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## Bahrain financial policies a regional trailblazer

**B**ahrain is one of the most financially forward-thinking of the Gulf Cooperation Council (GCC) states.

This is one of the key conclusions of a report published by business services firm KPMG. The *Succeeding in a Changing World* report is based on interviews with 1,500 leading executives across 22 countries in Europe, the Middle East and Africa.

“Having long since realised that it cannot rely on oil and gas exports to ensure its continuing prosperity, Bahrain has strived over the past several decades to diversify its economy away from the extraction of natural resources and towards a more sustainable model of development based on manufacturing and the provision of services, especially finance,” said the report, released in July 2011.

“In doing so, the Kingdom has earned a reputation for being a regional trailblazer and built the GCC’s most open economy.”

Despite negative short-term impact, the fundamentals upon which the country’s economy is based remain unchanged, said the report.

“Going forward, government and regional

investments are expected to have an immediate impact on Bahrain’s economic recovery,” it said. “Further reforms, however, and a planned revision of the national economic strategy, will be crucial to the Kingdom’s long-term growth and prosperity.

“Within this context, many government institutions, agencies and private businesses are looking at their internal reform agendas. For many, this includes rolling out transformation programmes to deliver operational efficiencies to enhance performance.”

Most senior executives surveyed are focusing on business performance management and aligning their cost base to their organisations’ future strategy and ensuring cash and working capital, said Mr. Narayanan Ramachandran, Head of Advisory at KPMG Fakhro in Bahrain.

“Bahrain-based respondents place a far greater emphasis on addressing risk throughout the organisation, accounting for 42% of those interviewed, compared to 30% across the survey, demonstrating the increasing emphasis on corporate governance and financial risk management,” he said.

In a separate research study, Kuwait

Finance Centre, Markaz, found that Bahrain’s corporate sector has been performing strongly, with banks leading the way.

On a like-to-like basis, companies in Bahrain which the report examined reported a profit of US\$270 million in the first half of this year, an increase of 28% year-on-year and a rise of 13% quarter-on-quarter. Banks reported an earnings growth of 63% over the first half of 2010.

Across the GCC, corporate earnings declined by 7% when compared to the first half of last year, according to the Markaz report.

“Corporate earnings declined due to a weak performance by the telecom sector in the region. Nevertheless, banks and commodity companies continued to perform strongly,” the report said. “The region’s continued dominance as a petrochemical hub, global recovery and increase in commodity prices supported the performance of companies across the region.”

## Economy posts strong growth

**B**ahrain’s economy is recovering at a fast pace, thanks to government reform efforts to stave off the negative effects of global, regional and local developments. The economy registered a significant growth of 19.8% during the second quarter of this year, according to preliminary figures released by the Central Informatics Organisation (CIO).

“Bold decisions taken by Gulf governments during the recent incidents, particularly Saudi Arabia and the UAE, have helped boost business sentiment in the country and improved the investment climate for the private sector,” said Dr Mohammed Al Amer, President of CIO.

“This positive impact will encourage foreign and institutional investors to return to Bahrain.” The country’s economy grew 19.8% at current prices during the second quarter compared to the same period last year, due to an increase in international oil

prices, according to CIO data.

Meanwhile, the growth rate at constant prices registered an increase of 0.8% during the second quarter, compared to the same period last year and about 1% compared to 2009. The oil sector contributed 1.9% to the growth, while non-oil sector contributed 0.6%. Retail banks registered a growth rate of 3.7% at constant prices.

The services sector also showed stable growth with goods producing industries surging 2.9%, transportation and communications 8.6%, government services 4.9%, social and personal services 12.9%, electricity and water 17.3%, wholesale and retail trade 1% and agriculture and fishing 8.3%.

Building, construction and real estate activities, business services and hotels and restaurants declined by 1.8%, 3.8% and 17.4% respectively.

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# Post-crisis governance reforms for Islamic Banks

*Worldwide, business failures have given corporate governance more attention, making it the issue of the hour. Ms Hana Ahmed Al Murran, Superintendent, Wholesale Islamic Banking Supervision, at the Central Bank of Bahrain (CBB), examines the issue and outlines CBB's response.*



Many argue that banks need a separate analysis for corporate governance given their importance to the economy and the role they assumed. With total assets of Islamic financial institutions (IFIs) reaching US\$1 trillion in 2011, the growth of Islamic finance can no longer be ignored. Islamic financial services have grown significantly with over 300 institutions operating in more than 75 countries.

Bahrain is well-known as a leading global hub for Islamic finance. For Islamic banks, corporate governance is a bigger challenge due to their unique characteristics. This stems from the additional risks and different business models used by Islamic banks compared to their conventional counterparts.

Banking crises, over time, have revealed poor governance. The latest major financial crisis that began in late 2007 triggered the renewal of the regulatory landscape focusing on corporate governance reforms. In October 2010, the Basel Committee on Banking Supervision issued principles for enhancing corporate governance to address banks' fundamental deficiencies in corporate governance that became apparent during the financial crisis.

Many of the recent regulatory proposals involve hot-button issues including, inter alia, board structure, directors' elections, executive compensation, remuneration committee structure and powers, investors' proxies and risk management.

The recent financial turmoil has led many investors to raise serious concerns with respect to the accountability and responsiveness of banks' boards of directors and managements. This has resulted in a loss of investors' confidence. Hence, regulatory reforms have included changes as advocated by institutional and other large investors such as shareholders proxies access, voting rights, transparency, etc.

Notably, most of the newly-issued legislations share a strong interest in governance reforms. In the United States, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law by President Barack Obama on 21 July 2010. Other examples are the Walker Review on Corporate Governance of UK

Banking Industry issued in November 2009 and the Green Paper on Corporate Governance endorsed by the European Commission in April 2011.

It is widely argued that the Islamic banking model helped the system by protecting it from the adverse impact of the global financial turmoil. Nevertheless, the negative systemic impact of the economic downturn could not be avoided by Islamic banks, which operate as part of the holistic conventional financial system.

## Unique Structure

The embodied features of risk and profit-and-loss sharing arrangements in Islamic banking represent a radical departure from conventional banks in the lens of corporate governance. Going back to origins, Islamic banks act as funds managers, collecting depositors' funds and investing them around in the economy, then distributing the profits amongst their depositors. Depositors in Islamic banks, or the investment account holders (IAHs), are a type of equity holder with residual claims to their share of the bank's assets. IAHs have the features of equity holders with risk and rewards attributes. In other words, the profit-and-loss sharing arrangements under Islamic banking imply quite different stakeholder relationships than under the interest-based system. Consequently, these arrangements entail a unique governance structure for Islamic banks.

Although there is a debate regarding the scope of corporate governance, the goal of corporate governance in Islamic banking is to enhance stakeholders' interest. Recently, there have been widespread discussions concerning the IAHs being a main stakeholder category.

Internationally, there is an increased demand for greater transparency and better disclosures called for by standards setting organizations and market participants. The Islamic Financial Services Board (IFSB) is working to enhance governance structures of Islamic banks. The IFSB has formed a task force on Islamic finance and global financial stability in cooperation with the Islamic Development Bank. The work of the task force touches upon topics related to risk management, corporate governance, transparency and market discipline.

