Islamic Finance *news*

2013

GUIDE

February 2013

Editor's Note

The Islamic Finance *news* Guide 2013 aims to provide our readers with a roundup of the year's industry highs and lows from an objective viewpoint of the market practitioners themselves. As part of this growing sector, we have witnessed unprecedented leaps in the Gulf Islamic capital markets space in 2012 beyond most expectations considering the current economic climate. Major issuances originating from up and coming sovereigns such as Qatar and Saudi Arabia created a stir in the market, and more importantly, has provided the impetus for similar issuances moving forward.

Apart from movements in the Islamic capital markets, the Islamic equities space also received a boost last year with the listing of a major retail Sukuk issuance in Malaysia, growing interest for customized indices in the Gulf, and increased efforts by the industry as a whole to push forth within this space. Although it is still far from being recognized as a major sector within the industry, Islamic equities and its subsets such as REITs and private equity are picking up in the more progressive markets.

Last year, we also saw a spate of project and infrastructure financing deals involving major corporations in Malaysia and the Gulf, as well as in the emerging markets. The Arab Spring countries have also begun to dabble in Islamic finance, as predicted by most market players in the previous year; with jurisdictions such as Egypt and Morocco pledging to issue Islamic paper to fund the countries' rebuilding and reconstruction.

In this issue of the IFN Guide, we traverse the global Islamic banking and finance landscape and cover all major sectors to provide our readers with unbiased and unrivalled coverage of the market. We hope you find this publication a pertinent and informative read.

Nazneen Halim,
Editor

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Sukuk market 2012: The best year ever

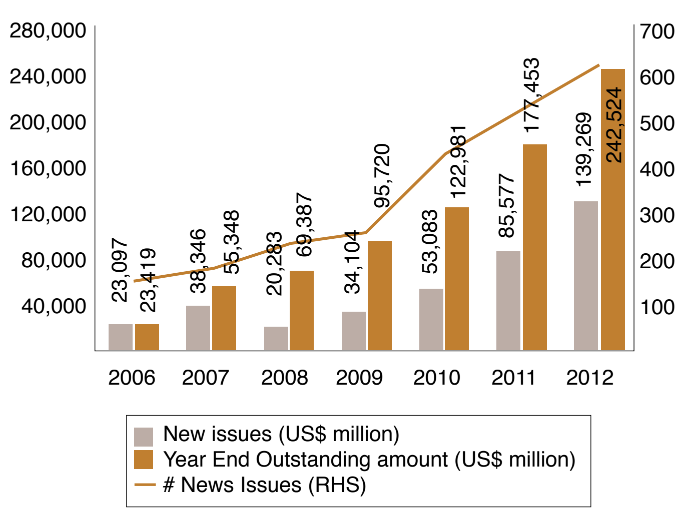
The Sukuk market experienced another stellar year in 2012, confirming its leadership as the fastest-growing segment within Islamic finance. The primary market has been very active and the secondary market registered significant spread tightening thanks to strong investor demand. Despite the growth, the imbalance between supply and demand remains and 2013 is expected to be another record year with new countries finalizing their legislation for issuing Sukuk. The increase of international Sukuk issuances and secondary market liquidity remain the key factors for further developments.

Primary market: New milestones achieved

Sukuk primary market activity registered another year on record on many fronts. During 2012, new issuances amounted to US$139.2 billion with an annual increase of 63% and total outstanding Sukuk reached US$243 billion (US$215 billion if we exclude Sukuk with maturities of less than one year that comprise mainly of monetary policy tools issued by central banks).

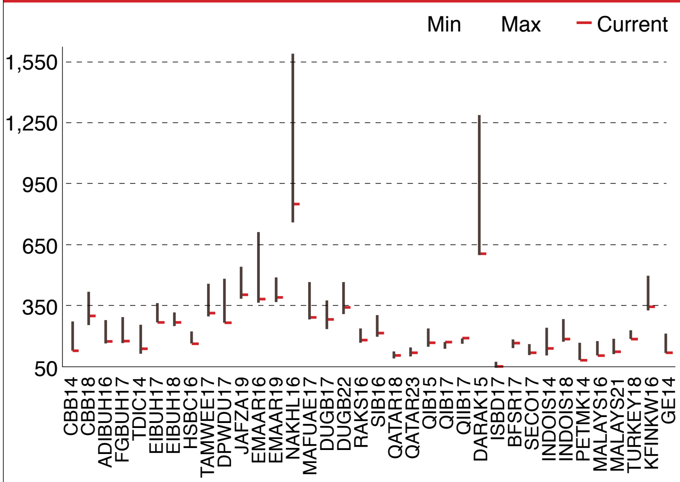
The year witnessed the biggest ever Sukuk issue (US$9.7 billion) by Projek Lebuhraya Utara-Selatan Berhad (PLUS), a highway concessionary operating major toll stations across Malaysia; Saudi Arabia issued the first quasi-government Sukuk (US$4 billion) by General Authority for Civil Aviation (GACA) for the expansion of Jeddah airport; Abu Dhabi Islamic Bank issued the first Tier I public Sukuk (US$1billion), starting a new potential trend for banks meeting tightening capital rules under Basel III regulation; Turkey issued the long waited first sovereign Sukuk with two issuances (one international and one domestic for a total amount of around US$2.5 billion).

Chart 1: Global Sukuk market trend (US$m)



Source: Zawya.com and Alkhair Capital calculation

Chart 2: 2012 Z-spread/Discount Margin trend (sample of international Sukuk)



Source: Bloomberg and Alkhair Capital calculation

Despite Malaysia still representing 56% of the total Sukuk issued during the year, Saudi Arabia witnessed the most significant activity with issuances amounting to US$10.4 billion vs US$2.5 billion in 2011. Domestic Sukuk represented 76% of the total Sukuk issuances vs 82% in 2011. UAE issuers continued to prefer international Sukuk to local currency issuances. Few GCC issuers accessed the Malaysian domestic market to issue ringgit-denominated Sukuk (Taqa US$212.9 million, Mumtalakat US$98.3 million, National Bank of Abu Dhabi US$163.8 million). Sukuk issued in the MENA countries during 2012 amounted to 36% of the total bond and Sukuk issued by MENA issuers. The preference for Sukuk over conventional bonds increased during the year and the number of GCC Sukuk reached 34 issuances from 19 in 2011 (10 issuances in 2010).

> “Despite the European credit crisis and social unrest in the MENA region, Sukuk have been perceived as a safe haven asset class, reporting another year of positive performance”

Secondary market: Steady performance continued

Despite the European credit crisis and social unrest in the MENA region, Sukuk have been perceived as a safe haven asset class, reporting another year of positive performance.

The HSBC/Nasdaq Dubai Sukuk Index returned 9.7% in 2012 (+7.2% in 2011) vs the 4.77% of the Barclays Global Aggregate Bond Index and 18% of the Barclays Emerging Markets Bond Index (conventional bond indices). The average spread tightened from 273.4 basis points (bps) to 182.14 bps. The 30-days average volatility remained contained at 1.36%.

The return of the Sukuk index has been mainly driven by the strong performance of Dubai names that continued their re-rating in 2011, thanks to favorable macroeconomic conditions, smooth refinancing of the maturing debt and the recovery of the real estate market. The repayment of the US$1 billion Sukuk maturing in July 2012 by Dar Al Arkan (Saudi Arabia) witnessed the re-pricing of the issuer credit risk. The overall performance has also been supported by the existing imbalance between supply and demand of Sukuk (estimated in 1:3) moving almost all traded Sukuk to YTD highs, as shown in Chart 2.

2012 also witnessed the first UAE company to miss a maturing Sukuk repayment. Dana Gas, the Sharjah-based natural gas producer, defaulted on its US$920 million convertible Sukuk maturing at the end of October. The company announced in November that it had reached a restructuring agreement with its main Sukukholders comprising a partial cash payment and the issuance of a new Sukuk.

2013 market outlook: Strong pipeline expected

The outlook for the Sukuk market remains bright. The global demand for Sukuk is forecast to grow to US$900 billion by 2017 (from the current estimated US$300 billion), according to projections by Ernst & Young’s Global Islamic Banking Center of Excellence.

An additional US$27 billion have already been announced or rumored for the coming year. Saudi Arabia is expected to represent 25% of the overall offering in 2013, followed by Malaysia and UAE, with important issuances including GACA II, Aramco, Sabic, Maaden, NCB, Almarai and Savola.

The governments of Egypt, the Philippines and Jordan are expecting to raise money through Sukuk for the first time. Tilal Development Company, the Omani real estate developer, is expected to issue the first Sukuk in the country. Focus remains on the Dubai refinancing risk but there are no major concerns before 2014 when US$30 billion will mature.

The theme for 2013 is searching for value after years of strong performance, balancing between risk and returns (in real terms). The challenge has only just begun.

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Islamic banking: Technology and the Arab Spring

The Arab Spring has changed the political landscape, mainly across North Africa, with new political forces inspired by religion. Islamic financial services will leverage this trend; underpinned by new regulations, commercial banking software and an increased focus on Islamic finance.

The results from the 2011 Gartner Islamic Banking Survey and further analysis derived from the more than 380 deals signed in 2011 have uncovered compelling patterns and trends that will shape this emerging market. The following key trends will drive double-digit growth across the niche market of the Islamic banking system (IBS):

- The number of conventional banks that will open Islamic windows and new fully-fledged Islamic banks is increasing to cover the world's large, untapped Muslim population, which has one of the highest demographic growth rates.
- The number of Islamic banks will increase due to the Arab Spring. Those involved governments will also accelerate the release of new regulations for Islamic banking at central bank level across a number of countries, such as the ones in North Africa.
- Total Islamic banking assets will increase, especially in the Islamic finance space, as a consequence of the Eurozone crisis that has pushed banking assets from Europe back in the Arab sovereign funds headquartered across the GCC countries.

> "The total Islamic banking assets will increase, especially in the Islamic finance space, as a consequence of the Eurozone crisis that has pushed banking assets from Europe back in the Arab sovereign funds"

In 2011, Islamic financial services exceeded US$1 trillion in banking assets for the first time, with more than 700 Islamic financial institutions (IFIs) throughout the world. The IBS market — that is, the market of the technologies that enable these financial products — is predicted to be US$1.3 billion in 2012 and to grow at about 10% for the year. The IBS market is expected to reach US$1.6 billion by 2014.

- Total Islamic banking assets grew 10.3% in 2011. The number of IFIs exceeded 700. This is predicted to reach US$8.6 trillion by 2023 with a compound annual growth rate (CAGR) from 2011 through 2023 of 18.9% according to a study by Maris Strategies. This double-digit growth appears unstoppable, and the market is still in its infancy. This growth is driving a new level of maturity in the regulatory approach, with governments stepping in more actively in this sector.
- The Arab Spring — that is, the revolutionary wave of demonstrations and protests occurring in the Arab world in 2011— has accelerated the political process of legalization of Islamic parties across a number of countries, such as Tunisia, Libya and Egypt, and it will boost the request for new Islamic banks in those countries.
- Islamic financial investments are leveraging the financial instability derived from the Eurozone debt crisis by attracting capital from western countries.

