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Learn crisis lessons, Islamic banks told

The Islamic finance industry has strong future growth prospects, provided it strengthens its foundations based on lessons learned from the global financial crisis, says Mr. Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain (CBB).

The crisis has opened up new opportunities for Islamic finance but the industry must learn from the mistakes of its conventional peers, in order to exploit the new opportunities, he told delegates attending the World Islamic Banking Conference, held in Bahrain on 22 and 23 November 2011. Mr. Al Maraj was the keynote speaker at the inaugural plenary session, titled 'Managing the Challenges of Industry Globalization: Strengthening Regulatory Frameworks to Accelerate the International Development of Islamic Finance'.

"Islamic finance is a relative newcomer, having hardly existed 30 years ago. Since then it has recorded impressive rates of growth, but even today's US\$1 trillion industry is still relatively small on a global scale," he said.

The global financial crisis has given the Islamic finance industry a great opportunity. The obvious flaws in conventional finance have created great interest in the Islamic financial model and this should provide the basis for the industry to sustain a period of strong growth for the rest of this decade.

The growth opportunities are especially strong as Islamic finance has its largest presence in rapidly growing economies that have been least affected by the financial crisis. These economies should continue to register high rates of growth in the years ahead.

However, as Islamic financial institutions (IFIs) expand, they need to make sure that their management and control functions keep pace with their growth. As the financial crisis has shown, there is a need for firms, especially those that become internationally

active, to make sure that risk management, control systems, and IT are capable of providing an accurate picture of a financial institution's overall risk profile.

Boards of directors and senior managers also need to ensure that they have the knowledge, expertise, and professional skills to manage businesses that are growing in complexity. Building high quality human capital is an essential building block for the expansion of the Islamic finance industry.

Finally, the regulatory framework needs to keep pace with an expanding industry.

The Islamic finance industry is fortunate in that it has several well-established standard-setting bodies, including the Islamic Financial Services Board (IFSB), the International Islamic Financial Market (IIFM), and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

"Over the years, these standard-setting bodies have demonstrated their ability to adapt international standards to the needs of the Islamic finance industry," said Mr. Al Maraj.

"They now need to take the lead in adapting the new international standards, including Basel III, to the specific circumstances of Islamic finance. Ensuring that firms have strong capital and liquidity buffers should not be seen as an optional extra for the industry, but as an essential foundation for its next stage of growth.

"The industry will be stronger if it strengthens its foundations, just as the foundations of interest-based finance are now being strengthened."

Although fixing the problems that caused the financial crisis will take time, considerable progress has been made in developing new regulations, in the form of Basel III.

This new capital framework tries to do several things, but its main aim is to ensure that banks have bigger capital and liquidity

buffers, so that they will be less highly leveraged than in the past.

"When a bank could operate at a leverage ratio of \$1 of equity to every \$40 of assets, it was clearly too highly leveraged. It meant that losses of as little as two percent on the bank's asset portfolio could wipe out its entire capital. The Basel Committee has, rightly in my view, set out to make sure that in future banks will not be able to operate with so little capital relative to their assets," said Mr. Al Maraj.

"It is essential for the future development of the Islamic finance industry that it learns from the mistakes of interest-based finance. This includes making sure that it is based on secure regulatory foundations."

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Strong growth ahead for Islamic retail banking

Islamic banking assets with commercial banks globally will reach US\$1.1 trillion in 2012, a significant jump of 33% from their 2010 level of US\$826 billion, according to a report presented at the World Islamic Banking Conference.

Ernst & Young's World Islamic Banking Competitiveness Report 2011 also highlighted that Islamic banking assets in the Middle East and North Africa (MENA) region increased to US\$416 billion in 2010, representing a five-year compound annual growth rate of 20%, compared to less than 9% for conventional banks.

As new geographic territories open up to Islamic banking, the MENA region Islamic banking industry is expected to more than double to US\$990 billion by 2015.

The report, titled 'A Brave New World of Sustainable Growth', was presented at a special plenary session of the conference where more than 1,200 industry leaders from over 50 countries gathered to chart the future of Islamic finance.

The report explores key industry trends and critical success factors guiding the global Islamic banking and finance industry into its next chapter of performance and growth.

"The global Islamic finance industry continues its quest to boost international competitiveness and to build a sustainably profitable business model," said Mr. Ashar Nazim, MENA Islamic financial services leader at Ernst & Young.

"Both the challenge and the opportunity currently facing leading industry players is how will Islamic banks succeed in making the historical growth curve sustainable."

The Islamic banking market share of total banking assets in the MENA region has reached 14%, whereas in the GCC it crossed the milestone 25% threshold in 2011.

The report expects that there will be a change of play going forward as Islamic banks compete for mainstream customers who are open to Islamic or conventional banking.

"A worrying concern is the limitations in enabling legislative, regulatory, tax and legal environment in most Organisation of Islamic Conference (OIC) markets, which add to the cost and complexity of Islamic banking operations," said Mr. Nazim.

"Where there are guidelines and standards issued by industry infrastructure institutions,

their reach and enforceability remains a concern. These must be addressed as priority."

Bahrain is one of the few jurisdictions with a strong enabling environment for Islamic banks, the report notes.

It cautions that the industry is still fragmented with most Islamic banks holding less than US\$13 billion in assets and, hence, facing pressure on profitability.

In addition, exposure to downgraded real estate markets remains a concern for Islamic banks and this may also affect future growth.

"Islamic banking has been continuously gaining market share across key MENA region markets, but the question remains on how sustainable this growth is, especially in view of ongoing prolonged pressure on profitability," said Mr. Nazim.

"As the leading industry players compete to stay ahead, many are looking into transforming and improving their operational performance. Investment in operating model redesign, customer analytics, capital management and regulatory compliance appear to be essential features of the chief executive officers' agenda in 2012."

Islamic finance benchmark rate launched

The world's first Islamic finance benchmark rate was launched by Thomson Reuters, at the World Islamic Banking Conference in Bahrain.

The Islamic Interbank Benchmark Rate (IIBR) is designed to provide an objective and dedicated indicator for the average expected return on Shari'a-compliant short-term interbank funding. It aims to give Islamic banking an index that will improve interbank lending in the industry and cushion it from the current fluctuations in interbank rates in conventional banking.

The IIBR uses the contributed rates of 16 Islamic banks and the Islamic windows of conventional banks to provide a reliable and much-needed alternative for pricing Islamic instruments to the conventional interest-based benchmarks used for mainstream finance.

"The de-linking from conventional performance benchmarks started more than a dozen years ago and now we are extremely proud to offer the world's first Islamic pricing benchmark, the Thomson Reuters Islamic Interbank Benchmark Rate," said Mr. Rushdi Siddiqui, Global Head of Islamic

Finance at Thomson Reuters.

"We have taken a collaborative approach as industry challenges are best solved by industry players working towards a common objective.

"The simplicity and robustness of the new benchmark's methodology, governance, and transparency, combined with the endorsement of many respected Islamic financial institutions and scholars, will result in a reliable and realistic benchmark that better measures the cost of funding for Islamic financial institutions. Together we are taking an important step forward for Islamic finance authenticity."