Various stakeholders should be able to exercise an

effective market discipline on the bank and its management and board of directors based on a sufficient level of information to reach an informed opinion. The management and boards of directors of Islamic banks must be committed to providing good disclosures, both quantitative and qualitative.

International best practices encourage banks to establish a corporate governance committee for overseeing matters of corporate governance for the board, including formulating and recommending governance principles and policies. As Islamic banks are subject to an additional layer of governance through their Shari'a Supervisory Board (SSB), members of the SSB should have an effective role in governing the interest of various stakeholders, including the IAHs. Moreover, there has been a wide discussion regarding the composition of the corporate governance committee. Many argue that such committees should also include SSB members and independent directors.

The Central Bank of Bahrain (CBB) has a long-established policy of applying international standards for regulating the financial sector in the Kingdom of Bahrain. The CBB has taken steps to ensure that its rules and regulations are in line with the international standards of Basel II and the IFSB. The CBB has also revamped corporate governance requirements to reflect the provisions of the Kingdom of Bahrain's new Code of Corporate Governance which was issued last year. The High-Level Controls and the Public Disclosure Requirements Modules of the CBB's Rulebook - Volume 2 - for Islamic banks has been updated recently towards an enhanced risk control environment and greater transparency and disclosure.

Corporate governance policies should be adhered to at all times. Banks' policies and procedures should be updated on a regular basis to be in line with regulatory requirements and international best practices. Banks' board of directors should hold the ultimate responsibility for implementing good governance practices and protecting the interest of stakeholders.

# Harmonizing Wakalah contracts

*The International Islamic Financial Market (IIFM) has initiated work on standardizing the Wakalah contract, which is being actively used by Islamic banks as a liquidity management tool. Mr. Ijlal Alvi, Chief Executive Officer of IIFM, examines the structures being used, the problems that have arisen and makes the case for standardization of the Wakalah contract.*



The Islamic inter-bank market is still in its evolutionary phase and various efforts are under way to diversify liquidity management tools available to Islamic banks. In the past few years, the Wakalah arrangement/transaction (restricted or unrestricted) has been actively used by Islamic banks to reduce their over reliance on commodity Murabaha.

Although both restricted (off balance sheet) and unrestricted (on balance sheet) Wakalah are being used, the unrestricted Wakalah arrangement has greater potential to emerge as one of the main Islamic inter-bank money market tools. However, comprehensive discussions are needed among Shari'a scholars and market practitioners to develop solutions on the following issues:

- Credit risk;
- Issue of off-balance sheet and on-balance sheet treatment;
- Operational handling of asset pool and indicative rate of return;
- Impact on shareholders if the risk is transferred back from the Muwakkil (investor) to Wakil (agent);
- Regulatory environment and applicability of arrangement; and
- Accounting issues and legal interpretation.

Addressing these issues through a standardized approach will provide the Islamic finance industry clear direction on the use of inter-bank unrestricted Wakalah.

The main difference between restricted and unrestricted Wakalah is that the former requires bilateral documentation which covers all the issues, while unrestricted Wakalah requires not only documentation but also involves the process and operational handling of the issues as well as legal implications.

The commonly-used structures can be summed up as follows:

a) Restricted Wakalah: In this contract, the agent invests the investor's funds in pre-agreed asset classes and the risk of the asset is transferred to the investor.

b) Unrestricted Wakalah (as outlined in an IIFM concept paper): This product funds the treasury pool which, in turn, invests in any of the assets on the balance sheet. Islamic financial institutions (IFIs) tend to prefer unrestricted Wakalah, while the view of regulators differs from jurisdiction to

jurisdiction.

There are various types of Wakalah used; the most common being the service agency for the management of funds (Wakalah al-istithmar). In return for undertaking investment services, IFIs are paid a pre-agreed agency fee for carrying out investments under Wakalah agreement on the basis of sharing in the profit and loss in the investment.

According to the Shari'a standard of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), Wakalah contract may take several forms: Specific vs. General; Limited vs. Absolute (Restricted vs. Unrestricted); Paid vs. Non-Paid; Binding vs. Non-Binding; and Temporary vs. Continuous.

When presented with the Wakalah concept (based on the typical documentation and structure used by most institutions), some argue that it displays the characteristics of a fund management activity. Their primary concern revolves around the customer bearing the risk of loss arising from the underlying Wakalah pool of assets and, therefore, lacking capital certainty.

Consequently, there is an argument that deposits taken under classical Wakalah need to be recognized as "client money" and accounted for and reported accordingly and that, although suitable for some applications, it is flawed under this interpretation as a money market instrument. Therefore, it is crucial that an appropriate Wakalah money market solution, comprising two distinct parts, i.e. Legal and Operations/Risk Management Framework, be developed as a standard, in addition to a Master Wakalah Agreement.

## Major Issues

Capacity investment risk: The issue of paying a minimum return on investment raises further questions in relation to the capacity of the agent to give such assurance and whether or not the agent can renounce his obligations under the Wakalah agreement on the basis of lack of capacity.

This is the core issue in the case between Kuwait-based The Investment Dar (TID) and Lebanon's Blom Bank. It has brought to the fore the issue of capacity risk and has caused IFIs to come

under scrutiny by rating agencies, which are being prompted to evaluate additional risks when assessing such transactions.

Mixing of Funds vs. Insolvency: Based on general market practice, when an investor invests money with the agent under a Wakalah, such money is usually mixed with the agent's own pool of funds. In the event that the agent becomes insolvent, the investor's money is mixed with the agent's other money and may well be treated by the liquidator, in certain jurisdictions, as part of the agent's liquidation assets. Investors, thus, are advised to consider this additional risk.

Honoring an Indicated Profit Rate vs. Low Return: A policy of honoring an indicated profit rate, in the event the portfolio return is lower than the indicated profit rate or certain assets from the reference pool need to be taken out due to not meeting the criteria under the operational process, has Shari'a, legal, accounting and shareholders implications, which need to be addressed.

IIFM, in coordination with leading Islamic banks, has initiated work to develop a standard unrestricted Wakalah agreement to contribute in the robust development of Islamic financial markets. This will be another step by IIFM to provide the industry with minimum market standards.

However, such an endeavour faces a number of challenges, such as:

i) What will be required to make the Wakalah standard agreement comply with laws of jurisdictions where Islamic finance is practiced?

ii) Issues related to central bank regulations, accounting treatment and capital allocation.

iii) Should operating standards be made compulsory for using the Wakalah document?

iv) Transfer of risk from fund placing institution back to fund taking institution and its impact to shareholders equity is a critical factor due to its Shari'a and legal implications.

IFIs are urged to assist IIFM in its endeavours, as the industry's collective efforts and involvement are needed to achieve the objective of a standardized Wakalah agreement.

# Waqf Fund launches courses for Shari'a reviewers

The Waqf Fund, a Bahrain-based special fund to support Islamic finance training, education and research, has announced two major initiatives aimed at building capacity of Shari'a reviewers in Islamic financial institutions (IFIs).

