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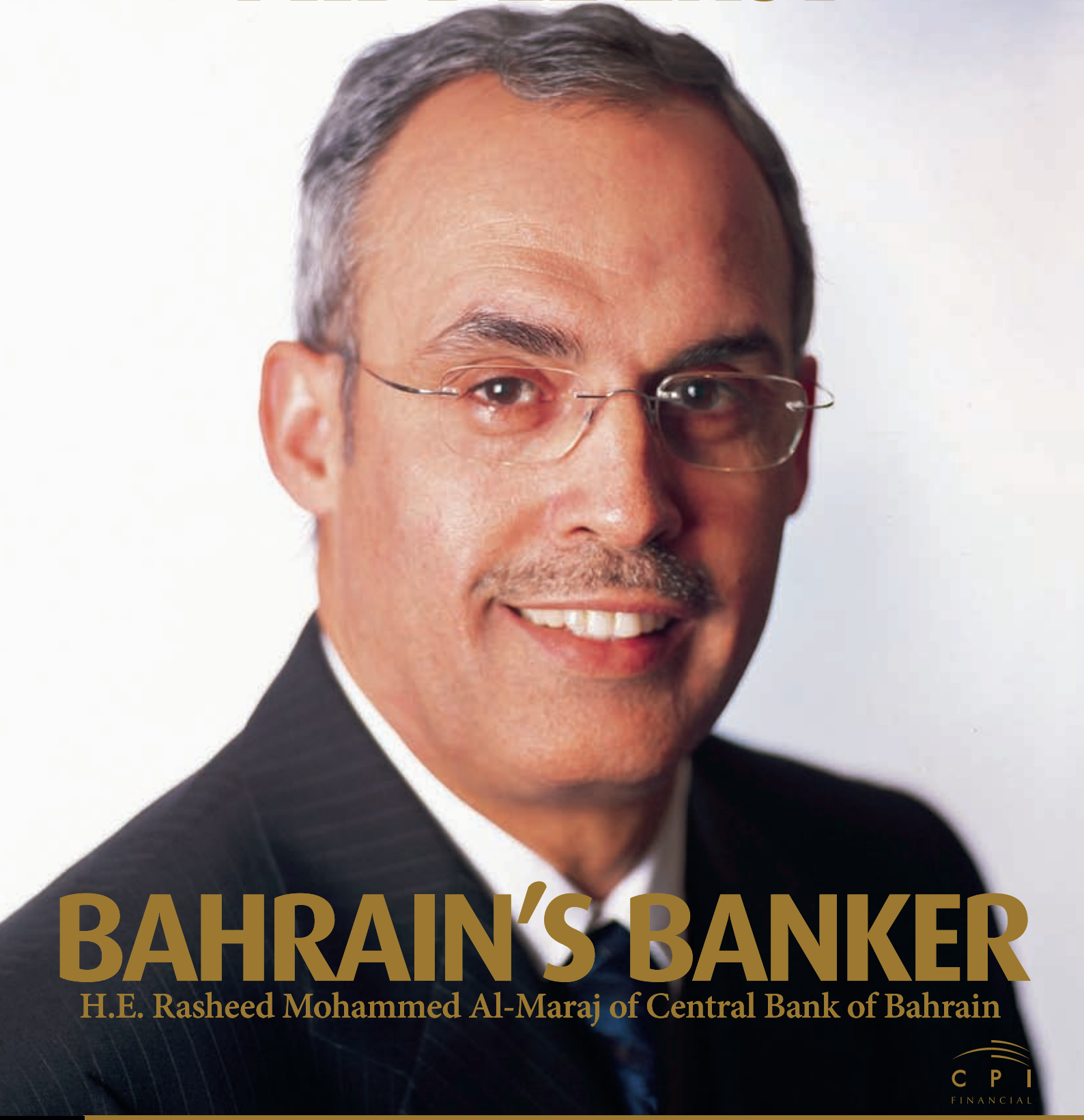
Banker MIDDLE EAST



BAHRAIN'S BANKER

H.E. Rasheed Mohammed Al-Maraj of Central Bank of Bahrain

CPI FINANCIAL

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Effective, transparent and pro-active

The Central Bank of Bahrain oversees one of the largest banking sectors in the Gulf Cooperation Council (GCC). The Governor of the CBB, H.E. Rasheed Mohammed Al Maraj, talked to Robin Amlôt about how the CBB had successfully managed to avoid taking any 'exceptional measures' to deal with the global financial crisis

Banking is a key part of the economy of Bahrain. As of March 2009 there were 418 licensed financial institutions overseen by the Central Bank of Bahrain (CBB). Within that total are 150 banks, including 31 retail banks (16 locally incorporated and 15 branches of foreign banks), 83 wholesale banks and 36 representative offices. Assets held by the banking sector totalled $243.9 billion. Within those totals are 26 Islamic banks with assets of $24.6 billion.

