

Rasheed Mohammed Al Maraj: Corporate governance and Shari'a compliance in Bahrain

Welcome speech by His Excellency Rasheed Mohammed Al Maraj, Governor of the Central Bank of Bahrain, at the AAOIFI (Accounting and Auditing Organisation for Islamic Financial Institutions) Annual Shari'a Conference, Manama, 7 May 2012.

* * *

Excellencies, distinguished guests, ladies and gentlemen, this conference comes at an important time for the Islamic financial sector. This conference is focussing on six key areas that both the standard setters and the financial sector must work together upon if Islamic finance is to continue to grow and achieve its full potential.

So I thought in this Welcome Address I would talk about one area where the Central Bank, as a regulator and as a member of AAOIFI has a special interest. And that subject is Governance.

AAOIFI currently has issued seven standards relating to governance and two standards with respect to ethics. Deficiencies in Governance at financial institutions have been repeatedly highlighted in the past five years following the commencement of the Global Financial Crisis in 2007. Three of the standards issued by AAOIFI specifically refer to governance. The first of these standards concerns the Audit & Governance Committee. In practice, this standard requires the Audit Committee to do rather more than just to review a financial institution's accounting practices and audit plan. It requires the Committee to review the use of Restricted Investment Accounts' funds. It emphasises the need to ensure that funds are invested in accordance with terms agreed with the customer. Too often over the past five years we have seen how the interests of customers at both conventional and Islamic banks have been neglected as bank management have focussed on bonuses and share price. If banks neglect customers' interests, then they will lose those customers. This theme of looking after the interests of customers is carried on in the AAOIFI Governance Principles paper issued in 2005. In particular Principle 3 of this paper warns against inequitable treatment of fund providers. The 2009 AAOIFI Corporate Social Responsibility paper also focuses on dealing responsibly with clients and "par excellence" customer service. If you couple the governance standards with the ethics paper for employees of financial institutions, you find a formidable set of requirements, principles and standards relating to putting the interests of customers first.

So against this background of improving levels of disclosures, the CBB will be making further efforts through its review of its corporate governance and business conduct rules to raise the bar for corporate governance. The review of the CBB corporate governance requirements has already finished its first stage of internal review. The next will be consultation with the financial sector.

Coupled with governance is Shari'a. This is one of the themes of this conference. From the perspective of the CBB as a regulator, we have noted that all too often, the approach of banks, particularly conventional banks has been to start with a conventional transaction or product and then try to give it a finishing coat of Shari'a compliant paint. Financial institutions must not regard Shari'a compliance as the finishing touch to product development. Instead, product development needs to **start** from Shari'a principles: i.e. Islamic financial institutions must become Shari'a **driven**.

And that is why this conference and the next set of consultations by AAOIFI are going to be so important. If financial institutions and standards setters can address the interest of customers, governance and Shari'a compliance satisfactorily then we can look forward to Islamic finance continuing its growth and reaching its full potential.

Thank you.