THE REVIEW

مصرف البحرين المركزي

Central Bank of Bahrain

Published by the Central Bank of Bahrain (CBB)

2030 البحرين BAHRAIN

June 2012 Issue 31

Bahrain's banks profit on domestic confidence

Bahrain's banking sector is bouncing back from the downturn caused by domestic developments a year ago and the global financial crisis of 2008.

The Kingdom's retail banks have seen growth of between 2.5 percent and 3.5 percent in the first three months of 2012. The growth has been driven by consumer spending, which is a reflection of growing consumer confidence in the economy and stability of Bahrain.

Although corporate business has not yet seen similar growth, some of the investment banks based in Bahrain are showing growth trends since the start of this year, said Mr. Abdulkarim Bucheery, Chairman of the Bahrain Association of Banks (BAB).

"Most of the retail banks have been showing growth while some investment banks, such as Arab Banking Corporation (ABC) and Gulf International Bank (GIB) have posted impressive growth rates of 13 percent and 23 percent, respectively," he said at a BAB meeting, held in Bahrain on 30 April 2012.

The financial services industry in Bahrain has remained resilient, despite recent challenges, with a direct contribution to the national gross domestic product (GDP) standing at 26 per cent, said Mr. Bucheery. The industry employs more than 14,300 people, of whom 66 percent are Bahrainis.

"We have seen growth in consumer lending although corporate banking remains flat," he said.

However, there are a number of major projects coming up, such as the proposed rail network to link the GCC countries and expansion plans for Bahrain International Airport, to name a few.

"The banking sector looks forward to being involved in these upcoming large projects. Things are looking up at the moment and 2012 looks promising," he added.

Mr. Hassan Jarrar, Chief Executive of Standard Chartered Bank Bahrain, said that the effects of the 2008 global financial crisis had hit banks the world over hard and that it would take some time for a full recovery, although there are clear signs of a positive trend towards growth.

"We have already seen signs of a pick-up in the economy, but it could take several years to make a full recovery," he said.

Banks have learned lessons from the crisis and now know they need to remain focused on business lines and customers they know and to avoid exotic financial structures, he added.

Mr. Robert Ainey, Chief Executive of BAB, said the organization will take part in this year's Annual Meetings of the IMF and World Bank in Tokyo. A BAB reception, to be held on 13 October 2012, is being strongly supported by local banks keen to showcase Bahrain's financial sector on the world stage.

Domestic credit posts big growth

The consolidated balance sheet of Bahrain's retail banks increased by 0.5 percent to reach BD26.1 billion (US$69.4 billion) at the end of March 2012, compared to end-February 2012. Year-on-year, the aggregated balance sheet at end-March 2012 was 5.1 percent higher than it was at the same time in 2011.

Total outstanding loans of retail banks increased by 0.5 percent at end-March 2012 compared to end-February 2012 to stand at BD6.6 billion (US$17.6 billion). Year-on-year, total domestic credit was 15.9 percent higher than it was at end-March 2011.

Lending rates for business and personal sectors declined to 4.64 percent and 6.27 percent, respectively, against 5.15 percent and 6.28 percent respectively at end-February 2012.

Total outstanding loans to businesses increased by 1 percent to reach BD4.2 billion (US$11.2 billion) at end-March 2012. The increase was mainly due to growth in loans to the transport and communication sector, which grew by 12.2 percent, construction and real estate (up 2.6 percent) and manufacturing (up by 1.8 percent). Year-on-year, outstanding loans to business were 14.3 percent higher than at end-March 2011.

Total outstanding loans to the personal sector decreased by 0.5 percent to BD2.1 billion (US$5.6 billion) at end-March 2012, mainly due to declines in property mortgage (down 1.5 percent) and salary assignments (1 percent). Year-on-year, outstanding loans to the personal sector increased 22.6 percent.

Total deposits grew 0.7 percent to BD9.7 billion (US$25.8 billion) at end-March 2012, compared to end-February 2012. Year-on-year, total deposits were 7.1 percent higher than at end-March 2011.

INSIDE

Need for vibrant Islamic financial markets

Deep and active Islamic financial markets are key to the further growth of the Islamic investment industry, a conference in Bahrain heard.

The potential size of the Islamic finance market is huge but the further growth of Islamic finance hinges on attracting the flow of these potential funds into Islamic investment, said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the Central Bank of Bahrain (CBB).

It is also important to ensure that the Islamic funds and investment industry has solid and strong foundations for future development and growth, he said at the Annual World Islamic Funds and Capital Markets Conference, held in Bahrain on 20 and 21 May 2012.

More than 350 key players, regulators and thought leaders in the global Islamic funds and investment industry attended the event, which was held under the patronage of the CBB. The theme of the conference was 'New Growth Horizons: Expanding the Global Footprint of Islamic Funds and Investments'.

In his opening address, Mr. Al Baker outlined the basic requirements for creating deep and vibrant Islamic capital markets, without which the Islamic investment industry cannot achieve its full potential.

"There is a need to build a system that can facilitate effective and efficient capital and trading flows," he said.

This requires further development of an Islamic financial system which has the entire required infrastructure that includes: (i) Islamic financial institutions (IFIs) ranging from banking, takaful, capital market, fund and wealth management entities (ii) creating a conducive legal and Shari'ah framework and (iii) a financial system that has a comprehensive range of Islamic financial 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.

Some progress has been achieved, with the primary issuance of globally accepted Islamic financial instruments, such as sukuk. In turn, this global issuance of sukuk has played a role in building the linkages between key players in financial markets, such as issuers and investors, and has paved the way for the creation of a supply of Islamic financial instruments. However, it has not led, as yet, to the promotion of active and efficient secondary markets, which requires a greater focus.

It is also important to adopt proper corporate governance practices in the Islamic investment industry, in order to enhance investor confidence and 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 and clear regulations for Islamic investment products 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, and accredited investors, who wish to invest their funds in accordance with Shari'ah principles. Such a regulatory framework should also cater to a wide range of Shari'ah-compliant investment products that include equity, sukuk, various types of Islamic funds with moderate as well as high risks.

Sufficient human resources, especially trained professionals who are well versed in capital markets and Shari'ah knowledge, are also needed to further develop the Islamic investment industry.

"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 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 availability of liquid Shari'ah-based Islamic financial market instruments and to achieve efficient money market operations for Islamic financial players.

Another important factor is to further enhance the innovation of new Islamic financial instruments and encourage more research and development, as well as to strengthen the efforts for capacity building and talent development for the Islamic financial services industry.

"Islamic asset management has come a long way since the 1970s when it began as a way for Islamic banks to make use of their excess funds. Today, as with other forms of Islamic finance, the industry has grown to become an increasingly substantial segment within the global financial markets and has gained significant interest as a viable and efficient alternative model of financial intermediation," said Mr. Al Baker.

