government is actively engaged in promoting the development of Islamic finance in Bermuda and ways to support its growth. These initiatives build on the existing relationship between Bermuda and the Gulf Cooperation Council (GCC). Investors from the GCC already invest heavily in Bermuda-based investment funds, including Shariah-compliant funds, and have significant interests in the local hospitality industry. Financing vehicles originating from the GCC use Bermuda exempt companies and trusts in Sukuk, investment holding and wealth management structures.

Bermuda is attractive as an international finance jurisdiction because it seeks to strike the right balance between maintaining an effective regulatory framework that meets relevant international

standards and ensures high standards of behaviour, while fostering an environment that remains attractive to business and enables them to grow and develop successfully.

Bermuda's legislation is robust, but flexible enough to accommodate Islamic financial products and structures.



## Why Bermuda

**Recognition** - Bermuda is a transparent and very well-regulated jurisdiction. Bermuda has executed over 20 Tax Information Exchange Agreements and has received international recognition for its successful efforts to get onto the Organization of Economic Cooperation and Development (OECD) "white list". Bermuda has been elected Joint Vice-Chairman of the Steering Group of the OECD's Global Forum for Economic Cooperation and Development, and hosted the 2011 Global Forum Plenary.

Bermuda's financial sector regulator, the Bermuda Monetary Authority (BMA), adopts a principle-based regulatory regime. The BMA has been appointed a member of the Executive Committee of the International Association of Insurance Supervisors.

**Political stability** – Bermuda is a self-governing British Overseas Territory; the legal system is based on English common law, the doctrines of equity and Bermuda statute law dating from 1612.

**Experience and expertise** – Bermuda has unrivalled talent and intellectual capital in key sectors, including insurance, investment funds and financial services.

**Infrastructure** – A substantial infrastructure of IT, high quality transport links, and professional services have been developed to support the financial industry in Bermuda.

**Economic stability** – Over the past decade, Bermuda's economic growth has surpassed that of the US and UK; Bermuda enjoys a high standard of living with all the amenities and conveniences of an advanced economy.

**Potential tax benefits** – Bermuda's tax neutrality is a competitive advantage



over its onshore competitors. As more innovative and complex Islamic financial products are developed by the global market, Bermuda offers promoters the advantages of effective tax structuring and speed to market.

Bermuda has signed a double tax agreement with the Kingdom of Bahrain which provides structuring opportunities for investors accessing the GCC region.

**Accessibility** – Bermuda's situation geographically (with easy access to and from New York and London) makes it an important hub for the global insurance/reinsurance and asset management industries.

**Modern legislation** – Bermuda has modern corporate and trust laws which are attractive for Islamic finance structures.

## Retakaful and captive Takaful

Innovation, entrepreneurialism and the leadership of Bermuda insurers with the cooperation of the Bermuda Government has fostered a highly successful reinsurance industry. Today, Bermuda is home to more than 50 major international insurance and reinsurance firms and there are 1200 international insurers and reinsurers licensed here.

As the largest offshore reinsurance and insurance domicile, Bermuda offers a range of opportunities for Retakaful (including retroretakaful) operators to assist in the growth and expansion of the global Takaful market. A number of Bermuda-based insurance and reinsurance companies as well as global insurance firms with a Bermuda presence are establishing relationships with GCC countries.

Bermuda is also the world's leading captive insurance market, with over 900 captive insurers, making it an attractive center to service the relatively untapped captive Takaful market.

### Structuring Retakaful and captive Takaful in Bermuda

The captive insurance and reinsurance industry is regulated by the BMA. The Insurance Act provides the statutory basis for regulating insurance and reinsurance in Bermuda, dealing with the establishment, operation and regulation of captive insurance and reinsurance companies. The Insurance Act also provides for the licensing and supervision of Bermuda insurance managers.

The same principles and requirements under the Bermuda Insurance Act apply to Retakaful and captive Takaful. Bermuda law provides significant flexibility with respect to corporate structures and governance, which allow for establishing and operating of captive

Takaful and Retakaful arrangements. Specific Retakaful and captive Takaful requirements are addressed in the entity's business plan and constitutional documents. The most widely used Takaful/Retakaful models which are Mudharaba, Wakala and the hybrid model can be structured under Bermuda laws.

Mudharaba is known as the profit-sharing model. The shareholders share in the profit or loss with the policyholders. The diagram in figure 1 shows how a Mudharaba model might work in Bermuda.

