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## **Mutual Fund Investments in Bahrain: An Overview**

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**Abstract:** *Bahrain is a host to a thriving Mutual fund industry since 1980 when the first overseas mutual fund was introduced in the Kingdom. Transition to greater openness, diversification and modernization as strong foundations of economic freedom, freedom to repatriate and transfer profits and capitals, freedom to import and export local and foreign currencies, hosting the GCC Commercial Arbitration Center and the like have greatly facilitated the kingdom in attracting the local and foreign investors. Given the history and regulatory framework in Bahrain, the financial authorities see the industry as an ideal niche market for the future. This paper presents a portrait of the growth and the future of mutual fund investments in the Kingdom of Bahrain*

**Keywords:** *Mutual funds, Investments, Assets under Management.*

### **1. Introduction**

A Mutual fund is a trust that pools the savings of a number of investors' who share a common financial goal. Mutual fund is a common vehicle that pools the savings of funds that are collected from the investors for the purpose of investment in securities such as stocks, bonds, money market instruments and similar kind of assets. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors. A mutual fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus. One of the main advantages of mutual funds is that they give small investors access to professionally managed, diversified portfolios of equities, bonds and other securities, which would be quite difficult to create with a small amount of capital. Each shareholder participates proportionally in the gain or loss of the fund. Mutual fund units, or shares, are issued and can typically be purchased or redeemed as needed at the fund's current Net Asset Value (NAV) per share, which is sometimes expressed as NAVPS.

### **2. Kingdom of Bahrain: A Snapshot**

Bahrain, one of the strongest economies in the Middle East which has a clear edge as a financial services jurisdiction, has always remained the hub for financial services in the region. According to the report of "The Heritage Foundation's 2014 Index of Economic Freedom", Bahrain remains the most economically free country in the Middle East and North Africa (MENA) region. Bahrain's economic freedom score at 75.1, making its economy the 13th freest in the 2014 Index first out of 15 MENA region countries. The report highlighted that Bahrain has maintained above-average levels of economic freedom in almost every measure included in the Index and remains a financial nerve center for dynamic economic activity, with high levels of trade and investment supported by a competitive and efficient regulatory environment.

The Kingdom of Bahrain enjoys the components and the expertise necessary to understand the needs of national or international investors. This includes competitive prices, increased accessibility to the GCC market worth more than 1.4 trillion USD and the remaining countries of the Middle East in addition to the modern infrastructure and labor legislations. As Bahrain's 2030 Economic vision aims at improving the competitiveness of the national economy, it greatly relies on the investment climate in the country. The Kingdom of Bahrain is therefore committed in providing and bolstering the advantages it already enjoys in order to become the most attractive business and investment hub in the Middle East ( e-Government portal)

Transition to greater openness, diversification and modernization as strong foundations of economic freedom, freedom to repatriate and transfer profits and capitals, freedom to import and export local and foreign currencies, hosting the GCC Commercial Arbitration Center and the like have greatly facilitated the kingdom in attracting foreign investors. Furthermore, at a broad level, there is a strong awareness in the country's financial community that Bahrain will never return to the position it held just a few years ago, when it was virtually alone as a large financial centre in the Gulf and Middle East region. In addition, Bahrain's open market environment climate have resulted in low average tariff rate and relatively few non-tariff barriers, no restrictions on repatriation of profits or capital, no exchange controls, and no restrictions on converting or transferring funds, whether associated with an investment or not, and thus have attracted both investors and companies. This can be evidenced through the stock market capitalization in the region that have accelerated from 2.9 (BD Billions) in the year 2002 to 7.0 (BD Billions) in the year 2013(Economic Indicators, Dec 2013, No-42).

Given the history and regulatory framework, focus is therefore being put on making Bahrain the mutual fund centre for the region. This is both for conventional funds, as well as Islamic mutual funds. The structure is well-suited to sharia-compliant instruments,

because of its shared-risk, shared-reward nature. With Bahrain keen to develop its Islamic financial industry, this adds purpose to the desire to expand the mutual fund market.