The recent credit crunch and widespread global economic slowdown have not dampened the prospects of Islamic finance, he said.

In Bahrain, the mutual funds industry is one of the fastest growing segments of the overall financial sector. With around US$9 billion in assets under management, through more than 2,700 funds, the industry has been growing at an annual average of about 15 percent in recent years. There are 100 Islamic funds incorporated and registered in Bahrain with total assets of US$1.7 billion, as of March 2012.

"The CBB, through its enabling legislation, promotes the development of new products for investors in both Islamic and conventional finance," said Mr. Al Baker.

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

To further enhance the CIU framework, the CBB has recently released Volume 7 of the CBB Rulebook which provides comprehensive rules and regulations pertaining to the authorization and supervision of CIUs domiciled or offered for sale in Bahrain. The new regulation recognizes 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).

"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 Shari'ah principles," said Mr. Al Baker.

"It is the CBB's hope that such initiatives will also go a long way in harmonizing market practices and creating a deep and vibrant Islamic capital market."

See also 'CBB issues CIU Rulebook' – Page 9

More critical mass needed in Islamic finance industry

Fast-growing Islamic finance must achieve more critical mass if it is to address problems of liquidity, said a market practitioner at the World Islamic Funds and Capital Markets Conference (WIFCMC) in Bahrain.

The sukuk market is definitely growing but it has yet to reach the necessary critical mass, said Mr. Mahesh Balasubramanian, Partner at KPMG Fakhro Bahrain.

"The industry needs sukuk and interbank lending to meet its liquidity needs, but unfortunately the bigger banks that have excess liquidity are not over keen to lend to smaller banks that do not have ratings," he said.

"We will need to see more consolidation in the banking market and that is something that we are already seeing."

While the sukuk market was expanding, almost all of the issuance in 2011 was in Malaysia. He added that the other problem the industry faced was a lack of standardization on how banks deal with each other and on the issue of regulation.

"The industry is moving forward in developing standardized practices but it is a slow process compared with the growth in the industry," said Mr. Balasubramanian.

Delegates and speakers from 25 countries took part in the eighth annual WIFCMC, which took place on 20 and 21 May 2012. It was held in strategic partnership with the Central Bank of Bahrain (CBB), under the theme, 'New Growth Horizons: Expanding the Global Footprint of Islamic Funds and Investments'.

"This has been, by far, the most international edition of this event that we have hosted so far and that is a reflection of the spread of Islamic finance from the Muslim world to further afield," said Mr. David McLean, Managing Director of conference organizer, MEGA Events.

"We are not just talking about financial institutions here because what we saw this year was a strong representation from corporate entities which are turning from conventional finance to Islamic institutions when it comes to looking at ways to raise money.

"We have had leading institutions from as far apart as Ireland and Luxembourg taking part and a strong showing from Malaysia which has been dominating the sukuk market in recent years."

Islamic finance may be fairly small compared with conventional finance but it is a fast growing industry which is attracting more international interest across a wide range of financial service sectors, he said.

"With key markets for Islamic finance, especially in Asia and the Middle East, now facing escalating infrastructure and development needs backed by solid economic growth, and the outlook for global lending markets still remaining uncertain, Islamic investments will play a key role in funding these multi-billion dollar projects, given the fact that the global liquidity pool continues to shrink," said Mr. McLean.

According to the Ernst & Young Islamic Funds and Investments Report 2011, liquid wealth of Shari'ah-sensitive investors in the GCC alone, is expected to add more than US$70 billion to Islamic funds by 2013.

Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the CBB said the increasing interest in Islamic finance in major markets across the globe presents a unique opportunity of expanding the global footprint of the Islamic investments industry.

Changing market dynamics pose new challenges

Changing market dynamics are posing new challenges for Islamic banks.

While Islamic banks have outperformed their conventional peers in most markets, two key indicators are cause for reflection: slowing growth rates and eroding profitability, according to A T Kearney, a global management consultancy.

Declining growth rates are occurring in key geographies, including Saudi Arabia, Bahrain and the UAE, where growth rates have dropped to between three and eight per cent from double-digit figures.

In parallel, cost income ratios are increasing in most markets, putting pressure on profitability. Up until now, Islamic banks have typically emulated the conventional bank offering, but the eroding profitability trend suggests it is now time for a new approach.

To sustain profitable growth, a more sophisticated leveraging of the Islamic banking potential is required.

"Strategically, Islamic banks need to revisit their positioning and decide whether they want to fully exploit the Islamic banking niche or compete head-on with conventional banks," said Mr. Cyril Garbois, Partner at A T Kearney Middle East.

"Operationally, Islamic banks need to seek greater efficiency across the value chain. Fully exploiting the Islamic banking niche means targeting customer segments that care most deeply about Shari'ah compliance in their financial dealings, as well as offering products and services that meet not only general financing but also Muslim-specific customer needs."

While Islamic banking products abound in car finance and credit cards, there are limited products available in more sophisticated segments, such as asset management and wealth management, he said.

In addition, products tailored to Muslim-specific needs provide a platform for true differentiation.

"These market opportunities are under-developed and present attractive platforms for profitable growth for players willing to exploit this niche," said Dr Alexander von Pock, Principal at A T Kearney Middle East.

Competing head-on with conventional banks requires Islamic banks to meet a broader set of customer needs, in terms of offer and efficiency of service, he said. However, Islamic banks are typically at a scale disadvantage as they are often smaller in size and this is testing their ability to remain on par with their conventional counterparts, and compete profitably."

"Banks willing to explore alternative models, as well as alternative channels, such as online banking and phone banking, will be better placed to face this challenge," said Dr. von Pock.

CBB updating governance rules for Islamic banks

The Central Bank of Bahrain (CBB) will soon begin a process of consultation on proposed new corporate governance requirements for Islamic financial institutions (IFIs).

An internal review of the proposed rules has been completed and the CBB will be seeking market feedback before finalizing the requirements, said Mr. Rasheed Mohammed Al Maraj, Governor of the CBB.

He was speaking at the Annual Shari'ah Conference of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The event, which was held on 7 and 8 May 2012 under the patronage of the CBB, attracted more than 300 delegates from 25 countries.

Speaking on the issue of governance, Mr. Al Maraj pointed out that deficiencies in governance at financial institutions have been repeatedly highlighted in the past five years, following the commencement of the global financial crisis in 2008.

AAOIFI has, so far, issued seven standards relating to governance and two standards with respect to ethics. Three of the standards specifically refer to governance.

The first of these standards concerns the Audit and Governance Committee. In practice, this standard requires the Audit Committee to do rather more than just review a financial institution's accounting practices and audit plan. It requires the Committee to not only review the use of Restricted Investment Accounts' funds but emphasizes the need to ensure that funds are invested in accordance with the terms agreed with the customer.