Islamic financial services in 2012-13

Islamic financial services haven't taken off in past years throughout North Africa. The main reasons have been the limited

adoption of retail banking services in these countries by the population, the lack of knowledge of Islamic banking among the banks, the language — in fact, Islamic banking has mainly developed across countries where English is broadly spoken, such as the Gulf, Malaysia and Iran — the lack of political support by governments that were all averse to any Islamic-based parties and, finally, the absence of central banks' regulatory frameworks.

Today, these conditions are changing. The Arab Spring is bringing new Islamic-based parties on the stage, and governments are willing to fill in the gap with other Arab states on the Islamic banking front. Also, the shift in focus for investment services firms from western countries to growth regions is offering a great opportunity to attract Islamic-based funds from the Gulf in the reconstruction of these countries involved in the Arab Spring. Finally, from a social perspective, the deep changes in the society of these states are announcing a broader adoption of banking services by the population. So, an increasing number of North African governments will finally step in and regulate Islamic financial services (at the central bank level, as it happens in many other countries, such as Iran, Bahrain or Malaysia) by 2013.

This change will increase the number of Islamic financial institutions throughout the region, from Morocco to Egypt, from 22 to about 50 by 2013. Gartner has revised these countries' banking systems and systematically scanned the expected number of new Islamic financial institutions by 2013 and listed (in parentheses) the estimated number of new Islamic COTS system implementations, as well as the regulatory situation. This analysis — based on the surveyed IBS vendors' pipeline, as well as on the existing financial statistics for these countries, such as the average bank assets, number of existing banks and the percentage of unbanked and Muslim population.

The GCC's IBS market has been considered as mature for some time. Nonetheless, some of these countries are undergoing profound restructuring to Islamic banking. The newly issued legislation for Islamic banking in Oman will create many opportunities to IBS vendors, as will new rules in Qatar that impose a marked separation between the conventional and Islamic banking practices. Gartner estimates that in Oman and Qatar there will be, respectively, six and 10, new Islamic banking COTS system deliveries by 2013. Bahrain will instead suffer from the low political stability due to social unrest, and consequentially, while existing Islamic financial institutions will be conservative in their IT budgets, new implementations of IBS will plummet across 2012. Other GCC countries, such as the Kingdom of Saudi Arabia and Kuwait, will instead see a persisting interest of banks for Islamic finance, and Gartner sees increasing sales of IBS for Islamic investments.

Financial analysts consider Asia-Pacific the most promising market for Islamic financial services. In a scenario analysis run by a leading media publication, by 2023 Asia Pacific countries are expected to overcome the traditional key markets in the Gulf region. For example, according to this analysis, in 2023 the top three countries in the world in terms of Islamic banking assets will be: Indonesia (US$1.6 trillion), Pakistan (US$1.4 trillion) and Bangladesh (US$1.2 trillion). This analysis provides implicit indications on where the majority of IBS deals will happen in the long-term. However in the short-term (2012) Gartner doesn't see such strong growth in IBS revenue. In fact:

- In 2011 only a few new contracts have been signed.
- Gartner has detected an important change in the vendors' behavior/involvement for 2012 from proactive to reactive/passive.
- The size of past deals has remained persistently low in contract value, even for those banks with a large branch network.

Contrarian view: If the Arab Spring does not turn into political stability

A different view in this context concerns a scenario in which the Arab Spring does not lead to increased stability and does not bring a real change in the society. This outcome might be the consequence of the strong contrasts among the several parties that are trying to win the power after this changing of guard. In this regard, there are three possible political scenarios that might inhibit the diffusion of Islamic banking across these countries:

- There will be no change, and actual politicians will preserve the status quo while Islamic parties are pushed back in the background.
- There is a change, but Islamic parties fail to win any political position.
- There is a change, and Islamic parties win, but the political situation does not stabilize and the business environment does not improve and enable foreign and domestic investments in the financial services industry.

> **"The Arab Spring is bringing new Islamic-based parties on the stage, and governments are willing to fill in the gap with other Arab states on the Islamic banking front"**

In all these cases, Islamic banks will neither be legalized/regulated nor establish a stronger presence and flourish across these countries. The Islamic banking expansion process will be inhibited and delayed for a longer term (that might mean even a decade or so). In this situation, only foreign branches of Islamic banks will be able to operate across these countries, and the IT opportunities in the IBS sector will be strongly hampered and growth expectations will not be met.

In this case, IBS providers should be ready to reduce their investments and follow an entrenchment strategy by leveraging the opportunities that will still come from the conventional banking sector. Also, they should consider using — rather than a direct go-to-market strategy — a partner strategy by networking with local vendors and global system integrators with local presence.

The Arab Spring has been the most important event across the Arab states in 2011, and many countries are still living it. The affirmation of Islamic-based parties on the political stage of these countries has created the social conditions for the exponential growth of Islamic-based financial services. This new strong emerging trend will bring many opportunities in the IT industry and the IBS software sector. In fact, this expansion will be underpinned by the increased standardization of the Islamic financial tools, by the overall adoption of COTS systems instead of internally developed software, and by the need of those countries to attract foreign direct investments in terms of Islamic development funds for reconstruction.

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Cross-border financing: A growth game

The current global environment demands that economies demonstrate their ability to sustain growth, through increased economic connectivity and trade between the global economies.

Islamic finance now has an excellent opportunity to prove its competitiveness and enhance its profile in the global financial landscape. Islamic cross-border financing in particular, has the potential to enhance its position in facilitating international trade and economic linkages between different parts of the world and influence the patterns of global financial and economic integration. This article focuses on cross-border financing in the form of Sukuk and syndicated financing.

2012: A review

The Islamic finance sector is undoubtedly well-placed to play a vital role in facilitating cross-border financial flows, particularly between emerging economies, hence the year 2012 marked a turning point as new markets proliferated in the industry. Several countries initiated Islamic finance operations, predominantly in the MENA region, Africa and central Asia, and this resulted in an increase in the quantity of cross-border financial flows and international participation in Islamic financial markets.

The global Sukuk market has been the fastest-growing sector in facilitating cross-border financing. As the credit markets continue to tighten, market players have found Sukuk an attractive and effective source of funding due to the need to diversify businesses and expand funding streams. New issuances of Sukuk reached approximately US$40 billion globally and this has fostered a significant boost in cross-border linkages. There have been sovereign Sukuk issuances by countries including Malaysia, Qatar, Indonesia, Dubai, Bahrain and Turkey; numerous Sukuk issuances by private entities including Axiata Group, Jebel Ali Free Zone Authority, Saudi Electricity Company and Majid Al Futtaim Group; and various Sukuk issuances by financial/multilateral institutions including Qatar Islamic Bank, Islamic Development Bank, First Gulf Bank and Abu Dhabi Islamic Bank.

Islamic cross-border syndicated financing on the other hand, has generally slowed down in the Islamic finance space. Market observers have commented that this is a result of greater reliance on financing being obtained domestically within each region and a decreasing reliance on transatlantic economies for direct and indirect financing due to the uncertainty surrounding the economy of the US and the Eurozone. However, project financing has been seen as one area which has markedly increased cross-border financing and there have been a number of project financing facilities structured particularly in the GCC. There is a continued trend in the use of the Tawarruq and Murabahah structures whereby a significant number of financial institutions continue to utilize them as a rapid and flexible way of acquiring financing. A reason behind this is because structures such as Musharakah and Mudarabah do not generally fit in with the regulatory and tax regime of most countries. Syndicated financing has also become prevalent among industry participants because of the current economic climate and is utilised in restructuring existing transactions or as an added feature to Sukuk issuances.

2013: A preview

The new global horizon in the year 2013 is expected to see the continued rapid internationalization in Islamic finance with cross-border financing continuing with more entrants to the industry especially from Africa and central Asia; more Sukuk issuances by new issuers; more Sukuk issuances dealing with the restructuring of existing transactions; and more syndicated financing, in particular, project financing. Although it is expected that we will continue to see the use of Tawarruq and Murabahah as the main structures utilized in syndicated financing, market players are keen to see some movement of Islamic financing structures away from such traditional and dominating debt-based instruments to the more participatory risk-sharing structures of Musharakah and Mudarabah that support entrepreneurship endeavours. The development of such risk-sharing transactions under participatory finance models is needed to meet the differing needs of various businesses and thus facilitate cross border investments. Its wider use will have significant scope in developing a broader representation of Islamic financial products to drive the growth and development of the industry.

It is anticipated that there will be more effort put into creating standardized base documents. While there has been work done with respect to this by international bodies, there is still room for disagreement between the advisers. It is an area that needs to be further developed to assure market players that their transactions and structures are Shariah compliant, meet the regulatory and legal requirements within the relevant jurisdictions and fulfil the economic objectives of the contractual parties. This further increases market efficiency, transparency and reduces the transaction costs as the industry strives towards seamless global cross-border inter-linkages.

Another challenge which remains with respect to cross-border financing is the development of policies and frameworks that will have a universal application. The landscape of growing cross-border financial flows between regions underscores the need for enhanced recognition and understanding of practices in the different jurisdictions. It is predicted that there will be continued effort in this area at a regional level based on existing policies and frameworks, domestic political initiatives and the regional economic cooperation structures in place. Such policies are essential to provide a comprehensive legal and regulatory environment under which effective cross-border financing activities can take place and at the same time, be fully compliant with the requirements of the Shariah.

In essence, there is a need for market participants to continue to develop the Islamic finance industry with the same (if not more) perseverance and intellectual rigor that has been applied in the past years to develop more effective cross-border financing. This is particularly important because cross-border financing remains an important segment of Islamic finance which may spearhead the industry and has become even more important in the current economic and regulatory climate.

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Islamic microfinance: A key tool in the fight against poverty

Islamic microfinance is becoming an important tool in reducing poverty.

It is a central issue of the authorities' actions. Governments have engaged projects toward the promotion of Islamic microfinance. These Islamic finance institutions provide financial services to poor customers whose incomes are precarious. Thus, they complete the classical services offered by conventional banking systems. They are characterized by their proximity to their customers. In this manner, they create a confident environment which is a warrant for the social viability of the institutions. The financial era is undergoing a decisive mutation in many countries.

The services provided have seen a dynamic trend since 2000. But these dynamics have not managed to ensure that the more vulnerable population are guaranteed access to financial services.

2012: A review

The Islamic Saving and Credit Cooperative (ISCC) in West and Central Africa is the first Shariah certified organization based on social performance and poverty alleviation. It has a unique and innovative Islamic microfinance model and business design according to the rules of Shariah. Most of the organizations in UEMOA (PAMECAS[2] , Muzdaïr, BIRIMA, MECIS in Senegal, MECIT in Togo, ISCCC in Cameroon, MECIB in Benin, Raouda Finance in Ivory Coast, etc.) have been formed according to the principles and values of the cooperative model. The notion of sharing same profit same loss is at the basis of the investment methodology.

The asset based on the integrated Islamic microfinance approach is the basic tool of the cooperative to get long-term sustainability. Indeed the ISCC has a strong belief that the sustainability of the members ensures the viability of the organization. Islamic finance institutions are resolute to bring social change on alleviating poverty. Murabahah (Islamic mode of sale and purchase), Musharakah and Salam are the core products of the institutions listed above. Qard-E-Hasna (interest-free loan) is a supplemental product which allows to users to start a business after a basic training. It provides trainees with the market linkages to be Zakat donors and not Zakat receivers. Health awareness and business education are also promoted.