The Fund is launching a Shari'a Reviewer Development Programme and the Diploma in Islamic Commercial Jurisprudence. Both programmes will be conducted by the Bahrain Institute of Banking and Finance (BIBF).

The programmes are aimed at capacity building of Shari'a human resources at IFIs and to better equip them to handle their job.

Mr. Khalid Hamad, Chairman of the Waqf Fund, said the Fund had conducted a successful two-day training session for internal Shari'a reviewers of IFIs in April 2010 to orient them with conventional banking concepts and practice.

"Based on the feedback received from the participants, we have now developed a full programme aimed at improving the knowledge base of internal Shari'a reviewers and others working in Shari'a departments at IFIs.

"Starting from September 2011, the Shari'a Reviewer Development Programme will be offered by the BIBF. We believe that it will help improve the efficiency of internal Shari'a review personnel working for our

member institutions."

The programme comprises six modules on Understanding Financial Statements for IFIs; Business, Banking and Trust Law; Islamic Liquidity and Treasury Management; Risk Management in IFIs; Shari'a Auditing and Corporate Governance for IFIs; and an Introduction to Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and Islamic Financial Services Board (IFSB).

Mr. Hamad further added: "The objective is to provide a high level perspective on the above topics in order to help Shari'a reviewers better understand the business and financial implications of the Shari'a and familiarize them with the relevant laws, regulations, standards and market best practices."

## Islamic Commercial Law

The Waqf Fund's Diploma in Islamic Commercial Jurisprudence is set to commence in October 2011 at the BIBF.

The new diploma programme provides an opportunity to develop an understanding of Islamic commercial jurisprudence in considerable depth, said Mr. Hamad.

The programme, which will be conducted in Arabic, consists of seven modules which will cover The Theory of Contracts and its Legal Maxims; Objectives of Shari'a

and Usul Al Fiqh; Principles of Fatwa and Applied Jurisprudence; Islamic Financial Transactions; Fiqh of Zakat and Waqf; Fiqh of Takaful; and Shari'a Auditing and Compliance for IFIs.

Dr. Mohammad Omar Farooq, Head of the Centre for Islamic Finance at the BIBF, commented: "Quality education and training in Islamic finance have been somewhat lagging in comparison to the impressive growth of the industry. We have a duty to make available substantive and up-to-date training for those working in the Shari'a departments of IFIs in various capacities.

"The Centre for Islamic Finance at the BIBF has been a pioneering contributor to this industry's education and training needs and we are pleased to have this opportunity to make a difference. The Waqf Fund and BIBF have an ongoing partnership in serving the Islamic finance industry. We are confident that this new diploma, reviewed and certified by AAOIFI, will be an important step toward filling the current void."

The Waqf Fund will bear the cost of participation in both programmes for its member institutions.

The Fund, established in November 2006, has been a major contributor to the development of Islamic banking industry in Bahrain. Twenty Bahrain-based financial institutions are its members.

# Corporate governance workshop for Islamic banks

Chief executive officers (CEOs) and Directors have a fiduciary duty to their investors, customers, employees and the general public, which demands loyalty, care and candor of the highest order. These were the focal points raised by former Harvard University Professor Nabil El-Hage during a workshop on corporate governance.

The event was organized by the Waqf Fund for Research, Education and Training in Islamic Finance and attended by over 20 senior professionals.

Professor El-Hage pointed out that business owners can no longer afford to ignore the ethical dimension of their decisions, in addition to the economic and legal aspects. This is true for all businesses but even more so in the case of Islamic banks, which have to fulfill the additional requirements of Shari'a compliance.

This inevitably means more ambiguity and board members should be prepared to give their judgment on such matters. He concluded that exercising sound judgment while fulfilling the duties of loyalty, care and candor was the best protection for board members and senior management.

Mr. Khalid Hamad, Chairman of the Waqf Fund, emphasized the importance of good corporate governance for sustainable business in good times and bad. He said that decision makers in Islamic financial institutions need

to understand clearly their responsibility as board members, especially in line with the code of corporate governance introduced recently in Bahrain.

The workshop also highlighted some of the global corporate governance issues which are relevant for Bahrain and the region.



Mr. Hamad, sitting fourth from left, is seen with workshop participants.

# The Shari'a way to good corporate governance

*Shari'a governance is the best way to ensure continued public confidence in Islamic financial institutions (IFIs), says Mr. Sohaib Umar, Senior Manager, Ernst & Young Islamic Financial Services Group, Bahrain. He outlines key elements of a Shari'a governance framework, which he says will go a long way in ensuring the health and sustainability of IFIs.*



The importance of corporate governance for the health and sustainability of financial institutions is well recognized. For Islamic financial institutions (IFIs), corporate governance has an added element – Shari'a Governance – which is arguably the make or break factor in the medium to long term for this US\$1 trillion industry.

Let's start from the basics. The Organisation for Economic Cooperation and Development (OECD) defines corporate governance as: "A set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined." Good governance lowers the cost of capital by reducing the perceived risk, facilitates access to external finance, leads to better operational performance and reduces the risk of contagion from financial distress.

## The Shari'a Filter

IFIs live in the same world as conventional financial institutions. They exist because there is a genuine demand for Islamic finance. They have to follow the laws of the land and they have to be good corporate citizens just like their conventional counterparts. But they are distinct in one aspect, which we call the 'Shari'a filter'. It is this factor which is their *raison d'être* and that sets them apart from conventional financial institutions. Anything that strengthens the Shari'a filter in effect strengthens the Islamic finance industry and vice versa.

If the Shari'a filter becomes weak, it will dilute the difference (real and/or perceived) between IFIs and their conventional peers, leading to a loss of public confidence in the former. Nothing can be more disastrous for the Islamic finance industry than this. How can we avoid this scenario? The answer is: Improved Shari'a governance.

## Shari'a Governance

We can define Shari'a governance as: "A system whereby an IFI attempts to comply with the Shari'a in all its activities." In other words, Corporate Governance + Shari'a = Shari'a Governance.

Before we outline the building blocks of

Shari'a governance, let's look at the current state of IFIs from a Shari'a governance perspective. Some common issues are:

- i. No fit and proper criteria for Shari'a board members, no formal assessment or training program, no maximum limit on board seats, no formal independence/conflict check;
- ii. No mandatory external Shari'a audit;
- iii. Lack of skills and competencies required for different functions/components of Shari'a governance framework;
- iv. No formal training for Shari'a department employees;
- v. No standard operating procedures to cover products pre and post launch;
- vi. Inadequate and varied disclosures to IFIs' shareholders and unrestricted investment account (URIA) holders;
- vii. No mechanism to protect the interests of URIA holders;
- viii. No institutional emphasis on Shari'a research for product innovation;
- ix. No concerted effort to educate stakeholders of Islamic finance – board members, management, staff, regulators and the general public.

## Best Practices

The global financial crisis dispelled the notion that the Islamic finance industry is somehow immune to a crisis. Islamic finance thought leaders were compelled to reflect on internal weaknesses of the industry. Regulators became active to introduce tighter controls throughout the financial sector. In Bahrain, a new corporate governance code was introduced, while Malaysia announced the implementation of a new Shari'a governance framework. The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) is in the process of drafting a consultation paper on Shari'a governance. The industry is converging on a number of best practices, though no one country has the perfect model as yet.