Interests of Customers

"Too often, over the past five years, we have seen how the interests of customers at both conventional and Islamic banks have been neglected as bank managements have focussed on bonuses and share price," said Mr. Al Maraj.

If banks neglect customers' interests, then they will lose those customers. This theme of looking after the interests of customers is carried on in the AAOIFI Governance Principles paper issued in 2005, he said.

In particular, Principle 3 of this paper warns against inequitable treatment of fund providers. The 2009 AAOIFI Corporate Social Responsibility paper also focuses on dealing responsibly with clients and 'par excellence' customer service.

"If you couple the governance standards with the ethics paper for employees of financial institutions, you find a formidable set of requirements, principles and standards relating to putting the interests of customers first," said Mr. Al Maraj.

Against this background of improving levels of disclosure, the CBB will be making further efforts through its review of its corporate governance and business conduct rules, to raise the bar for corporate governance.

The review of the CBB corporate governance requirements has already finished its first stage of internal review. The next will be a consultation with the financial sector.

Shari'ah-Driven

Coupled with governance is the Shari'ah dimension.

"Again, the CBB has noted that all too often, the approach of banks, particularly conventional banks, has been to start with a conventional transaction or product and then try to give it a finishing coat of Shari'ah-compliant paint," said Mr. Al Maraj.

"Financial institutions must not regard Shari'ah-compliance as the finishing touch to product development. Instead, product development needs to start from Shari'ah principles, i.e. Islamic financial institutions must become Shari'ah-driven."

If financial institutions and standard-setters can address the interests of customers, governance and Shari'ah-compliance satisfactorily, then Islamic finance will be able to continue its growth and reach its full potential.

Shaikh Ibrahim bin Khalifa Al Khalifa, Chairman of the AAOIFI Board of Trustees, pointed out that development of industry standards is a continuous process governed by the evolving dynamics of the Islamic finance industry.

"We need to ensure that the standards can continue to benefit the industry taking into account current changes in business and economic environment," he said.

Dr. Khaled Al-Fakih, Secretary General and Chief Executive of AAOIFI, said the global financial crisis has created a lot of interest in Islamic finance around the world, not just in Muslim countries.

The potential from new markets will help Islamic finance to spread a lot wider and grow.

"This new interest will clearly open up new markets and increase demand for Islamic finance," he said.

AAOIFI is the international body responsible for developing and issuing standards on Shari'ah, accounting, auditing, ethics, and governance for the global Islamic finance industry and it is continuing standards development to support the industry's growth.

He said Shari'ah scholars have been instrumental in helping AAOIFI not only in developing new standards but in reviewing and enhancing those standards. They have also been instrumental in working with the industry and guiding it to adopt AAOIFI standards.

AAOIFI also works closely with other bodies including the International Islamic Financial Market (IIFM), Islamic Financial Services Board (IFSB) and the Liquidity Management Centre (LMC), he pointed out.

"AAOIFI has so far issued a total of 84 Islamic finance standards and we are currently working on developing new standards and reviewing existing ones," said Dr Al-Fakih.

The Annual Shari'ah Conference forms part of AAOIFI's consultation process with the industry, to facilitate its standard-setting efforts by bringing together prominent Shari'ah scholars, senior representatives from central banks, regulatory authorities and financial institutions, as well as Islamic finance practitioners.

The conference provides a platform for exchanging ideas and discussing issues, especially those relating to AAOIFI's efforts on standardization and harmonization.

Discussions at the conference covered topics relating to some of these standards. The topics discussed included Shari'ah-compliance and supervision processes, continuing development of Islamic financial and capital markets, legal issues in Islamic finance, potential areas for further growth of Islamic finance, and development of human capital resources in Islamic finance.

The event also featured a graduation ceremony for candidates who recently passed AAOIFI's Certified Shari'ah Adviser and Auditor (CSAA) and Certified Islamic Professional Accountant (CIPA) professional development programs.

Integrating Islamic finance with Islamic philanthropy

If poverty alleviation is the core purpose of Zakah, it is better served in an endowment model rather than the prevailing consumption-only practice of Zakah giving, and Islamic finance has a role to play here, argues Sohaib Umar, Executive Manager, Ernst & Young MENA Islamic Financial Services, Bahrain. Muslims can create the largest endowment in the world by aggregating their Zakah and letting specialist Islamic fund managers manage it. Economically it makes more sense but would the scholars agree? This article is an attempt to raise some thought provoking questions about creating a more effective Zakah model by integrating Islamic finance with Islamic philanthropy.

Why is it that one in five Muslims today are living below the poverty line, despite the obligatory payment of Zakah by their rich fellow Muslims every year? How much Zakah is given annually? Does Zakah help alleviate poverty in a sustained way? Is a more effective Zakah model possible? Does Islamic finance have a role to play here?

It is strange that although Zakah is one of the five pillars of Islam, there are no authentic figures available for Zakah giving by Muslims globally or at the country level. Although Zakah is obligatory on every Muslim whose wealth exceeds a minimum benchmark, and a government can oblige its citizens to pay Zakah in the same way it obliges them to pay taxes, there is no central arrangement for collection of Zakah in any Muslim country (except Saudi Arabia where institutions have to pay Zakah).

And, despite large amounts of Zakah being paid annually, there is no established link between Zakah and poverty reduction in countries such as Indonesia, Pakistan, Bangladesh, Yemen or Egypt, where a large number of the Muslim world's poor live.

It is a known fact that within a hundred years of Islam's advent poverty was eliminated in the vast Muslim empire. So, the following questions come to mind:

1. If Zakah could eliminate poverty once in history, why can it not do so again?
2. More importantly, does this indicate a fundamental weakness in the current Zakah practice (in collection, disbursement or usage)?
3. What can we do to make the Zakah model more effective (and re-establish the link between Zakah and poverty alleviation)?
4. What role can Islamic fund management play here?

Zakah Market

Let us turn to sizing up the Zakah market. The lack of authentic data compels us to use proxies. In 2010, the US recorded US$290 billion in charity giving by its companies and citizens. This represents 2.2% of the US GDP for that year. For the UK, France and other European nations, the percentage is close to 1%.

Since Zakah is obligatory, it can be safely assumed that annual charity giving as a percentage of income for Muslim countries is close to the US percentage. Secondly, anecdotal evidence suggests that nearly 80% of total annual charity giving by an average Muslim comprises Zakah while the remaining 20% is the non-obligatory Sadaqah. Thirdly, we assume, conservatively, that only 50% of Muslims actually pay Zakah as a religious obligation.