The benchmark's ongoing implementation and integrity will be overseen by an Islamic Benchmark Committee of over 20 Islamic finance institutions, chaired by Dr Nasser Saidi, Chief Economist at the Dubai International Financial Centre and a Shari'a committee consisting of four renowned Shari'a scholars.

Rates for Shari'a-compliant US dollar funding will be contributed by the 16-member panel in the morning of each

business day to Thomson Reuters systems and will be published daily on Thomson Reuters terminals.

"The establishment of the IIBR marks an important milestone in the maturation of Islamic money markets by providing an international reference rate for interbank transactions," said Dr Saidi.

"Conventional money markets have relied on the London interbank offer rate (Libor), which by definition does not comply with Shari'a conventions. Islamic markets will be able to rely on the IIBR and it will become an international reference rate for both conventional and Shari'a-compliant transactions.

"Our aim is to provide an IIBR that is reliable, timely, representative of market conditions, transparent in its construction and accepted as the market reference. Islamic money and financial markets are coming of age and becoming part of the mainstream."

He said that while interbank transactions are Shari'a-compliant, in each transaction there was a feeling that the level of return was being set by traditional interest rates.

Islamic banks must embrace international standards

The Islamic finance industry must recognize the importance and relevance of international standards for its own long term well-being, says Mr. Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain (CBB).

Although international standards may not be designed to address the issues faced by the Islamic finance industry, they can, nevertheless, help build a strong and secure foundation for it, he said during a keynote speech at a major conference on Islamic banking and finance. The event, co-hosted by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and the World Bank, was held in Bahrain on 23 and 24 October.

“Recognition that international standards are relevant to the Islamic finance industry, even if they should not be blindly copied, will go a long way towards ensuring that the industry has the strong foundations on which to build for the future,” said Mr. Al Maraj.

There is a need to look beyond the differences and focus on the issues that are common to both industries, he urged. The principle of risk sharing, for example, is at the core of the Islamic finance industry. Unlike ordinary depositors, the holders of unrestricted investment accounts in theory share some of the risks that in a conventional institution would be borne exclusively by the shareholders of the bank.

While the principles of Islamic finance are very different to those of conventional finance, Islamic financial institutions (IFIs) are still subject to same kinds of risks and to the same laws of economics as are conventional ones.

Basel III requires conventional banks to hold a stock of high quality liquid assets that can be used to meet unexpected deposit outflows. These instruments include highly rated paper issued by sovereigns and by corporates.

The regulators of the conventional industry have focused on the issue of liquidity because, pre-crisis, conventional banks increasingly relied on their access to short-term interbank markets to fund relatively long-term assets to such an extent that the degree of maturity mismatching was no longer prudent.

“If we look at the trends in Islamic banking in the years prior to the crisis, we can see that there are important similarities between the practices of IFIs and those of conventional banks. Just like conventional

institutions, Islamic financial institutions increasingly funded long-term assets with short-term funding. Although the assets and liabilities were structured in a Shari’a-compliant manner, the degree of maturity mismatching was just as great as was practiced by conventional institutions,” said Mr. Al Maraj.

In some cases where the asset involved a long-term development project, the degree of maturity mismatching was significantly greater than that practiced by conventional financial institutions.

The Islamic finance industry must recognise that it also needs good liquidity risk management, said Mr. Al Maraj, while acknowledging that IFIs find it difficult to manage their liquidity risk given the relative lack of short-term money market instruments in which they can invest.

“There are genuine practical difficulties in applying Basel III to IFIs. Even so, they should not get in the way of recognizing the important principle that IFIs need to take liquidity risk just as seriously as conventional firms need to do. They need to make sure that they keep maturity mismatching to prudent limits,” said Mr. Al Maraj.

Another issue that Basel III seeks to address is to ensure that banks have sufficient capital to be able to absorb losses on an on-going basis. It has often been argued that IFIs need a different capital structure to conventional ones as IFIs’ account holders can expect to share in the risks to which the firm is exposed. This means that, in principle, they should expect to share in losses as well as profits. A similar assumption was made about investors who held the subordinated debt issued by conventional banks. When those banks failed, instead of taking their share of losses, subordinated debt holders were often protected by the terms of the bail-out.

“So, what applies in theory does not always apply in practice. This means that the regulators of IFIs also need to pay careful attention to the ability of capital structures to absorb losses on an on-going basis. It has become clear as a result of the financial crisis that the predominant form of bank capital needs to be equity. From an Islamic industry perspective, this has the great advantage that equity is without a doubt Shari’a-compliant,” said Mr. Al Maraj.

As for international financial reporting standards (IFRS), it is important to remember that transparency and consistency in the valuation of assets is every bit as

important to IFIs as to conventional ones. Because investment account holders are in principle exposed to similar kinds of risks as the holder of bank equity, it is important that IFIs present their financial results in a clear and understandable form which is comparable between institutions.

Mr. Al Maraj noted that AAOIFI has done a lot of immensely important work over the years in adapting international standards to the needs of the Islamic financial industry.

However, the need to adapt international standards to the needs of the Shari’a-compliant industry should not mean that the important underlying principles of transparency and comparability become neglected.

AAOIFI success in unifying practices

Harmonization of Islamic finance practices across the globe is largely the result of the application of standards issued by the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), said Shaikh Ebrahim bin Khalifa Al Khalifa, Chairman of the AAOIFI Board of Trustees.

Accounting, Shari’a and governance standards, developed and issued by AAOIFI, are now being followed – either as part of regulatory requirements or as internal guidelines – by all the leading Islamic financial institutions (IFIs) across the world, including in the Middle East, Asia Pacific, South Asia, Central Asia, Europe, and Africa, he told conference participants.

“The wide application of AAOIFI’s standards has resulted in a progressive standardization and harmonization of international Islamic finance practices,” said Shaikh Ebrahim.

AAOIFI has so far issued a total of 86 standards in the areas of accounting, auditing, ethics, governance, and Shari’a.

“I would like to thank central banks, regulatory authorities, and AAOIFI’s over 200 institutional members in more than 40 countries for their continuing support on the development and adoption of the standards,” said Shaikh Ebrahim.

Need for broadening Islamic finance markets

The Islamic investment industry needs to acquire more breadth and depth in order to maximize the potential of the Islamic finance industry as a viable and efficient alternative model of financial intermediation, a conference in Bahrain was told.

While the US\$1.5 trillion industry has become a significant segment of the global financial industry, its continued growth hinges on its capability of tapping the huge global interest in Islamic finance, said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the Central Bank of Bahrain (CBB).

“The potential size of the Islamic finance market is vast, and the accelerated establishment of Islamic finance hinges on attracting the flow of these potential funds into Islamic investment,” he said at the World Islamic Funds and Financial Markets Conference, held in Bahrain on 26 and 27 September 2011. The event was held under the theme, ‘Achieving International Scale: Creating Vibrant Islamic Financial Markets and Re-Invigorating the Islamic Investments Industry’.

In order to further enhance the growth of the Islamic investment industry and create deep and vibrant Islamic investment markets, there are several factors that need to be taken into consideration, said Mr. Al Baker.

