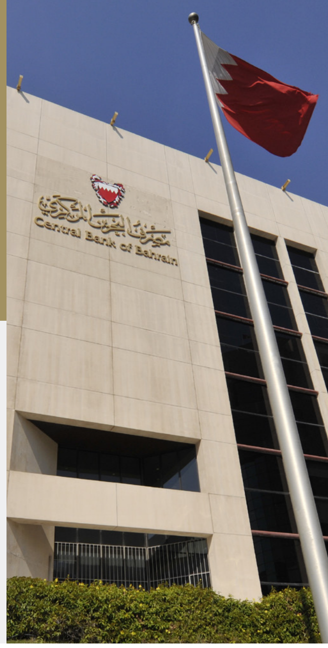
THE REVIEW

مصرف البحرين المركزي
Central Bank of Bahrain

Published by the Central Bank of Bahrain (CBB)

December 2014 Issue 41



CBB bolstering Shari'a governance with new rules

The Central Bank of Bahrain is developing new rules aimed at strengthening Shari'a governance in Islamic financial institutions based in Bahrain.

A Central Shari'a Board is also being established in Bahrain to help the Islamic financial services industry achieve consistency in Shari'a opinions, said Mr. Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain (CBB).

He was speaking at the opening of the 21st Annual World Islamic Banking Conference, held in Bahrain from 1 to 3 December 2014.

Convened under the patronage of HRH Prince Khalifa bin Salman Al Khalifa, the Prime Minister of the Kingdom of Bahrain, and held with the official support of the CBB, the event was attended by over 1,300 industry leaders from more than 50 countries.

"As the Islamic banking industry has witnessed nearly four decades of growth since its inception, it is time for us to reflect on where we are and where we intend going," said Mr. Al Maraj in his keynote speech.

"Success is not just a measure of what we have achieved as compared to the past but also what we have achieved as compared to the objectives we had set out for ourselves. In other words, what is the picture of the future of Islamic finance and banking, and what needs to be done to get there."

Islamic finance does not and cannot exist in a vacuum, he said. It needs an ecosystem of supporting industry segments and institutions to grow and prosper in a sustainable manner.

Takaful and retakaful, Islamic capital markets and wealth management (i.e. sukuk, equities and funds), Islamic microfinance, Islamic venture capital and private equity, Islamic SRI (Socially Responsible Investing) and Impact Investing, Zakah and Waqf are some of the major components of the enabling environment that is needed for sustained progress in Islamic finance.

"The industry is at varying stages of development when it comes to these components. A holistic approach is needed to take the next giant stride into the future," said Mr. Al Maraj.

A holistic approach would entail establishing or improving the following for each of the components mentioned above:

1. Regulatory frameworks;
2. Public awareness and communication;
3. Human resource training and education;
4. Corporate and Shari'a governance;
5. Risk management;
6. Standardisation by adopting AAOIFI, IFSB, IIFM and other standards;
7. Tax and accounting frameworks;
8. Sharing of experience, cross-border cooperation, investments and transactions.

"You can see that it is a monumental task. Fortunately, we have good solid foundations to work from and we have genuine growth to carry us forward while we create and develop an enabling environment," said Mr. Al Maraj.

He highlighted the importance of good governance, of which Shari'a governance is a special part which is unique to Islamic financial institutions.

"The CBB has always emphasised the need for good Shari'a governance and will be introducing new measures to strengthen this further," said Mr. Al Maraj.

"These include a new Shari'a governance module which will expand on the roles of Internal Shari'a Review and Internal Shari'a Audit functions and also introduce a mandatory requirement for external independent Shari'a Audit."

A planned Central Shari'a Board will help the industry achieve consistency in Shari'a opinions and set the direction of product innovation.

Another area for Islamic banks is to achieve and maintain excellence through the adoption of international standards and best practices. The CBB appreciates the recent developments which include new standards being introduced by AAOIFI, IIFM and IFSB.

"The New Year will see Bahrain adopting Basel III, a move towards a system that would have greater resilience to crises through higher capital adequacy, better liquidity management and more preparedness for unlikely scenarios," said Mr. Al Maraj.

Domestic Systemically Important Banks have been selected and their resolution and recovery plans are under assessment by the CBB.

See also 'Bahrain milestone' – Page 2

INSIDE

Bahrain milestone in Islamic finance studies

Bahrain's first-ever college students, with a Bachelor's degree in Islamic finance, are set to graduate from the University of Bahrain in 2015.

The pioneering four-year degree programme, developed with the sponsorship of the Waqf Fund, combines Shari'a studies with finance, business, banking and statistics, to create uniquely qualified graduates in Islamic finance. The first batch of students were inducted into the programme three years ago.

"This is among the first such initiatives anywhere in the world," said Mr. Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain (CBB), at the World Islamic Banking Conference.

"The first batch will graduate next year, and we expect that the industry will find them highly employable not just for the Shari'a department but any department due to their knowledge of the industry and exposure through seminars and internships."

He said human resource training and education has been a perennial issue for the Islamic finance industry. Although a number of institutions have come up and are doing good work in this area, yet the supply falls short of demand by a big margin.

"We have witnessed excellent progress in Bahrain, Malaysia and the UK; however, we see a need to foster closer cooperation among these centres in Islamic finance training and education," said Mr. Al Maraj.

As a pioneer in the development of many aspects of Islamic finance, the CBB is open to cooperation with its peers.

"We have seen in the last two years a number of new jurisdictions opening up to Islamic finance, especially in the Commonwealth of Independent States (CIS) and in Africa," said Mr. Al Maraj.

"Bahrain, as a global Islamic finance hub, has been a popular point of contact for many of these markets and we have had the pleasure of hosting half a dozen study visits for our counterparts in these markets."

This cross border cooperation is essential for market development because the sharing of experiences can significantly accelerate the process of introducing Islamic finance in a new market and the mistakes of early adopters can be avoided.

"The CBB continues to have an open door policy in this regard and is willing to share its experience with any regulator," said Mr. Al Maraj.

Islamic retail banks' assets cross $775 billion

Islamic banking assets with commercial banks in international markets are set to exceed US$778 billion in 2014, according to EY's World Islamic Banking Competitiveness Report 2014-15: Participation Banking 2.0.

The report says that global Islamic banking assets witnessed a compound annual growth rate (CAGR) of around 17 percent from 2009 to 2013.

However, the return on equity (ROE) rates of Islamic banks remain significantly lower than those of traditional banks in the same markets.

The findings of the report were presented at the 21st Annual World Islamic Banking Conference, held in Bahrain from 1 to 3 December 2014.

"Approximately 95 percent of international Islamic banking assets of commercial banks are based out of nine core markets, five of which are in the GCC (Saudi Arabia, the UAE, Qatar, Kuwait and Bahrain)," says the report.

Islamic banks in Saudi Arabia, Kuwait and Bahrain represent more than 48.9 percent, 44.6 percent and 27.7 percent market share respectively. Positive progress has been has made in Indonesia, Pakistan and Turkey, with 43.5 percent, 22 percent and 18.7 percent CAGR respectively from 2009 to 2013.