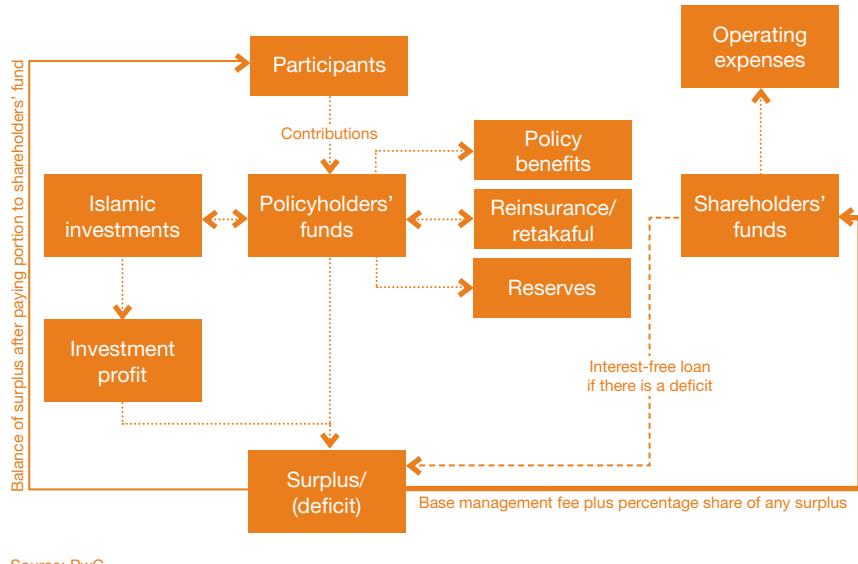
In the Wakala model, the operator acts as an agent of the participants. In this model, shareholders are paid a pre-agreed proportion of the contributions paid by the policyholders in return for running the insurance operations of the business on behalf of the policyholders. If the policyholders' fund makes a loss, the

operator provides an interest-free loan to the policyholders' fund that is repaid out of future surplus in the fund. The diagram in figure 2 shows how a Wakala model might work in Bermuda.

The hybrid model is a mix of the Mudharaba and Wakala models. In this model, the operator receives a Wakala fee for managing the insurance operation of the policyholders' fund as well as a Mudharaba fee for managing the investment fund. The diagram in figure 3 shows how a hybrid model might work in Bermuda.

In the Wakala Waqf model the policyholders' fund is replaced by a trust, which is the Waqf fund. Part of the capital of the shareholders' fund is used to create this trust, which is considered charitable under local law.

Figure 1: Mudharaba model



## Bermuda: Unique value proposition for structuring Retakaful and captive Takaful

- Bermuda's strong reinsurance and captive industry, well regarded regulatory environment, speed to market and talent pool makes it a natural home for Retakaful and captive Takaful.
- Rapid expansion in the global Takaful market and the limited availability of Retakaful capacity make it very attractive for reinsurance companies in Bermuda to develop Retakaful models.
- Bermuda's established reinsurance companies have access to significant capital resources and are at the leading edge of the conventional reinsurance industry. There are clear synergies to develop partnerships between Bermuda's conventional reinsurance operators and global Retakaful operators which have the requisite expertise and market knowledge.
- Either a fully-fledged Retakaful company or a Retakaful unit of a conventional reinsurer are attractive options in Bermuda.
- Bermuda offers opportunities to develop Retakaful for a nascent US Takaful market.
- Bermuda as the world's leading domicile for captives provides opportunities for GCC corporations to form Bermuda captive Takaful.

## Other key structuring considerations

- Bermuda insurers are allowed considerable flexibility in their investment policies. This is an important consideration for Shariah-compliant asset classes.

- A Bermuda Segregated Accounts Company (SAC) is a useful Retakaful structuring tool for ring-fencing the shareholders' fund from the funds belonging to the operator. A SAC could be used wholly for Retakaful business, or by a conventional reinsurer who wishes to operate a Retakaful window without having to incorporate and license a new entity.

- The Companies Act 1981 makes provision for mutual companies which is beneficial for structuring Bermuda Retakaful by virtue of their mutuality.

- A number of Bermuda reinsurers and financial institutions are governed by private act. It is therefore possible for Retakaful and captive Takaful to petition the Bermuda Parliament for private bespoke legislation to give enhanced flexibility.