“Despite the strong potential for Shari’a-compliant funds and investment instruments in the global market, a number of economic, legal, and regulatory challenges remain which need to be addressed to further strengthen growth. It is critical to facilitate harmonization of standards and practices globally so that the industry can realize its full potential in the international markets,” he said.

There is a need to build a system that would be able to facilitate effective and efficient capital and trading flows. This requires further development of an Islamic financial system which has the entire required infrastructure that includes: (i) Islamic financial institutions ranging from banking, takaful (Islamic insurance), capital market, fund and wealth management entities (ii) creating a conducive legal and Shari’a framework and (iii) a financial system that has a comprehensive range of Islamic financial products and services.

Having an active Islamic financial market is one of the contributing factors that will

further accelerate the growth of the Islamic investment industry, he said.

A vibrant Islamic financial market will facilitate fund-raising and investment activities and will also promote the creation of primary and secondary markets for Islamic financial instruments. In this regard, some progress has been achieved in the form of primary issuance of globally accepted Islamic financial instruments such as sukuk. In turn, this global issuance of sukuk has played its role in building the linkages between the parties of the financial markets such as the issuers and investors.

However, while the issuance of sukuk has paved the way for the creation of a supply of Islamic financial instruments, it has not led, as yet, to the promotion of active secondary markets. A greater focus is needed, therefore, in this aspect.

It is also important to adopt proper corporate governance in the Islamic investment industry in order to improve the confidence of the investors and to ensure that markets are fair, efficient and transparent. This includes having proper disclosure requirements, adequate disclosure of all terms and conditions of Islamic products, as well as transparency in disclosing financial information and indicators.

Creating adequate straightforward regulation for Islamic investment products, which industry players can use to grow their activities, is another factor to further strengthen the foundations of Islamic investment markets.

Such regulation should create the necessary framework for investment products targeting small, medium size, as well as accredited investors, who wish to invest their funds in accordance with Shari’a principles. Such a regulatory framework should also cater for a wide range of Shari’a-compliant investment products that include equity, sukuk, various types of Islamic funds with moderate risks, as well as high risk funds, Islamic real estate investment trusts (REITs) and other alternative investments.

“Addressing all types of investors and investment instruments will guarantee the wider spread of Islamic investment not only in the region, but also globally,” said Mr. Al Baker.

It is also important to have sufficient number of professionals that are well versed in both the capital market and the Shari’a

to further develop the Islamic investment industry. This, in turn, will further enhance product development and improve services to investors in the Islamic capital market.

“Another critical issue that needs to be addressed is related to the development of robust national and international liquidity framework, which is currently still underdeveloped in most of the jurisdictions in which Islamic financial services are offered,” said Mr. Al Baker.

The development of such a framework is necessary not only to reduce the cost of intermediation, but also to enhance the liquidity level in the financial system in order to achieve effective money market operations for Islamic financial players.

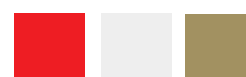
Furthermore, creating a robust rating process is another integral part of strengthening the Islamic capital market. Rating agencies need to fully appreciate the unique features, characteristics and risk profile of Islamic instruments. It is important to adopt a more holistic rating process, encompassing the fiduciary aspects and credit risk while giving due consideration to the transparency and visibility of the underlying transactions and the quality of management.

In addition, it is important to further enhance the innovation of new Islamic instruments and encourage more spending on research and development, in order to widen the contribution of Islamic investment in the global financial market.

“Last but not least, there is a need for Islamic financial institutions to develop strategic alliances with other financial institutions globally, especially in product structuring and offering, as the formation of such alliances will help to achieve economies of scale and improve services across the Islamic investment industry,” said Mr. Al Baker.

In Bahrain, a strong and robust regulatory framework adopted by the CBB will ensure that the Kingdom continues to be one of the leading financial centers in the region and a global leader in Islamic finance, he said.

“The CBB intends to remain at the forefront of Islamic finance and investment and we look forward to working closely with market players in developing this key industry,” said Mr. Al Baker.



Shari'a scholars and the governance debate

As Islamic finance continues to progress for an optimal regulatory and governance framework, various regulatory and governance issues remain on the cutting edge of the growth and development of the industry. Dr Ali Adnan Ibrahim, Vice President at Bahrain-based Al Baraka Banking Group and an Adjunct Professor of Law at the Georgetown University Law Center, highlights some of the issues.



The role of Shari'a scholars within the governance structure of Islamic finance is pivotal. With their unique position, Shari'a scholars not only provide oversight but also encourage innovation, and often guide the regulatory infrastructure for the Islamic finance industry.

In such capacity, the scholars not only influence new standards for Shari'a-compliant transactions, direct Shari'a-compliance policy of an Islamic finance institution and advise regulatory authorities in better appreciating and analyzing the special features of Islamic finance but also represent a norm-setting institution collectively.

This role is quite unique and unprecedented if viewed within the contemporary governance and regulatory systems. In this context, Shari'a scholars stand as a class of their own.

However, some perceive the role of Shari'a scholars as quite close to the role of other institutional constituencies like the board of directors. This view insists on somewhat similar regulatory treatment for the Shari'a scholars. The outcome of such an understanding would be to bring the Shari'a boards of an Islamic finance institution at par with the board of directors and how the directors are regulated.

As discussed below, this approach could potentially lead to a dangerous path, as it may weaken a time-tested regulatory system: a peer-review based self-regulation, which possesses an inherently strong check-and-balance system.

Peer Review

Viewing the Shari'a scholars without the historical perspective on the Shari'a scholarship would present a huge confusion. That is to say, it is important to understand that the Shari'a scholars have always existed as an informal institution (i.e., different from a modern organizational form), and often under various threats to their independence.

Not only did they survive such threats, the Shari'a scholars continued to be regulated by a sophisticated process of peer review. For want of space, it would suffice to mention that the peer review of Shari'a scholars not only regulated the Shari'a scholars but also the Shari'a view or advice (i.e. ijtehaad or fatwa) they maintained or provided. This self-regulatory system was so effective that

it would culminate in widespread public support for the scholars and their respective views.

The peer review process remained documented for the most part. This wealth of Shari'a scholarship represents a sophisticated Shari'a regulatory architecture that remains relevant even today.

Furthermore, the institution of the Shari'a scholars was one that never stopped functioning. In this respect, some argue that ijtehaad (or an independent juristic opinion for newer situations or circumstances) had stopped for several centuries. Opposing views argue that ijtehaad was only restricted due to apparent abuse but never became completely dysfunctional.

However, it would be fair to state that Muslims never experienced a total absence of ifta' (issuance of an opinion or advice, based on the Shari'a, in matters involving worship, business, family, inheritance etc.). Indeed, it is this process of ifta', with certain features of ijtehaad, that has allowed the Islamic finance industry to grow to its current levels. This truly signifies the strength of the Shari'a's regulatory system.

Furthermore, depending on how the shareholders' resolution is drafted, the Shari'a board may potentially review the functioning of the board of directors for Shari'a-compliance purposes. This would not necessarily mean that one body enjoys a higher position. This would, however, illustrate how different are the roles that Shari'a scholars exercise.

The upshot of the above discussion is that any new regulatory approach on Shari'a scholars would immensely benefit from the historical regulatory practice of the Shari'a scholars, and its continued effectiveness.