In the UEMOA countries, the first initiatives of Islamic microfinance have been implemented in Senegal, Ivory Coast, Benin, Togo, Cameroun and Chad. They share less than 2% of the market of microfinance. In Mauritania, initiatives are also thriving, but the implementation is difficult, as in the case of conventional credit and saving cooperatives.

The Islamic banks of Niger, Guinea, Senegal and Mauritania have been supported by the BID in terms of financial resources and review of approaches and financing mechanisms to better penetrate the market (within a year, five branches have been created in Senegal).

There have been many workshops on Islamic finance in West and Central Africa, including in Chad, Senegal and Togo. Besides this, enforcement programs are implemented according to the Islamic financing ideology. Through capacity building and the promotion of rural microfinance, they aim at reaching more women and vulnerable populations. In Senegal, the PALAM[3] is concentrated in four regions among the poorest in the country. In Chad a similar project, PROMIFIT[4], is being developed.

2013: A preview

Islamic finance is developing in Africa, particularly in the eight countries of UEMOA and in other countries of the CEMAC (Chad and Cameroun). Institutions provide services to vulnerable and destitute populations. In line of their mission, governments are elaborating projects for the regulation. Such is the case in Senegal. Under the supervision of the Direction Monnaie et Crédit (DMC), a regulation project is being validated by stakeholders. Expected in 2013, the validation should allow conventional institutions (banks and microfinance institutions) to open windows into Islamic finance.

Accordingly to the law on investment societies in UEMOA, establishments are being installed as (ESA[5]) and are oriented towards Islamic mesofinance with an important part for "nursing enterprises". Other investment societies au pair, like Tanwheel, provide Islamic financial services in the West African region.

Services providers have already finalized modules for training to come. ASCODEV in Senegal and AIIF are planning workshops for stakeholders of different West African countries in 2013. Accountability, product development and MIS will be central actions in 2013 to better spread Islamic finance. MIS is currently being implemented with partners to make a regional network within UEMOA countries. Actions are currently being undertaken with GIE CTISN and the group 4US in Morocco.

As for Senegal, financial resources are available from BID. A XOF13 billion (US$26 million) convention has been signed to support new dynamics in 2013. Alongside this, there are other opportunities to reinforce Islamic financial institutions in order to satisfy the need of financial services with adapted resources.

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[2] PAMECAS is one of the biggest conventional MFI in Senegal. Recently PAMECAS began activities in Islamic finance by opening windows for two products.
[3] Programme d'alphabétisation et d'apprentissage des métier pour la lutte contre la pauvreté.
[4] Projet de microfinance au Tchad.
[5] Entreprises Sociales d'Afrique (ESA), société d'investissement according the loi sur les société d'investissement et les sociétés de capital risque.

Retail banking & Islamic finance

Islamic banking has been growing for the past 30 years, reaching over US$1 trillion as an industry, and achieving an annual growth of 10-15%, despite a distressed global economy.

With approximately 70% of the Muslim population currently away from mainstream financial activity, there is a chance for financial institutions to enter into Islamic banking and bridge the gap.

Growth in banking services and products leads to development of other financial industries like insurance, capital markets and stockbroking. Islamic banking has increased its presence but still has to increase penetration not only amongst Muslims but also non-Muslims seeking ethical financial services and products. Islamic banking can be utilized to cater to the unbanked members of society globally and provide a platform for companies offering Takaful, Shariah compliant mutual funds etc.

The rapid expansion of Islamic banks in recent years has demonstrated the viability and feasibility of non-interest-based financial operations. This must be surprising to those who believed that banks and financial systems could not operate in a modern economy without interest-bearing financial instruments.

2012 saw many Muslim countries taking steps towards the establishment of the Islamic banking and finance industry. However, it is unfortunate that even in OIC member countries the infrastructure for Islamic finance is abysmally low. The global economic crisis also provided a growth opportunity for Islamic banking to grow and maximize its reach for people seeking alternatives to conventional finance.

2012: A review

Despite all the growth in the Islamic banking industry, its geographical reach is limited to a few predominantly Muslim countries. The year 2012 saw increased interest in socially responsible financial institutions, resulting in increased interest in Islamic banking.

Islamic retail banking reached some new geographical locations spreading the reach of Islamic finance industry. There was a serious move towards standardization of various rules and regulations across the Islamic finance industry, which helped in furthering the reach to the customers as one alternative solution. A standardization effort from regulatory bodies is a major step which has helped in the consolidation and growth of the industry. The global economic turmoil has led to the growth of Islamic retail banking as an alternative customer-centric approach, which encourages banks and financial institutions to make profits in a socially responsible manner. The retail Islamic banking approach of being customer-centric along with high liquidity in these banks makes them more safe - even above the global standards set for conventional banks.

The sector saw some operational challenges being overcome in 2012, setting the stage for future expansion across territories. Retail Islamic banking concentration in MENA and Malaysia increased and this will help in developing Islamic banking in other non-Muslim territories. Retail banking across the globe is undergoing change; with customer interests, protection and growth of customer money being the main focus for all the banks. The year also saw Islamic banks utilizing IT solutions to increase efficiency and reach for its customers with 24/7 banking order of the day. One more aspect that drew attention during 2012 was a non-availability of trained and well-qualified manpower for the growing Islamic retail banking industry. Despite the global economic turmoil, the Islamic finance rndustry and in particular Retail Islamic banking achieved growth and moved towards standardizing processes and procedures, thus reducing the confusion which plagues customers about the various interpretations of the provisions of Shariah law in Islamic finance.

2013: A preview

Islamic retail banking will have to play a crucial role in the development of the global Islamic finance industry as this will help the growth of other arms of Islamic finance. All the growth numbers have not been able to develop a very large Islamic retail bank which can help in mediating between financial resources globally and channelizing them in Muslim countries and vice-versa.

The growth of the retail banking industry will depend on its adoption of technology, and it must offer more internet and mobile banking services to its customers. In recent times we have seen the emergence of online banks offering services to their customers through internet and mobile only with very little branch level services. The adoption of this model by Islamic banks will help reduce capital expenditure while growing the banking network.

The growth of Islamic retail banking will also depend on the quality of value-added services banks provide to their customers. The products also need to be designed and marketed not only to Muslims but also to other community members to ensure Islamic banking reach is increased.

The human resource shortage for Islamic banks will also need to be addressed and regulators need to ensure that quality institutions are allowed to impart training and education on Islamic finance.

Above all the legal framework required in each country to facilitate the growth of Islamic banking must be in place and act as a facilitator. The regulators of established Islamic finance markets can share their expertise with regulators of new markets to ensure standardized products and services are available.

The most important issues that will attract attention are resolving Fiqh issues, establishing a legal framework in each country for better legal infrastructure, investment in training human resources to reduce the shortage of trained personnel and above all the adoption of technology to grow and provide better services to the customers.

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Islamic private equity: Misunderstood?

Three key misconceptions continued in 2012 to mar the Islamic finance industry's grasp of private equity and venture capital (PE/VC). Islamic finance actors must come to realize that real estate and private equity constitute separate asset classes. Arshad A Ahmed shares his thoughts.

That they may share a common organizational device — for example they both may be partnerships — does not eclipse the obvious difference between real estate assets and PE/VC assets. PE/VC funds invest in the equity (and, on occasion, debt capital) of operating businesses.

To the extent a PE/VC portfolio enterprise happens to own or lease real property, it is incidental, and certainly not central, to the business proposition. Where real property motivates a transaction to happen, it is an indication that the transaction should be treated and categorized for investment management purposes as a real estate asset and not as a PE/VC asset.

Though leveraged buyouts (LBOs) are the most glamorous of PE/VC transactions, they are far from being the most common (or profitable) type of PE/VC transaction. In my own PE/VC career spanning nearly 15 years, my most lucrative PE/VC deals relied on no leverage at all. They were 100% equity investments that generated over ten-times returns in just a few years. Growth equity, venture capital, and ordinary buyouts do not rely on debt, and they generally prefer investing in businesses that are debt-free.

In addition, they are the most common varieties of PE/VC deals in emerging markets. Yet, venture capital and growth equity investing continue to be glaringly absent from the Islamic world, even though VC alone is responsible for over a trillion dollars of new value creation added to the American economy in the past decade — all from equity.

In developed markets, banks and other debt financing sources have practically no meaningful role in venture capital, growth equity, and ordinary buyout activities. In the PE subcategory of LBOs (arguably the most caustic method of PE investing), banks show up to provide the debt financing such as the leverage.

No discussion of Islamic finance's key misunderstandings of PE/VC would be complete without emphasizing the bright line dividing PE/VC from public equities. Enough space is not available to spell out all of the differences, but the key principle here is that PE/VC tends to operate in the private sector, outside the limelight of public disclosure requirements. Due to this limitation, PE/VC tends to be limited to the most sophisticated investors.

However, the opposite is the case for businesses making their initial public offering of equities. With broader public disclosure comes a business' right to sell their equity securities openly to public investors. Because the same kind of demand for public disclosure applies to debt and fixed income securities such as bonds, it is hardly conceivable for PE/VC to be found participating in Islamic finance's rapidly expanding Sukuk markets.

As we look ahead, we disagree strongly with recent sentiments that Islamic PE's expansion ought to be led by an increase in LBOs (where the leverage comes from Islamic debt financing). As was noted in early 2013 by Alberto Brugnoni, chairman of Italy's Associazione per lo sviluppo di Strumenti Alternativi e di Innovazione Finanziaria, Islamic products have done little more than mimic their conventional counterparts by adopting the same debt-driven base. Extending this modus operandi to Islamic LBOs does nothing to benefit Islamic PE.

Several PE firms based in the Gulf have been operating this way for years, with no meaningful benefit to anyone other than their attorneys who continue to be enriched by billing hours on contriving legal structures resembling Murabahah that obfuscate not only each transaction's over-exposure to leverage but, more insidiously, their risk concentration and relative lack of profit sharing.

PE/VC is celebrated in Silicon Valley largely due to the asset class' attitudes on profit- and risk-sharing. It is a very different attitude than one encounters among commercial bankers. When it comes to banks and fixed income, it is a sine qua non that borrowers must repay their debts regardless of how their businesses do.

PE/VC firms are profitable when their portfolio businesses do well, and PE/VC lose their investments when those businesses go bankrupt. In the PE/VC mindset, risk is mitigated at the macro-level (by spreading risk among many investments) and at the micro-level (by grooming each company) — this is far from the way banks (Islamic or not) seek to handle risk of loss.

2013 also needs to be a time when deliberated legal reforms take place in Islamic countries with regard to property rights, corporate governance, and bankruptcy. So far we have seen severe lack of certainty in these areas, all of which are critical to fostering PE/VC investing. Instead of mimicking Western rulemaking in these areas of the law, Islamic countries may choose this year to develop policies thoughtfully and consensually in a manner bespeaking Islam's legal and intellectual heritage.

If Islamic finance now faces a dearth of qualified talent, this problem is magnified to the extreme in Islamic PE/VC. Recently the Malaysian sovereign, Malaysia Venture Capital Management, elected to make 2013 the year in which they enhance their Islamic PE/VC capabilities by partnering with Silicon Valley-based experts in both PE/VC and Islamic finance.

At Silicon Valley lies the heart and soul of PE/VC. The Malaysians realized that a banking mentality hinders PE/VC, and enduring success in PE/VC investing will come by linking with high caliber talent steeped in the intricacies and global best practices of equity investing rather than debt financing.