Figure 2: Wakala model

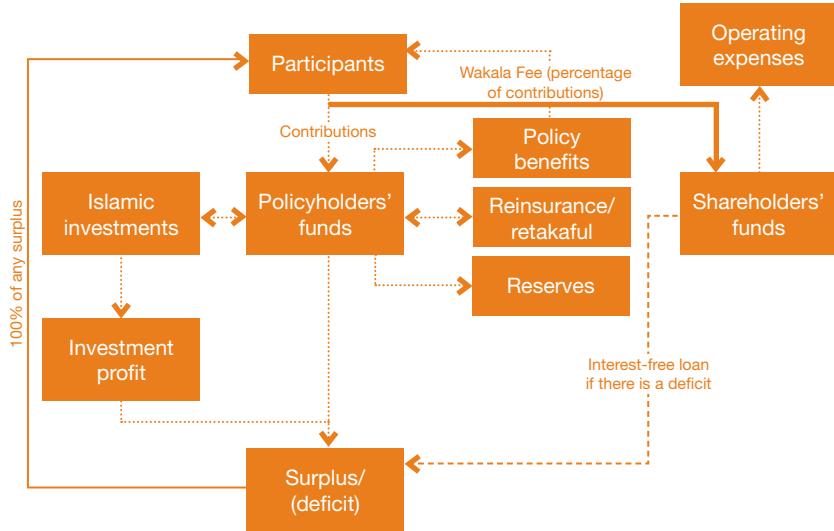
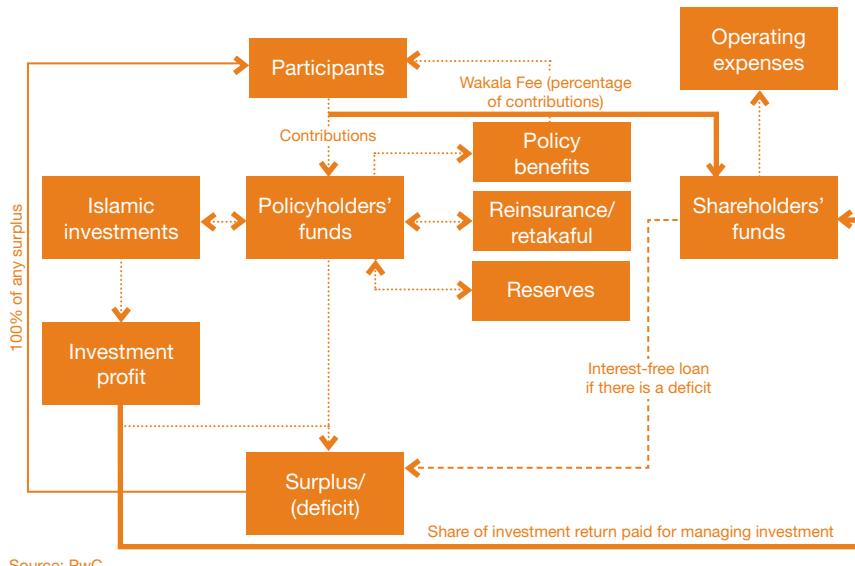


Figure 3: Hybrid model



## Shariah-compliant funds

Bermuda provides a favourable environment for the establishment of Shariah-compliant funds given its position as one of the world's leading jurisdictions for the asset management industry and the Government's receptive attitude to new entrants to the market. Bermuda offers an excellent and very stable platform from which fund promoters and investment managers seeking to expand their Shariah-compliant product offerings globally can confidently launch, manage and administer such products.

### **Shariah-compliant innovative investment funds and global investment fund platforms**

The investment fund industry is regulated by the BMA. The Investment Funds Act provides the statutory basis for regulating funds in Bermuda, dealing with the establishment, operation and regulation of investment funds. The Investment Funds Act also provides for the licensing and supervision of Bermuda fund administrators.

Structures commonly used in the investment fund industry can be created and utilized in Bermuda. Common structures include:

- Exempted companies;
- Segregated account companies;
- Exempted partnerships; and
- Unit trusts.

Shariah-compliant fund sponsors benefit from the presence in Bermuda of world-class asset management firms, fund administrators and other professionals. Funds can be listed on the Bermuda Stock Exchange (BSX), and Bermuda umbrella funds can be created as SACs.

Bermuda boasts a wealth of expertise in the area of mutual funds, hedge funds, private equity funds and real estate funds. Bermuda is home to hundreds of fund managers, nearly two thousand funds are registered here, and still thousands more administered by its world class fund

administration professionals. Bermuda has long recognized the changing needs of investors, including calls for greater transparency and regulatory oversight, while maintaining an efficient and entrepreneurial environment that allows funds and fund managers to flourish.