A regulatory approach to the governance and regulation of Shari'a supervision should also benefit from an in-depth empirical work that may highlight any Shari'a supervision issues. It is important to note that no such works exist to inform the governance discussions in the above context.

If any empirical work specifies any governance issues (such as conflict of interest, divulging confidential information etc.) facing Shari'a supervision, devising an adequate corresponding strategy would become imminent. In such case, it might be

more productive to invite the Shari'a scholars to take any appropriate measures in response to any such issues. An established body of renowned Shari'a scholars, such as the Shari'a Board of the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), may steer a self-regulatory evaluation process on behalf of the Shari'a scholars (and by possibly co-opting any additional scholars).

Shari'a Processes

Generally speaking, the Shari'a processes would mean the administrative functioning of the Shari'a supervisory boards. This may include different procedures involving Shari'a board meetings, delegation of powers, constitution of committees, quorum, resolutions or fataawa, secretarial affairs, and staffing.

Unlike Shari'a scholars, the institution of Shari'a supervisory boards is quite recent but has quite effectively responded to various important regulatory and governance objectives. One of the main achievements of this initiative has been achieving a greater uniformity of Shari'a opinions, which alone has contributed significantly to the efforts of standardization within the Islamic finance industry.

As is true for any organizational unit, the working of the Shari'a supervisory boards may benefit from any continuing research and scholarship that may enhance their productivity; and help achieve regulatory and governance objectives, such as increased transparency and objectivity.

The Shari'a emphasis on achieving fairness and other structural safeguards against any form of exploitation provide a common ground for achieving contemporary governance and regulatory objectives, such as ensuring integrity of the market and transparency, insisting on disclosures, providing a level playing field, and enhancing investor protection.

While the Islamic finance industry would benefit from various measures by contemporary governance and regulatory regimes seeking to support the industry, it appears that the contemporary governance and regulatory regimes may also be able to draw some important lessons on how Shari'a scholars may have regulated themselves historically.

Public hearing in Bahrain on IFSB standards

The Islamic Financial Services Board (IFSB) held a public hearing in Bahrain to receive comments on two standards currently under development.

The public hearing, held on 14 December 2011, was hosted by the Central Bank of Bahrain (CBB).

Representatives of the Islamic financial services community and interested parties attended the event to provide comments on two exposure drafts (EDs), issued by the IFSB.

ED-12 is on Guiding Principles on Liquidity Risk Management for Institutions offering Islamic Financial Services (IIFS), excluding Islamic insurance (takaful) firms and Islamic Collective Investment Schemes while ED-13 is on Guiding Principles on Stress Testing for IIFS.

The EDs, which are available on the IFSB website (www.ifsb.org), were issued on 12 October 2011. Public consultation on these EDs will end on 12 January 2012.

The public hearings for EDs are held as part of the IFSB due process for the development of standards.

ED-12: The proposed document on liquidity risk management endeavours to delineate a set of guiding principles for the robust management of liquidity risk by institutions offering Islamic financial services (IIFS) and its vigorous supervision and monitoring by supervisory authorities, taking into consideration the specificities of IIFS and complementing relevant existing and emerging international standards and best practices.

In keeping with the objectives of the IFSB, the Guiding Principles of ED-12 aim to help develop a prudent, efficient and resilient Islamic financial services industry, thus enhancing the stability of the overall financial systems in which IIFS operate.

In addition to providing necessary

conditions for effective liquidity risk management in the Islamic financial services industry, the Guiding Principles outline, among others, the:

i. salient characteristics of the liquidity risk management process to be undertaken by IIFS including identification, measurement, monitoring, control, reporting and mitigation;

ii. role of various components in the governance structure as well as that of different functional and business units in ensuring robust and effective liquidity risk management by IIFS;

iii. liquidity risk implications of various Islamic financing contracts during different stages of operations;

iv. important ingredients of supervisory framework to monitor the liquidity positions and liquidity risk management framework of IIFS that include, inter alia, initiatives for the development of a robust national liquidity infrastructure, supervisors' contingency planning for IIFS and supervisors role as provider of Shari'a-compliant liquidity support to IIFS.

ED-13: Guiding Principles on Stress Testing for Institutions offering Islamic Financial Services (other than takaful Institutions and Islamic Collective Investment Schemes)

The proposed document on stress testing aims to provide a set of guiding principles intended to complement the existing international stress testing framework, taking into consideration the specificities of IIFS as well as the lessons learned from the recent global financial crisis so as to contribute to the soundness and stability of the IIFS, in particular, and the Islamic financial services industry as a whole.

The Guiding Principles of ED-13 provide a framework for IIFS with the aim of guiding them in assessing and capturing vulnerabilities under various stress-testing scenarios, including extreme but plausible

CBB is IFSB chair for 2012

Mr. Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain (CBB), has been appointed Chairman of the Islamic Financial Services Board (IFSB) for the 2012 year.

The Deputy Chairman for 2012 is Sheikh Abdullah Saoud Al-Thani, Governor of the Qatar Central Bank.

The appointments are effective for one year from January 2012.

This is the second time the IFSB chair is with Bahrain. Earlier, Shaikh Ahmed bin Mohammed Al Khalifa, then Governor of the Bahrain Monetary Agency (now known as the Central Bank of Bahrain) was the inaugural Chairman of the IFSB for 2003. The chairmanship of the IFSB Council is on an annual rotational basis.

shocks, in order to achieve the following, inter alia:

i. identify how different portfolios respond to changes in key economic variables (for example benchmark rates, foreign exchange rates and credit quality);

ii. assess the quality of assets to identify existing and potential loss exposures;

iii. evaluate potential threats to the IIFS's ability to meet its financial obligations at any time, arising from either funding or market liquidity exposures;

iv. estimate the impact of stress events on baseline profit (as profits normally act as the first line of defence before dipping into capital);

v. analyse the IIFS's ability to meet its capital requirements at all times throughout a reasonably severe economic recession.

CBB attends regional meet on bank supervision

The Central Bank of Bahrain (CBB) was represented at a high-level regional meeting on strengthening financial sector supervision and regulatory priorities in the Middle East and North Africa (MENA) region.

Mr. Khalid Hamad, Executive Director, Banking Supervision, at the CBB, attended the meeting, held in Abu Dhabi on 26 and 27 October 2011. It was organized by the Arab Monetary Fund (AMF) and the

Financial Stability Institute (FSI) of the Bank for International Settlements (BIS), in collaboration with the Washington DC-based Institute of International Finance (IIF).

The meeting was attended by senior officials from Arab central banks, executives of large commercial banks, as well as senior representatives of BIS, the Basel Committee on Banking Supervision, the European Central Bank (ECB), the UK Financial Services Authority (FSA) and the AMF.

They discussed current priorities in the regulation and supervision of the financial sector in the MENA region, the risks and opportunities "post-crisis", key developments and practical implementation issues related to Basel III, regulating, supervising, and resolving systemically important financial institutions, in addition to the ECB perspective on systemic and macroprudential tools, as well as other key topics.

CBB's 7-year international sukuk oversubscribed

The Kingdom of Bahrain, acting through the Central Bank of Bahrain (CBB), successfully priced a US\$750 million 7-year sukuk offering in November 2011.