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Islamic Banking in Africa
Interview with Afzal Seedat, Head of Absa Islamic Banking

What do you believe is the potential for Islamic banking on the African continent?
Africa is home to the second-largest Muslim population after Asia. It is estimated that there are 450 million African Muslims. Sources indicate that Muslims make up 45% of the population on the African continent.

The presence of Islam in Africa dates back to the seventh century when the Prophet Muhammad advised some of his followers who were facing persecution to travel across the Red Sea to the safety of Abyssinia (now Ethiopia). Thus Africa became a safe haven for Muslims and the first place that Islam was practised outside of the Arabian Peninsula.

The prevalence of Muslims in African countries ranges from approximately 95% of the population of Egypt in the North, to only 2% in South Africa. Between those extremes lies a significant banking opportunity. Even when the percentage of the population is small, as in South Africa, the relative affluence tends to be high, as Muslims are often entrepreneurs and business owners. In South Africa for example, it is commonly believed that the 2% of the population which is Muslim contributes about 10% of the country's GDP.

The opportunity for Islamic banking provided by the large numbers of Muslims on the African continent has yet to be realized. The vast majority of Africans are unbanked. Delivering a faith-based solution that responds to a person's religious beliefs is bound to be a stronger proposition than conventional banking has been able to offer Muslims to date.

> "Africa is home to the second-largest Muslim population after Asia. It is estimated that there are 450 million African Muslims. Sources indicate that Muslims make up 45% of the population on the African continent"

What has been done to date to realize this opportunity?
Islamic banking in Africa began in Egypt in the 1960s and today

Egypt has four large Islamic banks. Shariah compliant banking has extended into some other countries, such as Morocco, Kenya, Nigeria, Tanzania and South Africa but the vast majority of African countries still lack a Shariah compliant banking offering.
The fact that most African countries are not governed according to Shariah is one of the challenges in establishing Islamic banking and in the development of Shariah compliant financial products and services. Having to comply with Shariah, as well as local statutory legislation and banking regulations makes product development challenging. The South African National Treasury has amended the Income Tax Act with the intention of creating a level playing field in South Africa for the growth of Islamic banking. These amendments to the legislation are a demonstration of South Africa's commitment to becoming a financial hub on the African continent. Any African country that wishes to attract Middle Eastern investment or become known as a financial hub, must offer Shariah compliant investment vehicles in order to fulfil these ambitions. Without Islamic banking they immediately limit their attractiveness to Muslim audiences. A number of other African countries are starting to discuss the regulatory changes required in order to become 'Islamic banking friendly.'

"The growth of Islamic banking in Egypt and Kenya are good examples of how the relevance of the offering to its target audiences drives growth. Islamic banking has only been available on the continent since the late 1960s, so it is still a relatively new concept in banking, but indications to date are that the potential is great"

How have Muslim communities in African countries responded to the availability of Islamic banking products?
The growth of Islamic banking in Egypt and Kenya are good examples of how the relevance of the offering to its target audiences drives growth. Islamic banking has only been available on the continent since the late 1960s, so it is still a relatively new concept in banking, but indications to date are that the potential is great. Word of mouth is the key driver of information about Islamic banking in Muslim communities and, as each new happy customer talks about the peace of mind he finds in banking according to his faith, the potential grows.

What changes do you expect to the availability of Islamic banking products during 2013?
I am confident that the number of countries in which Islamic banking is available will significantly increase during 2013. As part of the Barclays Group, we plan to launch an Islamic banking offering in these Barclays African territories where there is a demand for Shariah compliant financial products and services. We will play our part in supporting the Barclays strategy of becoming the 'Go-To Bank'.

Afzal Seedat
Head of Absa Islamic Banking

Afzal has more than 16 years experience in private, corporate and investment banking. He was involved with Islamic banking early in his career at Standard Bank. His immense knowledge of the banking sector spans his position as a transactor in structured finance; and as the director of the corporate bank and director of the private clients business at Standard Bank. Prior to joining the Islamic banking industry Afzal was the executive director of Absa Trust. He holds a B. Comm, LLB and Higher Diploma in Tax.

What regulatory changes would you expect in order for Islamic banking to grow on the continent?
The key issue for the spread of Islamic banking at this stage is central bank approval. Naturally, central bank officials in countries not yet offering Shariah compliant banking offerings are not familiar with this form of banking and this requires a period of knowledge transfer until they reach a point at which they feel confident to regulate the offering. Once the regulation is in place, the natural next step is to examine local tax and other financial laws to ensure that they don't disadvantage anyone who chooses Islamic banking. For example, in South Africa profit share is currently treated in the same way as interest for tax purposes.

As you take over as head of Absa Islamic Banking, what is your vision for the delivery of Shariah compliant products and services on the continent?
Africa is currently the continent which the rest of the world sees as having great potential. Our riches in minerals, energy resources, fertile land and large consumer markets are attracting the attention of international investors looking for new opportunities. South Africa is a member of the BRICS countries, a select group of five large, developing countries (Brazil, Russia, India, China and South Africa). The BRICS countries are distinguished from a host of other promising emerging markets by their demographic and economic potential to rank among the world's largest and most influential economies in the 21st century (and by having a reasonable chance of realizing that potential).

As we move from the relative safety of Islamic banking in South Africa towards the vastness of the African continent, there is the excitement of the potential available to us. This comes with the risks inherent in delivering a new offering to the wide range of cultures on the continent. People living on other continents are often tempted to see Africa as a homogeneous mass. In fact each country has a very distinct culture and we must understand and be sensitive to those cultures as we humbly enter their territories to offer Islamic banking, in most instances as a completely new concept. If my team and I can be instruments for ensuring that our fellow African Muslims are offered the choice of banking according to their faith, I believe we will have fulfilled my destiny.

Market makers

Maybank Investment in Malaysia has been actively involved in the vibrant Malaysian Sukuk market space over the last year, and was ranked as the top Sukuk manager by Dealogic for the last 12 months. The investment bank, a subsidiary of the largest bank by assets in Malaysia; Maybank Group, is a force to be reckoned with in the Islamic capital markets space. Tengku Dato' Zafrul Aziz, CEO of Maybank Investment Bank shares his insight on the Sukuk market and the bank's vision moving forward.

The Malaysian Islamic capital market space is ranked as one of the most competitive Sukuk markets in the world. With over 60% of the global Islamic deals originating from the country in 2012, the global Islamic banking and finance fraternity have ardently watched the Malaysian market, and aspires to achieve the heights that the country has scaled.

According to Tengku Zafrul, one of the reasons for Malaysia's success in the Islamic issuance space is because of its first-mover advantage. "Although Islamic finance has been made a focus of attention for a lot of countries since the global financial crisis of 2008 and commendable steps have been taken towards Islamic finance, none of Malaysia's Asian peers have been able to achieve a full framework which achieves the synergies required. What sets Malaysia ahead of its peers in Asia is the solid framework it has which makes it conducive and facilitative for both Sukuk issuers and Sukuk investors. Malaysia is home to one of the deepest and sizeable local currency bond markets in Asia (ex-Japan) for its sound regulatory, legal, tax and Shariah framework which co-exist seamlessly."

"The Malaysian government has always been supportive of the country's Islamic finance initiatives, creating a conducive environment for the industry to thrive"

In terms of Maybank's strategy as a group to maintain its lead in the Islamic banking and finance space in Malaysia and abroad, the bank has taken to launching its own intiative, dubbed the "Islamic First" strategy to promote its Islamic products and to make Malaysia the world's Sukuk hub.

Commenting on the strategy, Tengku Zafrul said: "This underlying philosophy, combined with our continuous efforts to be quick and nimble to adapt to market trends has allowed us to establish and maintain a leading position in the Ringgit Sukuk market. Not only do we aim to assert ourselves by number of deals and volume, but also by delivering innovative solutions to match the unique funding requirements of our clientele with the needs of the market. Furthermore, we endeavor to be a holistic

solution provider through continuous development of our Sukuk origination, structuring and execution capabilities. By working closely with Maybank Islamic, the largest Islamic banking group in the Asia-Pacific region we are able to tap their Shariah expertise, research and development, and distribution network to enhance our services."

International player

The Malaysian government has always been supportive of the country's Islamic finance initiatives, creating a conducive environment for the industry to thrive. Recently, Bank Negara Malaysia, the country's central bank announced that it will introduce a new comprehensive act, dubbed the Islamic Finance Services Bill 2012 to create more internationalization and to further drive the country's Islamic banking sector.

Tengku Zafrul believes that this initiative is imperative in making Malaysia a major global player and Sukuk originator: "Under Malaysia's existing framework, Malaysia has already demonstrated that it has been successful at attracting foreign issuers to the Ringgit Sukuk market with issuers from the likes of South Korea and the Middle East coming to Malaysian shores. The Islamic Financial Services Bill 2012 (IFSB) is intended to provide a strengthened regulatory and legal regime to meet the challenges and developments of an increasingly sophisticated and internationalized Islamic finance industry."

He added: "By consolidating and repealing two of the major Islamic finance acts in Malaysia – that is, the Islamic Banking Act 1983 and the Takaful Act 1984, the act will be a piece of legislation for the regulation and supervision of all key financial institutions, payment systems, Islamic money markets, and foreign exchange markets. In essence, the new law is meant to promote financial stability and compliance with Shariah for participants, systems and stakeholders on an all-encompassing basis. In my opinion such a law will bode well for the Malaysian Islamic capital market and for foreign issuers who intend to tap the Ringgit Sukuk market. The Malaysian Islamic capital market is very well regulated as it is and boasts a level of stability which has been demonstrated over the years."

Regional leader

Tengku Zafrul believes that Maybank Investment Bank is well poised to lead the region in its growth and development as it is backed by the Maybank Islamic Group, the largest Islamic banking group in Malaysia and the Asia Pacific region. "With the recent acquisition of Kim Eng, we have instantly acquired a footprint in the region. By combining this access to the regional markets and regional network we are in an ideal position to build relationships with our clientele by using our local expertise, originate sukuk deals and execute them, and by harnessing the financial strength of the Maybank Group, underpinning the success of these Sukuk transactions."

The CEO also aims to build on its existing reach and strengths to solidify its regional footing and build its customer base. "By educating the regional markets on Sukuk, engaging more corporates to participate in the Sukuk market and meeting their unique funding requirements with tailored Islamic solutions we can spread the notion of sukuk as a viable funding option. To support these endeavors, we are also stepping up our efforts to continue upskilling our people around the region especially when it comes to selling and structuring Islamic solutions."

LANDMARK SUKUK TRANSACTIONS:

- The largest Sukuk issuance ever in Malaysia and the world for Projek Lebuhraya Usahasama, as part of a massive privatization exercise
- The first foreign issuer to issue subordinated Sukuk in the MYR Sukuk market, in National Bank of Abu Dhabi P.J.S.C
- The first perpetual Sukuk issuance by a corporate in Malaysia and the world for Malaysia Airline System (MAS), as part of a balance sheet management exercise
- Holistic project financing for the first internationally financed power project in Malaysia, for Tanjung Bin Energy Issuer
- Unique restructuring for N.U.R. Power

In terms of maintaining its lead on the domestic Islamic capital front, Tengku Zafrul is confident of maintaining a robust pipeline for 2013. "We will continue to harness our regional network and create synergies from the various Maybank Kim Eng units in the region to mine opportunities for our regional clients to enter the Sukuk market in US dollar and regional currencies. This is part of our endeavor to expand our regional business and enlarge our footprint in the international Sukuk market," he concluded.

