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The Success Story of Islamic Banking in the Kingdom of Bahrain

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ABSTRACT

Islamic banking and finance has gained a global favor in countries which are dominated by Muslims and also the Non-Muslim countries other alike. The steady growth and acceptance of Islamic finance worldwide is the result of several significant factors, the most significant factor being the practices of Islamic finance being in compliance with Sharia principles. In the case of Bahrain, the role of Islamic banking to transform Bahrain into one of the major financial hub in GCC and MENA region is highly crucial. Islamic banking has created a niche' market for financial products and services that are Sharia complaint in an economy that is already home to a stable and substantial conventional banking system. In this paper, an attempt is made to highlight the role of Islamic banking in Bahrain and the factors that contribute to its worldwide expansion. The important organizations that are hosted by Bahrain which are crucial to the growth of Islamic banking and financial institutions worldwide are also discussed in detail.

1. Introduction

The advent and progress of Islamic banking and finance has been a steady process which has been substantiated through convention, regulation and edification in the Kingdom of Bahrain. The structural framework that is required to set up an assertive system to oversee that banking operations are carried out in a manner that are on par with international benchmarking standards and meet industry needs has been put in place.

Bahrain is one of the first countries to have welcomed Islamic Banking. Bahrain is also home to most of the Islamic scholars who help to conceptualize and improve the financial products as per the principles of Islamic banking. In the recent times, Bahrain has emerged into a world leader in the field of Islamic banking through hosting the largest group of Islamic financial institutions in the GCC. In addition, to playing host to numerous Islamic finance organizations, Bahrain also houses several significant organizations that are vital in the improvement of Islamic finance such as the Liquidity Management Centre, the Islamic International Rating Agency etc. The role of these organizations has been discussed in detail in the following section of this paper.

2. Objectives

1. To study the banking structure in Bahrain and the roles and responsibilities of Central bank of Bahrain.
2. To highlight the Islamic banking evolution in Bahrain and the factors contributing to the growth of Islamic Banking.
3. To review the existing governing bodies in Bahrain which regulate the Islamic banks according the Sharia law

3. Banking structure in Bahrain

Bahrain is home to not only the old traditional banks but also many Islamic banking institutions, which comprise the major segment of its economy, adding up to 85% of its total assets of financial nature. There are 23 retail banks, 69 wholesale banks, 2 specialized banks and 36 representative offices of overseas bank in the conventional banking segment. Additionally, there are 6 retail banks and 18 wholesale banks that offer Sharia compliant financial products and services in the Islamic banking segment. The banking sector assets are valued at US $ 188.7 billion as on November 2017. The financial sector contributed to 16.1% in overall GDP of Bahrain showing a major contribution from the financial institutions like banks and insurance companies.

All these banks operating under conventional banking principles or Islamic banking principles are governed by Central Bank of Bahrain. These banks are licensed by CBB and should follow the rules and regulations as fixed by CBB.

4. Central Bank of Bahrain (CBB) - Its role and responsibilities

The Central Bank of Bahrain (CBB) was established by the Financial Institutions Law 2006 in order to maintain stability, both monetary and financial in the Kingdom. It is also responsible for regulating the financial industry of Bahrain. Issuing licenses and supervising banks, insurance service providers and all other financial service providers are part of the CBB's duties. It also plays the role of Listing Authority for companies and monetary instruments and regulates conduct in the capital market of Bahrain.

Maintaining perpetually stable and sound financial markets and institutions is the prime aim of the CBB. According to the CBB, financial stability is defined as a state of affairs where the process of providing financial services is both prudent and continuous even in the case of unfavorable situations. Such financial stability is believed to be the contributing factor to

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maintaining the position Bahrain holds as an international financial hub and for ensuring the contribution of the banking sector to the growth and development of Bahrain. For achieving this, the CBB continuously monitors the financial system for identifying areas of concern, conducts research and analyses key issues.

Furthermore, CBB has recently initiated the setting up of a special fund called 'The Waqf Fund'. This will finance the education and training in the field of Islamic banking along with the research. It is actively involved in enhancing industry standards and standardizing the market practices in partnership with the stakeholders.

5. Evolution of Islamic banking in Bahrain

In the past 3 decades, the evolution, growth and expansion of Islamic banking has been exponential across the world. In many countries, it has become one of the rapidly growing segments of the economies. In Bahrain, owing to its extensive heritage and perseverant approach, Islamic banking has shaped Bahrain into a major financial hub in the Middle East. The Organization of the Islamic Conference (OIC) is an organization established as part of an inter-governmental effort of 56 states that collaborate for ensuring the welfare of the worldwide Muslim community. As a result of the recommendation made by OIC in 1978, the Islamic banking concept flourished worldwide.

The Bahrain Islamic Bank which began its operations in the year 1979 is the first Islamic bank in the Kingdom of Bahrain. Its success led to the development and provision of customized Islamic financial products in leasing, loans, investment schemes etc. Though the progress of Islamic banking was slow in the following years, its distinctive features and adherence to Shariah principles led to a steady growth.

