

Anwar Al-Sadah: Bloomberg Discussion Forum “Sharia Alternative Asset Management”

Speech by His Excellency Anwar Al-Sadah, Deputy Governor of the Central Bank of Bahrain, at the Bloomberg Discussion Forum “Sharia Alternative Asset Management”, Sakhir, 22 May 2007.

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Distinguished Guests, Ladies and Gentlemen – Good Afternoon.

It is a pleasure for me to be here with you today, and to be able to participate in this Bloomberg forum on Sharia alternative asset management. I should like to thank the organizers for putting together today’s interesting programme, and very much look forward to interacting with you, the industry, on this topical subject.

I should also like to pass on the apologies of the Governor of the Central Bank, Rasheed Al-Maraj, who was meant to be with us today – but who unfortunately now has to attend a meeting in Kuwait.

I believe this conference is particularly well timed. You need no reminding that the current regional macro-environment remains extremely positive. A combination of high liquidity and moves towards structural reforms has generated high growth rates and, for the first time, significant levels of intra-regional investment. With export revenues at record highs, the GCC countries have been recording current account surpluses larger than China’s for the past three years. In the meantime, inflation has been kept under control.

Not surprisingly, this buoyant macro-economic environment has benefited the financial sector. To quote just a few numbers, financial sector assets in Bahrain grew by over a quarter last year; financial sector employment grew by a fifth; and 51 new financial sector licenses were issued.

Within this overall picture, the Islamic financial sector has continued to develop strongly, beyond its niche status. Increasingly, regional investors are looking to invest in a Sharia compliant manner, providing the products are competitive. They are also being joined by international investors, looking for diversification.

Buoyed by strong investor demand, Islamic investment funds thus currently represent a fast growing element within the Islamic financial sector, albeit from a low base.

Products have proliferated in recent years, with investors now able to place their savings in a wide range of Shari’a compliant funds, including equity, commodity, real estate and Ijarah – i.e. leasing-funds. The growing number of major international financial services firms entering this market, and the establishment of credible Islamic equity benchmarks such as the Dow Jones Islamic market index and the FTSE Global Islamic Index Series, also testify to the firm foothold that this market has now gained.

In Bahrain, Islamic funds currently represent some US\$1 billion in assets, out of the \$9 billion plus invested in CBB-registered funds. In global terms these remain small numbers, of course, but the average annual growth in Islamic fund assets has exceeded 20% a year over the past five years.

Within this broad picture, the outlook for alternative asset management in the region also looks positive, in my view. The excesses experienced in several of the region’s stock markets during 2004-06 have now largely been eliminated. With more realistic valuations and returns now being experienced regionally, international alternative investment managers are able to compete more effectively for regional investors’ attention.

The experiences of the past two to three years have also helped mature the investor base. They are more sensitive to the need for expert managers, and the relationship between risk and reward. Finally, of course, the strong growth in institutional liquidity and private wealth of the past few years has created new demand for alternative investment vehicles.

The CBB has long-supported the investment funds industry in Bahrain, and we are currently working to ensure that the regulatory framework is suited to today’s environment.

Back in the 1990s, Bahrain was the first regional jurisdiction to create a credible regulatory framework for the regulation and supervision of collective investment schemes.

Bahrain's success to date as the region's leading funds centre is a testament to that commitment. As of end-April 2007, 2,294 funds were authorized by the CBB, of which 102 were locally domiciled funds – by far and away the largest concentration of locally domiciled funds in the GCC.

In recent years, various initiatives have been undertaken to facilitate the continued development of this sector.

These have included the streamlining of the authorization and commercial registration process for mutual funds; and the creation in 2004 of a new corporate vehicle – the so-called Special Purpose Vehicle (SPV) – that was better suited to mutual funds than the corporate vehicles previously available. In 2006, a new investment business rulebook was issued, creating a comprehensive and up to date framework for investment business licensees, one better adapted to activities such as asset management, funds administration and custody services.

This year, we have been working on updating our collective investment scheme regulations, first introduced in the 1990s. Whilst they created a strong base on which an investment funds industry could grow, the original regulations were geared towards retail funds and were thus increasingly ill-adapted to the evolution of this sector.

A key objective of the new regulations, therefore, has been to widen the range of schemes permitted. Besides retail schemes, the new regulations will also authorize expert schemes. These will be subject to less restrictive investment guidelines, compared to those applied to retail schemes, but in return will be subject to some limitations as to their investor base.

The regulations will also create a category of exempt schemes, formally recognizing for the first time the likes of hedge funds: exempt schemes will not require authorization, nor will they be regulated. However, exempt schemes may only be sold to institutions and high net worth individuals, and will be required to register with the CBB, in order to allow monitoring of market developments.

These regulations, I am pleased to say, have now been finalized, following the consultation exercise which took place earlier this year, and will be issued by the end of this month. We believe that they represent a significant step forward in the regulatory framework for funds and alternative investment vehicles, and will create a straightforward and proportionate framework within which the industry can work and grow.

I should like to close these opening remarks by noting another important on-going initiative, specifically relevant to Islamic funds. These are the separate projects currently underway between the International Islamic Financial Market, based here in Bahrain, with the international industry associations ISDA and ICMA (the International Capital Market Association).

These projects, which the CBB is actively supporting, are geared at developing a number of standardized Islamic contracts and their associated documentation. It is often said that Islamic finance requires greater standardization in these areas, if it is to continue growing successfully. These initiatives are aimed at doing just that, and will help reduce risks and costs for persons undertaking Sharia compliant transactions.

In conclusion, the region as a whole is experiencing unique conditions. Most obviously, liquidity is extremely high, and with it the associated demand for alternative investments. But for the first time you are seeing real reforms and an opening up of regional markets, creating the opportunity for local investments and local funds, catering to both regional and international investors.

Finally, here in Bahrain, we continue to work to ensure that our regulatory framework remains the best and most straightforward in the region, enabling operators to make the most of these opportunities and best serve investors' needs.

On this note, I should like to thank for your attention, and I look forward to taking your questions.