### 3. Mutual Fund Investments on Bahrain

Of the various investment avenues, mutual funds investments always have attracted the investors around the globe. Mutual funds put forward a way out to investors to approach most schemes and get well-diversified portfolio because investors with small savings neither have sufficient expertise nor have access to required diversification. In addition, Mutual funds as blessed with professional management use their diligent skills for efficient resource allocation by making markets more efficient, bringing transparency and foremost important risk management.

As the most economically free country in the Middle East, Bahrain is a host to a thriving Mutual fund industry since 1980 when the first overseas mutual fund was introduced in the Kingdom. The first overseas mutual funds were marketed in Bahrain during the 1980s, and the first Bahrain domiciled scheme was launched in 1984, long before most other Gulf countries even had stock exchanges. The Central Bank of Bahrain (the CBB) is the principal regulator of the investment funds industry in Bahrain. In 1992, Bahrain was one of the first countries in the region to produce formal regulations for collective investments schemes, and since then the industry has grown at an increasingly rapid pace (The Report: Bahrain 2007). Funds in Bahrain are generally referred to as Collective Investment Undertakings (CIUs). The funds normally launched are of two kinds:

#### 3.1. Open-Ended Funds

Allows the investors to redeem their interest in the fund (units) and also allows prospective investors to purchase units during the tenor of the scheme at the net asset value of the scheme prevailing on the date of redemption/purchase.

#### 3.2. Closed-Ended Funds

These are CIUs with a limited number of holdings. New holdings are rarely issued after the fund is launched and are not normally redeemable until the fund is liquidated. Typically, an investor can acquire or dispose of holdings in a closed-ended fund by buying or selling them on a secondary market, from a market intermediary or another investor, rather than by dealing with the CIU itself. Open-ended funds and closed-ended funds in Bahrain may be organized as unit trusts, investment trusts, mutual funds, SICAV and collective investment schemes

### 4. Growth of Mutual Fund Investments in Bahrain

Development of a fund industry is only possible in mature capital markets, because they need an existing array of stocks, bonds and other commodities in which to invest. In Western industrialized countries, mutual funds often account for more than 60% of equity market capitalization, where as in the Gulf, the figure is, at best, 5%, largely as a result of the limited nature of existing capital markets.( The Report, 2007). Apparently this percentage entails a huge potential for the growth of mutual fund investments in the Gulf region. The rapid growth of new regional financial centers, led by Dubai and including Doha, Abu Dhabi, Kuwait and Riyadh has led to a huge diversification of markets across the Arabian Peninsula. Many in positions of authority believe that the development of niche markets is the way forward as opposed to endeavoring to be financial generalists.

#### 4.1. Asset Management

The fund management industry in Bahrain traces its origins to 1980s, with the first locally incorporated fund established in 1984. The Kingdom has established itself as an important fund management hub in the region since its inception. According to the CBB, there were 2,811 funds being managed in Bahrain as of 1Q13(including open-end and close-end funds), 0.75% more than the total of 2,790 funds a year before. The total net asset value (NAV) of funds remained fairly unchanged at around USD8.4bn in 4Q12 (USD9.2bn in the previous year). According to consolidated data from the CBB, there were 127 Bahrain-domiciled funds at the end of 2011, with USD5.0bn in total assets, whereas foreign funds totaled USD3.4bn (invested across 2,711 funds). Reflecting the importance of Islamic finance, Bahrain was home to 101 Shariah-compliant funds, with assets totaling USD1.7bn (locally domiciled and foreign funds). (Bahrain Economic Year Book, 2013)