Mr. Gordon Bennie, MENA Financial Services Leader at EY, said: "The six rapid-growth markets – Qatar, Indonesia, Saudi Arabia, Malaysia, the UAE and Turkey (QISMUT) – commanded 80 percent of the international Islamic banking assets at US$625 billion in 2013. QISMUT Islamic banking assets are expected to continue to grow to reach US$1.8 trillion by 2019."

Mr. Ashar Nazim, Global Islamic Finance Leader at EY, said customers have mixed emotions about their experiences of dealing with Islamic banks.

"Going forward, growth will be most significant for banks that are able to strengthen customer experience through the use of digital technology," he said.

The report also finds that the ROEs of Islamic banks are about one-fifth lower than those of traditional banks in the same markets. This performance gap could cost its shareholders, and to some extent the investment account holders, up to US$17 billion in total forgone profit over the next five years.

Structural transformation and scaling up is, therefore, extremely critical to improving shareholder returns.

Trade finance, mobile payment solutions and managing the cost of regulatory compliance will drive the next phase of profitability. Most Islamic banks remain underweight in trade finance business.

Shaikh Esam Ishaq wins leadership award

Renowned Shari'a scholar Shaikh Esam Ishaq won the World Islamic Banking Conference (WIBC) 2014 'Industry Leadership Award'.

Shaikh Esam is a member of the High Council for Islamic Affairs in Bahrain and is recognised as an influential leader in Islamic finance.

The 'Industry Leadership Award' recognises outstanding contributions made by an individual towards the overall development of the global Islamic finance industry and significantly contributing towards shaping its future.

The WIBC 2014 'Islamic Banker of the Year' award went to Mr. Fadi Salim Al Faqih, Chief Executive of the Bank of Khartoum. The award, which uses a peer-based voting system, is given to an individual who is an established banker, leading a reputable financial services provider, and who has contributed significantly to the Islamic financial services industry.

The WIBC 2014 'Institutional Excellence Award 2014' went to Standard Chartered Saadiq.

Mr. Rasheed Al Maraj, Governor of the Central Bank of Bahrain, presented the awards to the winners at a ceremony held along the sidelines of WIBC 2014.

New issuers, innovation driving sukuk growth

The global sukuk market is once again growing strongly, with record issuances, entry of new sovereign issuers and innovation in sukuk structures, says the latest edition of the Sukuk Report, published by the International Islamic Financial Market (IIFM).

The 2014 edition, which covers the review period from January 2001 to July 2014 with particular emphasis on January 2013 to July 2014 period and provides insights into sukuk market trends, was released at the IIFM seminar, held as part of the World Islamic Banking Conference in Bahrain.

In a message in the report, Mr. Khalid Hamad, Chairman of IIFM and Executive Director, Banking Supervision, at the Central Bank of Bahrain (CBB), said that 2014 is proving to be another great year for the sukuk market globally, with a rising number number of international and domestic issues of increasingly bigger size.

"After two record years when global sukuk issuance crossed US$130 billion, we expect 2014 to close around a similar number (US$68 billion as of end-July)," he said.

The top 10 deals during the period under review were all US$2 billion and above, while there were 30 deals of US$1 billion and above, indicating that the sukuk market has attained a size which can no longer be ignored by the key players in the industry.

Mr. Ijlal Alvi, Chief Executive Officer of IIFM, said the progress of the Islamic financial services industry is continuing its double digit growth led by sukuk.

"During the last few years, the sukuk market has been led by sovereign and quasi sovereign issuers. Moreover, corporate sector issuances, especially in the Middle East and North Africa (MENA) region, are certainly another encouraging and remarkable development to be noted," he said.

Sukuk issuances by new Islamic jurisdictions, such as Senegal, Gambia, Kazakhstan, and Turkey, and sukuk issuances for the purposes of project financing, strengthening of institutions' capital base, and general working capital financing demonstrate that Islamic finance is contributing towards the economic growth and prosperity of many Islamic countries.

In addition, several non-Islamic countries, such as the United Kingdom, Luxembourg, Hong Kong and South Africa, as well as many conventional institutions, including Goldman Sachs and Bank of Tokyo Mitsubishi, have either already issued sukuk, or are in the midst of bringing their inaugural sukuk issues to the market, said Mr. Alvi.

Upward Momentum

The report finds that the sukuk market is playing a pivotal role in the development of Islamic capital and money markets. During the period under review, several innovations in sukuk structures as well as entry of new jurisdictions have taken place, making sukuk the most sought after fixed profile instrument.

Many milestones were achieved during the period under review, including:

- Long term sukuk issuances by Malaysia and Saudi Arabia;
- Perpetual sukuk issuance by a corporate, GEMS (school operator) from the UAE;
- Tier 1 & Tier 2 sukuk issuances by financial institutions;
- Debut international sukuk by the United Kingdom;
- Senegal debut sukuk in local currency;
- Pipeline of debut sukuk from Luxembourg, South Africa, and Hong Kong;
- Multi-currency sukuk programme by institutions;
- Debut sukuk issuance by Export Import Bank of Malaysia; and
- Short term sukuk issuances by jurisdictions and International Islamic Liquidity Management (IILM).

However, major efforts are required to improve the supply of corporate sukuk issuance and governments need to take a closer look at impediments which are hindering such sukuk issuance, as both the public sector as well as private sector need to play a major role in the sukuk market. One consideration would be to lower the investment denomination to allow for retail investors to invest in sukuk as part of a balance portfolio.

As far as international sukuk issuance is concerned, the picture on corporate and sovereign is quite different and the sukuk issuance of late has presented a balanced position, says the Sukuk Report.

The gap between sukuk pricing vis-a-vis conventional bond pricing is continuing to narrow and in some cases, sukuk came in tighter but the market continues to keep risk aversion strategy intact. This will most likely see continued sovereign and sovereign-linked sukuk taking centre stage.

It is no surprise that the domestic market is very much sovereign led, as the domestic market needs local currency instruments to manage liquidity while domestic investors prefer to invest in their home currency so as not to be exposed to currency risk.

Asia continued its dominance of domestic sukuk issuance due to its deep local currency fixed income market, with Malaysia and Indonesia being the driving force in the region. However, other regions, including the GCC, are becoming more active.

The total outstanding domestic sukuk, at July 2014, stood at US$226 billion.

In the international cross border market, corporates were the earlier dominant issuers but only after sovereign or quasi sovereign institutions laid the foundation that provided confidence in the sukuk as an acceptable and viable instrument (e.g. Bahrain, the UAE, Malaysia, Qatar, and Islamic Development Bank).

There were several landmark sukuk issuances from United Kingdom, Malaysia, Qatar, Turkey, the UAE, Saudi Arabia, Indonesia, and Bahrain, indicating that the sukuk market has fully recovered from the declining trend witnessed in 2008 till 2010 as a result of the global financial crisis.

Current outstanding international sukuk are worth about US$77 billion and it is expected that the year 2014 will close around US$90 billion.

Sukuk Trends

The sukuk mutual funds space is taking shape with a number of banks having set up their own Sukuk Fund for private clients. This is a positive sign that the sukuk market is coming of age, the report notes. Development of the sukuk funds is timely, as the current split between sovereign and corporate risk is very much desirable, since it offers investors and fund managers with a good mix of sovereign and corporate risk to consider.