### **Bermuda Monetary Authority Guidance Notes on Islamic Collective Investment Schemes**

The BMA recently published its Guidance Notes on Islamic Collective Investment Schemes ('Guidance Notes'), strengthening Bermuda's case as a favourable domicile for the establishment of Islamic investment funds. The Guidance Notes are principle-based, non-discriminatory (providing level playing field with conventional funds), hence adding to Bermuda's competitive advantages by offering flexibility to Islamic investment fund promoters who can confidently structure, manage and administer such funds in Bermuda, bringing innovative investment products, such as Sukuk funds and ETFs, to the global market.

There are no impediments to authorising Islamic investment funds in Bermuda under the current framework. The Guidance Notes provide clarity on a number of issues which such funds may need to consider in complying with the existing regulatory framework, such as required disclosures, notification of material changes, and the role and responsibilities of the 'Shariah Supervisory Board', an independent governance body to ensure such fund products conform to Islamic financial principles.

### **Structuring Shariah-compliant investment funds in Bermuda**

Shariah-compliant funds are similar in their set up to conventional funds and compliance with Islamic financial principles can be viewed very much

as an overlay, comparable to a fund established with a “socially responsible” investment ethos. The same principles and requirements under the Bermuda Investment Fund Act apply to Shariah-compliant funds. Generally there are no restrictions in the investment objectives under the Bermuda’s Companies Act and Investment Fund Act. The specific Shariah-compliant requirements and restrictions can easily be incorporated into a fund’s offering memorandum/prospectus.

### **Structuring Shariah-compliant private equity/venture capital, real estate and global infrastructure funds in Bermuda**

A Shariah-compliant private equity/venture capital, real estate or global infrastructure fund is typically structured as a limited partnership. Bermuda’s limited partnership rules accommodate both the Mudharaba and Musharakah structures. The Bermuda Partnership Act does not attempt to regulate the affairs of a partnership to any great extent. The specific requirements of either structure can easily be incorporated into the partnership agreement. Bermuda structures are also suitable parallel vehicles to accommodate both Muslim and non-Muslim investors.

### **Bermuda: Unique value proposition for structuring Shariah-compliant funds**

#### **Access to US investments -**

Investors such as sovereign wealth funds, institutions and high net worth individuals from GCC and South East



Asia regions who are seeking to diversify their global Islamic investment portfolios and access US investments can do so by investing in Shariah-compliant US securities such as Sukuk, listed securities screened for Shariah-compliance and private equity.

#### **Innovative alternative Shariah-compliant investment funds -**

Bermuda, as a centre of excellence for the alternative fund industry, can assist in the development of innovative Shariah-compliant alternative investment funds such as hedge funds, exchange traded funds and fund of funds, commodities funds and Sukuk funds.

**Global Shariah-compliant fund platforms** – US/global investors seeking geographic and product diversification may invest in Sukuk issuances (either directly or via Sukuk funds) and other

investment products targeting emerging markets. To facilitate such cross-border investment flows, it is vital to have tax efficient global fund platforms in a reputable jurisdiction such as Bermuda and benefit from its highly regarded regulatory environment, high quality infrastructure, and world-class fund administrators and other professionals.

The key benefits of having Bermuda-based global fund platforms are as follows:

- They provide access to alternative asset classes in emerging markets.
- They are attractive to US/global ethical investors seeking access to socially-responsible investments in emerging markets.
- They are attractive to US/global investors seeking global Islamic investment diversification.

***Bermuda is a leading jurisdiction in innovative investment products focusing on reinsurance risk such as insurance-linked securities, catastrophe bonds, insurance swaps, and weather derivatives***

# **Sukuk and Shariah-compliant structured products**

The recent credit crisis did much to strengthen the case for alternative investment approaches and ways of raising capital in the global capital markets. Sukuk is one of the fastest emerging alternative instruments and is increasingly used by governments and corporations in the GCC and South East Asia to access global capital markets. Investors invest in Sukuk for their attractive yields and institutions can use Sukuk for liquidity management. The Sukuk market is rapidly permeating the global capital markets as many Western jurisdictions are also tapping into it.