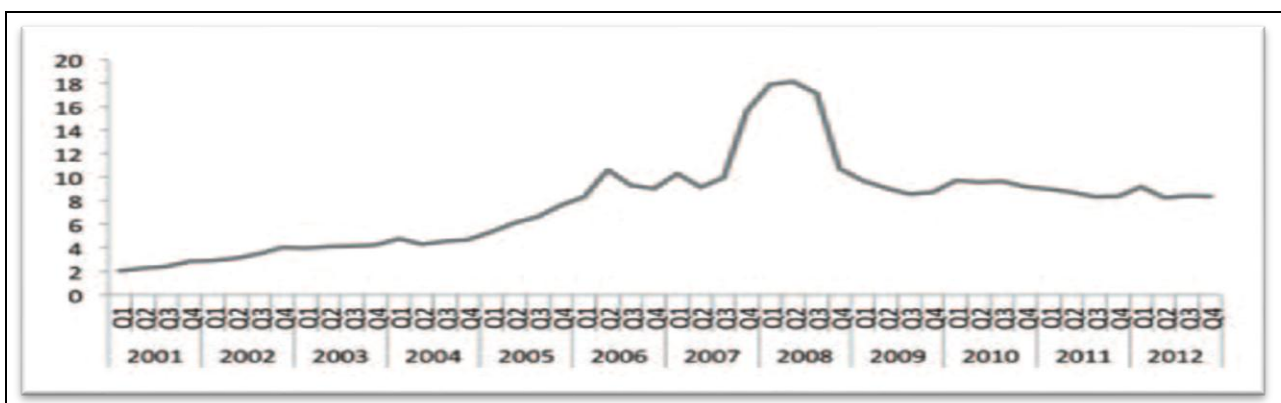


Figure 1: Total mutual fund assets under management in Bahrain (USD bn)

Source: Bahrain Economic Year Book 2013

Given this background there are large numbers of funds issued and traded in the kingdom; financial authorities see the industry as an ideal niche market for the future. The Bahrain fund industry experienced rapid growth during the economic boom of the past decade. Aggregate assets under management surged 308% to USD8.4bn from USD2.1bn between 1Q01 and 4Q12. However, the historic peak to date for assets under management was attained in 2008 when it reached USD18.1bn. Subsequently, reflecting global trends, a sharp correction was observed in 2Q08 and 2009. Despite the downward pressure on total fund assets due to the global crisis, the number of mutual funds distributed for sale in Bahrain consistently rose from 2004 to 2011. On the other hand, the number of new fund registrations has been declining since 2006, when it reached the highest level of 80 funds within the year. (Bahrain Economic Year Book, 2013). The total number of schemes constitutes 2824 with the total investment 6866 U.S million dollars as of Dec 2013. The growth in the total number of mutual funds in the Kingdom of Bahrain in depicted in the Figure 2 below.

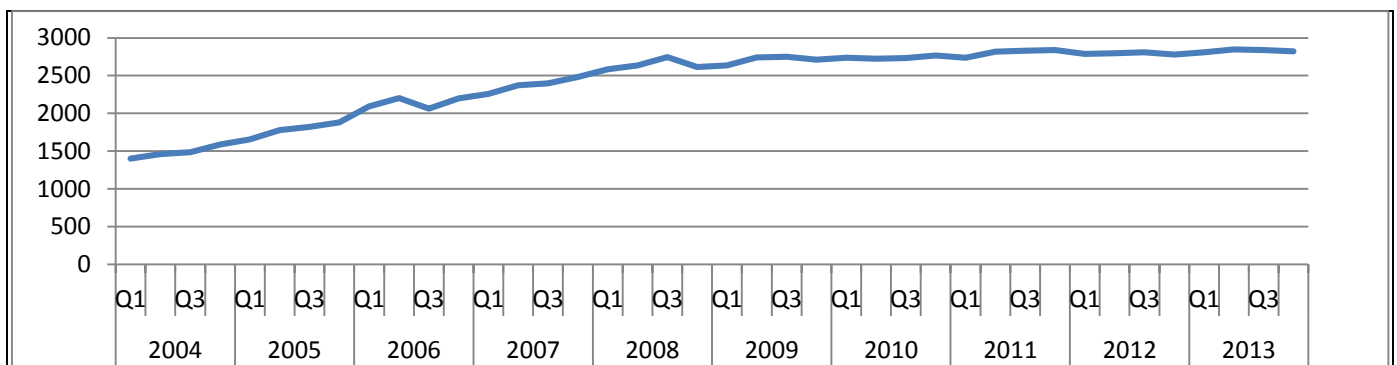


Figure 2 : Number of mutual funds in Bahrain

Source: CBB Statistical Bulletin

It could be evidenced from the above Figure that the numbers of mutual fund in Bahrain have been accelerated with 1588 funds in 2004 to 2824 funds as on 2013 showing an increase of 78% through these years. The total number of mutual fund schemes includes the locally incorporated funds, foreign funds and Islamic funds. Along with the total number of mutual fund schemes, the sharia based funds are also slowly gaining ground in the market.