In terms of tenor, the appetite for short-term sukuk is far greater than longer tenor sukuk. The trend towards issuing shorter tenor sukuk is increasing and is driven by sovereign issuers through central banks. Malaysian and some GCC corporate issuers are getting into this segment of the sukuk market and are providing diversity and depth to the local markets, which is essential in the development of money markets.

In terms of structures, Ijara is the most popular and widely used structure for international sukuk issuances, while Murabaha continues to be the most used structure for domestic sukuk.

AAOIFI committed to industry growth

The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) is committed to supporting the growth of the global Islamic finance industry.

AAOIFI will continue to craft new accounting, auditing and Shari'a standards to enable the sound and sustainable growth of the industry, said Shaikh Ebrahim bin Khalifa Al Khalifa, Chairman of AAOIFI's Board of Trustees.

He was speaking at the opening of the AAOIFI-World Bank Annual Conference on Islamic Banking and Finance, held in Bahrain on 17 and 18 November 2014.

"In the past few years, Islamic finance has witnessed steadily increasing cross-border activities and transactions. This has been facilitated by market liberalisation and deepening as well as favourable economic conditions in the major established Islamic finance centres across the world," said Shaikh Ebrahim.

Furthermore, Islamic finance has also expanded into new emerging markets throughout Asia, Africa and Europe – including into markets where Muslim populations do not necessarily form the majority. And, the international flow of Islamic finance capital and investments is poised to escalate in the coming years.

At the same time, in leading Islamic finance markets in South East Asia, South Asia and the Middle East, Islamic finance has been further mainstreamed into the overall financial systems. In some of the leading markets, Islamic finance now commands between 20 and 50 percent of the total banking assets market shares.

Going forward, three key areas of growth for Islamic finance include: facilitating trade flows in what has been referred to as key 'Rapid Growth Markets'; mobilisation of institutional investment funds such as sovereign wealth funds, pension funds, and Waqf funds; and facilitating growth of micro, small and medium enterprises.

"Recent research papers have identified and classified a number of economies throughout the world as Rapid Growth Markets. These are countries that have proven strong growth and future potential, sizeable economy and population, and strategic importance for business," said Shaikh Ebrahim.

The Rapid Growth Markets are expected to be major contributors to global economic outputs over the next few years. It is particularly significant for Islamic finance that the Rapid Growth Markets include countries that are the leading Islamic finance markets in South East Asia and the Middle East as well as countries that have sizeable Muslim populations, such as Indonesia, Malaysia, Saudi Arabia and Turkey.

Growth Opportunities

"Vibrant economic activities in these markets, and increasing trade flows from and between these markets, will present opportunities for Islamic finance to achieve further expansion and growth, especially in the area of trade financing," said Shaikh Ebrahim.

"Nevertheless, the Islamic finance industry will need to further develop its trade financing capabilities to effectively compete with conventional financial institutions."

Another prospect for further growth is the potential for mobilisation of institutional investment funds such as sovereign wealth funds, pension funds, and Waqf funds.

Such mobilisation can significantly improve the capacity for Islamic finance to particularly support large infrastructure projects as well as economic diversification programmes that are expected to be carried out over the next few years in the major economies throughout the Middle East, Greater Asia and Africa.

"In order to tap into this opportunity, it is critical for Islamic finance to continue developing robust long-term investment and financing mechanisms, and to ensure that the mechanisms are accompanied by a strong risk management framework and disclosures," said Shaikh Ebrahim.

On facilitating growth of micro, small and medium enterprises, it is well accepted that Islamic finance must always be linked to economic development, he said.

"A fundamental objective of economic development is ensuring the expansion of economic activities and creation of diverse economic sectors," said Shaikh Ebrahim.

"In order to achieve this objective, there must be support for the growth of micro, small and medium enterprises. Indeed, Islamic finance can play a major role in providing this support."

Nevertheless, this calls for the Islamic finance industry to, amongst others, further develop its capacity in offering equity-based financing, investment intermediation and other appropriate financial solutions, as well as in supporting entrepreneurial development programmes.

"All these aspects have significant impact on market and infrastructure development that are needed to support sustainability of Islamic finance," said Shaikh Ebrahim.

"The international Islamic finance industry will now need to intensify efforts on financial stability architecture and systemic liquidity management infrastructure – in recognition of the growing significance of Islamic finance in the overall financial and economic systems."

At the same time, the international Islamic finance industry must also continue the efforts on human capital and talent development, including through professional qualification programmes as well as Shari'a advisory development programmes.

Digital Innovation

Another area that the international Islamic finance industry must give increasing consideration to is the continuing digital innovation of financial services.

The past few years have seen increasing use of internet and smart-phones as channels for financial services, and interactive social media platforms as channels for communications between financial services providers and users. All these have been accompanied by the increasing use of electronic payment solutions, and also introduction of digital currency.

It has been argued that digital innovation will completely change the way financial services are carried out in the future. Hence, how Islamic financial services are carried out will also need to be changed accordingly, said Shaikh Ebrahim.

"From the Islamic finance standards-setting perspective, we need to be ready to explore and develop potential new areas of standardisation and harmonisation. In doing so, we also need to ensure that the paramount objective of Shari'a compliance is not compromised, and at the same time provide support for the sustainable expansion and growth of Islamic finance," he said.

"I would like to reiterate that the increasing internationalisation and further mainstreaming of Islamic finance are indeed extremely encouraging. Looking ahead, there is real potential that can be seized for further expansion and growth of Islamic finance.

"Nevertheless, the industry must continue its effort on market and infrastructure development to ensure sustainability of Islamic finance. And for our part, we will continue to work with the industry to make sure our standards can continue to support the industry."

Intensify standards development work, says CBB

Work on development of accounting standards for the Islamic finance industry must gather speed, to keep pace with international standards being developed for the conventional banking industry, says Mr. Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain (CBB).

Such standards development work should also be undertaken proactively and not only in reaction to global developments.

Mr. Al Maraj praised the work of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) for its pioneering efforts in developing accounting, auditing and Shari'a standards for the global Islamic finance industry.

He was speaking at the opening of the AAOIFI-World Bank Annual Conference on Islamic Banking and Finance, held in Bahrain on 17 and 18 November 2014.

The event was attended by leading Shari'a scholars and senior representatives from central banks, financial regulatory and supervisory authorities, financial institutions, universities and other Islamic finance industry stakeholders, from over 35 countries.

"I have seen the International Financial Reporting Standards undergo many changes in the past few years, especially after the global financial crisis, but these standards do not take into account the special aspects of Islamic financial contracts and processes," said Mr. Al Maraj.

"This underscores the need to strengthen efforts in the preparation of new accounting standards and further enhance existing ones. We must also work proactively rather than on the basis of reaction."

He urged AAOIFI to continue its distinguished work in standards development and that its financial reporting standards for Islamic banks will provide the much needed common ground with conventional banks. This will enable investors and other stakeholders to easily compare the financial statements of Islamic banks with those of their conventional peers.

On the application of Basel III requirements on Islamic financial institutions (IFIs), Mr. Al Maraj noted that IFIs enjoy a high level of capital adequacy, which exceeds the minimum requirement in almost every country.