## **Structuring global Sukuk transactions in Bermuda**

Sukuk and other Shariah-compliant structured products often involved an offshore structure in the form of a special purpose vehicle (SPV), which typically takes the form of an exempted company in Bermuda under the Companies Act 1981.

Already recognized as a centre of excellence for the domicile, management, administration and listing of investment funds and financing structures, Bermuda is a natural choice as a jurisdiction for Sukuk issuers. The GE Capital Sukuk, offered under Regulation S and structured using a Bermuda limited liability exempted company, represents a significant development for the global Sukuk market.

Bermuda SPVs and trusts are attractive for various Shariah-compliant structured products created under common Islamic contracts such as Mudharaba (partnership/ finance trusteeship), Musharaka (joint venture), Ijara (leasing), Murabaha (purchase order), Istisna (manufacturing or project

finance), Wakala (agency), Ijara wa Iqtina (finance lease), Salam (payment for future delivery), Arぶn (pre-purchase of right to acquire asset).

Bermuda offers administrative and cost efficiencies in that issuers may structure and list Sukuk in a single jurisdiction.

## **Bermuda: Unique value proposition for structuring global Sukuk transactions**

Sukuk structured and listed in Bermuda are particularly attractive for the following cross-border transactions:

### **Access to global capital markets**

- European and US-based corporations seeking alternative ways of raising capital globally (mainly from GCC and South East Asia) may structure and list a Bermuda-based Sukuk. Bermuda corporate and trust vehicles have been trusted by investors and capital markets globally for many years.
- Sukuk issuers from GCC and South East Asia seeking to raise capital from Western economies may structure and list a Bermuda-based Sukuk to benefit from Bermuda's reputation as a jurisdiction of choice for structuring cross-border transactions.

***The GE Capital Sukuk, offered under Regulation S and structured using a Bermuda limited liability exempted company, represents a significant development for the global Sukuk market***

## **Listing of Sukuk on the Bermuda Stock Exchange**

Besides its modern corporate and trust laws, Bermuda also offers listing facilities for Sukuk on the BSX, which has developed into a major offshore exchange for the listing of international securities. The BSX specializes in listing and trading capital market instruments such as stocks, bonds, mutual funds (including hedge fund structures), insurance-linked products and depository receipt programs. It provides high regulatory standards, visibility for issuers and transparency for investors, which facilitates cross-border flow of capital and bridges cross-border investment gaps.

The BSX's fully electronic capabilities offer attractive opportunities for Regulation S Sukuk offerings. The BSX adopts a non-discriminatory, religion neutral regime for Sukuk listing under its Specialized Debt listing rules. The BSX is suitable for the listing of a diverse range of Islamic financial products, including investment funds and ETFs.

PwC recommends that Sukuk listing is viewed as a four step process:

- Listing strategy
- Filing and communication with the competent authorities
- Continuous reporting
- Coordination of the listing process

## **Key benefits of using Bermuda SPVs for structuring Sukuk and other Shariah-compliant structured products**

- Bermuda offers SPVs that are tax efficient, based under common law principles, where the rights of all parties are clearly understood, recognized and consistently applied.
- The GE Capital Sukuk is proof that Bermuda's laws are tried and tested by rating agencies, regulators and investors globally for Sukuk structures.
- Bermuda-based SPVs and trusts vehicles are suitable for financing structures for the acquisition of global portfolios of assets.
- There are no restrictions in the 'objects' of a company under Bermuda company law. An entity may apply the principles of Islamic finance to its business dealings to achieve its objects.
- Bermuda companies may adopt a secondary name in non-roman script such as Arabic with the approval of the Registrar of Companies.
- Bermuda's private trust company legislation is attractive for Islamic finance structures. A private trust company is a company with trustee powers which is not required to

***BSX with its innovative and flexible approach is an attractive location for cross-border Sukuk listing***

be licensed under Bermuda trust legislation, provided that by the terms of its memorandum of association it is empowered to act as trustee of only a limited number of identifiable trusts.

- Financiers/institutions benefit from effective structuring of Shariah-compliant structured products through a combination of Bermuda SPVs and trusts, for example to create 'off balance sheet' or 'bankruptcy remoteness' structures.
- There is no exchange control for non-resident undertakings and no restriction on repatriation of funds.
- There is no stamp duty on any instrument affecting or relating to international businesses in Bermuda. This is a key consideration for global Sukuk issuances.