Azerbaijan: Well on its way

By Behnam Gurbanzada

Azerbaijan is the largest country in the Caucasus region, located at the crossroads of western Asia and western Europe. Azerbaijan is constitutionally a secular country with population of more than nine million people, with around 95% of them belonging to the Islamic faith. There is growing demand from the population for Islamic banking and financial products. The country is also keen to increase trade and investment activity with Islamic states, to be facilitated with the introduction of Islamic banking and financial intermediation in the country. In the last five years Azerbaijan has been one of the fastest-growing economies in the world. Also, Azerbaijan is a leader country in the South Caucasus and holds 73% of the whole economy of this region. The main reason for this growth is Azerbaijan's oil and gas sector, which accounted for nearly 50% of the country GDP over last five years.

The banking sector of Azerbaijan is one of the fastest-growing in the region. There are 44 banks in the country. There is a sole state bank, the International Bank of Azerbaijan (IBA), along with 43 private banks. Twenty two of the private banks are based on foreign capital. On the 31st June 2012, the total assets of the banks were equal to AZN14.82 billion (US$18.88 billion). The share of IBA in the total banking assets was AZN5.14 billion (US$6.55 billion). The share of banking sector in the total assets of the GDP is equal to 32%.

The only state-controlled bank in the banking system is IBA and 34.7% of the assets belong to this bank. The bank controls 32.1% of the total credit portfolio and 35.6% of total deposits.

2012: A review

Analyzing Islamic finance activity for the last 12 months in Azerbaijan one can observe certain developments. The main player in this activity is IBA, the largest bank in the country. The Azerbaijan Ministry of Finance is the bank's main shareholder, possessing a 50.2% equity stake. It is a positive factor that a public bank is interested in the development of Islamic banking. In 2009 IBA created a working group for analyzing the potential, formulating a strategy and engaging relevant stakeholders. The detailed study of this industry and of the organizational changes and risk, compliance and accounting policies and procedures in a formal advisory assignment in 2010/11 led to the formal approval of the launch of an Islamic banking window in the bank which will meet the needs of private and retail customers.

In August 2012, IBA launched an Islamic banking window and now is able to provide a limited range of Islamic financial products to its customers. IBA has also signed its first contract with the Islamic Corporation for the Development of the Private Sector (ICD) for a US$20 million commodity Murabahah Agreement. Now IBA is holding negotiations with an UAE banking group with the purpose of attracting a large syndicated credit that meets the Islamic financing requirements, in the amount of US$150 million.

2013: A preview

The further plan for Islamic banking is the continuous development and improvement of the business environment. Islamic banking is a promising industry — and not only for the Azerbaijani market, because its growth outpaces that of the traditional banking system. Over the last five years alone, cumulative Islamic assets have displayed an average annual growth of 25% and by the end of 2012 they will total an estimated US$1.25 trillion. Azerbaijan has a good chance of setting up an Islamic banking center across the CIS region. IBA is looking at the possibility of branching out regionally, although initially it will focus on the local market. Azerbaijan will be used as a testing ground for the implementation of its Islamic banking model in CIS countries. Then the bank is planning to create a common chain of IBA subsidiaries and representative offices and present Islamic banking along with general services and products. If it is successful, there will be strong reasons for setting up an Islamic Investment and Development Bank for the CIS countries.

Alongside this, IBA is working to establish a subsidiary bank in Qatar and boosting cooperation with international financial institutions.

However, there still remains a need to amend certain laws and do more to facilitate Islamic finance in the country. The major focus for 2013 is to develop the plan of amendments to the regulatory structure in order to enable a fully-fledged Islamic banking system in the country. IBA plans to cooperate with external consulting firms to assist it to identify a phased plan to develop the regulatory and tax system needed to support this young industry as it evolves and grows.

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Weathering the odds: Bahrain's economic resilience prevails

By Dr Hatim El-Tahir

The development of Bahrain's broad-based economy strategy and business friendly tenets has kept pace with a number of ambitious projects announced in 2012. However the year 2012, with its good and bad, will be remembered for its political reconciliation and reinforcement of a diversified economy.

Generally, the government is committing substantial resources to implant a sound business and investment environment, with a number of key infrastructure and investment projects underway. Official reports reveal that real GDP expanded 4.3% in the second quarter of 2012, and foreign direct investment bounced back strongly after a period of decline in the wake of the global financial crisis.

Three main sectors continued to shape the economy's activities and offered considerable stimulus to the economic growth throughout the year.

Financial sector

The Central Bank of Bahrain (CBB)'s monthly issue of short-term Sukuk Ijarah continue to attract investors and are regularly oversubscribed. Both the bond and Sukuk market issues reflected investor confidence in the Bahraini economy, with two anchor issues in mid-year.

The international bond of US$1.5 billion issued by the CBB with a 10-year maturity - which was oversubscribed by 400% - reaffirmed confidence in Bahrain's investment standing and created a new trend of long-term government bonds. In July, the government's sovereign wealth fund, Mumtalakat, issued a Malaysian ringgit-denominated Sukuk Murabahah. The 20-year RM3 billion (US$987.3 billion) Sukuk was rated 'BBB' by Fitch Ratings and was listed in Labuan in Malaysia.

This landmark issuance is considered to be a positive move towards market harmonization between the two countries and an important precedent towards an international Islamic liquidity management market. The issue of Mumtalakat will also pave the way for other Gulf corporates to reach out to investors in the Southeast Asian markets and enhance cross-border investment.

On the banking sector front – which contributes more than a quarter of the country's GDP - the industry remained buoyant with several banks showing profit for 2011 and the first half of 2012. However, some business analysts reported that key banking players are still cautious about domestic stability and regional challenging political environment. The widely-publicized bankruptcy of Arcapita has posed some concerns amongst investors but the bank has carefully kept investors informed of its restructuring and creditors' arrangement plans.

The wave of consolidation initiatives started in 2011 is yet to prove successful and Islamic banks are cautiously pursuing amalgamation opportunities between themselves.

So far, one major merger has been successful – the Capivest-Elaf Bank and Capital Management House. This transaction will bring a new pool of expertise, assets and revenues to the industry.

On the regulatory landscape, the CBB continued its efforts to building a sound regulatory framework. It is currently introducing a new set of rules overhauling its risk management rules for Islamic banks.

The new risk management rules module sets out 15 principles of risk management under six categories of risk management practice. This new rules module will come into effect in 2013. Similar new rules and practice guidelines are introduced in the collective investment undertakings (CIUs).

Energy

With changing dynamics of growth in the kingdom, the government has announced a major refinery modernization project as part of its strategy to keep abreast with the energy sector requirements and global energy efficiency programs. The planned US$8 billion project is under an implementation plan which aims to enhance the country's competitive edge for foreign and regional investors. In line with this development in the energy sector, the government is also planning to implement two pilot projects in renewable energy space.

Real estate

The economic and political factors discussed have undoubtedly impacted negatively on the sector's growth. But recent industry reports indicate that there is a rising need for low-cost housing in the kingdom and it is unlikely that there will be significant improvement in the real estate market until social and economic stability return to normal.

Outlook for 2013

The IMF projects that Bahrain's GDP will expand at a compound annual rate of 6% during 2012-15. Oil prices at their current high level will boost fiscal balances in the wider GCC economy and positively impact on Bahrain's economy. Infrastructure projects and transportation overhaul investment offer decent contracts pipeline to local contractors. These new projects will create new jobs and sustain profitability.

However, concerns about local unrest coupled with regional political uncertainty pose challenges to the pace and sustainability of economic growth prospects in the kingdom. But this drawback point will presumably be offset by a number of strategic infrastructural investment projects prevailed in the country and the region.

The GCC railway network, the expansion of Bahrain International Airport and the regional Grid project in the GCC all offer considerable investment and financing requirements. Through these projects, opportunities for private investors are likely to grow, and the role of SMEs and financial institutions will be crucial.

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Brunei Darussalam: Developments in Islamic banking and Takaful

By Hajah Salma Haji Abdul Latiff

The year 2012 in Brunei can be perceived as a year where the financial industry finally managed to fuse and strengthen its banking operations to conform to the regulatory changes introduced by the ministry of finance. The regulatory requirements included the tightening of credits by establishing ceilings for consumer spending in credit cards and personal loans.

Since the establishment of the Autoriti Monetari Brunei Darussalam (AMBD) in 2010, there have also been prudential standards issued by the body for ensuring continuing stability in the financial market in Brunei. The result has been productive, as evident in the promotion of new banking products and the development of enhanced technology, as well as a more stable financial environment.

Likewise in the Islamic banking sector of the financial industry, there is a conscious shift in direction from traditional retail banking to corporate banking activities, marked by increasingly active investments in local and international financial markets. In addition we also noted changes in the Takaful industry in line with regulatory requirements.

2012: A review

The introduction of the Banking Order of 2006 and the establishment of the AMBD has shown marked improvement in the stability and performance of the financial industry. The restrictions in loans and credit cards imposed in recent years have forced Islamic banks to move from their traditional domestic and consumer lending base to new grounds for investments. In November 2011, Bank Islam Brunei Darussalam (BIBD) signed a deal for a US$75 million Murabahah financing facility with Turkiye Finans Katilim Bankasi. The five-year facility is aimed to provide funding for small and medium-sized enterprises (SMEs). Other than that, BIBD has arranged transactions totalling more than BND2.5 billion (US$2.04 billion) as mandated lead arranger in a structured syndicated Murabahah to Turkish Islamic participation banks last year and raised a total of US$300 million and acted as co-lead manager for the Republic of Indonesia's US$1 billion Sukuk issuance. Its focus is on carefully selected OIC member countries and mainly on sovereign issues and top industrial companies, which has assisted in placing the surplus funds in less-risky investments. These financial strategies implemented have been reported to show positive results.

The capping of the size of loans on credit cards and personal loans was a direct response to control banks from excessive lending towards home mortgages, car and personal loans; and to prevent the outcome of excessive non-performing loans. As seen in 2010, personal loans accounted for 64.6% of all loans issued by both Islamic and conventional banks. To prevent personal banking from dominating the loans portfolio, Islamic banks have now introduced other Shariah compliant modes of lending with lower risk profiles, such as the debit card, which is based on Al-Wakalah and Ujr. This card is not only designed with better security against fraud but more importantly it curbs excessive spending since the amount of spending that can be utilized is limited to the amount available in the respective accounts.

To deter financial risk and to boost the confidence of the depositors, the government, under the Deposit Protection Order 2010, requires banks to set aside funds as reserves. The deposit protection scheme therefore protects depositors, whether individuals or businesses, against loss of their deposits in the unlikely event of a member institution failing to honour the transaction. The deposit protection scheme in Brunei Darussalam is administered by Brunei Darussalam Protection Corporation (BDPC). Although this would require banks to set aside cash reserves and pay premiums or fees to BDPC for their administration of the fund, it provides muscle to ensure a safe financial environment for consumers with deposits of up to BN$50,000 (US$40,923).