Based on these assumptions, Zakah in Muslim countries (excluding Zakah paid by Muslims in non-Muslim countries) can be estimated as follows:

GDP of Muslim countries in 2010:	US$4.7 trillion
Total charity estimate:	2% of GDP or US$94 billion
Zakah potential:	80% of charity or US$75 billion
Actual Zakah paid:	50% of Zakah potential or US$37.5 billion

We now turn to the US$37.5 billion question – where does this money go every year? Certainly not towards poverty alleviation in any meaningful way. Statistics show that countries that experienced accelerated economic growth did witness a reduction in poverty but, as soon as growth slowed, poverty re-emerged. Pakistan is a case in point. In the 1960s and 1980s, Pakistan's economy grew annually by 6%+, resulting in a decline in the number of poor. However, in the 1970s and 1990s, when growth slowed to 3-4% per annum, the situation reversed. During all these years, Zakah-giving continued and general charity giving also increased but it did not seem to make any tangible difference to the poverty situation.

We can, therefore, state with some confidence that the prevailing Zakah model has only contributed to fulfilling the immediate short-term needs of the poor, what we call a consumption-only model. But it has failed to tackle poverty on sustainable and permanent basis (since no capital formation was done). It has failed to transform Zakah recipients into Zakah givers, which is the real purpose of Zakah (narrates Hazrat Umar, "When you give, make (the recipient) rich").

This calls for a fundamental rethink of the current model of Zakah collection and disbursement and coming up with a paradigm shift to make Zakah more effective in achieving its real purpose.

Managing Zakah

Purely from an economic perspective (and subject to the consent of Shari'ah scholars) one can perhaps argue that Zakah can be more effectively utilized in an endowment model. Imagine for a moment that a global organization collects Zakah from all the 57 Muslim countries. If Zakah is centrally collected and invested, it would be the largest endowment in the world (Harvard University's US$32 billion endowment is the world's largest).

More importantly, since Zakah is paid annually, US$37.5 billion will be added to the endowment every year. Within ten years the endowment will grow to US$375 billion. Assuming a 5-10% annual rate of return, this endowment would generate as much money every year as the current annual total Zakah giving, while the endowment capital would remain intact. The benefits of central collection, planning and disbursement of Zakah under a properly governed institution are countless.

If a global organization seems impractical, country level organizations are very much doable. The creation of one global or many country-level endowments would call for specialist Islamic fund management companies to manage the money. This would revitalize the Islamic funds industry, which has barely reached US$60 billion in thirty years, a mere 0.3% of the US$23 trillion conventional funds industry. Almost overnight, it would shift the Islamic funds industry into a different paradigm and open new avenues of growth.

The endowment model is one way to make Zakah more effective. There may be others. It is up to Shari'ah scholars, economists and governments to jointly come up with permissible new models. Integrated with Islamic philanthropy, Islamic finance can be a lot more exciting than in its present role.

The views expressed in the article are not necessarily those of the CBB.

Call for Shari'ah-based solutions to manage risks

All stakeholders of the Islamic finance industry need to work together to develop a broader range of risk management products, to help the industry move into the next stage of its evolution, says a senior Central Bank of Bahrain (CBB) official.

As Islamic financial institutions undertake increasingly complex transactions, they can no longer afford to take on unnecessary risk due to lack of appropriate Shari'ah-compliant solutions, said Mr. Khalid Hamad, Executive Director, Banking Supervision, at the CBB.

He was speaking at a seminar on 'Hedging and Credit Enhancement in Islamic Finance', held in Bahrain on 28 March 2012. The event was organized by the International Islamic Financial Market (IIFM) and the Islamic Financial Services Board (IFSB) and hosted by the CBB.

Speakers and delegates at the event discussed the many aspects surrounding the use of hedging and credit enhancement tools in the Islamic finance industry, with the aim of improving products; techniques; practices; and the industry standards in the use of risk mitigation techniques in Islamic transactions.

"The CBB fully supports such discussions and, through our membership of the IIFM, we play an active role in helping to shape the future of the industry," said Mr. Hamad in his welcome speech.

Highlighting the importance of risk management, Mr. Hamad said that hedging and credit enhancement frameworks, and the products which can be used within those frameworks, are fundamental building blocks within the financial services industry. These are challenging and complex issues which are critical to the evolution of the Islamic financial industry now and in the future.

"I encourage all stakeholders to put forward their views as to how to assist the development of the Islamic financial services industry," he said.

Complex Issues

There is a need to delve deeply into the many issues involved, such as the impact of credit enhancement techniques on the credit rating of a sukuk; recent developments in hedging in the Islamic financial services industry; how hedging mechanisms can be applied in Islamic capital markets; the way in which the legal framework for hedging and credit enhancements is evolving; and the potential impact of Basel III, the new global regulatory standards on bank capital adequacy and liquidity risk.

"Within this context, it is important to remember that the Islamic finance industry is still at an early stage of its evolution," said Mr. Hamad.

The industry has grown rapidly in the recent past, and to continue this trend requires a greater degree of choice of products; where possible increased standardization of the frameworks for products; and a greater breadth of clarity as to how Islamic contracts will be interpreted.

Islamic financial institutions, governed by the tenets of Shari'ah, have remained largely insulated from the adverse, and often significant, consequences of entering into speculative deals, he pointed out.

"We can build on this by utilizing the lessons from the global financial crisis as a platform which provides a significant opportunity for the Islamic finance industry to become more competitive," said Mr. Hamad.

Renewed Focus

"In this context, there must be an increased focus on the management of risk. In addition, participants in the industry constantly seek a greater understanding of the principles and practices of Shari'ah. A more detailed explanation of the risk mitigation frameworks will assist in achieving that aim."

Furthermore, the industry requires an increased choice of Islamic products that can provide liquidity, especially in times of stress; and Islamic institutions will be required to provide a greater degree of transparency to stakeholders.

"A fundamental element in all of this is that Islamic financial institutions can no longer afford to leave their positions unhedged. The absence of hedging and credit enhancement mechanisms has often been cited as one reason for the challenges faced by Islamic banks in times of market volatility," said Mr. Hamad.

Whilst conventional markets provide avenues for transferring risks at market-determined prices which facilitate a reduction in institutional risk, such mechanisms are not readily available to Islamic banks.

"Developing a market architecture that facilitates risk mitigation and robust risk management has assumed critical importance for the Islamic finance industry," stressed Mr. Hamad.

The IFSB and the IIFM, together with central banks and other global regulatory bodies, have responded to these challenges by embarking upon a collaborative global initiative to develop a robust risk management framework for Islamic banks which can operate effectively across jurisdictions.

The ongoing initiatives are multi-dimensional, including capital adequacy standards, enhanced liquidity standards, improved corporate governance, Shari'ah standards, master agreements on certain products and contracts, internal controls frameworks, and efforts towards developing robust Islamic capital market products.

The exercise to build a framework for hedging and credit enhancement within Islamic tenets has necessitated significant contributions from scholars, on the one hand, and experts in modern risk management on the other.

One example of this is the Tahawwut Master Agreement and the Profit Rate Swap documentation, a joint initiative by the IIFM and the International Swaps and Derivatives Association (ISDA), which provide a standardized framework for Islamic hedging transactions. The framework is designed to reduce counterparty credit risk, increase transparency, and enable the growth of robust, stable, financial markets within a Shari'ah-compliant structure.