This was Bahrain's first 7-year international sukuk offering and further develops the Kingdom's presence in the international sukuk market and affirms its commitment to Islamic financing.

The oversubscribed offering was marketed in Asia, the Middle East and London.

The sukuk offering was priced at a spread over mid swaps of 450 bps to yield 6.273%. The maturity date of the certificates is 22 November 2018 and the certificates are rated BBB/BBB by Standard and Poor's and Fitch. The final pricing achieved was in line with pricing guidance at 450 basis points over mid swaps.

The transaction marks Bahrain's fourth transaction in the international sukuk

markets and demonstrates the Kingdom's commitment to Islamic capital markets.

The order book was driven by broad demand, with allocations of 62% to Middle East investors, 20% to European investors, 12% to Asian, and 6% to investors from other regions. By investor type, 40% of the sukuk were placed with banks, 22% with asset managers, 20% with central banks, sovereign wealth funds and supranationals, 12% with insurance companies, 3% with private banks, and 3% with other investor types. Approximately one-third of the offering was placed with Islamic accounts.

"Bahrain's return to the sukuk market through a longer dated issue is part of our desire to create a yield curve in the international sukuk market in the same way that we have done in our domestic market," said Shaikh Salman bin Isa Al Khalifa, Executive Director, Banking Operations, at the CBB.

"The strong demand from new as well

as existing international investors is a confirmation of investor confidence in our credit, particularly in view of the volatile market backdrop."

The certificates were issued by the CBB International Sukuk Company (No. 3) (SPC), with 22 November 2011 as the settlement date. The certificates have been listed on the London Stock Exchange.

The lead managers appointed for the issuance were BNP Paribas, Standard Chartered, and Citibank.

Despite a very active calendar, with over US\$3.5 billion in competing sukuk supply, Bahrain was able to price its 7-year offering in a historically attractive benchmark yield environment.

The transaction was smoothly executed despite softer market conditions on the day of pricing. The final orderbook came in at c.US\$1.8 billion, comprising a pool of 115 high-quality sukuk and conventional investors.

BFX launches trading of derivatives

The Bahrain Financial Exchange (BFX), the first multi-asset exchange in the Middle East and North Africa (MENA) region, commenced live trading of its conventional trading segment.

Following the successful launch of its Islamic division, Bait Al Bursa, in February 2011, the BFX began operations of its conventional division on 23 November 2011. The launch of the conventional segment is in line with the strategy to establish the BFX as the only multi-asset exchange in the region offering its members and their customers the opportunity to trade in various asset classes, such as derivatives, equities, fixed income, exchange traded funds (ETFs), and structured products in both the conventional and Islamic finance vertical.

In its initial phase, the BFX is listing three derivatives products for trading. These products are Natural Gas Futures, Gold Futures and Euro-US Dollar Futures. They are designed to provide market participants with opportunities to trade on precious metals, energy and currency asset classes to meet their investment and hedging requirements.

Additional offerings from currencies, commodities, and indices baskets will be introduced in the future.

Mr. Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain (CBB), said on the occasion: "We congratulate the Bahrain Financial Exchange and wish it

great success. The start of the conventional division of the BFX will greatly benefit the financial markets of the Kingdom of Bahrain. We are confident that the BFX market will be utilised by financial institutions, based locally as well as regionally, for the investment and trading requirements of their investors.

"The establishment of such sophisticated and next-generation exchanges like the BFX will facilitate the financial markets in Bahrain to achieve a higher level of maturity and uniformity."

Shaikh Mohammed bin Essa Al Khalifa, Chief Executive of the Economic Development Board (EDB), said: "We are pleased to see the establishment of the BFX and expansion of its membership base across the MENA region. Sophisticated financial markets such as the BFX enable the free flow of capital, which is vital in promoting economic growth and helping businesses to create jobs and opportunities for all Bahrainis."

Mr. Jignesh Shah, Chairman and Group Chief Executive Officer of Financial Technologies Group (FT Group) and Chairman of BFX said: "I would like to convey my appreciation for the support that we received from the Government of Bahrain, in particular the Central Bank of Bahrain and the Economic Development Board, without which the setting up of a true multi-asset exchange would have been impossible.

"The Kingdom of Bahrain being the most mature financial centre of the Gulf and a globally leading centre for Islamic finance is the ideal location for an international multi-asset exchange like the BFX, which offers products in both Islamic and conventional finance accessible to the trading community across the globe."

Mr. Arshad Khan, Managing Director and Chief Executive Officer of the BFX and the BFX Clearing and Depository Corporation (BCDC), said exchanges are considered as the barometer of an economy; therefore, the establishment of the BFX and the successful commencement of live trading signify a landmark accomplishment for Bahrain's financial sector.

"We are proud to play a major part in the evolution of the multi-asset market place for conventional and Islamic finance emanating from the Kingdom of Bahrain," said Mr. Khan.

The exchange will continuously develop its product portfolio to meet market requirements. He also thanked financial institutions that have joined the BFX as members, for their support.

In line with the other international exchanges, the BFX conventional division operates from Monday to Friday. Trading time is 8:30am to 9:30pm (Bahrain time), to bridge the gap between the Tokyo and New York markets.

Trust is key success factor for financial firms

Trust and integrity are the basis of a financial system that inspires the confidence of customers, said Mr. Rasheed Al Maraj, Governor of the Central Bank of Bahrain (CBB).

Only those financial services institutions, individually, and the industry, collectively, that adhere to ethical standards will be able to prosper and grow, he told participants at a seminar, titled 'Integrity at Work'. The event, held in Bahrain on 4 October 2011, was organized by the UK-based Chartered Institute for Securities and Investment (CISI) in conjunction with the Bahrain Institute of Banking and Finance (BIBF).

Established almost 20 years ago, CISI has been recognised as the leading professional body for the investment industry in the UK. It now has over 40,000 members in 89 countries. Bahrain is on course to have the largest CISI membership outside the UK, due in part to the success of the BIBF's Financial Advisor Programme (FAP), which allows successful candidates to become affiliate members of CISI.

The FAP is endorsed by the CBB as the minimum mandatory qualification for entry level financial advisors in Bahrain and is aimed at professionals who have entered (with three or less years of relevant work experience), or are aspiring to enter the profession of financial advice.

"Membership of CISI is recognition that an individual has achieved not only a high standard of technical competence, but also displays the ethical judgment and personal integrity necessary if confidence in the financial system is to be maintained," said Mr. Al Maraj.

"Confidence and integrity are, without a doubt, the foundation of the financial system. All financial firms – whether they

are banks, investment managers, insurance companies, or securities brokers – are alike to the extent that they make a promise to the customer."

Similarly, customers have to believe that people working in the industry are placing customers' interests first. If they doubt that the firm or its employees are truly interested in making the customers' money grow, rather than claiming as much of it as possible in the form of fees and bonuses, they will be reluctant to deal with financial firms.

"These are just two examples of the way in which consumers' trust in financial firms can break down," said Mr. Al Maraj.

"In the last few years, we have seen plenty of examples around the world of financial firms that have lost the trust of their customers and have paid a heavy price. The recent allegations that the employees of some large investment banks deliberately created financial products that would fail, imposing large losses on customers so their own firms could benefit, are simply the most high profile of many such allegations that have been unearthed following the financial crisis."