By realising the increasing thrives for mutual fund, the Central Bank of Bahrain revamped the Collective Investment Schemes in 2007 which was first issued in 1992 and issued the CIU module within CBB Rulebook Volume 6. As a result, the number of mutual funds registered with the CBB rose to 2,819 funds at the end of June 2011, compared to 2374 funds in June 2007. The net asset value (NAV) of those funds totaled US\$8.7 billion. The number of Bahrain domiciled funds totaled 127 funds as of June 2011, compared with 108 funds in June 2007. Of the total assets of the mutual funds industry, assets of such funds rose to US\$5.2 billion in June 2011 up from US\$3.7 billion in June 2007.

YEAR	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Q1	4,786.86	5,365.83	8,333.65	10,302.94	17,887.73	9,685.41	9740.6	8994	9174.1	7333
Q2	4,320.61	6,148.69	10,604.71	9,146.40	18,116.58	9,070.92	9555.8	8737.4	8244.4	7459.1
Q3	4,546.12	6,646.78	9,293.74	9,943.66	17,099.83	8,548.69	9633.19	8324	8393.7	6863.1
Q4	4,717.33	7,658.50	9,033.97	15,605.24	10,726.46	8,733.40	9,172.90	8378.2	7632.8	6,866.40

Table 1 : Total Investments In Mutual Funds (Usd Million)

Source: CBB Statistical Bulletins

As it could be seen from the above table, the total investments in mutual funds have accelerated from 4,717.33 US million dollars at the end of 2004 to 9,033.97 US million dollars at the end of 2006 manifest an increase of 62% growth rate in 2005, 18% in 2006 and a remarkable growth rate of 73% in 2007. Bahrain is of no exception to the turmoil of Global Financial Crisis in 2008-2009 which had its impact greatly on its financial sector leading to dropping of stock markets as happened worldwide. the global financial crisis which threatened the total collapse of financial institutions damaged investor confidence had an impact on global stock markets had its impact on the kingdom of Bahrain where the total investments at the end of the year 2009 slowed down to 8733.40 USD million as compared to the total investment of 10,726.46 USD million dollars at the end of 2008 leading to a decrease of 19%. Amid of the aftermath of financial crisis, the kingdom had recovered slowly and tries for a sustained its growth. Sector wise investments in mutual funds as individual and institutional investors in Bahrain are depicted in the Figure 3 below.

