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Islamic investment industry needs solid foundation

The Islamic funds and investment industry needs a solid foundation, if it is to grow and prosper, says a top official of the Central Bank of Bahrain (CBB).

Key elements needed for future growth include Islamic financial institutions offering comprehensive services and investment products, improved corporate governance and an adequate and enabling regulatory framework, said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the CBB.

He was speaking at the 10th annual World Islamic Funds and Financial Markets Conference (WIFFMC), which took place in Bahrain on 19 and 20 May 2014. More than 300 regulators and thought leaders in the global Islamic funds and investment industry attended the event, held under the theme 'Building scale and broadening horizons of Islamic investments'.

"Generally, the potential size of the Islamic finance market is vast, and the accelerated establishment of Islamic finance hinges on attracting the flow of potential funds into Islamic investment," said Mr. Al Baker, during his opening address.

"However, it is important to ensure that the Islamic funds and investment industry has a solid and strong foundation for future development and growth."

In order to further enhance the growth and expand the Islamic investment industry, there are several factors that need to be taken into consideration, he said.

First, there is a need to build a financial system that would be able to facilitate efficient capital and trading flows. Such a financial system would require Islamic financial institutions providing banking, takaful, capital market, fund and wealth management services; a conducive legal and Shari'a framework; and the availability of a comprehensive range of Islamic products and services.

"A vibrant Islamic financial market will facilitate fund raising and investment activities and will enhance the creation of primary and secondary markets for Islamic financial instruments," said Mr. Al Baker.

Second, it is critical for Islamic financial institutions to better understand their clients and their needs for financial products and services, as this will help further expand the horizons of the Islamic market. For example, Islamic financial institutions should shift their focus from key-holdings constituting long term assets with large amounts of real estate, toward new asset classes and markets.

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

"Creating an adequate regulatory framework for Islamic investment funds is another factor to further strengthen the Islamic investment markets," said Mr. Al Baker.

"Such regulation should create the necessary framework for investment targeting small, medium sized, as well as accredited investors, who wish to invest their funds in accordance with Shari'a principles. This regulatory framework should also cater for a wide range of Shari'a-compliant investment instruments that include equity, sukuk, and various types of Islamic funds."

Fourth, the industry needs professionals who are well versed in both the capital markets and Shari'a knowledge. "This, in turn, will further enhance product development and improve services to investors in the Islamic capital market," said Mr. Al Baker.

Another critical issue that needs to be addressed is related to the development of a robust national and international liquidity infrastructure, which is currently still underdeveloped in most jurisdictions where Islamic financial services are offered.

"The development of such a framework is necessary not only to reduce the cost of intermediation, but also to enhance the availability of liquid Shari'a-based Islamic financial market instruments and achieve efficient money market operations for Islamic financial players," said Mr. Al Baker.

"Last but not least, it is important to further encourage more spending on research and development, in order to further enhance the contribution of the Islamic financial industry in the global market."

Mr. Al Baker reiterated the CBB's commitment to work closely with market players to further develop the Islamic finance and investment industry.

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CBB is enabling growth of Islamic funds industry

The Central Bank of Bahrain (CBB) continues to develop a comprehensive regulatory framework for the Islamic funds and investment industry, a key conference in Bahrain heard.

With over 90 Islamic funds currently incorporated in Bahrain, the CBB is committed to enabling the growth of this fast-growing segment of the Islamic financial industry, said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the CBB.

He was speaking at the 10th annual World Islamic Funds and Financial Markets Conference (WIFFMC), which took place in Bahrain on 19 and 20 May 2014. More than 300 regulators and thought leaders in the global Islamic funds and investments industry attended the event, held under the theme 'Building scale and broadening horizons of Islamic investments'.

Mr. Al Baker highlighted the tremendous growth of the Islamic finance industry, since its emergence in the 1970s.

"Globally, Islamic financial assets reached an estimated US$1.5 trillion at the end of 2013, and are expected to exceed US$2 trillion by 2016," he said.

"Furthermore, there are more than 600 funds globally that comply with Islamic principles. One-third of these funds have been launched just in the past eight years."

Sukuk Revival

Sukuk is another Islamic financial instrument that has shown significant growth during the past five years. The global sukuk market is estimated to have reached US$272 billion during the first quarter of 2014, a growth of almost 16 percent over the same time last year.

He said this year has seen a revival in the global sukuk markets due mainly to the gradual recovery of the global economy and investor sentiment. Sukuk issuance in the first quarter of 2014 totaled US$31.1 billion, of which sovereign issuance accounted for almost 60 percent while corporates accounted for 24 percent and quasi-sovereign or government-related entities accounted for the remaining16 percent of the sukuk issuance.

"Despite of the recent credit crunch in international markets, prospects for growth in Islamic securities markets are positive. This positive trend can be attributed to the rapid expansion and increasing sophistication of the GCC financial markets, as well as the geographical spread of Islamic securities products and services that recorded outstanding growth in Europe, Asia Pacific, North Africa and Central Asian countries," said Mr. Al Baker.

In Bahrain, the mutual funds industry is one of the fastest growing segments of the financial sector, he said.

"With more than US$7 billion in assets under management, through more than 2,800 funds, the industry has been growing at a steady pace in recent years. Overall, there are 92 Islamic funds that are incorporated and registered in Bahrain with total assets amounting to US$1.5 billion as of March 2014," said Mr. Al Baker.

CBB Regulation

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 regulatory framework for Collective Investment Undertakings (CIUs) provides for a full range of investment funds catering to various types of investors, from retail to high net worth individuals and institutional investors.

In order to further enhance the existing CIU framework, the CBB has issued Volume 7 – Rulebook which provides comprehensive rules and regulations pertaining to the authorisation and supervision of CIUs domiciled in or offered for sale in Bahrain.

The regulation has recognised the importance of expanding key areas such as corporate governance, as well as the role and responsibilities of each relevant party of a scheme. It also expands the variety of funds that can be established in Bahrain by introducing rules governing Real Estate Investment Trusts (REITs) and Private Investment Undertakings (PIUs). PIUs are a new breed of investment funds with a high degree of flexibility in structuring, aimed at facilitating private investments, such as family held investments, single investor or a single investment type. Due to the investment risk characteristics, such types of schemes can only be offered to high net worth individuals and institutional investors.

"In keeping with Bahrain's leadership in Islamic finance, the CIU rules also provide a solid foundation for the establishment and management of mutual funds that comply with Shari'a principles," said Mr. Al Baker.

The CBB has also recently issued the Module on Issuing and Offering of Securities and Shari'a-compliant sukuk (Module OFS) offered through public or private placements in or from Bahrain, as part of Volume 6 – Capital Markets Rulebook.

Mr. Al Baker

Module OFS contains detailed rules and regulations that cover the issuing, offering, floating and subscribing to different types and classes of securities, including Shari'a-compliant securities. The Module also provides the procedures and documentation that need to be submitted by the issuer as part of their application to obtain CBB approval.