"The beneficial impact of such industry standards can hardly be ignored. Hedging and credit enhancement play a crucial role in the Islamic capital market in promoting efficiency of the Islamic financial services industry," said Mr. Hamad.

Hedging provides alternative risk management instruments for Islamic banks while credit enhancement products and techniques increase the attractiveness and acceptability of the underlying products to market participants. By doing so, they promote the attractiveness of the Islamic financial sector.

"However, developing a framework that promotes Shari'ah-compliant hedging instruments and credit enhancements raises a number of challenges," said Mr. Hamad.

"Perhaps the greatest challenge is to resolve the inconsistencies between Shari'ah principles and the legal and regulatory requirements of various jurisdictions. Agreeing and implementing standards which facilitate cross-border transactions will assist this aim, and this is best achieved through engaging all stakeholders in a constructive dialogue."

Regulating Islamic financial access and inclusion

The micro, small and medium enterprise sector of the Islamic financial services industry in most Muslim countries remains highly limited, says 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. He discusses the role that an enabling regulatory infrastructure can play in facilitating Shari'ah-compliant financial access and inclusion.

The outreach of Islamic small and medium enterprise (SME) and microfinance initiatives remains limited. Inadequate liquidity, lack of sustainable market strategies and products, and limited institutional support from mainstream Islamic banking and financial institutions may have led to the slower pace of development and growth in this sector. Lack of enabling regulatory infrastructure is one of the main factors in many Muslim countries. While the lack of liquidity and industry support are also important issues, we focus here on some of the regulatory issues that may have an enabling and facilitating role for Shari'ah-compliant financial access and inclusion.

Although there are some popular benchmarks, there are no universally accepted definitions of SME and microfinance. Most countries like to define them according to their respective economic conditions. Various countries also provide minimum and maximum thresholds for SME and microfinance. For the purposes of this article, we will use SME and microfinance to refer to those financial services to which access may be more expensive and/or restrictive based on the economic background of the customer.

Shari'ah defines and encourages certain economic behaviors that are aimed at economic development. There is, thus, an implied promise that Islamic financial institutions are expected to offer financial access and inclusion to those who may not otherwise be served.

Recent researches confirm that a significant number of people in Muslim countries do not have access to financial services. Based on the understanding of Islamic finance and the objectives of Shari'ah, it is obvious that there is no doctrinal impediment to Islamic finance providing greater financial access and inclusion.

The question, then, looms: Why has Islamic finance not been able to offer greater access to finance and financial inclusion? While there may not be a straightforward answer to this question, it appears that the relatively nascent history of Islamic finance may have a significant bearing on the current situation. Other explanations could come from the examination of the institutional infrastructure of each country where Islamic finance has so far thrived. Some explanations may also come from the examination of the economic development strategies of countries.

As overregulation may create a restrictive effect on the market (by making the business more expensive and/or by posing a higher risk of non-compliance), an expensive access to financial services has an exclusionary effect on micro and SMEs. Since markets price the risk of micro and SMEs higher than mainstream customers, providing financial services to micro and SMEs is expensive. Hence, the current market practices will continue to have an exclusionary effect on this sector, which is a highly undesirable outcome, in view of the Shari'ah objectives for enterprise development.

Enterprise Development

This apparent anomaly can only be redressed with all-encompassing enterprise development policies, for which the role of government is quite important. Such policies should include financial and regulatory incentives (which are not discussed here for want of space) so that an optimal integration and coherence with the micro and SMEs sector becomes possible.

Shari'ah-compliant financial access to micro and SMEs is offered in various ways. There are specialized SME banks, Islamic microfinance institutions, non-governmental organizations (NGOs), and cooperative societies. However, the availability of proper Shari'ah advice and supervision to SME and microfinance institutions may not be consistent and certainly not uniform.

The supervision of Shari'ah-compliant financial access has its unique challenges. As discussed in a previous work (The Review, March 2012), there are two principal ways in which Shari'ah supervision is offered currently: Through a central supervisory board in a particular country or through a self-regulated model where the Shari'ah scholars regulate themselves with the help of a subtle and yet sophisticated peer-review process. Keeping in view the peculiar nature of micro and SMEs, neither of these models may provide an optimal supervision solution.

Centralized Shari'ah supervision would entail increased involvement of the central Shari'ah supervisory board and the institutions dealing with micro and SMEs. As the lack of financial sophistication and sometimes basic education is expected, an effort to simplify financial transactions would pose a significant challenge both in terms of time commitment and cost perspective.

As for the self-regulatory model, the number of Shari'ah finance scholars is limited. Their existing commitments may not allow them to be available on an on-going basis to supervise microfinance and SME institutions. Therefore, Shari'ah supervision would need to be customized for the micro and SME sectors.

The transactions of micro and SMEs usually involve a larger number of the customers and relatively smaller amounts. As Shari'ah supervision entails an additional cost element, any increase in the transaction costs would make the access to financial services even more expensive.

As part of their economic development initiatives, the governments encouraging Shari'ah-compliant financial access and inclusion should consider:

1. Developing simplified model documentation and guidelines in local languages.

2. Engaging local community scholars (or Imams) in providing advice.

The model documentation can be developed on the basis of appropriate studies and research. Training of community scholars can also be conducted in a uniform, centralized manner. The institutions may collectively offer a retainer to the community scholars for providing frequent support in relation to the model documentation and guidelines.

The risk of controversial products, thus, could be significantly minimized, with model guidelines in place, frequent training, and peer-review among the community scholars.

Integration of economic development policies in enterprise development is critical. It becomes even more significant with regard to offering Shari'ah-compliant financial services to micro and SMEs. The cost of Shari'ah-compliance (in addition to already higher operational) is likely to make Shari'ah-compliant financial services for micro and SMEs less competitive and less sustainable. Efficient economic development policies are likely to make them competitive and sustainable.

The views expressed in the article are not necessarily those of the CBB.

Islamic banks must accelerate standardization

Lack of standardization is a key constraint facing the growth of the Islamic finance industry, according to a senior Central Bank of Bahrain (CBB) official.

"We are seeing continuing fragmentation in Islamic financial products. Unless products can be standardized, there will be less liquidity and documentation costs will remain higher than for conventional banks," said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the CBB.

He was speaking at a seminar titled 'Indonesia-Bahrain: Exploring Smart Partnership on Islamic Banking and Finance', held in Bahrain on 14 May 2012.

"Islamic banking also needs to gain a larger share of the retail market by providing investment accounts that are as flexible as conventional deposit accounts and to continue its provision of retail credit products, such as credit cards and other products which are flexible enough to be competitive with conventional products," said Mr. Al Baker.

Teaming up scholars and bankers from different countries can facilitate such developments as there needs to be a greater exchange of personnel between countries to facilitate exchange of ideas.