The CBB's total assets at end-March 2009 were BHD 1,962.6 million ($5.2 billion), down from BHD 2,4 billion ($6.4 billion) a year earlier. Money supply growth returned to positive territory in the first quarter of 2009 after contracting in the latter half of 2008. Money market interest rates eased to an average 1.2 per cent for three months' funds in Q1 2009. The average rate on personal loans fell to 7.9 per cent from 8.1 per cent in Q4 2008 and 9.9 per cent a year ago. However, charges for business loans showed a larger fall, down to an average seven per cent from 7.4 per cent over the same period.

Bahrain's banking system experienced annual average growth rates of 18 per cent during the period 2006-2008, fuelled partly by the growth in liquidity from oil revenues as the oil price rose. At the same time the banking sector benefited from annual growth

averaging around 20 per cent in funds available from high net worth individuals. Of course, the economic and financial landscape changed dramatically in a few short months.

What is the Central Bank's view of the outlook for the domestic (Bahrain) economy for the rest of 2009?

In common with the other GCC economies, we expect that Bahrain's economy will grow more slowly this year than last. However, we still expect growth to remain positive for 2009 and the Government and Central Bank have been active in taking measures to support domestic demand. We also expect inflation to continue to decline from the levels experienced last year.

I do not think you could expect any central bank governor to announce monetary policy six months in advance! The actions that we will take on monetary policy will depend on the economic out-turn and also the outlook for inflation and we will make our decisions accordingly.

The CBB reduced its reserve requirement ratio back to five per cent in March 2009, having raised it from that level in February 2008 – is this an indication that you believe the worst of the global financial crisis has now passed?

We raised the reserve requirement in response to the inflationary pressures that were building during 2007 and the early part of 2008. Consumer prices and asset prices were in our view growing too rapidly. The measure had its desired effect and in particular consumer price inflation has begun to moderate. Against this background we felt comfortable in restoring the reserve requirement to its previous level.

What other steps did the CBB take in order to protect the domestic banking sector and the economy of Bahrain from the fall-out of the global financial crisis?

The main impact of the financial crisis on our banking sector was in terms of liquidity. In common with many other emerging markets there was an acute shortage of liquidity during the period of September/October 2008. To mitigate this we introduced a new facility which allows banks to swap US dollars for Bahraini dinar at no penalty. This helped to ensure that our financial system continued to operate normally throughout a period of great stress. However, we did not consider it necessary to take some of the exceptional measures adopted elsewhere, such as general guarantees of deposits or the injection of capital from public funds.

Do you have any concerns about the exposure of the banking sector to real estate and construction in Bahrain? What do you make of the apparent concentration of lending to this sector?

The CBB has been raising concerns about the banking sector's exposure to real estate and construction for some time. We have emphasised to banks the need to have a well diversified portfolio of assets and have taken a variety of measures to discourage banks from increasing their exposure to real estate and construction. These measures were not always popular at the time, but many bankers have now acknowledged the wisdom of the CBB's approach. As a result, the role played by speculative activity in our real estate market has been comparatively modest. As I have remarked in several recent speeches, there is an issue of concentration risk that is specific to the Islamic banking sector. To address this issue we need to encourage a greater diversity of business models among the Islamic banks.

Have you revised your outlook for inflation this year and what pressures do you see on the upside and the downside?

As I said earlier, we expect inflation to remain contained during the rest of this year and possibly to decline further. One of the main factors in the higher than normal inflation rates that Bahrain experienced in the last two years was the rising costs of raw materials used in construction projects and rising rents for both residential and commercial properties. The global economic downturn has relieved much of the pressure on construction material prices while increased supply is likely to keep rents stable in the year ahead.

Do you believe that the delays to GCC monetary union present a challenge or an opportunity for Bahrain?

Bahrain has been a financial centre serving both the Gulf and the wider Middle East North Africa (MENA) region for over 30 years. In the long-term we expect monetary union to be positive for our financial system as it should facilitate cross-border transactions within the GCC. However, we are confident our financial sector will continue to flourish irrespective of the precise deadline agreed for the monetary union.

The Sukuk market has been very quiet – the CBB was virtually the only issuer of Sukuk in the GCC in the first quarter of 2009 – most of your issues were oversubscribed – would you describe that as a success and if so to what would you attribute this success?

