Rasheed Mohammed Al Maraj: Building a sound framework for the fund management industry

Keynote guest address by His Excellency Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain, at the FundForum Middle East 2008: "Building a Sound Framework for the Fund Management Industry", Manama, 2 December 2008.

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Ladies and Gentlemen:

I would like to thank the organisers of this Second Annual Fund Forum Middle East for their kind invitation to speak to you today. My topic is “Building a Sound Framework for the Fund Management Industry”, and a sound framework involves both macro-economic and micro-prudential elements.

The macro-economic elements are obviously the uppermost in everyone’s thoughts at the moment. The global financial and economic system is currently experiencing what is generally accepted are the worst conditions for the last 50 years. Until only a few months ago, many commentators and analysts believed that the economies of the GCC would be an oasis of calm in the on-going financial turmoil. We also tended to hear a great deal about the so-called “decoupling” thesis. This was the idea that the emerging economies would continue their recent strong growth despite the economic downturn in Europe and the United States.

Following the collapse of Lehman Brothers in mid-September we now know that these scenarios were too optimistic. It has become clear that no part of the world will be immune to the current crisis, and the IMF expects that this will be the first time in fifty years that all of the advanced economies will experience a synchronized recession. This cannot fail to have an impact on the rest of the global economy.

Although the GCC countries enjoy strong fundamentals, we have not been immune to the credit crisis. One consequence of the financial market disruption in the wake of the Lehman collapse was a substantial outflow of dollar liquidity from all of the emerging markets, including the GCC. The liquidity impact of the crisis has also combined with a general risk aversion which has had an adverse impact on the supply of credit to many emerging economies, including to the GCC countries.

As a result of these global financial market developments there have been significant stock market corrections in several GCC countries. Some GCC members have needed to provide support for banking sectors, in the form of recapitalization funds, or by providing blanket guarantees of the deposits, or by a combination of both. There is plenty of anecdotal evidence that the credit is becoming more restricted, and that investment projects are being delayed or scaled back.

Nonetheless, compared with many other regions of the world, the GCC countries remain in a strong position to withstand the current crisis. They now form a $1 trillion economy. In the first five years of this decade an economy the size of Sweden was added to the GCC in terms of aggregate output. The GCC is a net capital exporter, its Governments have surplus fiscal positions, and the GCC countries collectively are one of the world’s largest holders of foreign exchange reserves.

Although oil prices have recently declined sharply from their highs in July of this year, when the price peaked at 147 dollars per barrel, the economic outlook for the GCC remains sound. A range of economic forecasts, including from the IMF, suggest that the GCC can expect economic growth in excess of five percent next year. This will be lower than the 6.5 percent projected for 2008, but would, nonetheless, represent a solid performance when set against the background of current global economic conditions.

At the Central Bank of Bahrain we have been monitoring domestic and international developments very closely. However, our domestic financial markets have continued to function normally despite the enormous stresses of recent months resulting from international events. It is true that domestic liquidity conditions have become tighter, but this has been mainly due to outflows of capital linked to earlier speculation on the revaluation of GCC currencies. Our financial system has shown its resilience by absorbing both large capital inflows and outflows over the past year.

In recognition of tighter domestic liquidity conditions the Central Bank has taken a number of measures to provide additional liquidity to the market. However, we have not seen the need to take exceptional measures to support our banks, which remain liquid and well capitalized.

We will, of course, continue to keep the situation under review and will take appropriate monetary policy and liquidity measures to continue to protect the stability of the markets here in Bahrain.

Ensuring macro-economic stability is, of course, vital for the development of the fund management industry. The measures that the Central Bank has taken to ensure financial stability within Bahrain will continue to provide the conditions within which a vibrant and growing fund management industry needs for its further development.

The second component that the fund management industry needs for its development is a sound regulatory framework. Let me devote some remarks to this subject, as it is an area to which the Central Bank has devoted substantial resources in recent years.

The Central Bank of Bahrain is the single regulator for the financial services sector. We are the only central bank in the region with responsibility for regulating all banking, capital markets, fund management and insurance business under one roof. We have a policy of following international standards very closely, and in the area of Islamic finance, we have been a pioneer in developing prudential standards. We were the first regulator in the world to issue a comprehensive set of regulations tailored to the needs of Islamic financial institutions.

We see the development of the fund management industry as a vital part of Bahrain's strategy to remain the strategic financial hub for the MENA region. Our position was confirmed by the recent announcement that assets under management by Bahrain's mutual fund industry, surged by 73.7 percent to over US 17.2 billion dollars from September 2007 to September 2008. This growth in volume has come from both overseas funds and from mutual funds that are locally incorporated. The locally incorporated funds have been established by domestic and international asset management companies and banks based in Bahrain and abroad.

Although our domestic market is small, many of the asset management firms and banks use their presence in Bahrain as a hub from which to tap into the enormous opportunities that exist in both the GCC and the wider Middle East. These firms also tell us that they are attracted by the maturity and efficiency of our financial markets, and by our comprehensive and transparent regulatory framework.

Bahrain, via the CBB and the Economic Development Board, has actively encouraged inward investment, and the success of this strategy is evident in both the predominance of foreign funds – both regional and international – in Bahrain's capital markets. Of the 2,746 funds registered as of September 2008, 95 percent of them are domiciled overseas. The total assets of all funds are US$17.2, while the total assets of foreign funds are US$ 10.2 billion.

Recent changes that we have made to the CBB Rulebook have increased transparency across all types of investment. Our new rules aim to differentiate between the various categories of collective investment undertakings and to provide appropriate levels of protection for investors. Besides retail schemes, the new regulations also authorize expert schemes which are suitable for medium size investors. Also, the regulations create a new category of "exempt" schemes, under which hedge funds, leveraged buyouts, and other high risk funds could be established.

The creation of the exempt category, in particular, demonstrates that we understand the complex nature of investors' requirements, as well as those of market players. We are determined to offer 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.

These changes promise to be a catalyst for the development of specialist funds, such as hedge funds and other alternative investment products, for which investors have an increasing appetite. Specialist funds are quickly becoming a market niche in which Bahrain is becoming increasingly active.

We have also been developing our Rulebook as it applies to capital markets activities. We have made significant progress in the past year in developing a suitably comprehensive set of regulations for the capital markets, which will be issued as Volume 6 of the CBB Rulebook. The Capital Markets volume will include 13 modules which will contain regulations based on international best practice standards. We have recently finalized the Module on "Markets and Exchanges", and the consultation period for the Module on "Takeovers, Mergers and Acquisitions", ended at the end of October of this year. The Module on "Clearing Settlement and Central Depository", has now been issued for consultation.

I would like to end by mentioning a final development in the capital markets to which we attach great significance. This concerns the agreement that has just been entered into between the Bahrain Stock Exchange and the Singapore Exchange. The agreement between the two exchanges provides a platform for the further development of the Bahrain Stock Exchange, using the world renowned technical expertise of its counterpart in Singapore.

To conclude, in Bahrain we are taking a wide variety of measures to strengthen the framework for the fund management industry. These include: maintaining a sound macro-economic environment, developing our regulatory framework, and enhancing the role of the Bahrain Stock Exchange. Although we may now be entering the down-swing of the global business cycle, there will, I am sure, be many investment opportunities that will continue to arise in the region. As the leading financial centre in the region, Bahrain offers a strong platform from which to access these opportunities.

Thank you for your attention.