Regulators have an important role to play in ensuring that customers can trust the financial institutions that they deal with.

Regulators can set entry and licensing conditions to make it difficult for those who are dishonest or incompetent to set up firms or to work in the industry. They can require firms to have adequate financial resources to back the promises that they make, and adequate control systems to ensure that they can properly identify and manage the risks that they are taking. They can also mandate training and competency requirements for staff who deal directly with a firm's customers.

"However, a regulator cannot be everywhere at once. Nor should we aim to be," he said.

"To a very large extent, maintaining public confidence in financial firms is the job of the firms themselves and their employees. As regulators, we cannot set rules that ensure that people will behave honestly and with integrity. Those are values that must come from within, they must be part of a firm's culture."

Only an industry that takes seriously the need for ethical standards will be able to grow and prosper and to offer its customers the services they require, Mr. Al Maraj added.

"For this reason, I am very pleased that the CISI has chosen the subject of 'Integrity at Work' for its first interactive seminar in Bahrain," he said.

"By encouraging participants to debate real life case studies, to consider their responses to them, and to suggest ways to deal with these problems, this learning environment will encourage participants to think more deeply about the ethical implications of their workplace actions."

Financial firms in Bahrain place strong emphasis on the importance of integrity and trust, as is demonstrated by the large membership base of CISI in the Kingdom, he noted.

"This also illustrates one of Bahrain's many continuing strengths as a financial centre, our deep pool of qualified and experienced financial sector professionals. Factors such as these will ensure that we can move on from recent events and remain at the forefront of financial centres in the Middle East and North Africa (MENA) region," said Mr. Al Maraj.

Bahrain Bourse Rulebook on way

Bahrain Bourse (BHB), previously the Bahrain Stock Exchange, is finalizing its Rulebook, in consultation with the industry.

Shaikh Khalifa bin Ebrahim Al Khalifa, Deputy Director of BHB, said the Central Bank of Bahrain (CBB) had approved the bourse's Rulebook. Following the CBB approval, BHB has sent the Rulebook to listed companies, brokers, and other concerned parties to obtain their opinions and feedback, prior to its final publication.

Shaikh Khalifa said the Rulebook

contains 12 chapters that detail the legal, administrative, and technical requirements that BHB brokers (members) must possess, as well as their obligations towards their clients and the transactions they execute on their behalf. The Rulebook also contains general guidelines for brokers' behavior, stating the rules that brokers must comply with in performing their duties at the bourse and in providing services to their clients.

"The Rulebook addresses all legal, administrative, and technical matters concerning the trading system at BHB and the type of markets that support the trading

of the shares of listed companies at BHB and other securities listed at the bourse," said Shaikh Khalifa.

It also clarifies the arbitrating, legal, and administrative procedures that must be carried out by all concerned parties.

The industry was given until end-November 2011 to provide comments on the proposed new rules. The bourse will extend a certain period for all concerned parties to undertake the necessary procedures for implementing the rules prior to the effective date of publishing the BHB Rulebook.

CBB developing rules on microfinance

The Central Bank of Bahrain (CBB) is developing rules to govern the activities of the microfinance industry, a top CBB official announced.

The rules, expected to be issued during 2012, are in recognition of the need of small and medium-sized enterprises (SMEs) for dependable and affordable finance to facilitate economic growth in the private sector, said Mr. Khalid Hamad, Executive Director, Banking Supervision, at the CBB.

He was speaking at the MENA Conference on Increasing Access to Credit through Effective Financial Infrastructure, organised by the Arab Monetary Fund (AMF), the International Finance Corporation (IFC) and the MENA Centre for Investment. The event was held in Bahrain on 21 November 2011.

Bahrain hosts a number of institutions active in the area of microfinance, Mr. Hamad pointed out.

These include Ebdaa Bank and Family Bank, which have been licensed by the CBB in the past three years. Both institutions are specifically aimed at the provision of finance

of up to BD3,000 (US\$8,000) to single person companies or small businesses. These banks are providing working capital and asset-based finance to allow SMEs to expand.

In addition, the CBB has supported Tamkeen initiatives through the relaxation of the risk weighting of lending by banks to SMEs from 100% to 75% in 2008.

He highlighted the role played by Bahrain Development Bank in developing SMEs as the bank was the first to focus on this sector.

“In realizing the paramount importance of microfinance, the CBB has started the development of a specific regulatory framework for such business and it is expected to be issued next year after the necessary consultation,” said Mr. Hamad.

The CBB has also worked with the Benefit Company to widen the scope of the Bahrain Credit Reference Bureau to include SMEs and larger companies. Lenders will, therefore, have access to credit information on not just consumers but also on companies.

“This initiative should widen the availability of credit to smaller businesses and should also help improve the credit quality of banks’ credit portfolios,” said Mr. Hamad.

The CBB is also looking at setting a lower fee for enquiries to the Credit Reference Bureau in respect of SMEs in order to keep down borrowing costs for such businesses. The CBB has already advised banks not to increase charges on companies as a result of this initiative.

Finally, the CBB is intending to include single person companies under the umbrella of the CBB’s conduct of business requirements applicable to consumer finance so that they will enjoy greater protection.

“The CBB does not have any direct supervisory responsibility for smaller businesses. Nonetheless, the CBB recognises the importance of SMEs to the economy and, therefore, we have sought to provide what measures we can to ensure that their financing needs are met efficiently,” said Mr. Hamad.

Bahrain financial sector solid, mature

Bahrain’s financial sector has withstood many external global and regional challenges, since it first began developing four decades ago, said a top Central Bank of Bahrain (CBB) official.

However, a strong enabling regulatory environment and appropriate levels of supervision of financial institutions have underpinned Bahrain’s evolution and success as the Middle East region’s premier international financial centre, said Mr. Khalid Hamad, Executive Director, Banking Supervision, at the CBB.

He was speaking at a seminar, titled ‘Resilience of Bahrain’s Financial Services Sector’, held on 1 and 2 November 2011. The event was organized by the Bahrain Chapter of the Institute of Chartered Accountants of India.

“Our financial sector is about 40 years old and during this time it has been subjected to a series of stress events and shocks, some global, some regional, including wars, revolutions, stock market crashes, financial crises and large scale sovereign and corporate defaults,” said Mr. Hamad.

“In each case, there was an initial shock, and then a recovery and in each and every

case, Bahrain has emerged stronger and more resilient.”

Key elements in Bahrain’s success include:

- In 1992, the capital adequacy was set at a level 50% higher than the international norm, strengthening the ability of Bahrain’s banks to absorb shocks.
- A strict focus on loans to deposits and stable funds ratios since 1996 has ensured that banks are liquid under normal and stress scenarios.
- A robust multi-faceted process for approving Board members and senior management.
- Bahrain’s ability to attract and retain appropriately qualified and experienced expatriate human resources has greatly assisted initiatives to enhance the professionalism of Bahrainis in the financial industry. In addition, a focus on continually improving the breadth and quality of vocational training courses, with the support of industry, has enabled the incorporation of world class banking practices in Bahrain banks.
- The CBB’s two-pronged supervisory approach, off-site and on-site supervision, provides a proper check and balance approach, in assessing banks.