Shari'a Advisors

Furthermore, the CBB is in the process of finalising regulations governing the authorisation and supervision of Shari'a Advisory Services companies, as part of the Ancillary Service Providers Module under Volume 5 of the Rulebook. The new regulations will help small Islamic investment institutions and collective investment schemes to outsource their Shari'a review to these entities in order to enhance their operation and reduce the costs of such services.

The services of Shari'a advisory companies include evaluation of financial institutions' compliance to Shari'a principles as well as the issuance of Shari'a pronouncements on any aspect of an Islamic financial institution's activities and operations.

"Having pioneered the development of sukuk, the CBB remains active in the sovereign sukuk market through the issuance of medium to long term sukuk, complemented by a regular programme of short term issuance," added Mr. Al Baker.

"It is the CBB's hope that such initiatives will go a long way in harmonising market practices and further enhancing the Islamic capital market."

Also speaking at the event, Mr. Ijlal Alvi, Chief Executive, International Islamic Financial Market (IIFM), said that while work is continuing on documentation and product standards to strengthen and streamline the legal, operational and market practices as well as Shari'a harmonisation, it is important that the Islamic capital market industry maintains its positive growth trajectory.

He urged all stakeholders to work together to further improve the conditions and infrastructure essential for the continued international development of Islamic capital markets.

Islamic finance industry must try to 'shape' new rules

The Islamic investment management industry was urged to engage with national and international regulators to ensure that new rules take into account the specificities of Islamic finance.

Regulators from across the world are working to align local, regional and international standards and practices, said Dr. Khaled Al Fakih, Secretary General and Chief Executive Officer of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

"Incorporation of Islamic finance standards into the regulatory framework is, indeed, crucial to improve stability and promote further growth of Islamic investment management as well as Islamic finance as a whole," he said at the World Islamic Funds and Financial Markets Conference (WIFFMC), which took place in Bahrain on 19 and 20 May 2014.

Dr. Al Fakih pointed to the "avalanche" of regulatory reform initiatives in most major jurisdictions in recent years, including new regulations and policies relating to money market funds, retail structured products and alternative investments. The main aims for these regulatory initiatives include enhancing investor protection; promoting more stable and robust financial systems; and achieving harmonisation of international regulatory best practices.

"For Islamic investment management, it is important for all of us to reflect on these main aims, and consider how they can be applied to support continuing growth of the Islamic investment management sector, in particular, as well as the Islamic finance in general," he said.

In driving the enhancement of investor protection, the global discussions have given some emphasis to transparency, including relating to the structure of investment products; financial information for investment funds, including on fees and other remuneration for investment managers; and operational information for investment funds, including governance structure for investment management.

"In respect to transparency on information regarding structures of investment products, for Islamic investment management, it is crucial that this also incorporates the need for investors to have full understanding on how Islamic investment management mechanisms operate," said Dr. Al Fakih.

"Full explanation should also be provided, especially to investors and regulators, on the Shari'a compliance aspects of Islamic investment management structures or mechanisms, which often make them unique and distinct from the conventional ones.

"And from our point of view, in designing the structures of Islamic investment funds and products, as well as in providing the information on Shari'a compliance, incorporation of AAOIFI Shari'a standards can be helpful."

Financial reporting and disclosures of investment funds also need to support the overarching requirement on Shari'a compliance. In particular, fees and remunerations from investment management activities must reflect the Shari'a-compliant structure of the funds, and this needs to be disclosed accordingly.

The discussions on transparency have also given rise to the concept of "integrated reporting", which combines pure financial reporting with an organisation's strategy, governance, performance and prospects, especially pertaining to potential creation of value in the short, medium and long term.

Another area of additional reporting is "sustainability reporting" – to give information on the environmental impact of an organisation's operations, and in the context of investment management, on such impact relating to activities of the investments or investee companies.

"It should be noted that the global push for 'integrated' and 'sustainability' reporting has also been driven by the investment management community, at large. Hence, the Islamic investment management sector must also align itself with this global push," said Dr. Al Fakih.

There have also been a number of regulatory initiatives relating to stability of financial systems before, and especially subsequent to, the global financial crisis, he said.

"While these had largely been focused on the banking sector, there have been increasing discussions and researches over the past few years relating to financial stability and investment management sector," said Dr. Al Fakih.

Investment management activities differ in some ways from conventional commercial banking and insurance activities. Nevertheless, it has been argued that some types of investment management activities are actually quite similar to those provided by banks and other non-bank financial companies, and increasingly cut across the financial system.

For example, investment managers may create funds that can be close substitutes for the money-like liabilities created by banks. They may also engage in various forms of financial intermediation through collective investment vehicles, and provide liquidity to clients as well as the greater financial markets.

"The diversity of these activities and the vulnerabilities they may create, either separately or in combination, has attracted attention to the potential implications of these activities for financial stability," said Dr. Al Fakih.

The growing debate on financial stability has also now been extended to the "shadow banking system" – and this has particular significance to the investment management sector, he stressed.

The shadow banking system has been broadly defined as "credit intermediation involving entities and activities that are fully or partially outside the regular banking system" or non-bank credit intermediation in short.

Some forms of investment management activities, especially money market funds, arguably fall under this broad definition. The capacity for some investment management entities and transactions to operate on a large scale can potentially create bank-like risks to financial stability. Increasing emphasis on financial stability and concerns on shadow banking system will mean that there will be increasing cross-sector regulations.

There may also be increasing alignment of regulations between Islamic investment management, Islamic banking, and the finance industry as a whole.

"For Islamic investment management, and Islamic finance, it is important for industry stakeholders to continuously engage with national regulators and conventional international regulatory bodies to ensure that regulations take into account the specificities of Islamic investment management and Islamic finance transactions, and to ensure that such regulations support the overall objectives of achieving Shari'a compliance," said Dr. Al Fakih.

Bahrain-UK partnership on Islamic finance

Bahrain and the UK have agreed a joint framework to enhance collaboration on Islamic finance.

A memorandum of understanding (MoU) has been signed, setting out plans to boost cooperation through an education and skills programme and the establishment of a working group devoted to the development of Islamic finance-driven trade and investment between the two countries.

The MoU was signed by Mr. Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain (CBB) and Baroness Sayeeda Warsi, Senior Minister of State at UK's Foreign & Commonwealth Office, during the UK-Bahrain Islamic Finance Summit held in London on 8 April 2014.

The event was organised by the UK Trade & Investment and the Foreign & Commonwealth Office. It was attended by leading Government and industry figures from both the UK and Bahrain.

"I am delighted to host the UK-Bahrain Islamic Finance Summit," Baroness Warsi said.

"It is an honour to welcome so many prominent experts from both countries at this first bilateral Islamic finance sovereign summit of its kind in the UK."

As a leading global financial centre, the UK has a great track record on Islamic finance, she said. Currently, the UK is host to more than 20 institutions offering Islamic finance and six wholly Shari'a-compliant banks. There are also over 12 universities offering related specialist courses and qualifications.