He pointed out that important developments had been made in the standardization of wholesale Shari'ah-compliant financial instruments by the International Islamic Financial Market (IIFM). These include various master agreements, and also the profit rate swap and the interbank Wakala.

The Islamic International Rating Agency and the General Council for Islamic Banks and Financial Institutions are also performing a valuable role in fostering the development of a strong financial sector.

"But without liquidity, banks and banking centres are paralysed, as we have seen with the Eurozone crisis over the past two years," said Mr. Al Baker.

The CBB has played a key role in its program of sukuk issuance, since 2001. The sukuk issues give banks and financial institutions a liquid asset and a liquid form of collateral for secondary market trading and liquidity generation.

"With the IIFM, we have worked towards standardization of Islamic financial products in the wholesale market. But there is still much to be done before we see true industry-wide standardization of products," said Mr. Al Baker.

Education and training in Islamic finance are especially important because, unlike conventional finance, the tools, structures, products, and standards and regulatory frameworks are still developing, he said, adding that Bahrain has seen the need to invest actively in training initiatives.

The Bahrain Institute of Banking and Finance (BIBF) offers numerous Islamic finance qualifications, including the advanced diploma in Islamic finance and the advanced diploma in Islamic commercial jurisprudence.

He said Bahrain has been and intends to remain at the forefront of the development of Islamic finance.

Waqf Fund support for Islamic finance research

The Waqf Fund, a Bahrain-based special fund to support Islamic finance training, education and research, held its 16th Board of Trustees meeting on 17 May 2012.

The board took stock of the ongoing programs of the Waqf Fund and expressed its satisfaction that training was being delivered to Islamic banking professionals and Shari'ah resources at Islamic banks under the Graduate Sponsorship Program, Shari'ah Reviewer Development Program and Advanced Diploma in Islamic Commercial Jurisprudence Program.

The board decided to strengthen the Islamic finance resources at a major library in Bahrain in order to make it convenient for students and researchers in Islamic finance to conduct their research, making use of contemporary books, magazines, online databases and other digital resources.

"We want to facilitate research in Islamic finance by professionals and academics as it is very important for the long term success of the industry. For this purpose, we aim to provide support to a public library where anybody can access relevant material and databases both offline and online," said Mr. Khalid Hamad, Chairman of the Waqf Fund and Executive Director, Banking Supervision, at the CBB.

The board also decided to hold a workshop on corporate governance for the Chairmen, chief executive officers and Board Members of its member institutions. The main theme of the workshop will be the responsibilities of board members.

"We are really interested in improving the standards of corporate governance in Bahrain. As the new code of corporate governance gets implemented, the Waqf Fund wants to support the board members of its member institutions in their endeavor to understand their responsibilities and adapt world leading practices to their environment," said Mr. Hamad.

IIFM Board reviews standards development

Bahrain-based International Islamic Financial Markets (IIFM) held its 26th Board meeting in Singapore on 4 June 2012.

The board reviewed IIFM standards development, particularly the progress on Inter-Bank Unrestricted Wakalah, publication of the new Islamic hedging product standard on Mubadalatul Arbaah (Profit Rate Swap) as well as future standards development on foreign currency risk mitigation, as these are key instruments which are very much required by the industry.

On the collateralized liquidity management tool, which IIFM has been working on for some time, the board agreed to proceed in developing a product and documentation standard in consultation with Shari'ah scholars and market participants, as such a standard will pave the way for more efficient and more liquid domestic and cross border activity to facilitate liquidity management.

"These are exciting times in the development of the Islamic finance industry. IIFM has a major responsibility to not only set standards to support the growth of the industry but also to educate the market as a whole," said Mr. Simon Eedle, Vice Chairman of IIFM.

CBB issues Rulebook on mutual funds industry

The Central Bank of Bahrain (CBB) has released Volume 7 (Collective Investment Undertakings – CIUs), a new Volume forming part of the CBB Rulebook.

Volume 7 contains comprehensive rules and regulations pertaining to the authorization/registration and supervision of mutual funds domiciled in and/or offered for sale in Bahrain.

It builds on the CBB's previously-issued CIU regulations and introduces the first-ever rules for a newly-established category called Private Investment Undertakings (PIUs), a new breed of mutual funds aimed at high net-worth individuals and institutional investors.

The introduction of Volume 7 follows an industry-wide consultation that took place in October 2011, and incorporates the comments and feedback received.

"The new regulatory framework is aimed at enabling fund sponsors/managers and service providers to capitalize on the opportunities that best serve the needs of different types of investors," said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the CBB.

The new regulations add a much greater amount of detail to the earlier CIU regulations as mutual funds are increasingly attracting regional and international interest from specialized financial institutions that are actively involved in the structuring of mutual funds products.

"This increased interest necessitated the issuance of the revamped regulations as a separate Volume of the CBB Rulebook," said Mr. Al Baker.

The CBB issued its first rules on Collective Investment Schemes in 1992. These were subsequently revamped in June 2007, when the CIU Module was issued as part of the CBB Rulebook Volume 6.

Since then, the mutual funds industry in Bahrain has experienced further growth and development. As of the end of December 2011, the number of mutual funds stood at 2,838, of which 127 funds were Bahrain domiciled. The net asset value (NAV) of those funds totalled US$8.4 billion, with US$5 billion being invested by locally incorporated funds.

When markets began to slowly recover after the global financial crisis, investors immediately identified investment opportunities in the Middle East and North Africa region and there was instant demand for new, innovative investment products.

This, coupled by the fact that the mutual funds industry in Bahrain had matured to a certain extent, made it necessary for the CBB to undertake the exercise of revamping the regulatory framework for mutual funds, in order to keep pace with the current international and regional developments and best market practice, added Mr. Al Baker.

Mr. Mohammed Ayman Al Tajer, Director, Financial Institutions Supervision, at the CBB stated: "Recently, we have been observing a new trend in the applications for Bahrain-domiciled funds, in the sense that such applications are submitted with a pre-defined investment target and a very specific objective, unlike the previous norm which entailed subscribing to a blind pool that would search for available opportunities".

In drafting the new regulations, the CBB recognized the importance of expanding key areas such as the corporate governance framework, and the roles and responsibilities of each relevant party to a fund.

It also expands the variety 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, yet tailored to serve the needs of the local and regional markets.

Volume 7 additionally introduces rules for the newly-established category of PIUs, which are a new breed of mutual funds with a high degree of flexibility in structuring. PIUs are aimed at facilitating private investments, the like of club deals, single investor, family held investments or a single investment type. Due to the investment risk characteristics PIUs may exhibit, such investments can only be initiated/offered to high net-worth individuals and institutional investors.