- High disclosure and transparency standards have provided all stakeholders with appropriate and timely data, which has facilitated effective public oversight over and above the CBB’s regulatory and supervisory function.
- The concept of “treat consumers fairly” was adopted in the 1990s and has been in continuous development. A deposit protection scheme was introduced in 1994, followed by consumer finance rules in 2005, to protect against personal bankruptcies. A code of best practice on consumer credit and charging was the first in the region and more consumer protection enhancements are on the way.
- A well-diversified financial sector.
- A conservative dividend distribution policy has contributed significantly towards a stronger capital base for banks.
- CBB’s proactive approach in addressing market challenges and implementing forward-looking innovative solutions. Examples of such initiatives include the establishment of a credit reference bureau; CBB’s regular sukuk issuance program which has helped improve liquidity management at Islamic banks; and improvements in payment and settlement services leading to enhanced consumer confidence.

Revised mutual funds rules on way in Bahrain

The Central Bank of Bahrain (CBB) is in the process of revising and enhancing existing rules governing the mutual funds industry.

The revised regulations include rules to govern real estate investment trusts (REITs) and private investment undertakings.

A consultation paper, containing the Collective Investment Undertakings (CIU) Module of the CBB Rulebook (Volume 6) dealing with mutual funds, was issued by the CBB in October 2011. The CIU Module was earlier introduced in June 2007, replacing the CBB's previous framework, which was first issued in 1992.

Since the issuance of the CIU Module, the mutual funds industry has become one of the fastest growing segments of the overall financial sector, growing at an annual average of about 15% in recent years. The number of mutual funds registered with the CBB rose to 2,819 at the end of June 2011, compared to 2,374 funds in June 2007. The net asset value (NAV) of those funds totaled US\$8.7 billion.

There are 101 Islamic funds incorporated and registered in Bahrain with total assets of US\$1.6 billion as of June 2011.

The number of Bahrain domiciled funds totalled 127 as of June 2011, compared with 108 funds in June 2007. Of the total assets of the mutual funds industry, assets of such funds rose to US\$5.2 billion in June 2011,

up from US\$3.7 billion in June 2007.

"As the mutual funds industry has progressed, the CBB has found it necessary to expand the CIU Module so that it addresses in more detail the aspects of corporate governance," said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the CBB.

The revised Module is open for consultation, and is expected to be finalized and issued by the end of the first quarter of 2012. It expands the current regulations to include re-organization of the rules and chapters, and adds new chapters addressing areas like corporate governance requirements, and duties and responsibilities of relevant parties.

"We foresee that the re-organisation of the CIU Module would certainly provide users more comfort when navigating through the rules," said Mr. Mohammed Ayman Al Tajer, Director, Financial Institutions Supervision, at the CBB.

Additionally, the new framework broadens the range of funds that can be established in Bahrain, by introducing rules and regulations governing Bahrain Real Estate Investment Trusts (B-REITs), in line with best international practices, tailored to serve the needs of the local and regional markets. It also introduces new rules through which Private Investment Undertakings (PIUs) can be structured.

"We are delighted to introduce the B-REITs rules, as they will cater to service providers, who are focused on real estate investment opportunities in this region," said Mr. Al Tajer.

PIUs are new structures that facilitate private investments, and can only be offered to high net worth individuals and institutional investors, due to the risk characteristics they may exhibit, Mr. Al Baker added.

The CBB, through its enabling legislation, promotes the development of new products for investors in both Islamic and conventional finance, while at the same time providing credible regulation in both areas.

The existing CIU regulatory framework has served well the full range of investment funds catering to various categories of investors, from retail to high net worth individuals and institutional investors. And, in keeping with Bahrain's leadership in Islamic finance, the CIU rules also provide a solid foundation for the establishment and management of funds that comply with Islamic principles.

"In order to further enhance the existing CIU framework, the CBB is in the final stages to incorporate Bahrain's first-ever rules for REITs and PIUs, which will comprise a key element of the revised rules," said Mr. Al Baker.

Investment Business sector surges ahead

The Investment Business Firms sector in Bahrain has shown strong growth during the second quarter of 2011, compared with the same period last year. The number of Investment firm licensees as at 30 June 2011 totalled 52, compared to 50 licensees at the end of the second quarter of 2010.

The Investment Business (IB) license was introduced by the Central Bank of Bahrain (CBB) in 2006, to replace the Restrictive Investment Advisory License and caters for three different classes of investment firm licensees.

A Category 1 license permits the full range of activities such as investing as principal, asset management, acting as custodian of financial instruments, or offering brokerage and advisory services for financial instruments to clients, while Category 2 licensees are permitted to undertake the same with the exception of investing as principal. Meanwhile, a

Category 3 license accommodates firms wishing to provide brokerage and advisory services only.

With its wide range of conventional and Islamic financial institutions and markets, including two stock exchanges, listing and trading both conventional and Islamic financial instruments, the Kingdom of Bahrain offers a business-friendly jurisdiction for financial institutions, including firms who wish to offer investment products and services, providing clients alternatives to offerings by investment banks.

In addition to the CBB Law, IB licensees are regulated in accordance with CBB Rulebook Volume 4, which is updated on an ongoing quarterly basis to suit the needs of the market while maintaining international regulatory best practice. Major updates include corporate governance issues, management training and competency and regulatory reporting requirements.

The sector reported total assets under management of US\$9.93 billion as at 30 June 2011, an increase of 31.6% over the same time last year. Investments as Principal totalled US\$285.6 million, an increase of 5.4% from the figure of US\$270.9 million reported for 30 June 2010.

"In difficult times faced by the global economy, this sector has shown resilience and remains profitable," said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the CBB.

Mr. Mohammed Ayman Al Tajer, Director, Financial Institutions Supervision, at the CBB, added: "This sector enjoys untapped opportunities in the Middle East and North Africa (MENA) region, which require special skills of structuring of financial products to meet clients' needs and expectations."

Decade of growth for insurance sector

The Central Bank of Bahrain (CBB) issued the Insurance Decennial Report 2010, the first report of its kind in the region.

The report highlights the performance of the insurance industry in Bahrain over the 2001-2010 period and provides an analysis of insurance and reinsurance activities, both conventional and Islamic, by class of business.

The Bahrain insurance market posted continuous annual growth during the 2001-2010 decade, with gross premiums increasing steadily at a compound annual growth rate (CAGR) of around 15% to reach BD210.5 million (US\$558.3 million) in 2010, compared to BD155.4 million (US\$412 million) in 2001.

This is consistent with the rapid growth of Bahrain's economy as evidenced by GDP with a CAGR of almost 12% over the same period.

Insurance penetration has increased from 1.95% of GDP to 2.55% of GDP over the last decade. Similarly, insurance density (average per capita expenditure on insurance) has increased with a CAGR of 7.5% over the period under review.

Medical Surge

A significant part of this increase was due to a surge in medical insurance, which witnessed remarkable development especially during the last five years. Premiums of medical business rose from BD1.76 million (US\$4.7 million) in 2001 to BD31.75 million (US\$84.2 million) in 2010, a CAGR of almost 38% over the last decade. Medical insurance premiums represented 15% of the total premiums underwritten in the Bahraini market in 2010.