"This year we celebrate the 200th anniversary of UK-Bahrain relations. As well as the close and longstanding relationship enjoyed by our two countries, Bahrain is considered an established innovator in Islamic finance," said Baroness Warsi.

"It issued the first international sovereign sukuk in 2001, which drove the GCC Islamic capital market. And with the largest concentration of Islamic finance institutions in the region, Bahrain is one of the pre-eminent Islamic finance centres in the Gulf.

"We have much to share about how to grow the industry successfully," she said. It is to underscore this ambition that the MoU was signed, giving the UK and Bahrain a strong framework on which to develop their ongoing collaboration.

Mr. Al Maraj said the signing of the MoU marks an important day in the long history of Bahrain-UK relations as the two countries will be extending significant cooperation to each other to promote Islamic banking and finance.

"Both the UK and Bahrain have their strengths in Islamic finance education, training and practice, and their cooperation will open new opportunities for the Islamic finance industry," said r. Al Maraj.

Speakers at the event, which was the first of its kind, pointed to the growth of Islamic finance, which is currently growing 50 per cent faster than conventional banking and is worth US$2.2 trillion globally reaching an expanding market of over two billion people.

It accounts for over 25 percent of banking in the GCC region.

Bahrain asset managers establish association

A professional association of asset managers has been established in Bahrain.

The Bahrain Asset Managers Association is aimed at promoting the services and functions of the regional asset management sector in regional and global financial markets, engage with decision-makers as well as legislative and regulatory authorities in relation to the affairs of the sector. It will also promote professionalism, ethical practices and the highest standards of quality in the provision of services in the sector.

The first chairman of the association, established in May 2014, is Dr. Ahmed Al Jawhary, Chief Executive Officer, J Equity Partners, a founding member of the Association.

Speaking on behalf of the founders of the Association, Dr. Al Jawahery said the Association is expected to play a vital role in the progress and development of the asset management sector and in enriching it through the introduction of advancements in industry standards and the latest practices. The Association will encompass Islamic and conventional financial institutions specialised in asset management.

In addition to J Equity Partners, other founding members of the Association are Alpine Wealth Management, Tadhamon Capital, PineBridge Investments Middle East and The Family Office Company. The founders will, in due course, invite all investment firms and other financial institutions licensed by the Central Bank of Bahrain (CBB) to join the Association.

The Association is subject to regulation by and supervision of the CBB.

ACX signs partnership deal with NASDAQ

Bahrain-based Arab Common Exchange (ACX) Holding and NASDAQ's owning company, NASDAQ OMX, have entered into a partnership to establish a pan-Arab network of exchanges owned and run by the private sector to serve the Arab capital markets.

A Memorandum of Understanding (MoU) was signed by the two sides on 29 April 2014. Under the agreement, NASDAQ OMX will work closely with ACX in sharing its unique experience and best practices, as ACX evolves from a bourgeoning start-up to a network of pan-Arab regional exchanges.

"ACX has embarked over the past year to develop a plan of action and preparation of necessary studies and business models appropriate for the development of the investment environment," said Mr. Safar Al Harthi, Chairman of ACX, in a statement.

"This includes the development of flexible mechanisms to ensure the flow of Arab capital, regional and foreign development projects of all sizes and sectors in the Arab world."

The MoU will create an initial taskforce to lay out the framework of the partnership which will lead to establishing and operating a fully-fledged exchange in the Kingdom of Bahrain. The exchange will be a platform to list different types and sizes of companies such as closed, family, public, start-ups, Waqf, as well as real estate projects and trading of various conventional and Islamic instruments.

The exchange will operate both platforms, one conventional and one Shari'a-compliant, to meet the needs of participants who wish to trade on one or both of these markets.

Leading scholar provides guidance on Wakala

The Waqf Fund, a Bahrain-based special fund to support Islamic finance training, education and research, hosted its fourth Shari'a Scholar session featuring leading Islamic finance scholar, Shaikh Abdulsattar Al Kattan from Kuwait.

The topic under discussion was 'Investment Wakala'. Internal Shari'a Reviewers (ISRs) and Shari'a Auditors from Bahrain-based Islamic financial institutions attended the session, which was held at the premises of the Central Bank of Bahrain (CBB) in April 2014.

Shaikh Al Kattan provided insights on the general principles of Wakala and, in particular, Wakala as a method of investment. Most Islamic banks traditionally take deposits in the form of Mudaraba, he said. However, it has been observed in recent years that Wakala is gaining popularity because banks can determine fixed upfront fees, unlike under Mudaraba where the income and fees are determined subsequent to the success of the investment.

He clarified that Islamic banks cannot enter into a Wakala contract with conventional banks where the Islamic bank is the Muwakkil and the conventional bank is the Wakeel. However, it is permissible if the conventional bank is the Muwakkil and the Islamic bank is the Wakeel.

He also clarified that it is very important to disclose the Wakala fees in the Wakala contract; if no such disclosure is made, the fees must be charged as per the market norms.

Shaikh Al Kattan also provided guidance on several issues, such as convertible Wakala (convertible into shares), termination of Wakala before maturity, overdraft product structure based on Investment Wakala contract and market practice of Islamic banks compensating for the difference between expected and actual returns.

At the start of the session, Mr. Khalid Hamad, Executive Director, Banking Supervision, at the CBB, and Chairman of the Waqf Fund, welcomed Shaikh Al Kattan and the participants to the session. He emphasised the importance of the Internal Shari'a Review and Audit functions and the need to further develop these in order to ensure Shari'a compliance of Islamic banks and windows.

He underlined the importance of gaining knowledge of not just Shari'a issues but also contemporary issues and practices, which is necessary for Internal Shari'a Reviewers and Shari'a scholars to do justice to their job.

Waqf Fund sponsors CIPA programme revamp

The Waqf Fund is sponsoring the revamp of a key Islamic accounting qualification.

The Certified Islamic Professional Accountant (CIPA) is a flagship programme of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

A leading consulting firm has been engaged to prepare the revised curriculum, the first major revision of the CIPA curriculum since its launch in 2006. At that time, it was felt that the market lacked the unique skillset required to audit Islamic financial institutions using AAOIFI accounting standards. More than seven years and hundreds of CIPA graduates later, there is still a global shortage of the right human resources who combine conventional as well as AAOIFI accounting knowledge, understanding of the underlying Shari'a principles and standards and exposure of practical issues facing Islamic financial institutions.

The revised CIPA curriculum attempts to address these requirements. It will also include contemporary accounting and auditing issues that have come up in the last few years especially following the global financial crisis.

"The biggest challenge for the Islamic banking industry today worldwide is the human resource challenge," said Mr. Khalid Hamad, Executive Director, Banking Supervision, at the Central Bank of Bahrain (CBB) and Chairman of the Waqf Fund.

"We need people who are well versed in conventional accounting and auditing, and also understand the Shari'a-related peculiarities of AAOIFI's Shari'a and accounting principles. The development path shall ensure that the CIPA programme will reach the level of international practices."