On the progress of the mutual funds industry in Bahrain, Mr. Al Baker commented: "The fact that Bahrain-domiciled CIU vehicles have established a reasonably tested efficiency and operational track record, has made it attractive for operators to utilize CBB's CIU regulatory framework for the establishment of their CIU investment vehicles. This comes in addition to the fact that most of the mutual funds domiciled in Bahrain are focused on investments based in the region".

Mr. Al Tajer stated: "The CBB is fully supportive of the mutual funds industry and our revamped regulatory framework addresses investor needs through profiling mutual funds by category, i.e. Retail, Expert, Exempt and Private, each with a separate set of rules, observing the type of targeted investors and their level of sophistication, and applying the appropriate level of supervision on such basis. The application of such a framework is crucial for the industry to grow and progress in a healthy manner".

It is worth noting that all CIUs authorised/registered by the CBB prior to April 2012, are required to meet the provisions of Volume 7 by 31 December 2012. For newly-established CIUs, the rules are effective immediately.

Volume 7 of the CBB Rulebook can be accessed on the CBB website at www.cbb.gov.bh

Bahrain Bourse hosts CFA milestone

The CFA Institute celebrated 50 years of the Chartered Financial Analyst program by hosting a joint opening ceremony with Bahrain Bourse.

Joining more than 20 other cities including London, New York, Hong Kong, Mumbai and Singapore, Bahrain was part of a series of events happening in major financial centers around the world, representing the greatest number of stock exchanges to be opened or closed by one organization in a single day.

The events usher in a year of celebration for the CFA Institute, which offered the first CFA examination in June 1963. The CFA charter sets the standard for investment practice and is a globally recognized benchmark for ethics in the profession.

"Bahrain is taking its place alongside the world's major financial centers in helping to celebrate the 50th anniversary of the CFA Program," said Mr. Khalil Nooruddin, President, CFA Bahrain.

"As the global economy continues to grow and mature, the current financial crisis has reconfirmed the importance of ethics, education and good corporate governance in the financial markets."

Mr. Fouad Rashid, Director, Bahrain Bourse, said the exchange supports the activities of the CFA Institute and appreciates its role in providing highly qualified professionals who are helping reinforce Bahrain's position as a leading financial centre in the region.

BIBF, GARP agree on risk management course

The Bahrain Institute of Banking and Finance (BIBF) and the Global Association of Risk Professionals (GARP) have signed a memorandum of understanding (MoU) for collaborating to market, train and certify young professionals in the area of risk management.

GARP is the globally recognized membership association for risk managers and the world leader in financial risk testing and certification programs. The MoU provides the BIBF exclusive rights to train eligible candidates, in Bahrain, for GARP's Foundations of Banking Risk (FBR) examination, a program that is now being used extensively throughout the world. Successful candidates will receive a joint certificate from the BIBF and GARP.

The MoU also gives the BIBF exclusive rights to market the FBR in Bahrain.

The FBR is an introductory level program designed for a wide audience of financial services professionals, including new hires and accounting, internal audit, compliance, technology, operations, sales and risk-related staff.

The program covers bank operations, and how they're governed and regulated. Participants will learn the basics about the primary risks banks take -- credit, market and operational -- and how international regulation, including the Basel Accords, affect the management of these risks.

BIBF's first cohort of FBR students is currently comprised of University of Wales Validated Diploma program students who are simultaneously pursuing their academic degree and professional qualifications.

Many of the world's leading global banks and financial institutions use the FBR program as part of their professional development curriculum. The program combines classroom-based training for four months, on a part time basis, with e-learning from GARP, culminating in a final on-line assessment administered in the BIBF.

"GARP is delighted and honored to enter into this relationship with the BIBF," said Mr. Richard Apostolik, President and Chief Executive Officer of GARP.

"The BIBF is taking the lead in the GCC region in ensuring that financial services industry staff at all levels in an organization are able to identify and preliminarily access the risks their institutions must face every day, an indispensible requirement in this time of massive uncertainty and volatility."

Risk management stressed at key seminar

Risk management has become a top priority for banks' boards in the wake of the ongoing financial crisis. Most world markets and sectors continue to be adversely impacted, including the Islamic finance sector, which is currently facing regulatory and practice-related reforms, heard participants at a seminar in Bahrain.

Around 40 members and students of the Chartered Institute for Securities & Investment (CISI) in Bahrain attended the event on risk management, held on 29 May 2012. It was organized jointly by CISI and the Bahrain Institute of Banking and Finance (BIBF).

Mrs. Deepa Chandrasekhar, Senior Vice President and Chief Compliance Officer at United Gulf Bank, and Dr Hatim El Tahir, Director of the Deloitte Middle East Finance Knowledge Centre addressed the event. Both are CISI members, and Mrs. Chandrasekhar is also a member of the CISI's Advisory Council in Bahrain.

She stressed the role of information in risk management and how professionals continue to help develop effective systems for implementing a risk framework.

"The global financial crisis reiterated the importance of incorporating strong risk management and governance principles. The onus is on risk and compliance personnel in financial institutions to identify, assess and mitigate emerging risks proactively," she said.

Dr El Tahir focused on the importance of board engagement in risk management. "Greater pressure has been placed on financial institutions offering Islamic financial services to develop effective risk intelligence solutions," he said.

A recent report by Deloitte showed that although the practice of Enterprise Risk Management is relatively new in the Islamic finance sector, 79 percent of the institutions that took part in a survey conducted by the firm had established a risk department in the last five years.

The BIBF is an accredited training provider of CISI, the largest and most widely respected professional body for people working in the securities and investment industry in the UK and in a growing number of major financial centres around the world.

Evolved from the London Stock Exchange, CISI has more than 40,000 members in 89 countries. In the past year, it has set almost 42,000 examinations in 68 countries, covering a range of vocational qualifications.

Workshop held on Basel III

The Central Bank of Bahrain (CBB) and the Union of Arab Banks (UAB) hosted a workshop on Basel III requirements.

The three-day event, titled 'Practical Implementation of Liquidity Risk Management and the Internal Capital Adequacy Assessment Process (ICAAP) According to Basel III Requirements', was held from 20 to 22 May 2012. It was attended by more than 60 participants, representing banks in Bahrain, the UAE, Iraq and Sudan.

The workshop focused on the practical implementation of liquidity risk management according to Basel III recommendations (aspect and affecting elements, new standards and rates, best practices of liquidity risk management), in addition to stress testing in liquidity risk management and internal capital adequacy assessment process (ICAAP).

It was conducted by Mr. Nicolas Kunghehian, Associate Director, Moody's Analytics/Moody's Rating Agency; Mr. Rabih Nehme, Head of Risk Assessment,

Mr. Yousif Hassan (left), Director, Retail Banking Supervision, CBB, is seen with participants at the workshop.

Banking Control Commission, Lebanon; and Mrs. Rana Qambar, Head, Retail Banking Supervision, at the CBB.