The Takaful Order of 2008 has also made some changes where there are different requirements for Takaful operators to carry out Keluarga (Family Takaful) and Takaful Am (General Takaful). Due to this, the local Takaful companies need to re-strategize their business models since given the small local market size and increasing operational costs, the profit margins will deplete significantly. The apparent move would be for the Takaful business to be less reliant on standard insurance products such as the car insurance, which is their extant dominant sector, and to venture into other opportunities, probably in special risk profile products such as corporate industrial activities.

Brunei's AMBD has also brought confidence to the financial market as it vigilantly ensures the stability of the financial system by fostering prudential standards and regulating and supervising closely the financial institutions in the market-place. The tightening of the consumer lending through the Personal Loan Capping and Credit Card directives has affected the financial institutions with marginal decline in operational profits, but generally this has been welcomed by the public and banking institutions.

With a more robust and regulated financial structure and the evident growth of a vibrant economy, the country has set the premise for the establishment of a capital market which has been a spoken many times in the past. This would be a beneficial move in diversifying the economy to be less reliant on oil and gas.

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New initiatives in the Canadian Islamic finance industry

By Rehan Huda

Over the past year, there have been several new initiatives in the Islamic finance space of Canada. Though relatively underdeveloped compared to some other western jurisdictions, namely the UK and the US, Islamic finance is making small but steady strides in the Canadian market.

The Canadian Muslim population is rich in cultural, ethnic and linguistic diversity and is one of the fastest-growing in Canada with a current population estimated to be over 1.2 million. The Greater Toronto Area, Canada's metropolitan center, is estimated to be home to over 600,000 Muslims. Canadian Muslims are one of the best-educated communities in the country and they have the lowest median age (28 years) as well as larger family sizes. The population of Muslims is projected to double within the next 10 years.

The growth in size and affluence of the Muslim community in Canada has been accompanied by a growth in the level of observance, leading to more vocal demand for Islamic financial products and services.

2012: A review

A number of trade and cultural missions from Canada to the Middle East and vice versa have taken place in 2012 and this has fostered a number of business relationships between Canada and the GCC countries. The strength of the Canadian economy and its world-leading banking system has made Canada an attractive investment destination for international investors, including those from the Gulf region.

In addition, many GCC investors have had poor results from their investments in other western jurisdictions as well as in their own markets. With the best performing G8 economy over the past decade and a top performing real estate sector, it is expected that GCC investment funds, including Islamic ones, may be increasingly deployed in the Canadian market.

As a result, one of the key developments in the Canadian Islamic finance space in 2012 has been the introduction of significant Gulf investors to the Canadian market. Amana Canada Holdings, a Canadian firm specializing in structuring Shariah compliant product for the Canadian market, has partnered with SeaSpring Consulting, a financial consulting firm based in Bahrain and managed by Sheikh Isa bin Khalid AlKhalifa.

The goal of this joint venture is to source high quality Shariah compliant Canadian investment opportunities for GCC investors. Amana's management team and advisors include the former head of the Canadian senate, the former president and CEO of the Toronto Stock Exchange, a former vice-president of Citibank Canada and one of the leading experts of Islamic finance in Canada.

One of the leading Islamic financial institutions, Kuwait Finance House, formed a partnership with a Canadian entity to pursue real estate investment opportunities in Canada and this partnership has resulted in the acquisition of multi-family residential properties in Canada. A number of other Islamic banks and financial institutions are exploring the Canadian real estate market among other sectors.

At the domestic level, there are several Shariah compliant mortgage products as well as investment funds. Islamic housing cooperatives continue to provide funding, though very limited, for home financing.

On the commercial finance side, there have been several Shariah compliant financing for purchases of Islamic centers, Islamic schools and commercial properties for Muslim businesses. These financings were done by Canadian financial institutions including several major credit unions. A number of real estate projects are currently being undertaken that will be financed by using Shariah compliant commercial mortgage contracts.

In terms of Shariah compliant investment funds in Canada, the largest is the mutual of the Bullion Management Group, a firm specializing in investing in the storing of physical gold, silver and platinum bars.

The fund has over US$500 million under management and has had a stellar performance over the last decade due to the continuously rising prices in precious metals. The firm is also offering an investment product which physically stores the precious metals in a Canadian vault and this has been marketed to a number of GCC investors.

Another mutual fund is the Global Iman Fund which is owned by Global Growth Assets which is a part of the Global Financial family of companies which is one of the largest independent financial institutions in Canada. The fund is currently managed by UBS and is based on the Dow Jones Islamic Index.

2013: A preview

It is expected that in early 2013 several funds that are currently being structured for the Canadian Muslim community will be launched across Canada. These include Islamic mortgage funds and technology investment funds.

In 2012, the University of Toronto's Rotman Business School launched the first MBA course in Islamic finance. This was the first Islamic finance course to be taught at a leading North American business school. The course was very successful and plans are underway to repeat the course in 2013 and a number of higher level educational institutions are looking at offering similar courses.

The recent developments indicate that there will be a future for Islamic finance in Canada and potentially the creation of local Islamic financial institutions. As the Canadian market is becoming more and more attractive for international investors, there will continue to be opportunities for Islamic financial institutions to participate in the Canadian market and help develop Islamic finance opportunities there.

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Islamic finance remains under-developed but progress is being made

By JUDr Ivana Hrdlickova

Islamic finance practice is still a very new phenomenon in the Czech Republic, nevertheless, public and professional awareness about this method of financing has been increasing and more people want to know details about Islamic finance. Compared to the past, when there was absolutely no information and awareness about this way of financing, the situation has changed tremendously. No real Islamic finance practice has been started yet, but increased knowledge and interest from professionals from various financial institutions and the public suggests promising future development. The Czech Republic has still to overcome many prejudices coming from the past, when people were suffering from the communist dictatorship.

2012: A review

The first Islamic finance conference in the Czech Republic was held on the 29th May 2012, organized by the countries of the OIC with the support of the Czech National Bank. Although there is no Islamic finance practice in the Czech Republic yet, this first conference spurred the interest of many bankers, entrepreneurs, tax experts and legal experts to find out more about Islamic finance principles and practice, and showed that the Czech Republic could play a significant role in the Islamic finance practice among central European countries. The professional public is now waiting to know more about Islamic finance, and to get experience on how these principles may work within current legislation. As mentioned earlier, the current legislation does not prohibit but is starting to use some principles of Islamic finance.

The Prague branch of the International Commercial Chamber (ICC) hosted the East-West Business Forum 2012 on the 18th-19th September. This first business conference of ICC Czech Republic with the OIC countries was organized under the auspices of the prime minister of the Czech Republic, the minister of foreign affairs, the minister of industry and trade and the first vice-president of the senate of the Czech Republic.

The ICC of the Czech Republic and the embassies of the OIC countries worked together to organize this conference. Its main purpose was to establish and strengthen economic and investment cooperation between the Czech Republic and OIC countries.

The first Islamic Finance Conference held in Prague on the 29th May 2012 was a successful start to open up the Islamic finance market in the Czech Republic. The program of the conference focused on the trade between the Czech Republic and OIC countries, trade and investment opportunities in the energy sector, the machinery and engineering sectors and also in the infrastructure, health and medicine sectors, the water management sector, and the forestry, agriculture and food industry. All these sectors have great potential for cooperation between the Czech Republic and OIC countries.

There were many presentations, public lectures and professional discussions relating to Islamic finance in the Czech Republic in 2012, which helped to increase knowledge about Islamic finance. Czech law firms also showed their interest in being informed about Islamic finance to be able to cooperate in this field.

2013: A preview

There is a considerable expectation to increase public awareness and knowledge concerning Islamic finance issue in the Czech Republic, particularly through lectures, presentations and education. The Prague branch of the ICC does pay attention to the financial practice and is also focusing on Islamic finance news. International trade is a very important industry in the Czech Republic and Islamic finance is an important tool for exports and imports with Islamic countries all over the world. The first step has been taken: Islamic finance has been introduced in the Czech Republic. Nevertheless more explanation, practical examples, more training, seminars and public debates are needed to take the next steps.

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Egypt: Ready – Steady – Hold

By Walid M Hassouna

Despite the fact that Islamic banking is a very old practice in Egypt, it has never performed in a Shariah compliant way since its inception. The Islamic banks regulated by the Central Bank of Egypt (CBE) failed to comply with Shariah principles as the CBE never provided a set of regulations tailored for their operation, and the old regulations were not adequate to meet the needs of the industry. The economy has hitherto not functioned in a way to promote Islamic finance techniques and the government has not relied on Islamic finance structures to finance the budget deficit or government expenditure. Even corporates have failed to find a law or regulation that will allow them to use the Islamic capital market as a source of finance

Prior to the Arab Spring, limited attempts were made by the Islamic banks to endorse a fully compliant structure. Islamic banks' market share was less than 6% and has remained the same over the past two years. The banks functioned as conventional banks with a flavor of Shariah, as this was the best that could be done in the environemt at the time. All attempts to implement Islamic banking hit a double brick wall. The first issue was the absence of political will, while the second was the CBE's attempt to reform the banking sector after the late-1990's crisis, which made acquisition and consolidation in the banking sector the top priority, overshadowing Islamic banking.

After the collapse of the old regime, Islamic parties along with liberal economists were in favor of giving Islamic finance a push. Economists believed that a dual system would be of great benefit to the economy and would allow Islamic investors, especially from the Gulf, access to invest in Egypt and thus reverse the foreign direct investment migration. In addition, government Sukuk would decrease the cost of public debt and corporate Sukuk would allow Islamic corporates to access capital in a Shariah compliant and efficient way. Islamic corporates have up till now refrained from borrowing from Islamic banks, who are lagging behind in structures and services and could not fulfil their needs. In addition their structures are often Shariah 'masked' rather than real Islamic solutions.

Following the fall of President Mubarak, dual window banks ware expected to start activating their Islamic licenses and decoding the new era signals sent by Islamic parties. However, unfortunately only Banque Misr and Bank Audi have picked up on this opportunity and launched their Islamic activity. The other eight banks in the market have remained almost silent. While pure Islamic banks, they have not changed their old strategies but instead just increased their advertising campaigns to capture unbanked customers. The only exception to this rule is the National Bank for Development, which was acquired by Abu Dhabi Islamic Bank prior to the revolution and has since started to promote more customer-based Islamic solutions.

The three main players have started to knock on the previously closed doors of syndication, project finance and advanced retail products. The syndication market was only started in late 2012 by the same set of banks and one deal has already been inked. I believe there are a few more in the pipeline but again the whole market lacks the necessary knowledge. Legal advisors and audit firms are not used to Islamic structures and a number of banks have had to rely on international and regional firms to help.

The expected changes in laws, regulations and decrees have been put on hold. The Sukuk law never saw the light of day due to the dissolution of parliament. There is an expectation that this law will be passed in 2013.

The CBE regulations also need to be amended to allow Islamic banks a level playing field; but this again did not go through due to the absence of authority to move it forward. The legislation issues will be resolved soon but in the meantime Islamic banking is still on hold.

The unbanked segment still needs to become more comfortable with Islamic banks and be reassured that they conform with Shariah. Their past experience has made them wary. Accordingly they are still avoiding banks in the belief that it is forbidden by their religion. This segment is the most important one for Islamic banks due to the very low banking penetration rate in Egypt.