Dr. Khaled Al Fakih, Secretary General and Chief Executive Officer of AAOIFI, added: "The extraordinary pace of change in the accounting and auditing profession in the aftermath of the global financial crisis and continuous addition of new AAOIFI standards as well as revision of old standards require a major upgrade of the CIPA qualification for the benefit of the industry. We are thankful to the Waqf Fund for sponsoring this important initiative."

AAOIFI is the standard setting body for the global Islamic financial services industry. To date, AAOIFI has issued over 88 Shari'a, accounting, auditing and governance standards, as well as a code of ethics. In a number of jurisdictions, AAOIFI standards are either mandatory or adopted voluntarily by Islamic financial institutions.

BIBF course on AAOIFI standards

The Bahrain Institute of Banking and Finance (BIBF) organised a course aimed at enhancing the understanding of new Islamic finance standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

At least 18 new AAOIFI standards were covered by the course, held in June 2014.

"The new AAOIFI standards were set in place to enhance standardisation and harmony in accounting for Islamic financial transactions," said Shaikh Esam Ishaq, a leading Shari'a scholar, BIBF faculty member and member of AAOIFI's auditing standards committee.

"Standardisation not only creates trust and confidence in Islamic institutions and the industry as a whole, but also encourages trade and investment, benefiting the local, regional and global economy."

Mr. Hani Redha, Head of BIBF's Islamic Finance Studies Centre, said the course was aimed at clarifying the application of new standards in common Islamic banking tools, as well as explaining their legal implications.

"BIBF boasts the most robust range of Islamic finance training and educational offerings in the world, and is the content provider of choice for global institutions, including professional associations and leading universities," said Mr. Redha.

"As such, BIBF continues to play a critical role in the development of human capacity for the Islamic finance industry, with a focus on practitioner's perspective that enables Islamic financial institutions to achieve their growth potential."

CBB consultations enhance transparency

Over the course of the last few months, the Central Bank of Bahrain (CBB) has issued several consultations covering various topics. The following article provides a brief overview of some of the consultations issued.

Microfinance Institutions

Following the issuance earlier this year of the first set of specific Modules for microfinance institutions, the CBB has released a consultation on Module RM (Risk Management).

This Module incorporates the various risks faced by these Volume 5 specialised licensees and focuses on credit risk, operational risk, outsourcing risk and liquidity risk. In recognition of the limited scope of activities undertaken by these licensees, this Module has limited the requirements imposed. The consultation period for this release ends in June 2014.

Basel III Implementation

Following the release of its December 2012 consultation for conventional banks, the CBB updated its initial release and has now issued a second consultation for conventional banks. The consultation period ended on 15 May 2014. The CBB has also issued a Basel III consultation for Islamic banks based on the IFSB standards issued for which the consultation period ended on 22 May 2014. Neither of these consultations includes the requirements for the leverage ratio as this aspect will be issued at a later date.

Financial Crime

As part of the CBB's objective to meet the revised Financial Action Task Force (FATF) Recommendations issued in February 2012, the CBB is proposing to amend the Financial Crime Module (Module FC) of the CBB Rulebook. The amendments to the CBB Rulebook are being issued in several phases. For the first consultation, amendments to Volumes 1 and 2 for banks and to Volume 4 for investment firms have been released. The deadline for comments for this first consultation was 20 May 2014 and the changes will be released during the second half of 2014. Future consultations will take place for other CBB licensees.

Ancillary Service Providers

Earlier this year, the CBB issued rules to address ancillary service providers. As part of the first consultation phase, three specific Modules were issued. These are:

- Module AU (Authorisation)
- Module GR (General Requirements)
- Module BR (CBB Reporting)

The consultation ended on 30 March 2014 and the final Modules will be released in the second half of the year.

Dismissal of Persons in Control Function

In February 2014, for banks and financing companies, a proposed amendment was issued whereby prior CBB approval would be required regarding the dismissal of persons occupying functions related to control, including internal audit, compliance and risk management. Based on the comments received, the CBB opted to proceed with a 'notification' process as opposed to a prior approval requirement. The revised wording was issued as part of the April 2014 update of the CBB Rulebook for Volumes 1, 2 and 5.

Operational and Solvency Framework

A new approach, focused on an updated solvency framework for the takaful and retakaful industry, was consulted on and the final rules were included as part of the April 2014 update of the CBB Rulebook Volume 3 (Insurance). While the approach did focus mainly on the takaful industry, it also has implications for conventional insurance firms as new actuarial and risk management requirements have been included as part of the update.

SPVs and Shari'a Compliance for Banks

Chapter PCD-4 of the Prudential Consolidation Module for banks has been amended to focus on the special requirements dealing with special purpose vehicles (SPVs) for all banks. In addition, for Volume 2 (Islamic Banks), the Shari'a compliance requirements have been enhanced following consultation with banks in the first quarter of 2014. The updates to the CBB Rulebook Volume 1 (conventional banks) and Volume 2 (Islamic banks) were issued as part of the April 2014 update.

Special Murabaha Financing Contracts

A consultation dealing with the unique features attached to special Murabaha financing contracts offered by Islamic banks was issued. The proposed rules define these products as restricted investment accounts opened on a Wakala basis for funding specific financing where the investor(s) has agreed to bear the entire risk of default. Such products can be offered only to accredited investors. To ensure transparency for investors, the rules propose minimum terms and conditions in relation to such products. The new rules are to be issued in the second half of 2014.

The CBB is a firm believer of the public consultation process with the financial industry and publishes all consultations on its website (www.cbb.gov.bh).

In addition, for all finalised consultations, it provides feedback statements, also publicly available on its website. Such an approach ensures that the rules issued by the CBB are done in a transparent manner in line with international standards advocated by international standard setters, such as the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, the International Organisation of Securities Commissions, the Islamic Financial Services Board and the Accounting and Auditing Organisation for Islamic Financial Institutions.

The proposed rules define these products as restricted investment accounts opened on a Wakala basis for funding specific financing where the investor(s) has agreed to bear the entire risk of default.

Developing a framework for sustainable growth

The global financial crisis has challenged financial sector regulators like never before. Prashant Govil, Financial Sector Specialist, Retail Banking Supervision, at the Central Bank of Bahrain, spells out the key ingredients of a regulatory framework that can support the long-term growth of the financial sector.

The global financial crisis brought to centre stage the role of central banks in regulating the financial sector, since it was widely believed that the failure of regulations and the short-sightedness of the private sector were the root causes of the crisis. Prior to the crisis, the financial sector in the developed countries was characterised by progressive deregulation based on the consensus that a lower burden of regulations will deliver much higher growth of the financial sector.

However, as innovation overtook itself and financial sector growth became an end in itself, the excesses morphed into a global crisis leading to a host of challenges for regulators. The crisis showed that markets do not self-correct and they aim at short-sighted gains instead of long term sustainability. In responding to the challenges thrown up by the crisis, regulations were evaluated and given a paradigm shift, in particular, by looking at systemic risks and aiming at ensuring financial system stability.