I should clarify that the CBB issues Sukuk as the agent for the Kingdom of Bahrain. It is true that most of our issues were substantially over-subscribed, and I believe that this reflects confidence in the sound economic governance of Bahrain.

What are your views on the comments made by AAOIFI last year regarding the Shari'ah-compliant nature (or otherwise) of Sukuk issuances?

The comments to which you refer were made by an individual Shari'ah scholar who is associated with AAOIFI rather than by AAOIFI itself. Because of the high regard in which this scholar is held, his words carry a great deal of weight. As a result, a number of issuers have reviewed Sukuk structures to ensure that they do not too closely resemble conventional debt instruments. The comments were therefore a timely reminder of the principles of the Shari'ah-compliant finance.

As I have remarked in several recent speeches, there is an issue of concentration risk that is specific to the Islamic banking sector. To address this issue we need to encourage a greater diversity of business models among the Islamic banks.

It has been suggested by the CBB in the past that seven retail banks would be enough to service the domestic market – given the new framework for mergers, acquisitions (M&A) and takeovers which was issued in February 2009 – do you see a round of consolidation in the domestic market and on what timetable?

We are the first regulator in the GCC to have put in place a framework for M&A and takeovers, and we see this development as being vital to the development of Bahrain as a financial centre. The framework has been adopted for the purposes of capital market development and not to encourage consolidation in any particular sector. That said, there is scope for further consolidation in the banking sector although I would never put a specific figure on the number of banks that we need. Whether consolidation takes place is, however, a matter for the shareholders of the banks themselves.

Will banks in Bahrain look to other countries in the GCC/MENA region to expand and grow; if so do you expect to see takeovers on a regional basis?

As I stated in my reply to the previous question, this is really an issue for the shareholders of the banks concerned. From a regulator's perspective, if such cross-border expansion is planned our concern will be to ensure that the group can be properly supervised and that it will be able to meet all of the relevant prudential requirements on a group-wide basis.

Employment in financial services in Bahrain has risen by 68.5 per cent in the last three years. Is this growth sustainable or do you foresee retrenchment taking place?

We see the growth in financial sector employment in Bahrain as evidence, among other things, of the quality of our human capital. A large percentage of the growth in employment has been accounted for by Bahrainis, who employers tell us have the skills and work ethic that they require. Obviously, in the current global environment we are unlikely to see these sorts of growth rates in the near future, but neither do we expect there to be large scale retrenchment. The insurance and investment management sectors in particular continue to expand. It is a question of ensuring that we have people with the right skills.

What do you believe needs to be done to improve corporate governance in Bahrain?

During the past five years or so, the CBB has implemented several far reaching initiatives on corporate governance standards to complement the requirements of the Commercial Companies Law. Our emphasis has been on the internal governance, market conduct and transparency of listed companies and licensees. Our internal governance requirements have concentrated on the role of the Board and on ensuring sound internal controls and risk management systems. Market conduct has involved requiring banks to adopt codes of conduct for dealing with customers and also to adopt staff codes of conduct in dealing with potential conflicts of interest. Transparency requirements for both licensees and listed companies have increased dramatically over the past decade and we have sought to make management imports more accountable for their actions. The Ministry of Commerce recently issued a new Corporate Governance Code which is closely aligned with the CBB's approach. The next steps to improve corporate governance therefore involve the practical implementation of the new Code.

Do you expect the CBB's monetary policies to remain unchanged for the rest of 2009?

I do not think you could expect any central bank governor to announce monetary policy six months in advance! The actions that we will take on monetary policy will depend on the economic out-turn and also the outlook for inflation and we will make our decisions accordingly.

How much activity are you seeing on the overnight repurchase facility that was established in November 2008?

The facility that you refer to was not established in November 2008. We merely introduced some technical changes to an existing facility, in particular broadening the range of collateral that we would accept for repo. This is one of the Central Bank's facilities and remains open for banks to use at their initiative.

What changes do you think need to be made to the way banks manage liquidity and risk?

The global financial crisis revealed a multitude of deficiencies in the way that many banks had managed their liquidity and risk in the past. International standards setters, such as the Basel Committee, are reviewing the lessons to be learned and the CBB will follow its long-established practice of adhering closely to any new international standards that result. However, I think it is clear that banks have in recent years paid far too little attention to the need to develop stable sources of funding and to be able to meet liquidity stresses when they arise. If there is another lesson to be drawn, I think it is that statistical modelling can be no substitute for sound judgement and common sense.

Within the banking sector, where do you see the greatest potential for growth and why?