## Private wealth management

Bermuda provides sophisticated solutions designed for wealthy individuals and families and their advisers, for example:

- Family wealth management- wealth creation, enhancement, protection and distribution.
- Family offices or asset managers seeking a cross border platform complementary to their local providers.
- Investments outside of the Gulf: real estate, private equity, financial instruments, foreign direct investments.
- Entrepreneurs wanting to internationalize their business.
- Philanthropy.

Bermuda offers various types of trust structures which can be customized to accommodate varying personal estate planning objectives. Bermuda trusts, when properly structured, can offer tax-efficient global solutions, whereby assets are legally entrusted to a politically stable environment, with high level protection and confidentiality. A Bermuda foundation is a corporate alternative to the creation of a trust. Aside from serving family estate planning matters, Bermuda trust or foundation can be an

**Bermuda is a premium private wealth management centre**

excellent charitable structure for Islamic philanthropy such as Waqf.

Bermuda has a pool of talented people and service providers including trust administrators, lawyers and accountants who have expertise in dealing with complex estate planning, providing investment services and day-to-day administration. As a high-end, sophisticated jurisdiction, Bermuda is also an attractive location for family offices, philanthropy and foundations.

Bermuda also benefits from the presence of the world's top investment management firms, as well as large independent hedge fund and private equity fund managers. Asset managers locate their operations in Bermuda because it offers one of the world's highest standards of living and low taxes together in a prestigious international financial centre. Bermuda is a perfect location for Shariah-compliant asset managers to expand globally, access the US market and develop a globally recognized Shariah-compliant asset management brand.

The presence of asset managers and a significant number of alternative investment funds domiciled in Bermuda offer investment opportunities to HNWIs, pension funds, sovereign wealth funds, financial institutions, Waqf and endowments. Bermuda-domiciled funds and fund managers offer HNWIs and institutions significant choice of tax efficient investment strategies, with product and geographical diversification.

Bermuda's major banking groups and other wealth management firms offer advisory and discretionary investment services, and make available a wide range of investment vehicles from around the world, including bonds, equities, derivatives, structured products, mutual funds, and hedge funds.

## Work with you

PwC Bermuda is the leading provider of assurance, advisory and tax services to Bermuda's banking, asset management, reinsurance and financial services industry. We provide audit services to a significant proportion of the leading insurance and reinsurance companies in Bermuda and have ongoing advisory and other relationships with a vast majority of the remainder. Our asset management clients include investment partnerships and trusts, private equity funds, hedge funds, pension funds, treasury operations and investment managers, advisors, and banks.

PwC's global network has a dedicated, multi-disciplinary team of industry experts, including actuaries, tax and advisory specialists, who specialize in Islamic finance. PwC industry experts have extensive global experience in offering assurance and advisory services within the Islamic finance industry. PwC bring to the table the global resources of one of the world's largest networks of Islamic finance experts, with centers of excellence in Bermuda, Malaysia, the Middle East and North Africa and London.

### Retakaful

Globally PwC has more than 700 actuaries and Takaful/Retakaful specialists serving general, family, health Takaful and Retakaful markets.

PwC has solutions for the major challenges facing Takaful/Retakaful operators, such as tax issues, the potential lack of IT and operating infrastructure. PwC offers cutting-edge solutions for optimizing capital requirements, design and development of management information systems, to managing the impact of an insurer's conventional and Takaful/Retakaful portfolio. PwC

has carried out work for all elements of Takaful/Retakaful business, from reviewing business plans and helping people deal with investors, to financial modeling of Takaful business on an IFRS basis and on an AAOIFI basis. PwC has helped Takaful/Retakaful businesses at all stages of their development; from helping companies get established to reviewing and optimizing their reserving, underwriting and finance processes and controls and helping CEOs plan their strategies for growth.



### Shariah-compliant funds

PwC has significant experience in advising on launches of Islamic fund structures, including private equity, mutual funds, Sukuk, Islamic exchange-traded funds and funds of funds. Our tax specialists can advise on the most appropriate tax structure for each fund type.

For fund promoters PwC can offer guidance on eligible investments under Islamic principles and the monitoring of investment restrictions. PwC works with companies to monitor Shariah compliance function effectiveness. Advice is also available from PwC experts on the purification of non-Islamic income, cash management and the custody of Islamic

assets. As companies start to develop their fund ranges, PwC can offer staff training on Shariah principles.

For administrators, PwC can review the existing administration cycle of funds in order to identify gaps and to implement changes required to be within the scope of Shariah precepts, covering custody, cash management, fund accounting, financial reporting, trustee/fiduciary oversight, transfer agency, ancillary services and 'Shariah' board support.