We have looked at the various jurisdictions to identify the components of a robust Shari'a governance framework. The components, outlined below, include suggestions and recommendations from the industry and leading Shari'a scholars who participated in a Roundtable Discussion arranged by the Waqf Fund in December 2010:

- Regulators and industry players should allocate appropriate resources for a robust Shari'a governance framework.
- Independent, competent and empowered Shari'a boards, which enjoy the full support of the board of directors and management. In addition, regulators should introduce certain mandatory requirements for Shari'a board members, such as fit & proper criteria; formal training (to plug any knowledge gaps in banking, finance or economics); checklist for fatwa issuance; publication of fatwa, along with their bases/evidence in the annual Shari'a review report; annual independence and conflict of interest check; formal annual assessment (including attendance of Shari'a board meetings); limit the number of Shari'a board seats a member can hold; and disclosure of Shari'a board members' remuneration in the annual report.
- Mandatory Shari'a audit, both internal and external, by an independent third party (a number of jurisdictions highly recommend external Shari'a audit but none has made it mandatory as yet).
- Mandatory, well-resourced internal Shari'a review function, working independently of management (and reporting to the Shari'a board).
- A Shari'a research function to undertake research prior to product approval.
- A Shari'a risk management function dedicated to identify, measure, monitor, control and manage the real or perceived risk of Shari'a non-compliance.
- A mechanism to protect the interests of URIA holders.
- A central Shari'a board, at the central bank level, to resolve any conflict in IFIs' Shari'a boards and to provide overall guidance, if required.

Lastly, let us dispel the misconception that the risk of failure of IFIs due to bad governance is any less due to their Islamic nature. Nobel Laureate Albert O. Hirschman reminds us that "Under any economic, social or political system, individuals, business firms and organizations in general are subject to lapses from efficient, rational, law-abiding, virtuous or otherwise functional behavior." Islamic banks are no exception. A strong Shari'a governance framework is the best way to ensure continued public confidence in IFIs.

# New AAOIFI standard on financial reporting

The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), the international organisation that formulates standards on accounting, auditing, ethics, governance, and Shari'a for the international Islamic finance industry, has recently issued a new financial accounting statement standard on the conceptual framework for financial reporting by Islamic financial institutions (IFIs).

The new standard was issued to update and replace the previous financial accounting statement standards on objectives and concepts of financial accounting for Islamic banks and financial institutions.

Pertinent points that have been incorporated in the new conceptual framework standard include updated guidance on accounting treatment for on-balance sheet and off-balance sheet investment accounts.

## Investment Accounts

Investment accounts refer to funds received from investors for the purpose of investment in a Mudaraba arrangement where the investor retains the risk in relation to invested funds or assets.

The new conceptual framework standard introduces the concept of authority to make decisions in relation to the use of and deployment of funds received from investment account-holders in determining the treatment of such funds as on-balance sheet or off-balance sheet items. In contrast to the previous standards, under the new conceptual framework standard, accounting treatment for such funds is not dependent merely on whether the Mudaraba contract is designated as restricted or unrestricted investment account.

The new conceptual framework standard envisages a differential treatment for investment accounts that provide the IFI authority over decision-making in relation

to where, when and how the funds provided will be deployed versus circumstances where the decision-making ability is restricted to a substantial or significant extent. In respect of the former class of investment accounts, an on-balance sheet treatment is required. This is deemed appropriate primarily based on current practices which involve the entities making strategic policy as well as day-to-day decisions ("decision making authority") with regards to investing of funds received on a Mudaraba basis.

When such decision-making authority exists, the following have found to be typical:

- The IFI normally has an overall strategy and business model encompassing proprietary funds belonging to the owners or shareholders as well as funds mobilised through investment accounts. If not, the IFI has all the powers vested with it by the contractual arrangements with the investment account-holders to develop the strategy or investment policy in relation to the funds received from the account-holders.

- On the other hand, the investor relies entirely on the ability of the IFI for generating a profit and is normally unaware of the precise destination of the funds.

- Often the IFI is also able to commingle the pools of funds belonging to savers with its own. Accordingly, in many circumstances, the assets are jointly owned and funds are commingled with little legal or constructive separation of the cash and the assets.

The new conceptual framework standard considers an on-balance sheet treatment for such funds, regardless of the designation of the Mudaraba contract as unrestricted and restricted investment accounts.

However, when the IFI has little authority or limited or no discretion in respect of the use of and deployment of the funds, they qualify for an off-balance sheet treatment. Such off-balance sheet treatment needs to

be accompanied with sufficient appropriate disclosure or even separate financial statements.

An on-balance sheet treatment may be necessary even when funds are properly segregated if such authority does exist. On the other hand, an IFI is not precluded from investing jointly in assets that are funded also by investment accounts that are considered off-balance sheet. If an IFI shares an asset with investment account-holders whose funds are treated as off-balance sheet fiduciary items, then the IFI recognises only those rights or proportion of the asset that it controls.

Yet another important point of consideration is the manner in which the funds are received. If the funds are received through structured investment vehicles then the position clearly changes. The IFI would then need to consider if the structure investment vehicle is subject to consolidation rules.

As in any accounting framework, judgement plays an important role in agreeing and determining the approach when there is substantial doubt.

## Fiduciary Items

There are instances where IFIs do not accept funds in the form of investment accounts and yet deal in substantial funds belonging to clients in a fiduciary capacity. Such fiduciary capacity could mean investing funds, belonging to clients, as an agent or an intermediary. If the assets are held or managed or otherwise administered by the IFI, then there is a need to disclose the value of such assets as at the reporting date.

This is deemed necessary in view of the fact that there is an ongoing obligation to deal with the funds or the attributable assets in accordance with the arrangements with the client and in accordance with Shari'a requirements.

## AAOIFI, World Bank forum on Islamic banking

The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and the World Bank will be co-hosting the Annual Conference on Islamic Banking and Finance, under the auspices of the Central Bank of Bahrain (CBB) on 23 and 24 October in Bahrain.

Amongst the topics that will be covered at the conference are challenges in applying International Financial Reporting Standards (IFRS) for Islamic finance, inevitability of existence of Shari'a Supervisory Boards in Islamic financial institutions, growth potential for real estate investment trusts

(REITs) in Islamic finance, potential of using Islamic finance to further promote international trade, challenges in implementing Basel III in Islamic financial institutions, and distribution of takaful surplus to shareholders of takaful companies.

The opening ceremony of the conference will also see graduation certificates being awarded to candidates who have recently passed AAOIFI's Certified Shari'a Adviser and Auditor (CSAA) and Certified Islamic Professional Accountant (CIPA) professional development programmes. Training programmes for the current intakes

of CSAA and CIPA candidates will also be held following the conference.

On 25 October 2011, a workshop organised by the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the organisation that provides an international platform for more than 9,000 institutions in 209 countries to exchange standardised financial messages, will be held on automation and standardised transaction processing for Islamic finance, including the ISO 15022 Murabaha messaging solution and other potential Shari'a-compliant messaging requirements.