Growth was also seen in the long-term insurance (life and savings products) class, registering an increase with a CAGR of 16%, amounting to premiums of BD51.36 million (US\$136.2 million) in 2010, compared with BD13 million (US\$34.5 million) in 2001. The long-term market accounted for 24% of the total premiums generated during 2010.

Motor insurance constituted the single largest class of business, generating premiums worth BD57.5 million (US\$152 million) in 2010, with a CAGR of 10% over the period 2001-2010. Motor insurance accounted for 27% of the premiums market in 2010.

Fire, property and liability insurance premiums represented 17% of the total business underwritten in the market in 2010. Premiums generated by this class of business totaled BD35.7 million (US\$95 million) in 2010, compared with BD8.7 million (US\$23 million) in 2001, showing a CAGR of almost 17% over the period 2001-2010.

Marine and aviation insurance premiums amounted to BD8.04 million (US\$21 million) in 2010, compared to BD4.07 million (US\$11 million) in 2001, showing a CAGR of almost 8% over the 2001-2010 period.

Total assets of insurance firms in 2010 stood at BD1.36 billion (US\$3.6 billion), compared to BD680.9 million (US\$1.8 billion) in the year 2006, showing a CAGR of almost 19% over the period 2006-2010. Similarly, the investment portfolio of Bahraini insurance firms increased from BD352.8 million (US\$935.6 million) in 2006 to BD474.6 million (US\$1.3 billion) in 2010 showing a CAGR of almost 8% for the period under review.

Bahrain's domestic insurance market comprises 27 locally-incorporated firms and 11 overseas insurance firms (branches of foreign companies) carrying out insurance, reinsurance, takaful (Islamic insurance), retakaful (Islamic reinsurance) and captives business. The locally-incorporated firms consist of 14 conventional insurance firms, seven takaful firms, two reinsurance firms, two retakaful firms and two captives, while overseas insurance firms consist of eight conventional insurance firms and three reinsurance firms. In addition, there are a substantial number of firms restricted to business outside Bahrain and insurance ancillary services.

"The insurance sector in Bahrain holds tremendous promise for growth, as demonstrated by the industry's strong performance not only during 2010 but over the last decade," said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the CBB.

Takaful Expansion

The takaful industry continues to expand with overall gross contributions of the firms operating in Bahrain increasing significantly. The gross contributions have increased from BD1.89 million (US\$5 million) in 2001 to BD38.6 million (US\$102.2 million) in 2010 showing a

CAGR of almost 40% for the period.

"Bahrain is fast becoming a hub for major regional and international reinsurance and retakaful firms, as evidenced by the increasing number of such firms licensed in the Kingdom," said Mr. Al Baker.

There are currently five conventional reinsurance firms and two retakaful firms in Bahrain. The gross premiums of these companies have increased significantly, to BD323 million (US\$856 million) in 2010, compared to BD43.2 million (US\$114.6 million) in 2001, showing a CAGR of 25% over the period 2001-2010.

The growth was also reflected in a healthy increase in employment in the insurance sector. In 2010, insurance firms employed a total of 1,726 people, of whom 60% were Bahrainis, compared to 854 in 2001.

"We expect the insurance sector to continue its growth momentum in the coming years, mainly due to the increase in public awareness about the importance of life and medical insurance, as well as the introduction of new insurance products by insurance firms," added Mr. Al Baker.

Due to the well-established regulatory regime, a number of leading international insurance companies have established their insurance and reinsurance operations in Bahrain, which has further consolidated Bahrain's global profile as a leading international financial centre.

The increase of insurance ancillary services in Bahrain provides an important source of synergy to these international companies, said Mr. Nader Al Mandeel, Director, Insurance Supervision, at the CBB.

"The CBB continues to further enhance its regulatory framework to be in line with the best international financial standards and boost the confidence of the insurance licensees and general public," he added.

The CBB and Bahrain have received many insurance awards in recent years. Bahrain was named 'Best Financial Centre' at the International Takaful Awards at a ceremony held in London, while the CBB was named the 'Best Regulator Initiative of the Year' in insurance at the Middle East Insurance Awards, organized by Insurex in Dubai in 2010.

Financial Sector Fact Sheet

Regulator:	Central Bank of Bahrain
Financial Institutions:	412 (Nov 2011)
Financial Sector Workforce:	14,137 (2009)
	Bahraini nationals 9,313 (65.9%)
	Foreign nationals 4,824 (34.1%)
Key Economic Indicators:	GDP (Current) US\$21.9 billion (2010)
	Growth 13.5%
	GDP (Constant) US\$13.6 billion (2010)
	Growth 4.6%
	Financial Sector contribution to GDP 25%
	Sovereign rating BBB (S&P Dec 2010) with negative watch
	BBB (Fitch Dec 2010) with negative outlook
	Population 1,234,571 (2010)
Banking Sector:	Assets US\$202.2 billion (Oct 2011)
	No. of institutions 123 (Oct 2011)
	Retail banks 30
	<i>Locally incorporated 15</i>
	<i>Branches of foreign banks 15</i>
	Wholesale banks 76
	Representative Offices 16
	Bank Society 1
	Islamic Banks (included in above):
	No. of banks 26 (Oct 2011)
	Assets US\$24.2 billion
Insurance Sector:	Total No. of Insurance Companies & Organisations
	Authorised in Bahrain 165 (Nov 2011) * excluding Appointed Representative
	Domestic market
	Gross premiums US\$532 million (December 2009)
	No. of insurance firms 38
	Locally incorporated insurance firms 27
	Takaful & Retakaful Firms (included above) 9
	Captives (locally incorporated, included above) 2
	Overseas insurance firms 11
	Insurance Brokers 33
	Insurance Consultants 5
	Insurance Managers 3
	Representative offices 5
	Loss adjusters 11
	Actuaries 26
	Insurance Ancillary Services 3
	Insurance Pools & Syndicates 2
	Insurance Society 1
	Insurance licensees restricted 37
	Insurance Firms restricted 31
	Insurance Brokers restricted 4
	Insurance Consultants restricted 2
	Insurance Appointed Representative 7
	Corporate 6
	Individual 1
Investment Business Firms:	No. of firms 48 (Nov 2011)
	Representative Offices 11
Capital Market:	Market Capitalisation US\$16.865 billion (Nov 2011)
	Licensed Exchanges 1
	Licensed Clearing, Settlement and Central Depository Systems 1
	Licensed Securities Broker - Dealer 2
	Licensed Securities Clearing Member 1
	Stockbrokers 5
Specialised Licensees:	No. of firms 23 (Nov 2011) [comprising: Trust Services Providers 3;
	Reg. Admin 4; Ancillary Services 14; Registrar License 1; Registered
	Professional Body 1]
	Money Changers 18
	Financing Companies 8
	Microfinance Institution 2
Funds Industry:	Authorised Funds 2,838 (Nov 2011)
	NAV US\$8.32 billion (Sep 2011)
	Local Funds 127
	NAV US\$4.98 billion (Sep 2011)
	Conventional-Local 71
	Islamic-Local 56
	Foreign Funds-Offshore 2,711 (Nov 2011)