On the capital markets side, there are around nine Islamic funds including equity and balanced funds, but again where are the Sukuk that should be the major contributor to these balanced funds? A further three funds were launched after the revolution but these have seen a very low subscription level thanks to the fluctuating stock exchange and the absence of Sukuk.

What Egypt needs is an expression of political will from the Islamists, and real changes in the legal framework, before Islamic finance can succeed in the country.

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A small step for the Islamic finance industry, but a giant step for Muslims in France

By Merbouh Kader and Antoine Saillon

Over the last year, French leaders in Islamic finance have played a great role in the development of Islamic finance in Europe providing necessary support to the country's practitioners. So far, three products have been launched this year, and one banking product is now on offer.

2012 : A review

Chaabi Bank remains the only bank to offer banking products such as Shariah deposit accounts, launched in June 2011. Since June 2012, it has offered Murabahah home financing following the tax directive Murabahah FE4/SE1/02. At this stage Chaabi Bank offers only a 10-year financing, and has already received more than 100 Murabahah financing demands.

2012 remained the year of launching Family Takaful products; a French innovative product demonstrating the potential of Islamic finance.

- **Salam Pax: the first life insurance product**
  The first Shariah compliant life insurance product in France was launched by Hassoune Conseil in April 2012 few days after the approval from market regulators (AC-Banque de France). This product provides French Muslims with a way to invest their money in conformity with their ethical principles. Anouar Hassoune, the director of the SICAV and the former senior vice-president of Moody's who structured the Undertakings for Collective Investments in Transferable Securities that will serve as the investment vehicle, expects EUR15 million (US$19.7 million) in subscriptions by the end of the year.

- **Orasis: the first green French Sukuk**
  Launched in August 2012 by Legendre Patrimoine, this product carries twin social responsibilities. It is in line with the requirements of Shariah, and it channels investments towards an ecological and sustainable economic sector. Islamic finance serves environment-friendly asset allocation, which is in turn socially acceptable and economically sustainable.

- **Financing the French SMEs by Sukuk**
  As the French economic fabric is almost entirely composed of SMEs, the new Sukuk launched in September 2012 by BIBARS, a french distributor of Halal products, for an amount of EUR500,000 (US$641,000) will open a new way to finance SMEs using an Islamic instrument. However it needs to be industrialized in order to target more SMEs.

Universities: An influential developer of Islamic finance in France

The increasing number of conferences held this year shows the great interest given to Islamic finance. Many conferences are becoming references within the finance discipline as major players become more interested in presenting their works and advancements on Islamic finance. These include:

- The second edition Annual conference on Islamic Retail Banking developed by Dauphine University in June 2012;

- The third conference on real state Islamic finance in France co-organized by Baker McKenzie and Dauphine University in May 2012;

- The traditional annual trip of the executive master in Malaysia in June 2012. Major players of Islamic finance industry in Malaysia were visited (Bank Negara Malaysia, Bursa Malaysia, CIMB Islamic, IFSB, IILM, IIUM) with the support of the Malaysian embassy in France.

2013: A preview

Islamic finance in France suffers some weaknesses regarding its industrialization.

- Lack of international communication about advances and opportunities in France, because many international players still believe that the French market is a closed market or a non-market and worse, that it is not a market at all.

- Lack of political support due mainly to international perception of France with regard to its Islamic community.

- Need to enhance the collaboration between players in France. Islamic finance players need to collaborate more, but also insert Islamic finance in ethical finance in a more practical way.

- Need to improve the understanding of Islamic finance principles and practices within Muslims and non-Muslim communities.

Volume One of the main 20 AAOIFI Shariah standards was recently officially translated into French. The French standards give a thorough transcription of the Shariah law concepts (as described in the AAOIFI standards) into French law concepts. Moreover, the French civil law system is very close to those of many French-speaking countries in Maghreb and Africa (which contain more than 250 million people). The rest of standards will be published into the Volume Two by the end of 2013 as the Europlace Commission experts are still working on the translation.

To conclude, international investors have a strong interest in the promising French market. They understand that today is a good time to seek for opportunities. Developing Islamic banking activities in France is becoming more important as the environment is getting more and more welcoming.

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More hurdles projected

By Anthony Chan and Lawrence Cheng

With economic unrest in many parts of the world, Hong Kong's economy had remained relatively stable in 2012, with the republic continuing to cement its position as one of the major financial centres of the world. Despite the Hong Kong government taking a few initiatives to strengthen Hong Kong as an ideal market for Islamic investors, the proposals made are yet to be finalized and implementation plans are yet to be realized.

As we start 2013, we summarize developments in Hong Kong in the Islamic finance sector during this year and surmise what 2013 may hold in store.

2012: A review

Hong Kong's Financial Secretary, Mr John Tsang Chun-wah, in delivering the 2012-13 Hong Kong Budget, finally announced that the Hong Kong Government was finalizing legislative amendments to promote Islamic finance. In the first half of 2012, the Financial Services and the Treasury Bureau (FSTB) published the Consultation Paper on the "Proposed Amendments to the Inland Revenue Ordinance ("IRO") and the Stamp Duty Ordinance ("SDO") to Facilitate Development of an Islamic Bond (i.e. Sukuk) Market in Hong Kong" ("Consultation Paper").

Under these legislative proposals, four types of Sukuk are covered–namely Ijarah, Musharakah, Mudarabah and Murabahah. As the majority of Sukuk are in a tripartite structure comprising an originator, a bond issuer (typically a SPV established for the purpose of issuing Sukuk) and a bond holder, the proposed framework is also drafted based on this tripartite structure. There are amendments in place which aim to extend the tax concession exemption under the Qualifying Debt Instrument (QDI) scheme to cover Sukuk, to accord coupon payments payable on Sukuk the same tax treatment as interest payable on conventional bonds, and to expand the exemption to cover non-resident Sukuk holders who can be exempted from certain profits tax.

The legislative proposals provide substantial incentive for financial institutions trying to promote the Shariah compliance products. Even without these potential changes, Islamic finance activities continue in Hong Kong - for example, Hong Leong Bank started already offering Islamic banking services. The bank announced a growth of 289% in revenue generated from Islamic banking services in the third quarter of 2012 compared to that of the previous year. The active participation of Hong Kong investors in Islamic investment was evidenced by the fact that 55% of the investors in a RMB1 billion Sukuk (US$160.83 million) launched by Axiata Group of Malaysia were from Hong Kong. In addition, the Dow Jones Islamic Market China/Hong Kong Titans 30 Index recorded an increase of more than 10% to about 1670 bps by the end of 2012. These all are encouraging figures for banks and financial institutions as it indicates a strong growth in demand in Shariah compliant products which are regarded as new and perhaps safer forms of investment.

2013: A preview

Recently the FSTB issued a Consultation Conclusions with regard to the Consultation Paper. It is anticipated that the main developments for 2013 will still likely centre on the progress made

with legislative reforms, as the government is due to finalize the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Bill ("Bill").

Following the consultation, the Bill will cover an additional type of Sukuk structure, namely, Wakalah, a form of agency arrangement as a result of its increasing popularity in recent years. The Bill will also build in flexibility to enable the expansion of the scope of the Sukuk covered in the IRO and SDO by way of subsidiary legislation. Although it will take a while before the effects of the amendments can be realized, we believe local financial competitors will capitalize on these opportunities in the upcoming year.

Another area that may see development in the Hong Kong Islamic finance sector relates to renminbi-denominated Sukuk issues. Being the leading offshore renminbi market and a developed securities market, Hong Kong can provide unique opportunity for the Islamic investors to invest in renminbi-denominated Sukuk while at the same time, allow institutions to access the large Muslim community in China. It is therefore likely that there will be more renminbi-Sukuk bonds being issued this year.

Some more hurdles have to be overcome however in 2013. For instance, the legislative amendments aim only to accommodate a limited number of Shariah compliance products. More adjustments and amendments will be needed after the proposed legislations come into effect. Furthermore, changes in regulations entail that more skilled Islamic finance professionals will be needed. This remains a challenge in promoting Islamic finance in Hong Kong.

Nevertheless, the amendment initiative is a milestone for the development of Hong Kong as a centre for Islamic finance in the region. Though it may be seen as a late entrant to the Islamic finance field, with the probable implementation of the relevant reform in 2013, Hong Kong will excel in providing a comprehensive legal and regulatory framework for Islamic finance.

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Finally waking up to Islamic finance opportunities

By Suprio Bose and Pooja Yedukumar

Islamic finance may have finally reached a turning point in India with the regulators ie. the Reserve Bank of India (RBI) making statements about amending the laws to allow Islamic finance. While the Prime Minister has already spoken about facilitating Islamic finance in India, it is heartening to note that the RBI is finally waking up to the opportunities in Islamic finance.

2012: A review

While the Kerala High Court has allowed the Kerala State Industrial Development Corporation (a state-sponsored financial institution) to invest in a private company, set up to carry out Shariah compliant financing activities in India, the litigation resulted in a regulatory scrutiny from the RBI on non-banking financial entities carrying out Islamic Finance in India. One such entity that came under RBI's scrutiny was the Kerala-based Alternative Investments and Credits (AICL).

AICL was registered as a registered as a non-banking financial company (NBFC) and its business objective was to lend on a participative basis. In early 2012, RBI cancelled AICL's NBFC license. RBI's main premise for revoking AICL's license appears to be that NBFCs that are lending on a participative basis, are not in strict compliance with the RBI directions on 'Fair Practice Code' which requires NBFCs such as AICL, to ensure that interest on loans are not usurious and for this purpose NBFCs should have internal policies to arrive at the interest rates and disclose the same to the borrowers.

AICL filed a writ against seeking stay against the RBI's order in the High Court of Mumbai. The matter is still sub-judice.

Notwithstanding the RBI's cancellation of AICL's NBFC license, RBI appears to have woken up to the issue at hand and is in the process of taking some proactive measures to facilitate Islamic finance. This is evident from statements made by the governor of the RBI, Dr Subba Rao, in October 2012, that the RBI has asked the ministry of finance to amend the Banking Regulation Act of 1949 to facilitate the introduction of Islamic banking in the country.

This is a major development and significant more so, because a 2005 report prepared by an internal committee (set-up at the behest of the RBI) had held a contrary view. Should the lawmakers allow Islamic banking to operate in India, it could easily catapult India into position as one of the top five Islamic finance market in the world in terms of size.

2013: A preview

With the introduction of the regulations on Alternative investment funds by the Securities and Exchange Board of India (SEBI) (AIF Regulation), the capital market regulator of India, we expect Shariah compliant funds to be registered under the AIF Regulations. SEBI has not raised any objection to Shariah compliant products being launched and had even approved exchange traded funds and portfolio management products in the past. Hence, Shariah compliant real estate funds can be registered under the AIF regulations for investing in real estate. The AIF regulations do not apply, if such funds are set up outside India.

On the NBFC side, we do not expect any major development, and expect the status quo to continue, given that the matter is sub-judice. The outcome of the Mumbai High Court litigation in this aspect is keenly awaited. Since, the policymakers (the ministry of finance and the RBI) have talked about taking some proactive steps to facilitate Islamic banking in India, some progress can be expected in the future.

Although the Indian GDP has witnessed a slowdown, the domestic story is still intact and demand for capital subsists. Sukuk can be issued to facilitate fund infrastructure, commercial or residential projects in India and there is a lot of interest amongst participants in this regard. In order to alleviate the high transaction costs, state legislators can propel executive action to provide specific concessions, as is being done in other jurisdictions.