# The challenge of managing risk in Islamic banks

*The financial crisis has brought to the fore areas of improvement in the risk management framework of Islamic banks, who now have the opportunity to move towards a robust enterprise-wide risk management (ERM) framework, says Dr Sunando Roy, Advisor, Inspection, at the Central Bank of Bahrain.*

Although Islamic banks were spared from the first round effects of the global financial crisis due to the Shari'a compliant nature of their transactions, the sector faced risks that arose from global recessionary pressures as risk concentrations rooted in the business plans of Islamic banks transformed material risks into realized losses. The real estate boom preceding the recession lured Islamic Banks into concentrated, leveraged exposures in large scale real estate projects and the downturn culminated in large provisions significantly affecting the profitability of Islamic Banks. As a fairly new segment of the Banking Sector, strategic business decisions in Islamic Banks were carried out in an environment where the corporate governance framework and systems of risk management and internal controls were being devised and implemented. The recessionary pressures thus revealed the imminent need to enhance governance framework, implement robust processes, apply appropriate risk identification methodologies and enhancing the quality of human resources in the banks. Within the overall need to put in place robust system and controls, developing a risk management framework to identify, assess, monitor and mitigate risks has emerged as a priority for Islamic Banks. The first challenge in this respect is the necessity to align the risk management framework and business strategy. The real life stress test scenario triggered by the financial crisis demonstrated the necessity to enhance the effectiveness of the risk and internal control functions. With the ushering of a proactive regulatory regime, it has become abundantly clear that to foster effective bank-wide risk management, the risk function needs to be empowered with the 'voice' to put forth the words of caution to senior management and the board of directors. Two other crucial control functions, compliance and internal audit, would also require adequate access to senior management and board committees to effectively highlight compliance concerns and internal control weaknesses in a timely manner. This has been underscored in the recent corporate governance guidance from the Basel Committee and other regulatory agencies with the implementation of enhanced corporate governance regulations the above control functions are likely to assume a greater role in the strategic decision making process in Islamic banks.

## Risk Framework

One major lesson from the financial crisis is that shocks can arise from risks not covered by regulatory capital requirement

but from Pillar II risks such as liquidity, concentration, strategic and reputational risks. While both conventional and Islamic banks are exposed to the challenges of effectively synchronising Pillar I and Pillar II implementation, the constraints of underdeveloped markets for liquid instruments and concentrated risk exposures made Islamic banks more vulnerable to the misalignments among the Basel pillar. The lack of balance in the treatment of Pillar I and II risks, evidenced in weaknesses in the internal capital adequacy assessment process, has constrained the risk function in providing proper recommendations to senior management about the intensity and likely adverse impact of material risks and, thereby, deprived top management of a holistic view of the sustainability of the business strategy. Islamic banks, therefore, face the challenge of adopting a balanced approach in aligning regulatory capital management with economic capital management. The Basel 3 initiatives currently underway to strengthen the capital, liquidity and the overall governance framework of banking institutions will pose a further challenge to Islamic banks in the form of strengthening the quality of capital, increasing access to liquid assets and instituting robust risk governance.

## Fiduciary Risk

Another key challenge for Islamic banks is the management of fiduciary risks that arise out of their responsibilities towards investment account holders. Islamic banks, worldwide, follow a model of risk sharing with investors through a variety of contractual arrangements. Such agreements not only expose them to the core investment risks (rate of return risk, exit risk etc) but also to significant legal and reputational risks. Moreover, in a competitive landscape, Islamic banks are confronted with pressures on profit rates as compared to their conventional counterparts. Along with efforts to implement risk mitigants in the management of investor funds, the Islamic Banks should diversify their activities to finance economic activities like health, education, agriculture and infrastructure industries that contribute to long term economic growth. Augmentation of profit equalization reserves and investment risk reserves would also assist Islamic Banks in the management of investor funds. The unique nature of fiduciary responsibilities of Islamic banks implies that conventional risk models become ineffective in the Islamic context. The usual silo-centric risk measurement fails miserably in Islamic banks where risks are interlinked. At present, risk aggregation

methodologies in Islamic banks are, at best, work in progress and not able to accurately quantify risk exposure. Moreover, stress testing in Islamic banks is predominantly sensitivity-based and fails to incorporate transmission of shocks through investment projects where the bank's own funds as well as managed funds are deployed. It is precisely due to such deficient modeling that macro shocks are not properly assessed and risk reports fail to raise alerts even when the banks become exposed to significant adverse shocks from exit delays and valuation losses at the project level.

## Systemic Risk

Last but not the least, central banks have a major role in ensuring that Islamic banks remain well capitalized, develop and implement a sustainable business strategy and are able to manage and mitigate their risks. Central banks should, in addition to their initiatives at deepening the markets through development and standardization of instruments, also focus on robust implementation of risk based supervisory practices with a view to ensure a disciplined approach to risk management in Islamic Banks. The risk based supervisory framework of central banks needs to be supplemented by a framework of assessment and management of systemic risks. There is widespread recognition that micro level management of institutional risk, in isolation from systemic undercurrents, can potentially lead to pro-cyclical behavior of banks, thereby accentuating the intensity of cycles. Prudent risk management of systemic risks through identification of systemically important Islamic banks, based on size, interconnectedness, fiduciary roles, customer base and complexity of operations, and putting in place enhanced supervisory oversight of such banks will be needed in a post-crisis world.

## ERM Framework

Many Islamic banks have by now initiated the process of building a comprehensive enterprise-wide risk management (ERM) framework. The key challenges in this endeavour involve articulating the risk appetite, aligning risk and business strategy, comprehensive assessment of risks, robust regulatory and economic capital assessment, developing effective models tailored to the risk profile and putting in place appropriate mitigants to manage the diverse risks faced by Islamic banks. The above challenges can best be addressed by an appropriate IT infrastructure and human resources with the necessary skill sets and expertise.

# New rules on handling customer complaints

The Central Bank of Bahrain (CBB) conducted earlier this year a consultation dealing with the introduction of minimum requirements for customer complaints handling procedures in banks, insurance and investment firm licensees. The results of this consultation have led to the introduction of new measures ensuring that customers are protected by having in place efficient and effective arrangements in dealing with customer complaints. Customer complaints handling is to be provided to all customers free of charge.

Protection of the interests of customers of financial institutions is one of the key objectives of the CBB, as stated in Article 3 of the Central Bank of Bahrain and Financial Institutions Law 2006, while Article 4 of this law places a requirement on the CBB to assume responsibility for safeguarding the legitimate interests of licensees' customers.

Mr. Rasheed M. Al Maraj, Governor of the Central Bank of Bahrain noted that: "This Directive demonstrates clearly CBB's commitment to consumer protection and formalises for many licensees current practices being followed in dealing with customer complaints".

## New Directive

The CBB proposals were aimed at promoting fairness, honesty and professionalism among those who provide financial products and services, and reduce systemic risks by ensuring that the customer complaint handling arrangements are working in an efficient and effective manner.