As I said in my answer to the previous question, banks need to develop more stable sources of funding and this means attracting a strong retail deposit base. The banks that can do this are likely to enjoy the greatest growth potential in future.

Do you believe hedge funds still have a significant role in the financial sector in Bahrain and in the GCC at large?

The hedge fund sector is very diverse and contains a wide range of investment firms with very different objectives and trading strategies. As a result I think it is difficult to talk about a hedge fund sector as such. Nonetheless, I believe that hedge funds will continue to play a very important part, not only in Bahrain but in the global financial system. In recognition of this last year we introduced a new category of 'exempt' schemes into the CBB Rulebook. This will permit hedge funds, leveraged buy-outs, and other high risk funds to be established in Bahrain. We are committed to offering the necessary amount of regulation without stifling innovation and, provided that they satisfy certain criteria, to allow financial institutions to set-up various types of funds.

What new services would you expect to see being offered by the banking sector over the course of the next 12 months?

Given my earlier comments about the importance of building a strong retail customer base, I would expect to see banks focusing on the quality of customer

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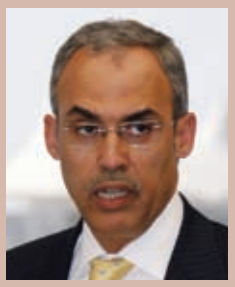
H.E. Rasheed Mohammed Al Maraj

Governor of the Central Bank of Bahrain



Rasheed Mohammed Al Maraj has been the Governor of the CBB for four and half years, joining the Central Bank on 17 January 2005. Immediately prior to this he had been the General Manager and Chief Executive Officer of Arab Petroleum Investments Corporation in Dammam, Saudi Arabia, a position he had held since April 1999. Previously he had held a number of posts in the Government of Bahrain including that of Undersecretary, Ministry of Transportation; Assistant Undersecretary for Economic Affairs, Ministry of Finance and National Economy; and Engineer, Ministry of Industry and Development.

As Governor, he carries ministerial ranking and is the Chief Executive of the Central Bank, which is the single regulator of the Bahrain financial services industry. Al Maraj has also served as Chairman of Bahrain Telecommunications Company and was, in 2004, appointed to the Consultation Council of the Co-operation Council for the Arab States of the Gulf. Since 2000, he has been a board member of the Economic Development Board (EDB) of Bahrain. He is also a member of the board of trustees of the Oxford Institute for Energy Studies, UK.

He holds a degree in Industrial Engineering from the US University of Houston in Texas and a Diploma in Projects Evaluations, Training Programs in Investment and Asset Management from Strathclyde University in the UK. ■

service and the efficiency with which they handle retail transactions in order to build these relationships.

What has been your greatest challenge since taking office in January 2005?

Ask any of my colleagues in the central banking community this question and they will all give you the same answer – the events of the second half of 2008 were by far the most challenging in at least a generation. Ensuring that our financial system continued to operate normally during the stresses of that period was undoubtedly the greatest challenge that I or any other central bank governor has faced for a long time.

What are your aims for the CBB and the financial sector over the medium term, say the next five years?

For the CBB my aim is to build on our reputation as an effective, transparent, and proactive regulator that adheres closely to international standards and best practices. For the financial sector itself, it will be to encourage quality growth with firms being attracted to Bahrain by the high standards that we will set as a regulator. We also need a financial sector that is diversified and in which insurance and investment management play an even bigger role than now. ■

Central Bank of Bahrain

Also known as: CBB

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مصرف البحرين المركزي
Central Bank of Bahrain

Board of Governors

Name	***Position***
Rasheed Mohammed Al Maraj	Governor

Board of Directors

Name	***Position***
Qassem Mohammed Fakhro	Chairman
Hamid Salman Al Sairafi	Vice Chairman
Rashid Mohammed Al Maraj	Board Member
Youssef Abdullah Humoud	Board Member
Zakaria Hejres	Board Member
Mohammed Hussein Yateem	Board Member
HH Sheikh Mohammed Bin Ahmad Al Khalifa	Board Member

Principal activities: Organisation of the issue and circulation of the currency of the State of Bahrain; regulation of exchange and credit policy; licensing and supervision of banks; fiscal agent for the government.
Formerly known as: Bahrain Currency Board until 1973, Bahrain Monetary Agency until September 2006.
Date of Establishment: 1964
No of Employees 322 (Company)

Organisation Structure and Related Entities
Subsidiaries/Associates/Affiliates

Name	***Country***	***Holding***
CBB International Sukuk Company	Bahrain	100.00%

Supervised Institutions

Name	***Country***	***Holding***
Ensurion	Bahrain	-
Bahrain Stock Exchange	Bahrain	-

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