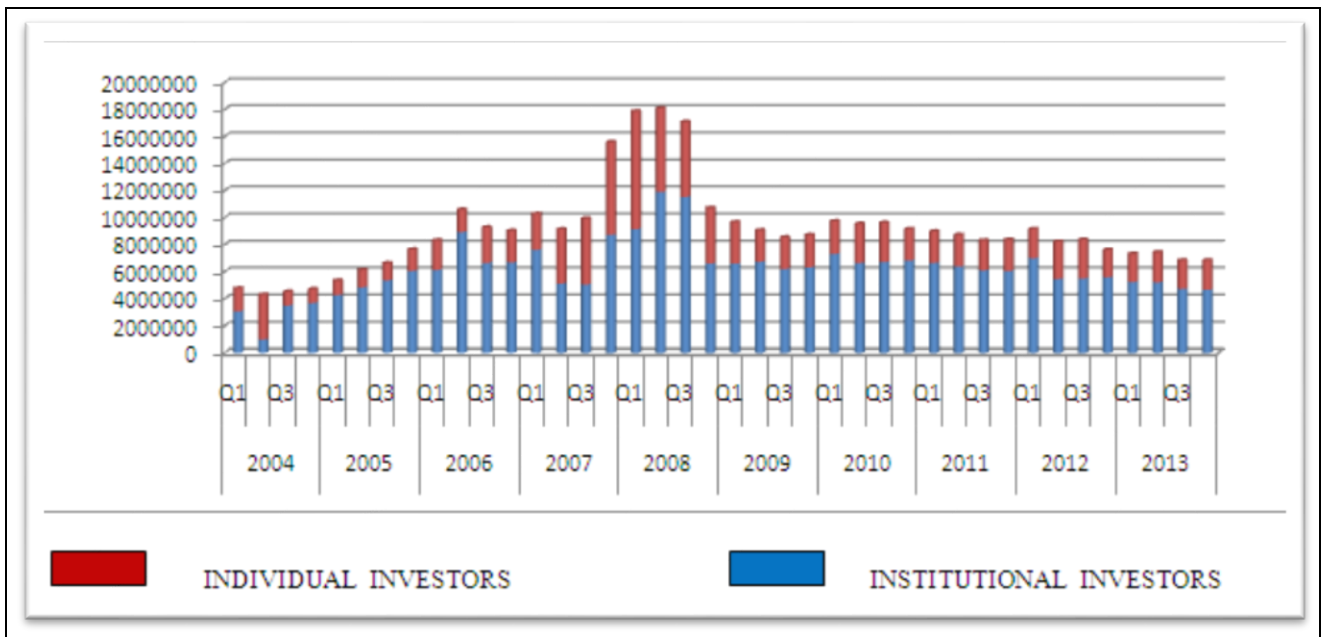


Figure 3 : Individual and Institutional Mutual Fund Investments  
Source: CBB Statistical Bulletins

As it could be seen from the above Figure 3 that the total amount invested by both the institutions and individual investors were in a rise from the year 2004 till 2008. The institutional investment increased by nearly 65% in 2005 as compared to 2004 and showed a 30% increase in 2007 compared to 2006. Nonetheless the individual investments also increased 55% in 2005 as compared to 2004 and manifested a prodigious growth rate of 194% at the end of 2007. The global financial crisis which collapsed the investors' confidence during 2008 made the mutual fund investments to dropdown to nearly 42% in 2009.

During 2012, mutual fund investments to institutional investors witnessed an increase while investment to individual investors had a drop (Figure 4-6). Amounts invested in by institutional investors increased by 2.1% from USD 6,055.1 million in 2011 to USD 6,180.0 million in 2012. In contrast, individual investments have shown a different pattern during the year. During 2012, individual investments in mutual funds fell by 5.8%, from USD 2,323.1 million in 2011 to USD 2,187.7 million in 2012 mainly due to a 53.5% decrease in individual wholesale bank investments in mutual funds (CBB, Economic Report 2012).

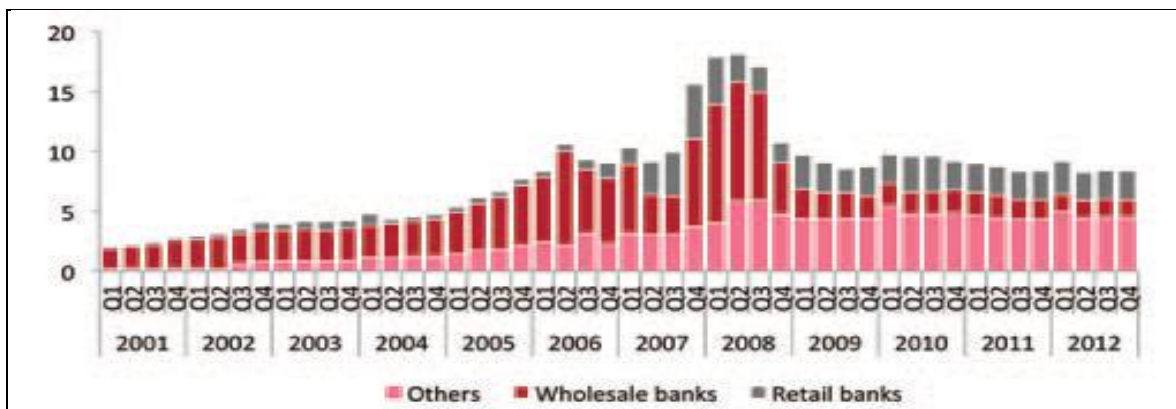


Figure 4: Mutual fund investments – Total assets by distributor (USD bn)  
Source: Bahrain Economic Year Book 2013