Thus, post-2009, the focus on regulatory practice is shifting from principle-based supervision to rule-based supervision. The regulatory reforms emphasise increasing supervision and regulation of the financial sector, while putting a high premium on increasing risk appetite of financial institutions.

Although, it is widely perceived that increasing regulations raise the cost of doing business, these costs will decline over time as better capitalised banks are able to access cheaper funding and also able to increase their market share at the expense of poorly capitalised institutions. Thus, overall, the benefits of increasing regulations will surely outweigh the loss of short-term gains.

Despite this, regulators have become the bane of many financial institutions. However, it must be understood that regulators, as a part of their overall responsibility, strive for the long-term stability and growth of financial institutions and the financial sector as a whole.

Against this backdrop, what should be the main ingredients of a regulatory framework for banking sector supervision which can support long-term sustainable growth of the financial sector?

To start with, the framework should have a vision and mission for the regulator which would encompass ensuring financial sector stability and soundness, along with achieving sustainable growth of the sector.

This would be followed by the objective of financial sector regulation, which overwhelmingly would be to:

a. Promote and preserve financial stability and sound financial institutions;

b. Support and facilitate the growth of the financial sector in a way that enhances the confidence of the public in this sector;

c. Safeguard the interests of depositors and customers of financial services; and

d. Encourage innovation in the financial sector for its further development.

The framework would further lay down the following tools to be used by the regulator in order to facilitate the achievement of the aforesaid objectives:

1. Issue prudential regulations that promote financial soundness of banks individually and issue macro prudential regulations that promote financial system stability. These regulations would not only mandate enhancing the capital base of individual institutions but also require them to have adequate liquidity at their disposal while further restricting the institutions from taking excessive leverage. The regulations would emphasise that the banks are alert to any incipient sickness in their assets quality while taking proactive measures to ensure that their asset quality does not deteriorate. These would be augmented by prudential regulations that envisage restricting the institutions' concentration of exposure to specific sectors, geographical areas, and product markets etc.

2. Implement risk focused supervision which is proactive and forward looking. The supervision practices therein would be consistent in application and aligned to international best practices while being tailor-made to suit local market conditions. Accordingly, the framework should be aligned to universal guidance principles being issued by the Basel Committee, OECD, EU, IFRS and the proposed GCC Monetary Union.

3. Use a consultative process in a transparent manner for issuing regulations wherein industry feedback is obtained and duly considered before finalising the rules.

4. Adopt a mechanism for timely and effective communication with all the stakeholders, namely licensees, government, other regulators and consumers.

5. Support and facilitate the growth of banking infrastructure to enhance effectiveness and efficiency of banking service delivery.

6. Encourage market innovation for further development of the sector.

7. Protect the legitimate interests of customers of financial services, through:

i. A consumer code for banks that mandates transparency and fairness in customer dealings, including informing the consumer about the risks involved in the specific transaction.

ii. A banking ombudsman as part of an effective and efficient customer grievance redress mechanism.

iii. Support to programmes on a continuous basis that help in enhancing education of consumers about the sophistication of banking services and products as well as their associated risks.

iv. A deposit protection scheme to safeguard the interests of depositors.

8. Facilitate the establishment of a legal framework that supports effective enforcement through penalties and other actions, while discouraging breach of the rules. Such enforcement would also aim to reduce the likelihood of financial institutions being used for financial crime, including money laundering activities.

Although these points are not a complete list but they largely constitute the necessary tools required to achieve the desired objective. It is interesting to note that the current supervisory framework being used by the Central Bank of Bahrain harnesses almost all the tools mentioned above, indicating that its supervisory model is not only aligned to international best practice but would also be useful in achieving long term sustainability of the financial sector in Bahrain.

Developments in Basel Standards

The 'new' Basel standards, commonly referred to as Basel III, cover many areas of banking. Some of the requirements are new; several have either been in existence for some time or are an update of previous standards.

In total, Basel III currently extends to 42 separate papers. That requires a lot of reading time, and a good memory to fit all of the pieces together. Seeking to be an expert in every area is admirable, and very challenging.

The Core Principles of Effective Banking Supervision are the fundamental building blocks of all supervisory activities. Understanding these Core Principles is fundamental to understanding the other areas.

These include liquidity, which itself covers the liquidity coverage ratio; intraday management of liquidity; and liquidity risk measurement. Basel III also provides standards in respect of the capital structure of a bank, including instruments which are regarded as Tier 1 (liquid capital); how to treat investments; the risk weighting of capital; plus the how and when capital can be and should be used to absorb losses.

The management of risk remains a central tenet of the Basel standards, therefore credit, market, and trading book risk should remain at the forefront of supervisory considerations.

A key element introduced in this round of standards is the identification of Systemically Important Financial Institutions (SIBs), both at the domestic and global level.

These financial institutions – they include insurance and re-insurance companies – play a crucial role in economic stability and development. SIBs represent the key components of the financial system, and they require careful, on-going monitoring.

So what does all of this, and the other associated standards, mean for a supervisor? In short, a great deal of reading and thinking to absorb the material and understand how it all fits together. This is best done in a structured, focused manner; therefore, it is advisable to plan your approach in advance.

For instance, each Domestically Systemic Important Bank (DSIB), of which there are currently nine in Bahrain, is required to submit to the Central Bank of Bahrain (CBB) a Recovery Plan (which is a plan to continue to trade following a serious negative impact to the business) and a Resolution Plan (a plan to liquidate the assets of the bank).

The plans must be approved by the CBB, and their relevance and effectiveness monitored over time. There are specific Basel papers which deal with this. DSIBs are subject to intensive on and off-site supervision, including an increased number of prudential meetings.

The standards covering liquidity are detailed and wide-ranging. They are also technical, and they include both qualitative and quantitative components.

These standards link closely to the availability of capital, which in turn is derived from the speed with which cash and cash equivalent assets can be used to absorb shocks.

The CBB is in the process of introducing updated rules to incorporate the new standards, and licensees should be alert to the Rulebook updates.

Global financial sector reforms assessed

The implications of global financial sector reforms for the Bahraini economy was the focus of a panel discussion, organised by the Bahrain Economic Development Board (EDB) and Bahrain Institute of Banking and Finance (BIBF).

The event, held on 19 June 2014, brought together high level speakers from the financial sector, who were able to assess the wave of regulatory reforms adopted internationally in response to the global economic crisis, and the impact of these changes on financial services in the region as well as the broader implications for the Bahraini economy.

Panelists participating included Dr. Jarmo Kotilaine, Chief Economist, EDB; Mr. Richard Ellis, Advisor, Banking Supervision, Central Bank of Bahrain (CBB); Mr. Hassan Jarrar, Chief Executive Officer, Standard Chartered Bank, Bahrain; and Professor Sudhakar Raju, Miller Chair of Finance, Helzberg School of Management, Rockhurst University and Kennedy School of Government, Harvard University, US.