The CBB's objective in introducing this Directive is to provide consumers with complaint handling procedures that are:

- Easy to follow;
- Transparent;
- Effective; and
- Free of Charge

These new procedures will be added to the October 2011 updates of the various volumes of the CBB Rulebook and all licensees concerned must be in compliance with this Directive by 31 March 2012.

## Summary of Rules

As a starting point, the Directive defines what is included under customer complaints, as follows:

"Any complaint in relation to the provision of regulated services by a licensee in which the customer alleges that he (or she) has suffered, or is likely to suffer financial

prejudices as a result of the licensee:

- a. Contravening or failing to comply without reasonable explanation with any reasonable instruction given by the customer, or any agreement or mandate entered into with the customer;
- b. Contravening or failing to comply with CBB Rules and Directives;
- c. Acting dishonestly, negligently or recklessly; or
- d. Treating the customer unreasonably or unfairly.

The consultation undertaken clearly outlined the need for CBB licensees to have in place customer complaints handling procedures that are documented appropriately and follow a set of minimum standards. In addition, customers of CBB licensees must be informed of the availability of such procedures.

The requirements outline Rules on:

- Documentation that must be maintained;
- Effective handling of complaints;
- Internal complaints handling procedures;
- Recording of complaints;
- Procedures and options for redress; and
- Timing of licensees' responses to complaints.

Where needed, the Rules were tailored for the different types of licensees recognising the unique nature associated with the various players in the financial sector. The Rules also considered the existence of other requirements in place such as the Code of Best Practice on Consumer Credit and Charging for Retail Banks as well as the Investment Business Code of Practice applicable to investment firms.

## Documenting Complaints

In order to make customer complaints handling procedures as transparent and accessible as possible, licensees must document their customer handling procedures. Such procedures must be set out in writing and include:

- (a) The procedures and policies for:
  - (i) Receiving and acknowledging complaints;
  - (ii) Investigating complaints;
  - (iii) Responding to complaints within prescribed time limits;
  - (iv) Recording information about complaints; and
  - (v) Identifying reoccurring system failure issues;
- (b) The types of remedies available for

resolving complaints; and

(c) The organisational reporting structure for the complaint handling function.

## Handling of Complaints

The CBB Rules provide principles to deal with the effective handling of complaints. The principles deal with: Visibility; Accessibility; Responsiveness; and Objectivity.

While all principles are important in the effective handling of complaints, the objectivity principle provides a series of standards to be followed such as: Openness; Impartiality; Accessibility; Completeness; Equitability; Sensitivity; Objectivity for personnel; Confidentiality; Objectivity monitoring; Charges; Customer focused approach; Accountability; and Continual improvement.

The internal complaint handling procedures must provide for the receipt of written complaints as well as for their appropriate investigation. There should also be in place an appropriate decision-making process in relation to the response to the complaint as well as a process for notifying the decision to the customer. Finally, a record of all complaints should be maintained and must include the identity of the complainant and the substance of the complaint. The record should also provide the status of the complaint – whether resolved or not and whether redress was provided – and all correspondence in relation to the complaint. Such records must be retained by the licensee for a period of five years from the date of receipt of the complaint.

## Redress

Licensees should communicate with the customer how it proposes to provide the customer with redress. Where appropriate, the licensee should also explain the options open to the customer and the procedures necessary to obtain redress. Where redress is provided in the form of compensation, such compensation should be fair. Where redress is in a form other than compensation, it should be provided as soon as practicable.

The prescribed time to respond to complaints has been tailored in accordance with current industry practice and the nature of the financial service being offered. As an example for non-life insurance related complaints, insurance licensees must respond to these in writing within one week of receipt whereas for life insurance related complaints, licensees are to respond within two weeks of receipt.

# Global woes outweigh regional fundamentals

*Mr. Jithesh Gopi, Head of Research at Bahrain-based Securities & Investment Company (SICO), reviews the performance of GCC capital markets during the past quarter and provides insights into the developments that affected the listed companies as well as an outlook on the overall markets.*



**G**CC equity markets are passing through a peculiar period in which listed entities' strong operating performances are being overshadowed by an uncertain global outlook, coupled to Middle Eastern political uncertainty.

Regional investors are cautiously evaluating opportunities after a dull summer and Ramadan season, which passed off without any major regional events or surprises. As the region lacked any major triggers or dampeners, the GCC markets' direction remained largely focused on global issues - global recessionary fears, Euro-zone debt crisis, and S&P's US sovereign rating downgrade. GCC equity markets (S&P GCC index) lost 6.3% QTD and 10.1% YTD compared to 12.9% QTD and 8.5% YTD losses in S&P Global index.

The Bahrain Bourse Index lost about 3.8% QTD (until 14 September 2011), taking its YTD losses to 11.3%. Bahrain's stock market losses were lower compared to Saudi Arabia - the region's largest stock market - which lost 7.7% QTD, as global concerns weighed heavily on Saudi petrochemical companies and that rely on global markets.

Saudi markets' higher losses led to the steep 6.3% QTD fall in the broader S&P GCC index. Qatar with a marginal 0.5% QTD loss was the best performing market during this period, followed by Kuwait and Dubai. Trading activity on the Bahrain Bourse remained subdued, with an average daily volume and value traded of 1.7 million shares and US\$0.55 million respectively in 3Q11 to date, lower than the previous quarter.

Continued weakness in investment companies' stocks affected Bahrain's market sentiment with Gulf Finance House (GFH), Esterad and United Gulf Bank (UGB) being the top losers. Trafco was the top gainer this quarter, as its profits continued to grow sharply compared to the corresponding period last year. National Bank of Bahrain (NBB) and Ahli United bank (AUB) were the only other gainers.

## Healthy GDP growth

Bahrain's 2Q11 nominal GDP grew 20%

YoY to US\$6.4 billion owing to a 44% YoY increase in the oil and gas sector. The manufacturing sector, which includes petrochemical and aluminium industries, also posted a strong 38% YoY growth during the same period. These two sectors combined, which form about half of GDP, contributed an additional US\$0.44 billion in 2Q11, as high commodity prices boosted margins and improved profitability. In addition, on a QoQ basis, GDP grew 7% owing to the two sectors, which increased by 12% and 18% respectively. This is an improvement from the previous quarter, which witnessed only a marginal 0.3% QoQ growth.

The non-goods producing sector (excluding banks and real estate) posted healthy 5% YoY (2.5% QoQ) growth. Contribution by hotels and restaurant sector fell 17% YoY (-0.3% QoQ) reflecting a decline in tourism. The wholesale and retail trade, on the other hand, grew by a modest 1.1% YoY (2.6% QoQ) while business services declined by 1% YoY but increased by 5.2% QoQ. Bahrain's financial sector fell marginally by 0.2% YoY (+0.6% QoQ) in 2Q11. Real GDP growth, on a YoY basis, continues to decelerate reaching its lowest growth level of 0.8%.

## Strong Performance

Bahraini listed companies reported a total 2Q11 profit of BD201 million (US\$533.3m) in 2Q11, compared to BD183 million (US\$485m) and BD158 million (US\$419m) in 2Q10 and 1Q11 respectively; indicating a 10% YoY and a 27% QoQ growth. The significant QoQ improvement was led by ALBA, AUB, and Batelco while the YoY growth was driven by AUB, Arab Banking Corporation (ABC), Trafco and Bahrain Saudi Bank to name a few.