Same-day cheque clearing system launched

Shaikh Salman, (sixth from left) is seen with representatives of The Benefit Company

The new Bahrain Cheque Truncation System (BCTS) went live on 13 May 2012, replacing the earlier paper-based cheque clearing system in the Kingdom of Bahrain with a fully automated image-based cheque clearing system.

The move was announced by the Central Bank of Bahrain (CBB) and Bahrain's National Electronic Network for Financial Transactions (Benefit) Company, which has implemented the new system. The firm will operate the BCTS under the guidance, supervision and oversight of the CBB.

Shaikh Salman bin Isa Al Khalifa, Executive Director, Banking Operations, at the CBB, said the BCTS was a national initiative to modernise and improve efficiency of cheque clearing in Bahrain, in keeping with global trends.

The BCTS does not change the current practice of writing and depositing of cheques by bank customers.

The new system speeds up the clearing cycle for bank customers, enabling them to get cheque proceeds on the same day (i.e. Sunday to Thursday), instead of two to three days previously.

With the introduction of BCTS, bank customers who deposit cheques at banks before 11:30 am can receive the proceeds of their cheques on the same day.

The new system is expected to enhance the efficiency of cheque payments of individuals and corporates. Furthermore, BCTS reduces costs and risks associated with handling physical cheques and makes banks' operations more efficient.

Banks commenced issuing 'image friendly' cheques to customers as far back as January 2010, in preparation for the launch of the BCTS.

Since BCTS is based on the electronic transmission of images and payment information, it is important for customers to use 'image friendly', new design cheques which comply with security and operational requirements of BCTS. Old design cheques that do not provide clear images may experience delays in clearing.

BFX posts trading success with Gold Futures

The Bahrain Financial Exchange (BFX), the Middle East and North Africa region's first ever multi-asset exchange, posted a cumulative (single-side) trading turnover of US$3.68 billion for the first six months of trading on BFX Futures.

The cumulative trading volume reached 77,076 contracts between 23 November 2011 and 25 May 2012, said a BFX statement.

The highest daily trading turnover was U$224.74 million, with a trading volume of 4,535 contracts achieved on 16 May 2012.

The BFX Gold Futures contract was the most actively traded during this period, with its trading volume increasing to 59,065 contracts and total turnover of $3.03 billion. This is equivalent to 1.89 million ounces or 58.79 metric tons.

The first $1 billion mark in cumulative trading turnover was achieved in 107 trading days, the next $1 billion mark was achieved in only 12 trading days, and the third in just seven trading days.

Remarkably, the trading turnover of US$3.35 billion during the second three-month period was 14 times the trading turnover of US$237 million during the first three months.

The total trading turnover of BFX Futures, between 1 and 25 May 2012 was US$2.42 billion, which was nearly double the total trading turnover during the entire period between 23 November 2011 and 30 April 2012.

"Quadrupling the total trading volume from US$1 billion to close to $4 billion in a period of one month reflects the immense opportunities the BFX has created for market participants," said Mr. Arshad Khan, Managing Director and Chief Executive of BFX.

"We take pride that in less than six months time, the BFX has achieved tight spreads in all products, liquidity is increasing rapidly and prices are getting in line with international markets."

With these attributes firmly in place, the BFX Futures market can be more efficiently utilized for trading, investment and hedging purposes by the financial services industry of the Middle East region.

"Establishing such a market place in such a short timeframe underscores our commitment to position the BFX as the market of choice," added Mr. Khan.

Banking interns begin summer training

The Bahrain Association of Banks (BAB) has launched its seventh Summer Internship Programme, in partnership with the University of Bahrain (UoB).

Ten member banks have selected 31 students for the program, which focuses on preparing meritorious Bahraini students for a career in banking.

"The UoB appreciates the efforts of participating banks in this highly successful and beneficial training program," said Dr Mervat Ameen, Assistant Professor, College of Business Administration, at the UoB.

"The university values highly the opportunity for students to acquire valuable work experience, which helps them develop professional work ethics and introduces them to the real work environment."

The partnership between the UoB and the banking industry continues to prove to be tremendously beneficial to all parties involved, he added.

"Training is one of the vital objectives of the financial sector to help build a knowledge-based workforce," said Mr. Robert Ainey, Chief Executive of BAB.

Financial Sector Fact Sheet

Regulator: Central Bank of Bahrain
Financial Institutions: 414 (May 2012)
Financial Sector Workforce: 14,342 (2010)
Bahraini nationals 9,467 (66%)
Foreign nationals 4,875 (34 %)

Key Economic Indicators

GDP (Current) US$25.8 billion (2011)
Growth 17.8%
GDP (Constant) US$13.9 billion (2011)
Growth 2.2%

Financial Sector contribution to GDP 24.7%
Sovereign Rating
BBB (S&P Dec 2011) with negative watch
BBB (Fitch Dec 2011 with stable outlook
Population 1,234,571 (2010)

Banking Sector

Assets US$198 billion (Apr 2012)
No. of institutions 121 (Apr 2012)
Retail banks 30
Locally incorporated 15
Branches of foreign banks 15
Wholesale Banks 75
Representative Offices 15
Bank Society 1

Islamic Banks (included in left):
No. of banks 27 (May 2012)
Assets US$25.1 billion (Apr 2012)

Insurance Sector

Total No. of Insurance Companies & Organisations
Authorised in Bahrain 165 (Apr 2012) * excluding
Appointed Representative
Domestic market
Gross premiums US$556 million (December 2010)
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 32
Insurance Consultants 5
Insurance Managers 3

Representative Offices 5
Loss Adjusters 11
Actuaries 30
Insurance Ancillary Services 3
Insurance Pools & Syndicates 2
Insurance Society 1
Insurance Licensees Restricted: 35
Insurance Firms restricted: 29
Insurance Brokers restricted: 4
Insurance Consultants restricted: 2
Insurance Appointed Representative 10
Corporate 7
Individual 3

Investment Business Firms

No. of firms 49 (May 2012)

Representative Offices 12

Capital Market

Market Capitalisation US$16.72 billion (March 2012)
Licensed Exchanges 2
Licensed Clearing, Settlement and Central Depository Systems 1

Licensed Securities Brokers 4
Licensed Securities Dealers 1
Licensed Securities Clearing Member 3
Licensed Securities Broker Dealers 6

Specialised Licensees

No. of firms 23 (May 2012)
[comprising: Trust Service Providers 3; Ancillary services 14; Fund Administrators License 2; Registrar License 1; Registered Administrators 2; Registered Professional Body 1]

Money Changers 17
Financing Companies 8
Microfinance Institution 2

Funds Industry

Authorised Funds 2,793 (Mary 2012)
NAV US$9.17 billion (Mar 2012)

Local Funds 121
NAV US$5.68 billion (Mar 2012)
Conventional-Local 66
Islamic-Local 55
Foreign Funds-Offshore 2,672 (May 2012)