Dr. Kotilaine said: "The increase in global regulatory pressures is coming at a time when regional investment and economic development needs are at an historic peak. This creates the need for new solutions and mechanisms for pooling capital. Innovation by regional financial institutions is becoming more important than ever.

"Alongside these challenges, though, there are excellent opportunities available. Populations are growing rapidly, and investment in infrastructure projects, small and medium enterprises (SMEs), and diversification is growing. However, in order to play a full part in this, banks will have to widen their activities as businesses look for different sources of funding."

Mr. Ellis noted: "Although the amount of new regulations is huge, they create opportunities for financial institutions which can comply and help their customers comply. Opportunities are there and financial institutions will enhance their earnings in the longer term if they grasp these opportunities."

Mr. Jarrar commented: "Ever since the 2008 global financial crisis, the banking industry worldwide has seen nothing short of an avalanche of new regulations. Such regulations, though mostly originated in the US and Europe, have, and will continue to have direct implications to the rest of the world, including Bahrain and the region at large. As a result, the banking industry has been undergoing a significant transformation the likes of which has not been seen since Dodd-Frank."

Professor Raju highlighted the importance of understanding the manner in which international market forces and financial regulations impact the Kingdom, as the Bahraini economy becomes more diversified and globally focused.

Bahrain is one of the region's leading financial centres, home to 405 registered financial institutions, including 177 banks with total assets of $186 billion. The sector employs more than 14,000 people, of whom nearly two-thirds are Bahrainis.

Bahrain Bourse to allow margin trading

The Bahrain Bourse (BHB) will allow investors to buy stocks using borrowed money, in a move to boost trading and liquidity in the stock market.

Margin trading will be allowed from 1 September 2014, along with trading of options, exchange-traded funds (ETFs) and real estate investment trusts (REITs).

The new changes are part of a raft of "market rules" announced by the BHB on 10 June 2014. The new market rules provide improvements across several areas relating to the main operations of the bourse, which has a market capitalisation of US$21 billion.

The new rules also allow non-Bahraini brokers, who are licensed by capital market regulatory institutions in their countries, to trade in the BHB without having a representative office in the Kingdom of Bahrain, as long as an authorised clearing member has been appointed to settle transactions executed at the BHB.

In addition, the new rules outline the general framework for market makers and the mechanisms that should be used to organise their buy and sell transactions. A notable area is the reduction of the number of exceptional cases from 16 to four, which will have a positive impact on the BHB main market.

Moreover, the market rules organise the procedures of issuing licenses to brokers according to new requirements. This will contribute to developing the services brokers provide to investors at the Bourse.

The issuance of the market rules is in line with the goals of the strategy adopted by the BHB in 2011 which includes a plan to develop several legislative and technical areas of the Bourse.

The market rules allow the trading of new investment instruments such as options, ETFs, REITS, and includes other areas related to developing trading mechanisms at the Bourse.

BHB's independent systems will also be developed, including an Arbitration Committee that will adjudicate on all disputes relating to transactions carried out on the Bourse and a Disciplinary Board to decide on any violation to the Law, Internal Regulation and resolutions which regulate the Bourse, and any violation affecting the conduct of business and discipline in the Bourse.

Brokers are being given a six-month transitional period from the date of implementation to meet the requirements of the new market rules.

Shaikh Khalifa is new chief executive of Bahrain Bourse

Shaikh Khalifa bin Ebrahim Al Khalifa is the new Chief Executive of Bahrain Bourse (BHB).

Shaikh Khalifa, who took the helm of the BHB in early May, was previously Deputy Chief Executive and Chief Operating Officer of the bourse.

He joined BHB in 2010 as Deputy Director of Settlement, Central Depository and IT and was also responsible for implementing the bourse's development strategy which was approved by the board in 2011.

In other appointments at BHB, Ms. Afnan Al Zayani has been appointed as Head of the BHB Executive Committee and Mr. Ayman Almoayed as her deputy.

Mr. Mohammed Ahmed Hassan has been appointed Head of the Audit, Risk and Corporate Governance committee, and Mr. Nabeel Khalid Kanoo as his deputy.

Meanwhile, BHB posted a growth of 77 percent in revenues from trading commissions during the first quarter of 2014, compared with the same period last year. The growth in trading revenues contributed to a 9.5 percent increase in total revenues during the first quarter of this year, compared with the same time last year.

In reviewing progress on the BHB strategic plan, the BHB Board welcomed the Central Bank of Bahrain's approval of the new 'Market Rules', which allow non-Bahraini brokers to trade in BHB without having a representative office in Bahrain, as long as a clearing member has been appointed to settle transactions executed at the bourse.

Shaikh Khalifa

The rules also re-classify exceptional cases to four, instead of the previous 16, while other transactions have to be executed on the trading floor.

In addition, the board was briefed on the steps taken by BHB to introduce the Murabaha programme that will be launched in co-operation with CBB and various Islamic banks and institutions.

Shares to be transferred swiftly between BHB, KSE

The Bahrain Bourse (BHB) has signed an agreement with the Kuwait Clearing Company (KCC), to facilitate the transfer of shares traded on the BHB and Kuwait Stock Exchange (KSE).

The agreement was signed in Kuwait on 5 May 2014 by Shaikh Khalifa bin Ibrahim Al Khalifa, Deputy Chief Executive Officer and Chief Operating Officer of Bahrain Bourse and Mr. Othman Ibrahim Al-Issa, Chief Executive Officer of KCC.

The agreement sets new technical arrangements and procedures that implement an electronic mechanism to promptly transfer the shares of Bahraini companies listed on the KSE as well as the shares of Kuwaiti companies listed on the BHB once they are settled.

Shaikh Khalifa said he was delighted to sign the agreement with KCC, which was in line with joint efforts to strengthen the link between systems and institutions in the financial sector in the GCC countries.

"The agreement will greatly facilitate investors' procedures of transferring shares they trade in on both exchanges with a high level of confidentiality, security, and precision. The agreement will reflect positively on the Bahraini and Kuwaiti markets, given that Kuwaiti investors own 30 percent of the shares of Bahraini listed companies," he said.

Mr. Al-Issa emphasised that the Kuwait Clearing Company had developed a system to facilitate all procedures for investors that will, in return, reflect positively on the economy of Bahrain and Kuwait.

The agreement between BHB and KCC was important as it would help in organising work and facilitating the technical procedures for cross-listed companies in Bahrain and Kuwait.

Bahrain banks get clean bill of health from IMF

The International Monetary Fund (IMF) has given Bahrain's banking sector a clean bill of health.

Bahrain's banks have strong capital bases and the sector weathered well a recent bout of volatility in global financial markets, said the IMF in a statement issued on 25 March 2014, following the conclusion of a mission for the 2014 Article IV consultation.

"The banking sector is in good health. The capitalisation of the banking system is high on average, around 18 percent for retail banks and above 22 percent for wholesale banks," said the IMF statement.