Consumer goods, tourism, and telecom sector companies' earnings were adversely affected during 2Q11 by the slowdown in economic activity. As a result, profits of companies such as Bahrain Cinema, Bahrain Hotels, National Hotels, BMMI, and Seef Properties declined in double digits YoY on lower operating levels.

Commercial banks' profits improved by 36% YoY led by AUB and Bahrain Islamic

Bank. Investment and insurance companies reported profits in 2Q11 compared to losses in the corresponding period last year.

Bahrain's financial, commercial and tourism sectors are expected to do better during the third quarter after getting affected during the first half of 2011. Tourism arrivals, which drive Bahrain's service industry, picked up sharply during July-September 2011 period, which we believe will contribute to GDP and corporate profit growth in the coming quarters.

## Public Spending

Spending by Bahrain's Government and private companies picked up during the quarter. Bahrain's Government approved extra budget spending of BD325 million (US\$862m) in early August, to cover an increase in public sector salaries. The Cabinet also approved a draft law to raise the borrowing ceiling to BD3.5 billion (US\$9.3 billion) from BD2.5 billion (US\$6.6 billion) previously.

Infrastructure development projects picked up with a 3-level highway interchange contract worth BD25 million (US\$66m) awarded to Afcons Infrastructure Company, with a time frame of 28 months. The highway will be built on an existing highway - the entry point to Bahrain between the King Fahad Causeway and Khalifa bin Salman Port. Similarly, Nass Corp. was awarded a BD12.5 million (US\$33m) deal by Arab Shipbuilding and Repair Yard to set up quay wall infrastructure works at Asry North Development project.

In the short term, regional markets are expected to be driven by upcoming 3Q11 results but, more relevantly, by global macro-related news flows. Bahrain's stock market offers attractive dividend and value plays such as Batelco, Seef Properties, and BBK for long-term investors, which are trading at historically low levels. GCC markets are trading at a PER of 11.9x based on FY11 estimates, with Saudi and UAE markets trading at a PER of 11.4x and 9.5x respectively.

## CBB approves XO Bahrain as BFX member

The Central Bank of Bahrain (CBB) has granted its approval for XO Bahrain as a licensed broker-dealer of the Bahrain Financial Exchange (BFX).

XO offers access and technology services across capital markets as well as consultancy and connectivity services to clients. It has more than 10 years of experience in commodity and currency trading in the regional and global markets.

XO is establishing operations in Bahrain and also has a range of partnerships throughout the Middle East, Europe and North America.

As part of the membership facilities, XO Bahrain will operate from a fully automated and serviced trading facility offered by the BFX to its licensed members on its trading

floor.

“This partnership between BFX and XO Bahrain clearly shows the opportunities which exist for international financial institutions in Bahrain,” said Mr. Abdul Rahman Al Baker, Executive Director, Financial Institutions Supervision, at the CBB.

“This also proves that Bahrain continues to attract new financial institutions. We are glad that the BFX is facilitating foreign investment in the Kingdom.”

Mr. Arshad Khan, Managing Director and Chief Executive Officer of BFX, said: “We welcome XO Bahrain as our latest member which highlights our continuing commitment to creating a strong network

of BFX members, resulting in the establishment of a distribution channel across the Middle East and North Africa region.

“This further strengthens Bahrain's leadership position as the financial hub of the region.”

Mr. Mohamed Abdelhamid, Managing Director of XO Bahrain, said the firm was delighted with its expansion and membership at BFX.

“This membership provides our clients access to BFX's platform, making it easier to trade all asset classes and instruments under one roof. We anticipate that this collaboration will prove to be very successful,” he added.

## CBB, BFX host e-Tayseer workshop

The Central Bank of Bahrain (CBB) and Bahrain Financial Exchange (BFX) hosted a workshop on e-Tayseer, which is a fully automated Shari'a-compliant platform launched by BFX for the supply, purchase and sale of assets for facilitating Murabaha transactions between financial institutions.

The event was held at the CBB premises and was attended by over 20 senior management executives from banks in Bahrain.

Speaking on the occasion, Mr. Khalid Hamad, Executive Director, Banking Supervision, at the CBB said: “BFX is an integral component of Bahrain's financial services industry. It has established Bait Al Bursa as its Islamic finance division to exclusively offer exchange traded Islamic financial instruments.

“One key advantage of an exchange is that it does not compete with the banks and financial institutions. Instead, its aim is to help the institutions in ways such as increasing accessibility, standardization, and transparency. We believe that exchange traded products such as e-Tayseer can advance Islamic finance to the next level.”

Mr. Arshad Khan, Managing Director and Chief Executive Officer of BFX said: “The uniqueness of BFX is something Bahrain can take advantage of. Not only is it a multi-asset exchange, which means it can offer both conventional cash and derivatives products, it can also offer Shari'a-compliant financial instruments. And with Bahrain being the hub for Islamic finance, it is most appropriate to have the leading Shari'a-compliant exchange hosted

in the Kingdom of Bahrain.”

BFX launched e-Tayseer to facilitate Murabaha transactions between financial institutions, he pointed out. e-Tayseer addresses many existing issues and also improves the way of conducting Murabaha transactions.

“We have worked closely with our Shari'a advisors to ensure the product is Shari'a-compliant, and we are now working to extend the functionality of e-Tayseer to allow for corporate and retail transactions as well,” said Mr. Khan.



## Bahrain outlook stable, says Fitch

Rating agency Fitch has affirmed Bahrain's long-term foreign currency issuer default rating (IDR) at BBB and its local currency IDR at BBB+. The outlook is stable.

The agency has simultaneously affirmed Bahrain's country ceiling at BBB+ and short-term foreign currency IDR at 'F3'.

Fitch said it is encouraged by the establishment of an independent

commission to investigate complaints and analyse the grievances.

On balance, Fitch also considers the National Dialogue a positive development because it eschews violence in favour of consultation.

“Unless there is a serious resumption in violence, in Fitch's opinion, the worst of the short-term economic fallout from the political unrest is likely to have passed,”

said the agency in a statement.

Meanwhile, Standard & Poor's (S&P) lessened the possibility of a potential downgrade of Bahrain's sovereign rating during the quarter by removing it from 'downgrade watch' in light of easing political pressures. S&P expects Bahrain's increased public spending to lift economic growth next year; although the agency assigned a negative outlook due to concerns that political turmoil could re-emerge.

## Pioneering course for financial advisors

The Bahrain Institute of Banking and Finance, in collaboration with the Central Bank of Bahrain (CBB), has launched the Financial Advice Programme (FAP).

It is the first locally customised programme in Bahrain and based on the requirements set out in the CBB Rule Book.

The FAP is endorsed by the CBB as the minimum mandatory qualification for entry level financial advisors in Bahrain and is aimed at professionals who have either recently entered (or have three or less years of relevant work experience), or are aspiring to enter the profession of financial advice. Successful candidates will go on to become members of the Chartered Institute for Securities & Investment (CISI).