However, the bigger challenge is that of liquidity management because of the dearth of liquid instruments in which IFIs can invest.

"The industry should make greater efforts for the issuance of securities that are both sound and commercially viable," said Mr. Al Maraj.

He said the increasing internationalisation and geographic expansion of Islamic finance is a very welcome development.

According to industry estimates, the assets of the global Islamic banking industry are worth US$1.3 trillion, while the value of outstanding sukuk is US$250 billion, funds assets are about US$70 billion, and Islamic insurance contributions are US$18 billion.

"The growth of the Islamic finance industry also places a bigger responsibility on all of us, whether regulators, Shari'a scholars or practitioners, to provide the necessary supervisory standards, regulations, products and services to enable the industry to compete with the conventional banking industry," said Mr. Al Maraj.

Financial Reporting

A conference session on convergence of international accounting standards and implications for Islamic finance reinforced Mr. Al Maraj's comments on the importance of financial reporting for IFIs and the need for harmonising financial reporting practices in the Islamic finance industry across the globe.

Such harmonisation can promote greater transparency of IFIs' operations and financial positions as well as increase comparability of their performances, said session participants.

In order to facilitate the harmonisation process, AAOIFI will continue to enhance cooperation with the international Islamic finance industry, international multilateral institutions such as the World Bank and International Monetary Fund, and other international standard-setting organisations such as the International Accounting Standards Board and International Auditing and Assurance Board.

Speakers pointed out that AAOIFI, as a leading global Islamic finance standard-setter, is in a position to play a substantial role in this respect. Over the past 25 years, AAOIFI has developed institutional expertise in dealing with fundamental theories and industry practices of Islamic finance. This has been facilitated by the leading Shari'a scholars and Islamic finance professionals serving on AAOIFI standards boards and committees.

Going forward, AAOIFI will need to enhance international cooperation as it develops new strategies to improve its operations.

Sukuk Standards

During a session on sukuk and Islamic capital markets, the conference also discussed the areas of further harmonisation and standardisation on structuring and issuance of sukuk.

AAOIFI has issued, amongst others, Shari'a standards on sukuk and Islamic finance mechanisms that are used as underlying structures for sukuk, such as Ijara (leasing), Murabaha (deferred-payment sales), Mudaraba (investment management) and Musharaka (partnership). It has also issued accounting standards on these Islamic finance mechanisms and investments in sukuk.

In order to complement and supplement the existing standards, AAOIFI will be carrying out development of new standards relating to sukuk that will give more comprehensive and extensive guidance in order to support continuing growth of sukuk.

In this respect, Dr. Hamed Hassan Merah, Secretary General of AAOIFI, said: "Following recent extensive discussions with our Shari'a Board, we are planning to carry out an integrated programme to potentially revise or supplement the existing Shari'a Standard on Sukuk.

"We are also looking at the possibility of developing clearer guidance on sukuk that will incorporate accounting, legal, technical, and tax-related aspects. This will take into consideration the current and evolving developments in the industry.

We hope this will enhance transparency of sukuk transactions and promote further harmonisation, and effectively provide further support towards growth of sukuk across the globe. We will deliberate this further with the industry and provide details of our work programme in due course."

Investment Accounts

Meanwhile, a session on updates on AAOIFI accounting standards discussed the impending issuance of a revised accounting standard on investment accounts and the ongoing revisions of accounting standards on Ijara and Mudaraba.

The revised accounting standard on investment accounts is scheduled to be issued soon, while the consultation notes and exposure drafts of revised accounting standards on Ijara and Mudaraba will be issued during the first half of 2015.

IIFM launches new master agreement

Bahrain-based International Islamic Financial Market (IIFM), a global standard-setting body for Islamic finance, has launched the IIFM Master Collateralised Murabaha Agreement (MCMA). The global standard document is accompanied by an Operational Guidance Memorandum.

Speaking at the launch, held in Bahrain on 16 November 2014, Mr. Khalid Hamad, Chairman of IIFM, said: “This much awaited 6th (sixth) documentation standard from IIFM is based on Rahn, or collateral, and will provide an alternative avenue to institutions for low risk financing arrangements locally as well as cross-border.

“With the publication of this global standard document, institutions of all sizes will be equally comfortable to transact and better utilise their Islamic securities portfolio, particularly sukuk. Another feature of this master agreement is the potential to make use of tri-party agent for safe-keeping as well as marking to market and other such services.”

Mr. Ijlal Ahmed Alvi, Chief Executive Officer of IIFM said the MCMA has been developed as an additional tool to be used for liquidity management by institutions active in Islamic finance.

“It is the best possible alternative to conventional repurchase arrangements (Repos) and will enable institutions to utilise their idle sukuk or Shari’a-compliant portfolio for generating liquidity. The master agreement also provides for credit enhancement resulting in better risk management in an environment where the global finance market is generally moving away from clean lending,” he said.

The standard document has been developed in accordance with IIFM’s comprehensive procedures in developing global standards, i.e. consultation with the IIFM Shari’a Board from the early stages, market consultative meetings, forming a global working group and the appointment of external legal counsel.

The key feature of the agreement is that the fund placing institution will have the comfort of having the collateral in case of any eventuality, segregated safe-keeping and margin maintenance mechanism to support risk management.

The collateral is taken through a pledge mechanism and envisages that the collateral will be held by a third party custodian to facilitate getting hold of the collateral in case of default or severe impairment of the collateral-giving institution’s credit worthiness.

“The Operational Guidance Memorandum for the MCMA is one of the unique features of IIFM’s efforts to enhance the development of the Islamic finance industry. The industry will find this Memorandum very useful in explaining how the standard is to be used and, in addition, it provides very comprehensive recommendations,” said Mr. Alvi.

Mr. Naveed Khan, Deputy Chairman of IIFM and Managing Director, ABC Islamic Bank, said: “This standard fills the acute gap and removes a disadvantage for the Islamic finance industry compared to its conventional counterpart. In as much as re-use is not a feature, it retains its full Shari’a-compliant flavor. I am hopeful that both existing and new users will find the standard useful in bridging their liquidity needs.”

Mr. Habib Motani, Partner, Clifford Chance, said: “This new standard document provides the Islamic financial market with a significant new tool for addressing the increased regulatory focus on liquidity and collateral and Clifford Chance is delighted to have been able to contribute to its development.”

Dr. Ahmed Rufai, Head of Shari’a, at IIFM said IIFM has achieved yet another milestone in its quest to achieve the ultimate objective of advancing the Islamic financial industry globally through its pioneering role in producing Shari’a-compliant standard documentation with the clear objective of providing harmonisation, best practices, transparency and clarity for sound business activities.

“The MCMA is characterised by a number of positive features hardly to be found in other Islamic finance Master Agreements. Among these unique features is the inclusion of Shari’a standards as footnotes for the purpose of clarification, authentication and acceptance of all the related transactions,” he said.

Mr. Alvi praised the role of the IIFM Board of Directors, the IIFM member institutions, the IIFM working group members and the regulators for their invaluable support and guidance in IIFM market unification initiatives. He specially thanked the Central Bank of Bahrain for its unwavering support and the Islamic Development Bank for partly funding the cost of the project.