With regard to the distribution of funds in Bahrain, retail and wholesale banks recorded a decline in total assets managed after the financial crisis. As of December 2012, the fund assets of retail banks increased by 1.8% YoY to USD2.4bn, whereas wholesale banks experienced a 13.6% YoY drop to USD1.5bn. Assets in funds distributed by other institutions, including representative offices, grew by 4.2% and totaled USD4.5bn. (Bahrain Economic Year Book, 2013)

In the wake of global economic recession the Central Bank of Bahrain increased its scrutiny over the funds regime to improve the investor confidence, reduce the risk exposure, and to promote good corporate governance. On April 1, 2012 the Central Bank of Bahrain replaced the rules within CBB Rulebook Volume 6 with a far more comprehensive set of rules and regulations in a separate Volume 7 titled as Collective Investment Undertakings (CIUs). Volume 7 enhanced the existing rules and regulations, with regards to authorization and/ or registration and regulation of Bahrain Domiciled CIUs and Overseas Domiciled CIUs that are offered and marketed to investors and residents in the Kingdom of Bahrain. It provides comprehensive details with regards to the fund disclosure and documentation requirements, as well as the respective role, rights, obligations, and responsibilities of the

relevant parties to a fund scheme. Volume 7 also makes provision for Shariah compliant ICUs as well as traditional ICUs. Furthermore, Volume 7 also expands the variety financial products by introducing the Bahrain Real Estate Investment Trusts (REITs) and Private Investment Undertakings (PIUs). REITs' objectives are to acquire, hold, administer, manage and sell income generating local and foreign real estate properties whether directly or indirectly. Private Investment Undertakings are new breed of investment funds with a high degree of flexibility in structuring, aimed basically to facilitate private investments, the like of a family held investment, single investor or a single investment type. PIUs have greater flexibility in structuring and are subject to limited regulatory and supervisory requirements to cater for private investments. In view of the associated risks, this type of scheme can only be offered to High Net Worth Individuals and Institutional investors and has a minimum investment threshold of USD 3 million (or its equivalent in any other currency)( Zaid Khonji ,2012).