Mr. Khalid Hamad, Executive Director, Banking Supervision, at the

CBB commented: "This is an important development in the CBB's stated objective of improving the level of knowledge and understanding which professional financial advisors provide to their clients.

"Financial advisors have a central and critical role in shaping the decisions made by individuals in respect of building a portfolio of assets which is designed to protect their financial future, and often the future of their children. This initiative underlines once again the CBB's commitment to ensure Bahrain continues to be the financial regulator of choice for financial institutions in the Gulf and a safe place in which to invest."

Mr. Gary Muriwai, Director of the BIBF, said: "The BIBF is committed to serving Bahrain's financial sector. As part of this commitment, BIBF's Financial Advice

Programme is aimed at developing a pool of skilled financial advisors for Bahrain which will further strengthen our position as an international centre for financial services."

Mr. Khalid Rashid Al Zayani, President of CISI's Advisory Council in Bahrain, welcomed the initiative.

"Improving the professional skills of those who work in banks and other financial firms is a key factor in maintaining confidence in the system," he said. "Membership of a global professional body will give young Bahrainis a solid foundation for their careers."

Mr. Simon Culhane, Chief Executive of CISI said: "We look forward to welcoming our Bahraini colleagues into our global family, and helping strengthen yet further the Kingdom's resilient financial sector."

## BIBF in e-Learning deal with SunGard

The Bahrain Institute of Banking and Finance (BIBF) has selected US-based SunGard Higher Education to help it deliver training and professional development programmes for Bahrainis in the fast-growing financial services sector.

SunGard Higher Education is a global provider of higher education software and technology services. BIBF will deploy SunGard Higher Education's PowerCAMPUS Digital Campus to help streamline routine tasks by providing an array of 24/7 self-service applications through its e-Portal.

This includes an integrated collaborative

e-Learning solution designed to engage learners and promote interaction through an integrated set of Web 2.0 tools.

Additionally, BIBF will implement SunGard's reporting and analytics solutions to help measure its institutional performance and further enhance efficiencies.

"This is a significant step in our mission to build world-class training and professional development programmes for Bahrainis in the fast growing financial services sector," said Mr. Gary Muriwai, Director of the BIBF.

"We have selected SunGard Higher Education because of their expertise and track record in supporting educational

institutions to deliver on their strategic missions and objectives."

Built on Microsoft technologies, PowerCAMPUS Digital Campus is a complete enterprise resource planning solution designed to help small and mid-sized institutions meet growing demands for improved accountability, performance and productivity.

BIBF's new digital campus will help it manage core and support functions including recruitment, admissions, registration, student records and bill processing, as well as the provision of institutional performance data and operational reporting.

## Rules on transaction advisory service on way

The Central Bank of Bahrain (CBB) recently conducted a study to establish current practices in place by retail banks and financing companies to reduce the risk of fraud or the misuse of credit cards and debit cards. Specifically, these financial institutions were requested to outline what practices if any, were in place, whereby customers would be notified every time a transaction takes place on their account by way of instantaneous SMS messages.

The study specifically asked whether customers were advised of the following details by SMS every time they used their credit or debit card: Date of transaction; Time of transaction; Name of counterparty

to the transaction; and Amount of transaction (credit or debit).

The findings of this study revealed that for the most part, retail banks and financing companies were either already offering this service to their customers or were in the process of making arrangements for such service to become available.

"Clearly, such SMS messages give strong reassurance to customers so that they are informed of transactions through their bank account or credit card," said Mr. Khalid Hamad, Executive Director, Banking Supervision, at the CBB.

"The CBB considers such SMS

messaging as a sound business practice to protect the consumer and is an important tool in the prevention of fraud or the misuse of debit and credit cards."

As a result of this study, the CBB is putting in place new requirements for all retail banks and financing companies.

These financial institutions will be required to provide transaction advice service to their customers, free of charge, through SMS for all types of local and international financial transactions on credit and debit cards by no later than 31 March 2012. The new requirements are to be included in the October 2011 update for Volumes 1 and 2 of the CBB Rulebook.

## Financial Sector Fact Sheet

Regulator:	Central Bank of Bahrain
Financial Institutions:	409 (Aug 2011)
Financial Sector Workforce:	14,137 (2009)
	Bahraini nationals 9,313 (65.9%)
	Foreign nationals 4,824 (34.1%)
Key Economic Indicators:	GDP (Current) US\$21.9 billion (2010)
	Growth 13.5%
	GDP (Constant) US\$13.6 billion (2010)
	Growth 4.6%
	Financial Sector contribution to GDP 25%
	Sovereign rating BBB (S&P Dec 2010) with negative watch
	BBB (Fitch Dec 2010) with negative outlook
	Population 1,234,571 (2010)
<b>Banking Sector:</b>	Assets US\$196.9 billion (Jul 2011)
	No. of institutions 132 (Aug 2011)
	Retail banks 30
	<i>Locally incorporated 15</i>
	<i>Branches of foreign banks 15</i>
	Wholesale banks 76
	Representative Offices 26
	Bank Society 1
	<b>Islamic Banks</b> (included in above):
	No. of banks 26 (Aug 2011)
	Assets US\$24 billion
<b>Insurance Sector:</b>	Total No. of Insurance Companies & Organisations
	Authorised in Bahrain 173 (Aug 2011)
	Domestic market
	Gross premiums US\$532 million (December 2009)
	No. of insurance firms 38
	Locally incorporated insurance firms 27
	Takaful & Retakaful Firms (included above) 9
	Captives (locally incorporated, included above) 2
	Overseas insurance firms 11
	Insurance Brokers 33
	Insurance Consultants 5
	Insurance Managers 3
	Representative offices 5
	Loss adjusters 11
	Actuaries 26
	Insurance Ancillary Services 3
	Insurance Pools & Syndicates 2
	Insurance Society 1
	Insurance Appointed Representative 7
	Corporate 6
	Individual 1
	Insurance licensees restricted 39
	Insurance Firms restricted 33
	Insurance Brokers restricted 4
	Insurance Consultants restricted 2
<b>Investment Business Firms:</b>	No. of firms 48 (Aug 2011)
	Representative Offices 11
<b>Capital Market:</b>	Market Capitalisation US\$18.242 billion (Aug 2011)
	Licensed Exchanges 1
	Licensed Clearing, Settlement and Central Depository Systems 1
	Licensed Securities Broker - Dealer 2
	Licensed Securities Clearing Member 1
	Stockbrokers 5
<b>Specialised Licensees:</b>	No. of firms 23 (Aug 2011) [comprising: Trust Services Providers 3;
	Reg. Admin 4; Ancillary Services 14; Registrar License 1; Registered
	Professional Body 1]
	Money Changers 18
	Financing Companies 8
<b>Funds Industry:</b>	Authorised Funds 2,829 (Aug 2011)
	NAV US\$8.74 billion (Jun 2011)
	Local Funds 127
	NAV US\$5.18 billion (Jun 2011)
	Conventional-Local 71
	Islamic-Local 56
	Foreign Funds-Offshore 2,702 (Aug 2011)