Salient features of the Master Collateralised Murabaha Agreement (MCMA):

- The MCMA is a master agreement to be used primarily between two Islamic financial institutions for interbank transactions but can be adapted to cater to other situations and counterparties. The MCMA envisages that a provider of liquidity (Seller) will sell commodities to a party wishing to raise liquidity (Buyer) pursuant to a Murabaha Contract entered into pursuant to and in accordance with the terms of the MCMA.
- The deferred payment obligation of the Buyer under each Murabaha Contract entered into are collateralised, with the Buyer granting a security interest to the Seller over certain Shari'a-compliant assets (which may include, without limitation, sukuk, cash, and Shari'a-compliant securities).
- The MCMA incorporates margin call features.
- The Seller may not make use of the Posted Collateral and must keep the Posted Collateral in a segregated and identifiable account.
- The Buyer may elect to substitute Posted Collateral and the conditions to such substitution are to be agreed between the Buyer and the Seller.
- Upon the occurrence of an event of default, the Seller will be able to enforce its rights under the security granted in its favour, including, but not limited to the sale of the Posted Collateral.
- Upon the discharge of the deferred payment obligation of the Buyer under a Murabaha Contract, the security over the Posted Collateral is released.

New capital requirements for banks are here to stay

Mr. Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain, explains why higher capital adequacy requirements are necessary after the global financial crisis. He was speaking at the Institute of International Finance (IIF) MENA Regional Economic Forum, held in Bahrain on 29 and 30 September 2014. The event was hosted by Gulf International Bank.

‘A recurring comment I have heard since the Central Bank of Bahrain (CBB) announced its implementation plans for Basel III last year is the cost to banks of maintaining higher capital ratios. In fact there has been growing comment from the financial sector about the general burden of regulation and costs of compliance that are hitting banks.

I would like to take the opportunity to reassure the industry that the role of regulators is not to strangle the financial sector with red tape or to weigh it down with excessive capital requirements.

So if I may, I would like to present a few brief arguments as to why higher capital adequacy requirements are not only necessary after the global financial crisis but why they are here to stay.

Specifically I want to talk about Basel III and the substantially increased Tier One capital requirements that are being applied globally. In many countries, including Bahrain, regulators are choosing to apply higher Tier One ratios than the minimum ratio of 6 percent recommended by the Basel Committee. And furthermore, they are choosing to impose them faster than the timetable prescribed by the Basel Committee. Are we trying to punish the bankers?

No; the higher capital adequacy requirements are not arbitrary, or excessive or punitive. They are based on a solid body of impact assessments and cost-benefit analyses performed by various bodies in many different countries since 2010. In fact, the more recent studies not only support the initial studies performed by the Basel Committee and the Financial Stability Board, they point to strong evidence that the ideal minimum Tier One ratio for banks is in the 10 percent to 13 percent range. Furthermore, given the increased risk of a banking crisis associated with progressively lower Tier One capital ratios, these studies conclude that higher minimum Tier One ratios should be implemented as quickly as possible.

In Bahrain, we approached the issue of whether and when to implement Basel III and at what sort of level.

Since 2000, the CBB had required banks to observe a minimum capital adequacy ratio of 12.5 percent. This was the so-called target ratio. Below that was the trigger ratio requirement of 12 percent where the CBB could step in and require a bank to cease operations, or we could impose restrictions on activities or put it into administration.

So when we implemented Basel II in 2008, we kept the old Basel I minimum ratios. Continuity and confidence were our watch word. When in 2010, the Basel Committee unveiled Basel III, we were faced essentially with the same questions that confronted us with Basel II. Should we change our minimum capital ratios? And if so, why?

Our largest and most systemically important retail banks had come through the crisis unscathed. In fact, 2010 financial statements were already showing an improvement on 2009 results. There had been losses in the wholesale sector which had required recapitalisation in some cases and closure in two cases, but overall the financial sector was healthy.

The 12.5 percent target ratio had served us well on balance.

Public confidence in banks was strong. We conducted two impact assessments in 2010 and 2011 which indicated that the vast majority of our banks were well-placed to move to a Basel III regime without incurring extra costs. We looked at the new minimum capital ratios set by Basel and compared them with our existing requirements. We decided that the arguments for the majority of regulatory capital being in the form of shareholders' equity were compelling and so if we were to continue with the 12.5 percent minimum ratio, then that pointed to a minimum Common Equity Tier (CET) 1 ratio of at least 6.5 percent.

Adding in the capital conservation buffer brought the CET1 ratio up to 9 percent. If we added the minimum additional Tier One requirement of 1.5 percent and the Tier Two requirements of 2 percent that brought the minimum total capital requirement up to 12.5 percent. Continuity was served and the buffer range gave banks a minimum total capital requirement of 10 percent. This was below our previous Basel II requirement, but comfortably above the 8 percent set by the Basel Committee.

But were our proposed levels appropriate? Were they too high? By 2013 there was a wealth of studies and cost-benefit analyses available on Basel III which indicated that there was an 'optimal' range for minimum capital adequacy ratios for banks. These studies ranged from multi-jurisdictional exercises such as the original Basel Long-term Economic Impact report published in 2010 through to individual country studies. Although these reports used different baselines and techniques and were based in different countries, they all pointed to a consistent range of so-called optimal capital adequacy ratios. Basically these studies balanced the marginal costs to GDP of higher capital ratios against the marginal GDP benefit of the reduced impact and probability of bank crises due to higher capital ratios. These studies pointed to an optimal range of 10 to 13 percent for common equity.

These studies looked at the wider macroeconomic costs and benefits rather than the immediate costs to the banks and their shareholders. And it is the macroeconomic picture that central banks must look at when we apply regulations to the financial sector. The financial sector must be strong. It must not be overleveraged or illiquid. It must be able to endure shocks from its resources without requiring other parts of the economy to pick up the bill.

And so, we as regulators need to be mindful of the consequences of excessive or overbearing regulation, lest we stifle the financial sector and cause 'credit crunches' or paralyse capital markets. But we also need to ensure that excessive risk-taking in the banking sector does not happen again and result in systemic failure.

I hope these comments provide some background as to why higher capital requirements are here to stay and why there are other measures to address the need for a cultural shift in banks towards strength, stability and sustainability.’

New solvency assessments for insurers

From 2015, insurers throughout the world, including Bahrain, will be required to perform their own risk and solvency assessments (ORSAs), as part of new solvency regimes being crafted as a result of the global financial crisis. In the first of a series of articles, Mr. Adeel Mushtaq, Senior Manager, KPMG Assurance and Advisory Services, explains the implications of ORSAs for Bahrain insurers.

The Bahrain insurance sector is the most mature in the GCC, vibrant and competitive. Looking ahead to 2015 and onwards, the industry will face a big regulatory change as regional insurance supervisors prepare to introduce a regulatory framework for insurers based on the revised Insurance Core Principles (ICPs) as issued by the International Association of Insurance Supervisors (IAIS).

The insurance sector in Bahrain needs to take steps to enhance insurance regulation with a view to developing a global financial centre and providing international standard infrastructure, regulatory environment and necessary support for innovative solutions.