##### 5. Future of Mutual Funds Investments in Bahrain

- The future growth of the global fund market is intended to tap into several regional trends. The first is a sudden interest in the Middle East by global institutional investors. For most of the region's history stock markets have been small and listed companies sparse and lacking in transparency. The region has been seen as having no industry, and the most important economic sectors are largely held by the various governments of the region. Therefore, for global investors, the Middle East was not even on the emerging market map, with funds going instead to Asia, South America and Eastern Europe. However, the situation has changed in recent years. There has been a sharp growth in large private-sector industrial and service ventures, specifically in the telecoms industry, real estate and finance. At the same time, many of these ventures have been listed on local stock exchanges. Prices are relatively cheap; transparency is better than it used to be and, as a result, many global funds are pouring money into Gulf equities for the first time. But markets remain illiquid, meaning there remains concern as to whether investors can liquidate their holdings easily. The answer, according to market authorities in Bahrain, is to quickly expand the mutual fund market in the kingdom, thus allowing a vast range of funds to be established and for Western institutional investors to take stakes in key regional equities, while having the liquidity associated with funds so that they can both spread their risk and enter and exit the market more easily. For this reason there is a particular focus on development of expert funds, to give institutional investors access to very narrow niche sectors (The Report: Bahrain 2007).
- As per the report of PWC, it is predicted that Assets under Management (AuM) in the Middle East and Africa will rise to \$1.5 trillion by 2020, from a 2012 total of \$0.6 trillion. This represents a CAGR of nearly 12%. The report also highlighted that penetration of the Asset Management (AM) industry in MENA is still low compared to global markets; mutual funds under management in 2012 was around 2.5% of market capitalization hence there is huge potential available to local and international players. It is worth identifying that MENA based high net worth individuals (HNWI) are moving their wealth back from developed markets to the region; AMs and private banks have doubled their share of assets in the past decade. Furthermore, PwC has seen interest from foreign private banks to set-up operations in the GCC following strong economic fundamentals. Bahrain as among the most liberated country in the Middle East, the waiving of taxes on private companies, in addition to the freedom of capital transfer offers a very good platform for mutual fund investments. In addition, Bahrain enjoys a unique record as the oldest and most developed international business economy in addition to a financial services sector that flourished over the past forty years is expected to continue the same in the future makes it among the most advanced Gulf financial markets according to the 2011-2012 World Competitiveness Report issued by the World Economic Forum.
- According to the KPMG report, the regulatory frameworks in Bahrain provides opportunities to local investors to obtain exposure to investment opportunities all over the world based on the overseas fund they invest in.
- To attract local and foreign investors, Bahrain Mutual Fund Industry also expands the variety of funds to that can be established in Bahrain, by introducing rules governing Real Estate Investment Trusts (REITs) and Private Investment Undertakings (PIUs). Private Investment Undertakings are new breed of investment funds with a high degree of flexibility in structuring, aimed basically to facilitate private investments, the like of a family held investment, single investor or a single investment type.
- The Islamic finance industry is enjoying explosive growth with increased product innovations around the globe. The number of Islamic funds globally has increased to 1,057 with 8 new funds having been set up during the first quarter of 2014. As at 17 March 2014, the global Shari'a compliant asset management industry has reached USD73.8bln in assets under Management (AuM), up 3.0% from end-2013's USD71.6bln and 10.3% from USD66.9bln at end-2012. The report by Kuwait Finance House on "Islamic Finance 1Q2014 Performance Review" have highlighted that the first quarter of 2014 has been broadly positive for the Islamic industry as some countries such as Bahrain and Pakistan. According to Thomson Reuters, Bahrain ranks second globally in Islamic finance development, behind only Malaysia, and first worldwide in terms of Islamic finance governance and corporate social responsibility. In lieu with this, the Central Bank of Bahrain has issued the Module on Issuing and Offering of Securities and Sharia-compliant Sukuk (OFS Module) offered through public or private placements in or from Bahrain, as a part of Volume 6 Capital Market Rulebook. The OFS Module contains detailed rules and regulation that covers the issuing, offering, floating and subscribing to different types and classes of securities, including Sharia compliant securities. In keeping with Bahrain's leadership in Islamic finance, the CIU rules also provide a solid foundation for the establishment and management of mutual funds that comply with Sharia principles. These hosts of factors create a favouring climate for Bahrain to become an ideal destination for Islamic funds.