"Nonperforming loans (NPLs) to gross loans have continued on a downward trajectory in conventional retail and wholesale banking, and now ranges between 5-7 percent. While the Islamic retail banking segment has been tackling high NPLs, capital buffers for this segment remain adequate, at about 17 percent, with NPLs falling to about 13 percent of gross loans. Bahrain has not been affected by the most recent bout of volatility in global financial markets."

International rating agency Moody's also recognised the strength of Bahrain's banking sector by raising its outlook on the retail banking segment to stable, from negative.

The raised outlook reflects Bahrain banks' solid funding base and capital buffers, and an economic recovery driven by increased government spending and construction activity that will support banks, profitability and asset quality, said a Moody's report published on 31 March 2014.

It noted that economic growth will buoy banks' credit fundamentals. "Given that most bank lending in Bahrain remains directed toward the non-oil economy, Moody's forecasts domestic credit growth of around 7-8 percent over the next 12-18 months. Stronger activity in the construction industry, manufacturing and the ongoing recovery in the tourism/property markets will drive the growth in non-oil GDP," said the Moody's report.

"System-wide asset quality will remain stable overall for the system, as the domestic economy strengthens and the banks diversify into higher-growth Gulf Cooperation Council countries (Moody's estimates that 40-45 percent of loans are granted to entities outside Bahrain)."

NPLs are expected to remain around 6 percent of gross loans over the outlook period, as current NPLs are still concentrated toward a few large borrowers that are under stress.

Moody's also expects banks' capital metrics (with an aggregate Tier 1 ratio of around 14.5 percent as at December-end 2013) to remain broadly stable over the outlook period, and sufficient to absorb losses under its scenario and stress-testing analyses.

"Moody's expects that Bahraini banks will continue to exhibit sound deposit-funded and liquidity profiles. Deposits will remain stable over the outlook period, even though the banking system remains highly concentrated toward government deposits. Deposits accounted for 76 percent of non-equity funding as of December-end 2013, and liquid assets totaled 34 percent of total assets as of year-end 2013," said the report.

The Bahrain Economic Quarterly (BEQ) report (March 2014 issue), published by the Economic Development Board, said the results of Bahraini banks have shown continued improvement over the past year. The combined net profits of the three leading conventional retail banks in the Kingdom rose by 45.5 percent to BD315.1 million (US$835.7 million) in 2013.

Bahrain banks' assets on upward trend

The consolidated balance sheet of the banking system in Bahrain, comprising retail and wholesale banks, stood at a months-long high of US$192.6 billion at the end of March 2014, according to the latest issue of the Central Bank of Bahrain's Monthly Statistical Bulletin.

This was a slight increase over the consolidated balance sheet of $192.0 billion at the end of December 2013.

Retail banks represented 40.2 percent of the consolidated balance sheet at March-end 2014, with an aggregate balance sheet of BD29.1 billion ($77.4 billion). This was an increase of 2.8 percent over a balance sheet of $75.3 billion at December-end 2013 and 4.7 percent over March 2013.

The aggregate balance sheet of wholesale banks stood at $115.2 billion in March 2014, a decline of 1.3 percent over a balance sheet of $116.7 billion at December 2013.

Total domestic assets of the banking system grew to $49.5 billion in March 2014, from $48.7 billion in December 2013. Foreign assets only marginally declined to $143.1 billion in March, from $143.3 billion in the previous quarter.

Total domestic liabilities of the banking system totaled $51.1 billion in March, compared with $50.5 billion in December 2013, while foreign liabilities remained almost unchanged at $141.5 billion.

Bahrain's retail banking system continued to post steady growth, both in its loan portfolio as well as assets, reflecting the healthy growth of the domestic economy.

Domestic assets of retail banks stood at BD15.8 billion (US$42.0 billion), while foreign assets amounted to BD13.3 billion in March 2014. Domestic liabilities stood at BD15.4 billion, while foreign liabilities amounted to BD13.7 billion.

Total deposits at retail banks stood at BD15.3 billion in March 2014, an increase of 2.7 percent over the December 2013 figure of BD14.9 billion.

Total outstanding loans and advances extended to residents by retail banks increased by 1.4 percent to BD7.3 billion in March, from BD7.2 billion in the previous quarter.

Of the total loans at March-end, 60 percent were in the form of business lending, while the personal and government sectors accounted for 37.6 percent and 2.4 percent respectively.

The distribution of the loans to business indicate that 21.2 percent were extended to the construction and real estate sector, followed by 15.7 percent to the trade sector and 11.5 percent to 'other' sectors, which include the hospitality industry and the transportation sector, while the manufacturing industry received 8.8 percent of the loans.

The aggregate balance sheet of Bahrain's Islamic banks (retail and wholesale) stood at $24.2 billion in March 2014, compared to $23.3 billion at the end of the previous quarter. Domestic assets stood at $13.8 billion in March, while foreign assets amounted to $10.4 billion.

Money supply in Bahrain's economy, represented by M2 (currency in circulation and demand, time and saving deposits) rose to BD9.4 billion in March 2014, from nearly BD9.2 billion at the end of December 2013.

By the broader monetary measure M3 (which includes M2 as well as government deposits), M3 stood at BD11.25 billion in March, only marginally higher than the BD11.21 billion level registered in the previous quarter.

Bahrain economy grew by 5.3% in 2013

In a significant rebound over the 3.4 percent rate seen in 2012, the national economy expanded by 5.3 percent during 2013, according to the April 2014 update of the Bahrain Economic Quarterly (BEQ), published by the Economic Development Board (EDB).

Citing data released by the Central Informatics Organization at the beginning of March, the BEQ April update said real GDP growth in Bahrain exceeded expectations in Q4 of 2013.

The fastest growth during 2013 was recorded in crude oil and natural gas (15.3 percent), followed by hotels and restaurants (9.5 percent), and social and personal services (6.5 percent). The non-oil sector as a whole expanded by 3 percent. Quarterly growth was positive in all quarters with the exception of Q2, which was flat as compared to Q1.

Growth was heavily driven by the hydrocarbons sector which was responsible for 2.9 percentage points of the headline growth rate, in other words more than half the total. This rebound was thanks to output levels returning to normal at Abu Sa'afa offshore oil field. Due to unscheduled maintenance, average crude production from Abu Sa'afa was 128,000 b/d in 2012 – markedly below its capacity of 150,000. By contrast, the average daily output in 2013 reached just over 149,700 b/d, or 99.8 percent of full capacity. In addition, average production of the onshore Bahrain (Awali) field rose to approximately 48,000 b/d in 2013, up from 45,000 in 2012. The total daily average rate of crude extraction in 2013 was 198,000 b/d.

Earlier, the March 2014 issue of BEQ noted the improving global economic outlook, which would be generally supportive of sentiment and growth in Bahrain and the broader region during this year. However, worries about the outlook for some emerging markets constitute a potential complication.