However for most insurers, the upcoming wave of change will present challenges to their business models, cost structures and how they communicate with stakeholders. Insurance sector executives should plan ahead to achieve sustainable growth in this fast-changing environment coupled with equally fast-evolving regulatory and governance landscape. Regulatory change, coupled with the upcoming Phase II of the International Financial Reporting Standards (IFRS) 4 Insurance Contract project, is not only complex but also has broad implications for underlying system changes which many of the insurers may not be prepared for.

Insurance firms that wish to stay ahead need to strategise the change and build tools and capabilities to cut through the complexity for the implementation of the new regulations. In 'The New State of Play – Regulatory developments' series, I will endeavor to introduce topics from the upcoming regulatory changes and how insurers can prepare better. In this article, I am discussing the Own Risk Self-Assessment (ORSA) and explore why Insurers should consider embedding ORSA as a strategic tool and not just a compliance requirement.

What is an ORSA?

Own Risk and Solvency Assessment (ORSA) is a new policy tool required by the IAIS. It is also a key feature of many global regulatory frameworks such as Solvency II in Europe. The ORSA will have an impact on insurers on a variety of levels. ORSA is commonly defined as a detailed forward-looking examination of the adequacy of an insurer's risk management policies, procedures and controls and the insurer's present and future solvency positions.

Benefits of ORSA

- A forward-looking approach will help insurers reduce volatility and uncover opportunities.
- Provides a sound concept, and one that will ultimately help to ensure the future success of a business and benefit all stakeholders.
- Strengthens the robustness of oversight functions within firms and can provide an additional layer of expertise and assurance to assist insurers in avoiding some of the crisis experiences.
- Identifies unwanted negative or unwanted risk exposures.
- Contingency plans can limit losses when unavoidable risk events occur.
- Provides commonality across emerging global regulatory initiatives.

How Insurers in Bahrain should approach ORSA

The current operating environment is characterised by low global growth, flat yield curves and high expectations from external stakeholders. Considerable pressure is, therefore, being applied to the managements of insurers to grow and write profitable business, achieve an increasing return on capital while, at the same time, maintaining robust risk and capital management frameworks and reducing operating expenses.

There are some fundamental principles that insurers should consider to get the most out of ORSA:

- Assess the overall solvency needs, including taking a view of the risk profile as a business strategy tool and not a mechanical calculation to meet regulatory requirements.
- Understand business risks, risk appetite and limits and ensure all material risks are noted in the assessment including strategy, and capital considerations.
- Proactively consider the future evolution of the risk profile to prepare for what lies ahead.
- Take a forward-looking view of the firm's capital needs and the basis for regulatory capital to cope with such outcomes.
- Take action to address the identified risks and shortcomings, i.e. how the insurer proposes to manage all the material risks it faces through capital buffers or other mitigating actions.
- Develop a defined documentation process to evidence the adopted approach and responsibilities to keep ORSA current, including formalising the role of chief risk officers.
- Make ORSA a factor in the capital add-on decision – it should not act as a "one-off" exercise.
- Assess the adequacy of capital resources and any additional capital sources needed.
- Estimate a range of outcomes and costs using techniques such as stress and scenario testing, reverse stress testing.
- Understand the elements of risk management that are value-adding and capable of providing the insights to optimise commercial management of risk and capital, going forward.
- Assess the ability to maintain and fund operations of critical functions and the resultant implications to conserve or restore the firm's own funds.
- Examine the sufficiency of funding arrangements and ensure adequate access to contingency funding sources at appropriate cost, including in extreme stress scenarios.

I expect most insurers to have some processes, people and systems in place to manage risk and capital in their businesses and would like to build ORSA on their existing risk and capital management frameworks.

The ORSA, coupled with other regulatory requirements, is undoubtedly challenging and the cost of developing an ORSA is likely to be high. Therefore, it is recommended that efforts should focus on developing better ORSA rather than low-cost alternatives, nevertheless considering how the existing frameworks can be enhanced to link strategic management. The ultimate aim should be to create a competitive advantage by identifying, managing or avoiding unwanted risks, increasing capital efficiency and identifying potential opportunities for growth.

Collective effort needed to grow takaful industry

The global takaful (Islamic insurance) industry continues to post strong growth but the myriad of challenges it faces require the collective effort of all stakeholders – the industry, the regulators and the community at large, a major conference heard in Bahrain.

Issues related to governance, policyholder rights and investment opportunities are among key challenges facing the industry, said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the Central Bank of Bahrain (CBB). He was speaking at the third Annual Middle East Takaful Forum (METF), held in Bahrain on 13 and 14 October 2014.

"The global takaful industry has continued to demonstrate a strong growth momentum, and is increasingly being recognised as one of the major components of the Islamic financial system. Today, as with other forms of Islamic finance, the industry has gained significant interest as a viable and efficient alternative model of insurance," he said.

Global takaful contributions are estimated to reach US$14 billion in 2014, a significant growth of 14 percent over the previous year. The GCC market contribution is estimated at US$8.9 billion, more than 63 percent of global takaful contributions, while the contributions of Malaysia and Indonesia are estimated at US$4.2 billion of the total gross takaful market.

During the past five years, the global takaful industry has recorded an average growth rate of around 20 percent per annum, indicating high growth potential in the years to come, partly due to the current low rate of takaful market penetration.

Bahrain Market

In Bahrain, the takaful industry is one of the fastest growing segments of the overall insurance sector. Total takaful premiums reached BD57.2 million (US$152 million) in 2013, compared to BD53.7 million in 2012, a strong growth of 7 percent.

"The Bahrain takaful market has grown almost 14 times in terms of premiums compared to 2003," said Mr. Al Baker.

This growth is mainly due to the increasing demand for Shari'a-compliant insurance, increasing public awareness about takaful, entry of international takaful players in the local market and the existence of enabling legislation that promotes the development of takaful in Bahrain.

Currently, takaful premiums constitute 22 percent of total gross premiums of the insurance industry in Bahrain, and the outlook for growth of this segment of insurance is very promising.

"During the past three years, we have observed positive changes in the mix of takaful contributions, as family takaful business has gained ground. The share of family takaful in total takaful business increased to 20 percent in 2013, from 15 percent in 2010," said Mr. Al Baker.

"This growth is mainly due to the increase in public awareness about the importance of long-term takaful products, as well as the change in the appetite of clients towards life products that are linked to investment."

CBB Support

As a regulator, the CBB believes in continual enhancement and improvement of its regulatory infrastructure for the growth and betterment of the industry.

"The CBB has played an important role in launching new initiatives to develop the insurance industry both locally and regionally. The current launch of new solvency requirements for takaful is one step in reaffirming Bahrain as the jurisdiction of choice for takaful and retakaful companies," said Mr. Al Baker.

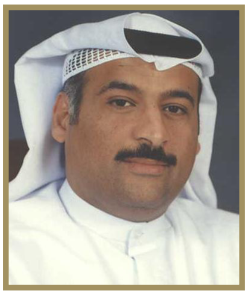
"As you may be aware, the main objectives of modifying the existing takaful rules is to facilitate faster growth of takaful business in Bahrain while protecting the interests of all stakeholders, vis-à-vis participants, shareholders and takaful operators. It is also expected that the changes to the model will attract new entrants to the market and will foster competition for the betterment of the consumers."