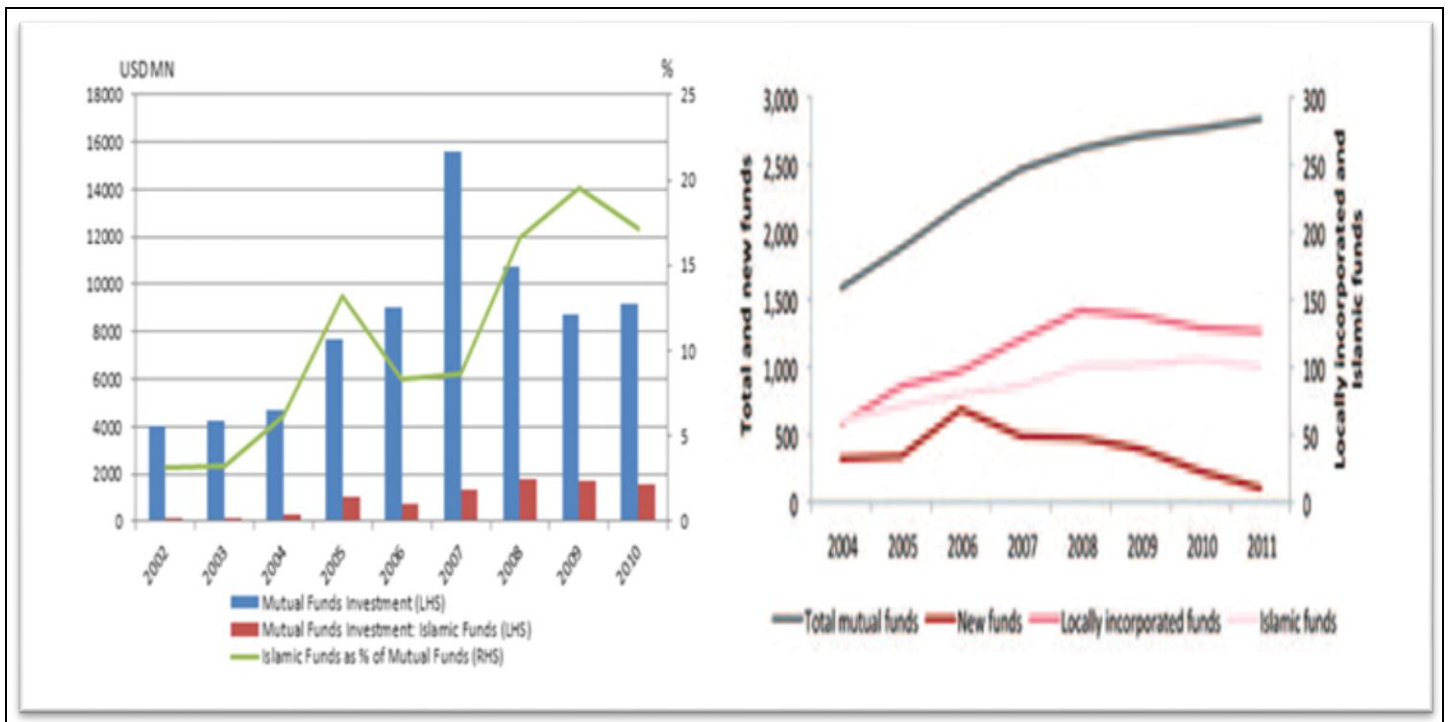


Figure 5 : ISLAMIC FUNDS

(a)Source : CEIC, 2012 (b) Source : Bahrain Economic Year Book 2013

Bahrain has become the ideal destination for Islamic funds as it is the first country in the region to establish a finance industry over 40 years ago and a pioneer of Islamic finance. Islamic fund industry grew by 78.5% to reach 1.3 billion USD by the end of 2010, invested through 86 funds, compared with 752 million USD and 80 funds in 2006. As of June 2011, there are 101 Islamic funds with total assets of 1.6 billion USD. On the other hand, the number of Bahrain domiciled funds totaled 127 compared with 108 funds in June 2007. Assets of mutual funds rose to US\$5.2 billion in June 2011, up from 3.7 USD billion in June 2007. In general, the Islamic funds industry has shown a significant increase from about 3% in 2002 to about 17% in 2010 as a division of the total mutual funds.(CEIC, 2012)

- Another key factor driving fund growth has been a change in the attitude of retail investors in the Gulf. Through 2005, many poured their savings into stocks across the region. They initially earned high returns, but the crash of 2006 wiped away profits for many, leaving painful losses, especially among those who had taken a punt on small, unknown companies that had seen fast share-price growth. Analysts say these investors are now seeking a way to put a toe back in the water, but with a lower level of risk. For them, mutual funds are seen as a more appropriate vehicle, just as it is in Europe and the US, as the risks are spread and transaction costs generally lower. Therefore, there is great confidence across the market that Bahrain has a bright future as a venue for the fund industry, with a rush of new issues and listings expected to hit the market in the future. (The Report: Bahrain 2007)

## 6. Conclusion

There is a great confidence across the market that Bahrain has a bright future as avenue for the fund industry with a rush of new issues and listings expected to hit the market in the future. Favourable regulation, transition to greater openness, great investment opportunities, freedom to repatriate and transfer profits and capitals, low penetration of Asset Management Industries as compared to global markets, huge potential for Islamic funds, wide array of both Islamic and conventional funds, and the change in the attitude of retail investors in the Middle East all these provides a solid and strong foundation for the future development and growth of Mutual fund investments in Bahrain.

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