6. Factors contributing to growth of Islamic Banking

The growth of Islamic banking on a global level can be attributed to several factors. The morals, on the basis of which it operates and lower levels of risks associated have earned a lot of praise for Islamic banking. Following are the significant factors that have contributed to the growth of Islamic banking:

6.1 Muslim population

The rise in the population of Muslims in the non-Muslim countries has led to the increased demand for establishing and developing the financial products and also the financial services that are Sharia compliant. This resulted in increased and far-reached awareness about the concept of Islamic banking. Consequently, even the non-Muslim countries have come to understand and accept the system of Islamic banking and finance as one that can cater to the financial needs of the population.

6.2 Globalization

Globalization has led the world toward a more open-minded approach about concepts that are relatively new. Though Islamic banking is not a new concept, its adherence to the principles of one religion alone has created a significant level of skepticism. However, the world is now one unified market place and hence, satisfying the needs of all communities or groups has become tantamount to the success and advancement of every economy. This has, in turn, led to the acceptance of Islamic banking in several non-Muslim countries.

6.3 Coexistence

In Muslim as well as non-Muslim countries, Islamic banking and finance is viewed as a significant equivalent of the conventional banking system. Rather than posing a threat to the existence of conventional banks, Islamic banks caters to the needs of the segment of an economy which does not use the services of the conventional banks for its non-compliance with Sharia principles. This peaceful coexistence with the conventional banking system has increased the attractiveness of the Islamic banking system as a viable alternative.

6.4 Gulf influence

The dominance that the Gulf countries possess over the oil reserves of the world is one of the major factors that led to the sustained growth of Islamic banking on a global level. The Gulf States strictly adhere to conducting all financial transactions in a manner that is in accordance with the Sharia principles.

6.5 Green financing

Islamic banking offers a Green financing platform in order to promote socially responsible investments in addition to completely restricting the participation in business activities that involve alcohol, pork, gambling etc.

6.6 Shared responsibility

Islamic laws do not oppose the accumulation of wealth, however, emphasize on exercising awareness among investors about sharing responsibility for dealing with worldwide poverty. The concept of Zakat is aimed at reducing economic disparities across the world through donating wealth for charitable purposes.

7. Important organizations significant to the development of Kingdom of Bahrain in the field of Islamic finance:

7.1 Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which was set up in Bahrain in 1991, is an internationally leading non-profit organization. The AAOIFI is mainly responsible of developing standards for the worldwide Islamic banking and Islamic finance industry. It issued 100 standards in the Sharia areas of accounting, governance, auditing and ethics of global Islamic finance. These standards are being followed by renowned Islamic financial institutions from around the world and therefore, a progressing level of harmony in international Islamic finance practices has been established. In addition, the AAOIFI offers Professional qualification programs like CIPA and CSAA for enhancing the human resource base and governance structures of the industry.

7.2 LMC (Liquidity Management Centre)

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The Liquidity Management Centre, an Islamic Investment Bank, was incorporated in July 2002 in Bahrain and is regulated by the Central Bank of Bahrain. It is aimed at providing optimum solutions for Islamic financing and investments that contribute towards the growth of the Islamic capital market. It is involved in the delivery of innovative Sharia compliant short and medium term financial instruments in both the primary and secondary Islamic finance markets.

7.3 IIFM (International Islamic Financial Market)

Under the Royal Decree Number (23), in 2002, the International Islamic Financial Market (IIFM), a non-profit infrastructure development institution, hosted by the Central Bank of Bahrain, was established in Bahrain. The Islamic Development Bank, Autoriti Monetari Brunei Darussalam, Bank Negara, Bank Indonesia, Central Bank of Bahrain and the Central Bank of Sudan collectively put in efforts for the establishment of the IIFM. In addition to the founding members, the Dubai International Financial Centre Authority, State Bank of Pakistan, The National Bank of Kazakhstan and several other regulatory bodies and government bodies support IIFM. The IIFM strives to create and promote awareness about Islamic banking and finance through facilitating seminars and technical workshops.

7.4 IIRA (Islamic International Rating Agency)

The Islamic International Rating Agency (IIRA), an infrastructure institution for supporting Islamic banking and finance, began its operations in 2005 in the Kingdom of Bahrain. The role of IIRA necessarily involves providing independent assessments to both issues and issuers concerning Islamic finance. Developing local markets and providing momentum through rating of ethics based finance are its prime focal points. Transparency, integrity, quality and independence are its core values. The Central Bank of Bahrain (CBB), the Central Bank of Jordan (CBJ) and the Banking Regulatory and Supervisory Agency (BRSA) in Turkey officially recognized IIRA as an approved External Credit Assessment Institution (ECAI).

7.5 Shariya Review Bureau (SRB)

The Shariya Review Bureau (SRB) is an independent services provider relevant to Sharia review and compliance. It has been granted license by the Central Bank of Bahrain to operate under the “Ancillary Service” license category. The SRB is a member of the AAOIFI and it mainly reviews and analyses corporate transactions and activities of Islamic finance institutions to ensure conformance to Sharia laws.

8. Conclusion

According to the Islamic Finance Development Report and Indicator (IFDI) by Thomson Reuters, Bahrain has been ranked second on a global level and first in the MENA region. The Islamic Corporation for the Development of the Private Sector (ICD) which is an important arm for the development of Islamic finance by Islamic Development Bank has also given the same rank for Bahrain. Bahrain is at the foremost position in the International Islamic Financial Services (IFS) industry. The Islamic banking industry in the Kingdom of Bahrain has been continuously on the rise and serves both domestic and international markets with Sharia compliant financial products and services.

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