Taking into consideration the significant growth of takaful industry locally and globally, there are several factors that contribute to such growth. These include the remarkable growth of Islamic banking industry in the Middle East and North Africa (MENA) region and other parts of the world which support the setting up of takaful companies to complement banking services.

Furthermore, the low penetration of insurance in the Islamic world makes it possible for significant growth of takaful, especially in the MENA region which represents more than 3 percent of the world GDP.

Challenges Ahead

However, there are several challenges facing the takaful industry that need to be properly addressed in order to further enhance the long term profitability and the soundness of the industry, said Mr. Al Baker.



First is the corporate governance issue regarding policyholder rights. In contrast to policyholders in a conventional mutual insurance company, who are the owners of the company and have the right to remove the management, takaful policyholders have no such governance structures or rights, although in principle they are exposed to similar insurance risks.

In fact, takaful policyholders seem to have no more governance rights than the policyholders of a conventional proprietary insurer, and must rely on market competition to get a fair deal and good value for money in their dealings with the takaful operator.

The second challenge is the issue related to the standardisation of takaful accounting standards and disclosure, especially those related to capital adequacy and solvency, disclosure of Qard Hassan, and regulatory framework.

Another challenge is the lack of human talent with the necessary exposure and experience in takaful business, as well as those with knowledge of Shari'a.

"One of the most critical challenges facing the takaful industry is the issue related to the limited availability of Islamic instruments like sukuk, or other Islamic products which are suitable for investment by takaful companies," said Mr. Al Baker.

"Another challenge is the ability to find the appropriate distribution channels to offer takaful products and services, as well as the appropriate promotion mix for such products.

"In conclusion, the future prospects of takaful industry will hugely depend on the combined efforts of all relevant parties: the regulators, market players and the community at large, to chart the strategic direction for the industry. Collective effort is critical in order to maximise the potential of the takaful industry."

Broad-based growth drives Bahrain economy in Q2

The increased activity in the non-hydrocarbon sector, paired with the unexpectedly high output gains in the hydrocarbon sector, spiked an acceleration in growth during the second quarter of 2014, according to the September 2014 issue of the Bahrain Economic Quarterly (BEQ), published by the Economic Development Board (EDB).

The Kingdom's real GDP growth of 5.6 percent during Q2 stands in sharp contrast to the 3.2 percent pace recorded during the first three months of the year. This marked improvement reflected a broad-based acceleration in activity across the economy. Growth in the non-oil sector stood at 4.7 percent YoY, while the oil sector expanded by 9.3 percent in Q2, compared to 3 percent and 4.1 percent, respectively, in Q1.

The Q2 data put the pace of expansion in the economy ahead of previous projections for the year. The headline rate of real GDP growth during the first half of the year taken together reached 4.4 percent with the oil sector expanding by 6.7 percent and the non-oil sector by 3.9 percent.

In contrast, the EDB assumes that hydrocarbons production for the full year will remain at capacity, which would translate real GDP to advance by 3.7 percent during 2014. The EDB also projects a steady acceleration in non-oil growth during the second half of the year as project activity should pick up momentum. The EDB's current forecast for non-oil growth this year is 4.3 percent.

In 2015, the EDB expects oil production to remain flat, and non-oil growth to accelerate further to 5 percent, translating into a headline real growth rate of 4 percent.

Diversified Growth

While the boost in growth in the non-oil economy in Q2 was fairly broad-based, services saw the fastest pace of expansion. The hotels and restaurants sector, followed by social and personal services, and transportation and communications, all posted higher than average growth. Growth in the hospitality sector was in excess of 10 percent, continuing the strong momentum seen in Q1. Social and personal services experienced a clear acceleration to 8.2 percent, while transportation and communications, similarly, rebounded to 6.2 percent, according to the EDB.

Overall, the non-oil private sector remains firmly in the forefront of driving growth in the economy.

Among other things, the economy has benefited from a positive dynamic in visitor numbers. While the holy month of Ramadan saw some slowdown, this was more than made up for by a strong influx during the Eid al Fitr holidays. According to the BEQ, the tourism sector in the Kingdom is set to benefit from the launch of a number of important hotel projects as well as renewed expansion by the national carrier. The first half of 2014 has been a major turnaround period for Gulf Air as the company posted a YoY increase in revenue by 10 percent and cut its losses by 30 percent.

Tourism should further benefit from new visa rules that extend visa on arrival facility to nationals of about 100 countries. The policy will enable visitors from these countries to obtain a one month visa on arrival, with the ability to renew for an additional three months.

A favourable dynamic in the oil sector has been one the main positive surprises for the economy during the first half of the year, the EDB said. The combined output from onshore and offshore production reached a daily average of 202,444 barrels in 1H2014, which represented a fairly pronounced 6.6 percent increase over the corresponding period of 2013.

Capital Market Activity

Bahrain Bourse has continued its measured but fairly steady progress in recent months. By late September, the All-share Index was up by just over 17 percent since the beginning of the year, which was around the regional average.

The strongest performing sectors during the January-August period were Investment and Services, which gained 22 percent and 19 percent, respectively. Commercial Banks, as well as the Hotels & Tourism sector, both posted 11 percent year-to-date gains. The Industrial index gained 3 percent while the Insurance sector was flat.

Bahrain also witnessed a revival in IPO (initial public offering) activity after a lengthy lull. Zain Bahrain, a telecommunications company which was founded as a closed joint stock company in 2003, offered 15 percent of its issued share capital in early September 2014. The company holds a license to install, operate, and manage a telecommunications operation and operates in mobile and fixed telecommunications services. The IPO consisted of an offer of 48 million new shares and targeted institutional and retail investors in Bahrain as well as institutional investors in the GCC.

The issuance of these shares was managed by Gulf International Bank, which was also the underwriter, and co-managed by NBK Capital. Zain is hoping to use the proceeds from the public offering to upgrade its network infrastructure.

Fixed income activity in the Kingdom has involved a landmark bond by the Government as well as ongoing short-term issuance by the Central Bank for liquidity management purposes.

The Government of Bahrain broke new ground in September with an unprecedented 30-year bond issue. The offering raised US$1.25 billion and met with strong investor demand, with orders reportedly reaching US$5.75 billion. The bond was priced to yield 6 percent, at the bottom of the expected range thanks to a significant recent improvement in market conditions. The proceeds from the bond are used for general budgetary purposes. The issue was arranged by Citigroup, Gulf International Bank, Bank Mitsubishi, and Standard Chartered.

Bahrain economic outlook

	2013	2014f	2015f	2016f
Real GDP growth, %	%5.3	3.7%	4.0%	3.6%
Non-hydrocarbons sector	%3.0	4.3%	5.0%	4.3%
Hydrocarbons sector	%15.3	1.3%	0.%0	0.5%
Nominal GDP growth, %	8.3%	3.6%	6.2%	5.%9
Inflation (CPI %)	%3.3	%3.0	%3.0	%3.0
Current account (% of GDP)	%7.8	5.8%	5.4%	5.3%
Fiscal balance (% of GDP)	-%3.3	-3.4%	-3.2%	-3.2%
Crude Oil Arabian Medium (USD)	106.4	100.0	100.0	100.0

Source: Bahrain Economic Development Board

Banking system remains stable and solid

The consolidated balance sheet of the banking system in Bahrain, comprising retail and wholesale banks, stood at US$191.8 billion at the end of September 2014, according to the latest issue of the Central Bank of Bahrain's Monthly Statistical Bulletin.