► The prospect of relative oil price stability should underpin confidence, an effect that may be amplified in the event of mounting supply concerns from Russia.

► The US tapering effort has the potential to push up the cost of capital but the process is likely to be gradual. The Federal Reserve remains committed to a very low interest rate stance for now.

► The growth prospects of emerging markets are improving and should be supportive of Bahraini exports which are increasingly directed eastward. However, the pace of growth is likely to be fairly measured by historical standards.

Against this backdrop, Bahrain's non-oil growth is likely to accelerate markedly this year and the oil sector is likely to see a year of relative stability.

Non-oil sector set for growth

In a likely reversal of the pattern observed last year, economic growth in the Kingdom looks likely to be driven by the non-oil economy, which should contribute virtually all of the increment in GDP in 2014.

After a slowdown in its growth last year, the Bahraini non-oil sector is well positioned for a clear acceleration this year. The approval of the two-year budget half way through 2013 put new growth drivers in motion and significant capital investments, many of them funded from regional sources, are expected to be launched shortly.

The liquidity situation of the local banking sector is favourable. These trends potentially offer the makings of a virtuous circle which, with positive knock-on effects on confidence, could fuel an acceleration in non-oil growth to well over 4 percent. With relative stability expected in the hydrocarbons sector, headline growth for the year as a whole now looks likely to end up between 3.5 and 4 percent in a slight deceleration from the pace seen in 2013 thanks to the oil sector rebound. This is broadly in line with what looks likely to be the regional norm.

Following an impressive rebound last year, the hydrocarbons sector looks likely to experience a year of stability in 2014 as the main offshore Abu Sa'afa oil field looks likely to remain at full capacity with the exception of scheduled maintenance in May.

Production from the onshore Bahrain field is expected to remain more or less at current levels this year as the results of various pilot projects are being evaluated. In contrast to last year, this is likely to mean, at best, a modest contribution from the hydrocarbons sector to GDP growth this year.

GCC debit card service launched

A GCC point of sale (PoS) service for debit cards has been launched in Bahrain.

The service, which links Bahrain, Kuwait and Qatar in the first phase, is aimed at significantly facilitating debit card purchases in the three countries.

The launch of the service was earlier agreed by the central banks and monetary authorities of the GCC.

The GCC PoS service is expected to add many benefits to the stakeholders, starting from a reduction in general transaction cost to the end customers, merchants and the banks.

Furthermore, funds settlement of all the GCC PoS purchases will only be maintained within the GCC central banks and monetary authorities, directly in GCC currencies. In addition, such GCC debit card transactions will be governed by the rules and regulations of the GCC central banks and monetary authorities.

The service in Bahrain, Kuwait and Qatar was launched successfully on 1 May 2014. The remaining GCC countries will join the service in the near future.

Increased capital market activity

The Bahraini stock market saw a clear improvement in its performance last year with the main index advancing by 17.2 percent during the year as a whole, according to the March 2014 issue of the Bahrain Economic Quarterly (BEQ), published by the Economic Development Board (EDB).

In terms of market capitalisation, the Bahrain Bourse experienced a growth of 16.6 percent during 2013. This positive growth came as a result of strong performance across most sectors, with commercial banks making a 40.3 percent gain in 2013.

The positive momentum has carried over into this year with the market up by 10.3 percent as of the end of February.

In a welcome sign of renewed primary activity, Zain Bahrain is expected to launch an IPO by 3Q2014. The company is expected to divest 15 percent of its shares.

The best performers of Bahrain Bourse during the past year were financial service companies, led by the Commercial Banks sector index and followed by Investment and Insurance. Also the Industrial sector has reached double-digit growth. The Services sector posted a small decline while the Hotels and Tourism sub-index was flat.

Bond market activity since the beginning of the year has been dominated by the regular flow of short-term sovereign issuance. Oversubscription levels have been high while the average interest rate has slightly trended down. In addition, the Bahrain Commercial Facilities Company issued a US$53.3 million five-year bond in January.

Financial Sector Fact Sheet

Regulator: Central Bank of Bahrain
Financial Institutions: 406 (April 2014)
Financial Sector Workforce: 14,009 (2012)
Bahraini nationals 9,253 (66%)
Foreign nationals 4,756 (34 %)

Key Economic Indicators

GDP (Current) US$32.8 billion (2013)
Growth 6.9% (2013)
GDP (Constant) US$28.6 billion (2013)
Growth 5.5% (2013)

Financial Sector contribution to GDP 16.7%
Sovereign Rating
BBB (S&P June 2014) with stable outlook
BBB (Fitch June 2014) with stable outlook
Population 1,195,020 (2011)

Banking Sector

Assets US$191.5 billion (May 2014)
No. of institutions 123 (May 2014)
Retail banks 28
Locally incorporated 13
Branches of foreign banks 15
Wholesale Banks 76
Representative Offices 19
Bank Society 1

Islamic Banks (included in left):
No. of banks 24 (May 2014)
Assets US$24.2 billion (May 2014)

Insurance Sector

Total No. of Insurance Companies & Organisations Authorised in Bahrain 152 (Apr 2014) * excluding Appointed Representative
Domestic market
Gross premiums US$531 million (September 2013)
No. of insurance firms 36
Locally incorporated insurance firms 25
Takaful & Retakaful Firms (included above) 8
Captives (locally incorporated, included above) 1
Overseas insurance firms 11
Insurance Brokers 31
Insurance Consultants 5
Insurance Managers 3

Representative Offices 5
Loss Adjusters 11
Registered Actuaries 23
Insurance Ancillary Services 6
Insurance Pools & Syndicates 2
Insurance Society 1
Insurance Licensees Restricted: 29
Insurance Firms restricted: 23
Insurance Brokers restricted: 4
Insurance Consultants restricted: 2
Insurance Appointed Representative 16
Corporate 11
Individual 5

Investment Business Firms

No. of firms 61 (Apr 2014)
No. of Investment Business firms 52 (Apr 2014)

Representative Offices 8
Bahrain Asset Manager Association 1

Specialised Licensees

Total no. of institutions 48 (Apr 2014)
Money Changers 18
Fund Administrators License 3
Registered Administrators 1
Financing Companies 8

Microfinance Institution 2
Trust Service Providers 3
Ancillary services 12
Registered Professional Body 1

Capital Markets

Market Capitalisation US$21.5 billion (Apr 2014)
No. of firms 28 (Apr 2014)
Licensed Exchanges 2
Licensed Clearing, Settlement and Central Depository Systems 1

Licensed Securities Brokers 4
Licensed Securities Dealers 1
Licensed Securities Clearing Member 7
Licensed Securities Broker Dealers 13

Funds Industry

Authorised Funds 2,827 (Apr 2014)
NAV US$6.87 billion (Dec 2013)

Local Funds (CIUs) 92
NAV US$3.9 billion (Dec 2013)
Conventional-Local 51
Islamic-Local 41
Locally Incorporated (PIUs) 2
Foreign Funds-Offshore 2,733 (Apr 2014)