### Sukuk

PwC has a dedicated, multi-disciplinary global team of industry experts, including tax and advisory specialists, who specialize in Sukuk and have the knowledge to assist with a variety of areas including structuring, operations, compliance, and tax.

PwC can support clients throughout the Sukuk listing value chain, starting from guidance on strategy to the final admission on the Bermuda Stock Exchange.

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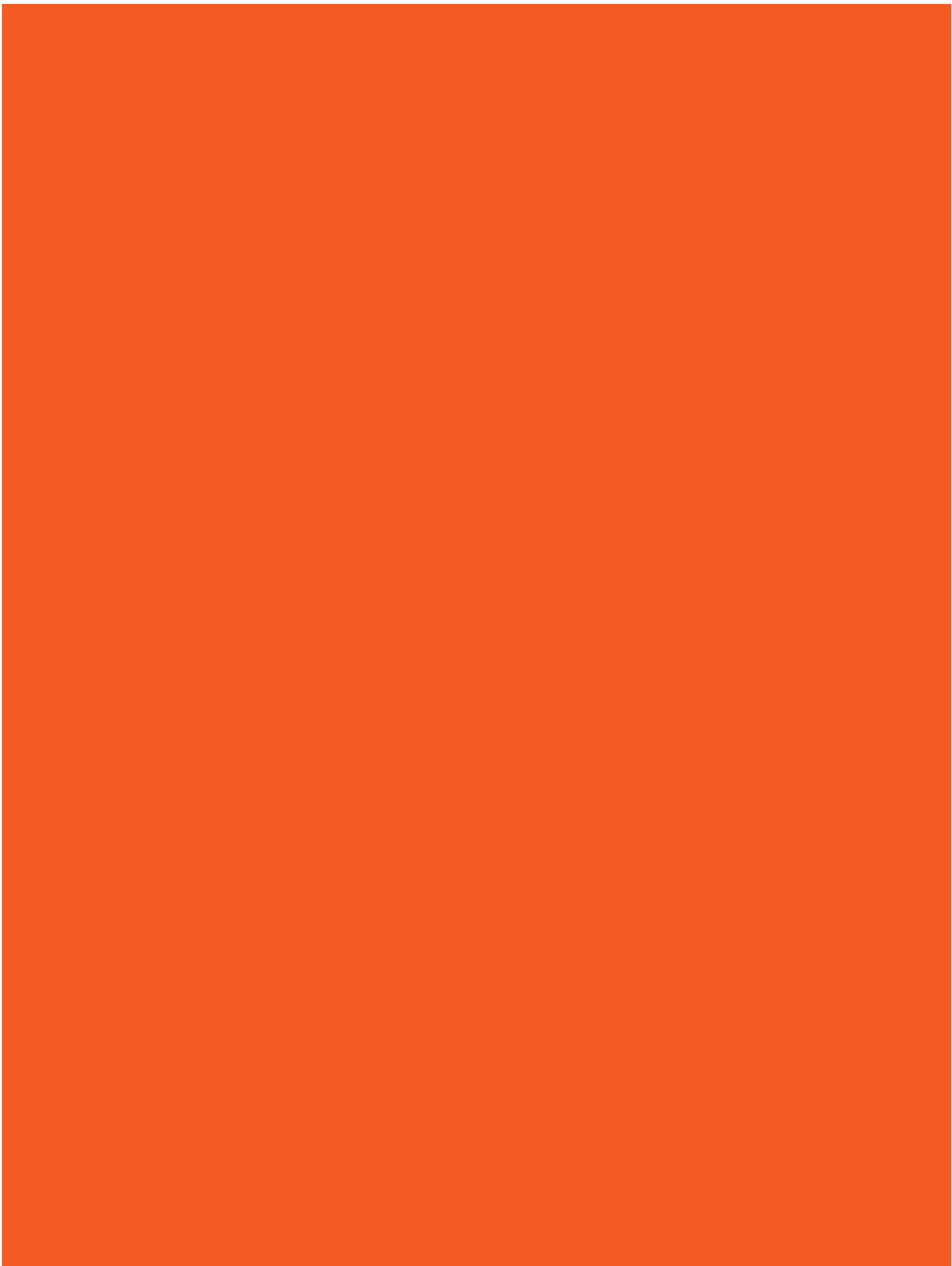
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