This was a slight decrease over the consolidated balance sheet of US$193.6 billion at June-end this year.

The assets of retail banks eased slightly to total BD29.8 billion (US$79.4 billion) at September-end 2014, compared with BD30.1 billion (US$79.9 billion) at June-end. Retail banks represented 41.4 percent of the consolidated balance sheet of Bahrain's banking sector.

The aggregate balance sheet of wholesale banks stood at US$112.4 billion at September-end, down from US$113.7 billion at June-end.

Total domestic assets of the banking system increased to US$49.2 billion at September-end, from US$48.8 billion at June-end. Foreign assets declined to US$142.6 billion at September-end, from US$144.8 billion at June-end.

Total domestic liabilities of the banking system stood at US$51.9 billion at the end of the third quarter, compared to US$52 billion at the half-year, while foreign liabilities declined marginally to US$139.9 billion, from US$141.6 billion.

Domestic assets of retail banks stood at BD15.5 billion (US$41.2 billion), while foreign assets amounted to BD14.3 billion at September-end. Domestic liabilities stood at BD15.6 billion, while foreign liabilities amounted to BD14.2 billion.

Total deposits at retail banks increased marginally to BD15.7 billion at September-end, from BD15.5 billion at the half-year.

Total outstanding loans and advances extended to residents by retail banks declined slightly to BD7.3 billion at the end of the third quarter, from BD7.1 billion at June-end.

Of the total loans at September-end, 56.1 percent were in the form of business lending, while the personal and government sectors accounted for 40.2 percent and 3.7 percent respectively.

The distribution of loans to business indicate that 20.1 percent were extended to the construction and real estate sector, followed by 13.2 percent to the trade sector and 11.4 percent to 'other' sectors, which include the hospitality industry and the transportation sector, while the manufacturing industry received 6.9 percent of the loans.

The aggregate balance sheet of Bahrain's Islamic banks (retail and wholesale) stood at US$24.8 billion at the end of the third quarter, compared with US$24.6 billion at June-end. Domestic assets remained unchanged at US$14.1 billion at September-end, while foreign assets amounted to US$10.7 billion.

Money supply in Bahrain's economy, represented by M2 (currency in circulation and demand, time and saving deposits) remained unchanged at BD9.6 billion at September-end.

By the broader monetary measure M3 (which includes M2 as well as government deposits), also remained unchanged at BD11.5 billion at the end of the third quarter, compared with the half-year.

Bourse obtains full membership of WFE

Bahrain Bourse (BHB) has become a full member of the World Federation of Exchanges (WFE), a premier trade association of stock, futures and options exchanges.

WFE members voted to approve full membership for BHB at the WFE general assembly and annual meeting held in Seoul, South Korea on 28 October 2014.

Mr. Yusuf Humood, Chairman of BHB congratulated the wise leadership on the international status attained by Bahrain Bourse which is expected to enhance BHB's position as a globally-recognised investment market.

The achievement reflects the confidence of international federations in the solid technical and legislative infrastructure of the capital markets sector in the Kingdom of Bahrain.

Shaikh Khalifa bin Ebrahim Al Khalifa, Chief Executive Officer of BHB, expressed his pleasure for the achievement, and assured that this is the outcome of all the efforts of the Board of Directors of BHB, the Executive Committee, and its employees.

The vote by WFE members acknowledges the international recognition and appreciation of the status that BHB has attained and ensures that BHB is on the right path to continue its developments on all work aspects, which will enhance BHB's status for investors globally, said Shaikh Khalifa.

"Bahrain Bourse's achievements, including the legislative and technical developments made during the previous years impressed the members of the WFE," he added.

Shaikh Khalifa clarified that, following the attainment of full membership of WFE, BHB will undergo a periodic review by the WFE to ensure BHB's commitment and compliance with internationally recognised standards in all work aspects. Due to the international significance of WFE's membership, this achievement is expected to result in attracting further foreign investments.

AMEDA Conference

Meanwhile, BHB hosted the 20th meeting of the Africa & Middle East Depositories Association (AMEDA), a non-profit organisation comprised of central securities depositories and clearing houses in Africa and the Middle East.

The event, held in Bahrain on 9 and 10 November 2014 was attended by more than 50 delegates representing 22 countries.

AMEDA conferences are aimed at enabling participants to exchange experience and expertise and share information about the latest developments in clearing, settlement and depository services.

"Bahrain Bourse is committed to taking all the necessary steps to provide high quality services in the field of central depository to its clients, and is keen to apply international standards in all aspects of its work in order to meet that the needs and expectations of its investors and issuers," said Shaikh Khalifa.

Financial Sector Fact Sheet

Regulator: Central Bank of Bahrain
Financial Institutions: 406 (November 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 6.8% (2013)
GDP (Constant) US$28.6 billion (2013)
Growth 5.5% (2013)

Financial Sector contribution to GDP 16.7%
Sovereign Rating
BBB (S&P December 2013) with stable outlook
BBB (Fitch December 2013) with stable outlook
Population 1,195,020 (2011)

Banking Sector

Assets US$189 billion (October 2014)
No. of institutions 115 (November 2014)
Retail banks 28
Locally incorporated 13
Branches of foreign banks 15
Wholesale Banks 76
Representative Offices 10
Bank Society 1

Islamic Banks (included in left):
No. of banks 23 (October 2014)
Assets US$25 billion (October 2014)

Insurance Sector

Total No. of Insurance Companies & Organisations
Authorised in Bahrain 151 (November 2014) * excluding
Appointed Representative
Domestic market
Gross premiums US$685 million (December 2013)
No. of insurance firms 36
Locally incorporated insurance firms 25
Takaful & Retakaful Firms (included above) 7
Captives (locally incorporated, included above) 1
Overseas insurance firms 11
Insurance Brokers 31
Insurance Consultants 4
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 10
Individual 6

Investment Business Firms

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

Representative Offices 8
Bahrain Asset Manager Association 1

Specialised Licensees

Total no. of institutions 53 (November 2014)
Money Changers 19
Fund Administrators License 3
Registered Administrators 1
Financing Companies 8

Microfinance Institution 2
Trust Service Providers 3
Ancillary services 16
Registered Professional Body 1

Capital Markets

Market Capitalisation US$21.9 billion (November 2014)
No. of firms 26 (November 2014)
Licensed Exchanges 2
Licensed Clearing, Settlement and Central Depository Systems 1

Licensed Securities Brokers 4
Licensed Securities Dealers 1
Licensed Securities Clearing Member 6
Licensed Securities Broker Dealers 13

Funds Industry

Authorised Funds 2,865 (November 2014)
NAV US$9 billion (March 2014)

Local Funds (CIUs) 91
NAV US$4 billion (March 2014)
Conventional-Local 50
Islamic-Local 41
Locally Incorporated (PIUs) 7
Foreign Funds-Offshore 2,767 (November 2014)