Rasheed Mohammed Al Maraj: Supervising Islamic financial institutions – developments in Bahrain

Speech by His Excellency Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain, at the 4th IFSB Summit, Session 1: An Overview on Alternative Regulatory Structures for Effective Supervision, Dubai, 15 May 2007.

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Your Excellencies, Ladies and Gentlemen: Good Morning.

It is a pleasure and an honour to be with you here today, and to see so many people participating in this 4th IFSB Summit. Bahrain was a founding member of the Islamic Financial Services Board, and we very much support its objectives of developing common regulatory standards for the Islamic financial services industry. This task is becoming all the more important, as the industry grows and internationalizes.

Today's panel on alternative regulatory structures is a pertinent one, given the need for effective supervision to underpin a healthy Islamic financial services industry, as well as the development in recent years of new regulatory organizations in the GCC. Of course, innovations in regulatory structures in many developed markets can be traced back to the late-1980s, so experience elsewhere has helped inform many of this region's developments.

I am sure that my distinguished fellow panel members will provide us with useful insights as regards the wider international experience in this area. For my part, I will focus on our own regional experiences, with particular attention to developments in Bahrain, where over the past 5 years we have significantly changed our institutional regulatory landscape, by moving to a single regulator model.

Let me also preface my remarks by stating that they do not explore the issue of whether particular regulatory structures are best suited to Islamic finance, as compared to conventional forms of finance. Suffice it to say that in our experience, we have been able to support the growth of the Islamic finance industry both as a sectoral banking regulator and, now, as a single regulator.

On this issue the key point I believe is that whichever structure is in place, supervising Islamic financial institutions obviously requires specialist knowledge. More importantly, given its nature as a fast developing industry, much attention and focus needs to be placed on putting in place the infrastructure and standards that will help support its growth in a healthy and sustainable manner.

Until a few years ago, then, regulatory structures in the GCC were predominantly sectoral in nature, and Bahrain was no exception. Banks tended to dominate the financial sector and financial intermediation, and they were therefore the primary focus of regulation.

In all cases, responsibility for regulating and supervising the banking sector rested with central banks. This reflected, of course, the pattern typically established around the world, with central banks taking on banking supervision as an extension of their responsibilities for maintaining orderly payment systems and monetary policy.

In most cases, the regulatory mandates of central banks in the GCC also extended beyond banks, to cover certain types of related non-bank institutions (such as money changers and sometimes investment firms). However, insurance supervision was separately regulated by Commerce Ministries, whilst stock markets (and their broking members) were run as self-regulatory organizations.

In Bahrain, the above model changed in May 2002, when the government announced the transfer of regulation of the insurance sector and capital markets to the Bahrain Monetary Agency – the organization which at the time undertook the functions of a central bank and banking supervisor. This process culminated in September last year, with the passage of new legislation and the replacement of the BMA with a new organization – the Central Bank of Bahrain.

This was a far reaching reform, creating the first integrated regulator in the region, and bringing together under one roof both prudential and conduct of business regulation for the whole financial sector. In addition to its comprehensive regulatory responsibilities, the CBB very much remains of course a central bank, responsible for systemic stability (including oversight of the payments system and monetary policy), as well as for other central bank functions such as currency issue, reserves management and the provision of banking services to government.

Other GCC countries, of course, have also initiated a variety of institutional changes. SAMA, for instance, has assumed responsibility for regulating insurance, and a separate capital markets authority has also been established. Both Qatar and Dubai, meanwhile, have established integrated regulators for the separate jurisdictions established inside their territories, although existing regulatory structures largely remain unchanged for the rest of their financial sectors. Qatar, however, recently moved regulation of the Doha stock market out of the exchange, into a separate Qatar Financial Markets Authority.

In short, this region is seeing a period of significant regulatory reforms, reflecting a variety of different approaches. However, they all share a common desire to see regulatory standards increased.

Different countries, of course, need to develop the institutional structures that work best for them, depending on the state of development of their markets and institutional considerations. In our case, we strongly believe that the single regulator model has worked well for us, for a number of reasons.

The key advantage for Bahrain has been the economies of scale and scope that the single regulator model offers. For a relatively small country such as ours, the impact of these economies was significant.

We have been able to utilize scarce specialist resources, such as our on-site examiners, who were previously available only in the BMA, across the different sectors. We have also been able to apply the more extensive supervisory experience and institutional capacity available in the BMA across the other sectors as well. And we have been able to centralize and undertake more efficiently key functions such as policy development.

The net result has been to upgrade significantly the quality of regulation and supervision applied to non-banking sectors, at a time when insurance and capital markets activities are fast developing regionally. In 2005, for instance, we introduced a completely new rulebook for the insurance sector, including the first prudential rules specific to takaful firms; and we followed this up with a completely new rulebook for investment firms in 2006. Now, we are busy upgrading our capital market rules.

Whilst convergence within the financial services industry was a secondary factor, it was not insignificant. In particular, the development of capital markets has obviously impacted on our supervision of financial institutions: creating a single regulator gives us the opportunity to streamline notification and approval procedures for financial institutions undertaking such activity. This is something that we are now actively looking to achieve.

Let me conclude by highlighting what I see as some of the lessons arising out of our experience. First, creating a single regulator can benefit the industry, but only providing the regulator works hard at harmonizing the approaches of its predecessor organizations and internal processes, for instance creating single points of contact at the new regulator for firms. Merely merging organizations is not enough.

Second, combining different regulatory organizations, each with their own corporate cultures and way of doing things, requires a great deal of management attention. Staff need to be motivated and retained, to counter the unsettling nature of change. New systems and processes need to be put in place.

Third, as with most other jurisdictions that have undertaken such reforms, new laws also need to be put in place, which inevitably takes time.

In Bahrain’s case, pending the enactment of a new law in 2006, we were able to make progress by the simple expedient of initially issuing short amendments to existing sector laws, such as our 1987 insurance act – the only change being to transfer regulatory responsibility to the BMA. This allowed us to make a start on integrating the different regulatory organizations early on, even though we continued to operate for a time under different laws for banking, insurance and capital markets.

In short, a single regulator in our experience has offered many benefits – but it is not an instant solution. To be successful, it requires sustained effort and focus over several years. Five years on, we believe we have made significant progress in this respect, but there still remains more to do.

Thank you.