The Middle East region will remain an important source of foreign capital, especially if Shariah-based foreign funding is being targeted, given the number of non-resident Indians living abroad. The Kerala government and the Kerala High Court have recognized this and we expect the RBI and the ministry of finance to act upon it.

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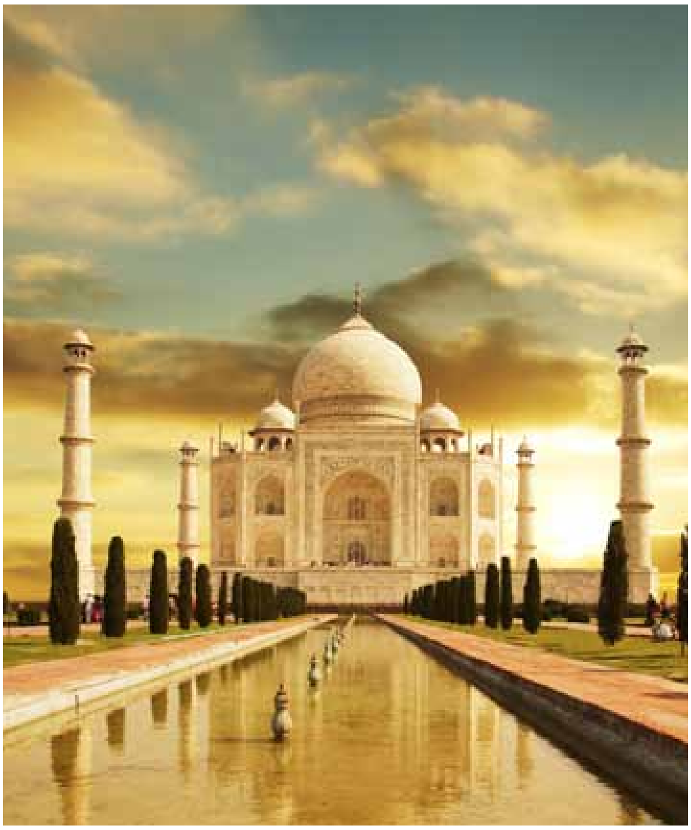

Review on the anatomy and sustainability of the high growth regime of the Indonesian Islamic banking industry

By Farouk Abdullah Alwyni

The year 2012 up to the third quarter of 2012 i.e. as of September 2012 signified the slowing down of the growth of Indonesian Islamic banking sector. Although we have yet to see the figures in the last quarter of 2012 to take any definite conclusion, it is safe to say that the 2012 growth of Indonesian Islamic Banking sector has been considerably slower compared to its 2011 growth. In order, to make the Islamic banking sector more significant in Indonesia and increase its share beyond 5% of total banking industry (it is still around 4% to-date), consistent high growth is still needed. However, what really needs to be addressed is the reason behind the slowdown growth.

Review on Indonesian Islamic banking industry in 2012

After recording a very high growth in 2011, there has been a slow down in the growth of Indonesian Islamic banks up to September 2012. The year 2011 recorded the asset growth of almost 50% to IDR145.47 billion (US$15 million) in 2011 from IDR97.52 billion (US$10.06 million) in 2010. Asset growth for September 2012, however grew only by 15.94% to IDR168.66 billion (US$17.4 million) in September 2012 from IDR145.47 billion (US$15 million) in 2011.

Two major Indonesian Islamic banks, Bank Syariah Mandiri (BSM) and Bank Muamalat Indonesia (BMI), which both accounted for 55.78% of total Indonesian Islamic banking assets in 2011, have played a significant role in affecting the rise and the decline of the growth of Indonesian Islamic banking assets as a whole. BSM and BMI grew at 49.84% and 51.47% respectively in 2011. However, for the period ended in September 2012, BSM and BMI only grew 5.2% and 9.92% respectively.

It remains to be seen whether or not both banks could grow faster toward the end of 2012, which in turn, will affect the growth of Indonesian Islamic banking industry as a whole. However, other than the two major Indonesian Islamic banks above, it seems the rest of the Islamic banks are slowly catching up. This is based on the fact that both BSM and BMI experienced a decreasing market share up to September 2012 compared to decrease in 2011.

BSM's market share decreased to 30.36% in September 2012 compared to 33.46% in 2011. Similarly, BMI's market share also decreased to 21.17% in September 2012 compared to 22.33% in 2011. In the previous year, both banks recorded a modest increase in term of market share in 2011 compared to 2010. The market share of BSM and BMI in 2010 accounted for 33.31% & 21.99% respectively.

Based on the information in Table 1 showing selected Islamic banks and windows (Table 1), it can be seen that the second tier Indonesian Islamic banks and/or windows (in terms of assets) such as BRI Syariah, Permata Syariah (Islamic window known in its Indonesian term as Unit Usaha Syariah [UUS]), and CIMB Niaga Syariah (also Islamic window) also recorded very high growth in 2011 ranging from 66.08% (CIMB Niaga Syariah) to 131.09% (Permata Syariah). Similar to BSM and BMI, their growth also experienced some slow down in 2012.

However, unlike the two major banks above (BSM & BMI), Permata Syariah and CIMB Niaga Syariah still maintained their level growth at 58.84% and 45.32% up to September 2012. BSM, whose growth in 2011 was only around 20.01%, seems to be able to steadily increase its growth pace to 31.24% as of September 2012.

The question now is, will the high growth regime of Indonesian Islamic banks be sustainable? The internal and external issues affecting the business of the banks will also affect the growth itself. However, apart from macro-environment issues, the banks should not be tempted to push for the growth only towards the end of the year as shown in the case of BMI and BRI Syariah where they experienced a decline in March 2012 from December 2011.

Preview of the Indonesian Islamic banking industry in 2013

Looking at the development in 2012, it is important to reflect on the sustainability of the high growth regime of Indonesian Islamic banking sector. The case of BMI and BRI Syariah, which experienced decline in the first quarter of 2012, showed that pushing for growth only towards the end of the year will not mean anything if it cannot be maintained in the following year.

Here, the bank's management should have a more steady & sustainable approach in fostering growth. Rapid asset growth not accompanied by proper risk management could also create financing risk in the medium and long term, especially for bigger sized banks. 2012 could be a good lesson for the second-tier banks to learn from the experience of the first-tier banks, which is to strengthen the foundation for the growth itself. This includes developing people, crafting meaningful values & vision, enhancing products and services, and upgrading information technology. They need to look beyond just the numbers and have bigger objectives, and let the numbers come on their own sustainably.

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Table 1: The Total Assets of Selected Indonesian Islamic Banks & Windows (in Million Indonesian Rupiah*)

	2010	2011	March 2012	Sept. 2012
BSM	32,481,873	48,671,950	49,616,835	51,203,659
BMI	21,442,596	32,479,506	30,836,353	35,700,818
BRI Syariah	6,856,386	11,200,823	10,552,693	12,199,091
BNI Syariah	6,394,924	8,466,887	9,223,555	9,374,602
Permata Syariah (Islamic Window)	2,273,612	5,254,828	7,014,526	8,347,203
CIMB Niaga Syariah (Islamic Window)	3,169,090	5,262,903	5,673,384	7,648,363
Bank Syariah Mega Indonesia (BSMI)	4,637,730	5,565,724	5,874,897	7,305,239

Source: Bank Indonesia (the Central Bank)
*Note: *In December, 1 USD is hovering at around IDR 9,600.*

Iran: Towards capital market development

By Majid Pireh

After the Islamic revolution in 1979, financial system in Iran has had a great tendency to implement Islamic laws and reform the structures to comply Shariah rules and regulations. Although there has been done a great deal of precious works, there is still a long way to achieve the Shariah goals. For this, it is not lawful in the capital market to issue any instrument which contradicts Shariah rules and regulations.

2012: A review

The previous year was the year of significant attempts for capital market development. Surely it is a long way to meet a developed market, but the steps are passing. Some challenges for issuance of new cases of Ijarah Sukuk may be an important point to overcome. In this regard the cooperation of banking system and the capital market is vital. But the Securities and Exchange Organization (SEO) has structured some new Sukuk issuance models which briefly shall be discussed. Some important clues that resulted to the market development claim are as follows:

Establishment of energy bourse

Energy bourse witnessed its first steps to start the operations. In the new established exchange, some Islamic instruments shall be issued and traded. Sukuk Salam is amongst the important issues. It is planned to finance some industrial sectors by Salam Sukuk through energy bourse. By the new exchange, now in Iran four exchanges are operating which includes securities exchange, commodity exchange, Farabourse and energy exchange.

Financial literacy to promote more

In 2012, the SEO continued its attempts to promote a level of financial literacy in the country. Some significant aspects of this claim include:

1. **Professional qualifications test**
   These tests evaluate market players level of financial literacy' and are conducted semi-annually. Those who are going to actively take a position in the Iranian capital market have to pass these tests. Islamic knowledge is among the important issues that practitioners should be aware of.

2. **Organizing the 4th Islamic capital market course**
   The 4th International Course on Islamic Capital Market was held in Tehran on the 6th – 8th May 2012. Participants from all over the world accepted the invitation and shared their ideas and experiences through the course. It has become a tradition for Securities and Exchange Organization (SEO) to organize such courses annually in order to provide a vibrant sphere to talk and think about new aspects and perspectives of the Islamic capital market.

Derivatives market is moving ahead

After the Shariah board of SEO approved a model for derivatives, the market started its operations. Gold was the underlying asset in futures contract that structures the market. In 2012, besides gold coin futures contract, the SEO ratified single stock futures. The second one was not as successful as the first but it is still persevering. After that, embedded put options made new experience for derivatives market. The market faced some

challenging issues for some underlying assets such as copper, but it is developing at a satisfying pace.

2013: A preview

The coming year determines some important aspects of the market development. The banking system is growing in parallel to the capital market. Both markets are meeting with industry needs for financing. While most of Sukuk Musharakah in Iran is traded in the banking system, other types such as Ijarah or Murabaha is taking a more prominent position in the capital market. While Sukuk profit rates was a challenging issue, essentially the cooperation between the two pillars opens new horizons. 2013 shall answer many questions for market development. What shall take place in the market is highlighted as follows.

Rating agencies to start operations

Pakistan Credit Rating Agency (PACRA) and the SEO entered into MoU wherein PACRA will provide technical assistance in establishing a credit rating regime in Iran. Under the MoU, PACRA shall prepare regulatory framework for regulating the credit rating business in Iran and in establishing rating agencies in Iran. The cooperation opens the door to new comer institutions in the Iranian capital market.

Salam Sukuk

Because Iran produces its own energy, its energy sector has a lot of potential for trade and attracts interest among investors. Establishment of Iran's fourth Bourse was part of the five year development plan. Islamic financial instruments shall play a significant role in the energy bourse. Salam Sukuk is one of the instruments for financing oil-producers. The SEO ratified the issuance structure. Hopefully in the coming year, the market will witness a new Sukuk.

New model for Sukuk

The SEO planned for issuance of Murabaha Sukuk in the coming year. Although the fundamental issuance rules are ratified, it essentially requires a stable platform for convergence of banking system and capital market as the two pillars of the financial system. Anyway, the SEO should prepare the rules and regulations as its own duty. Istisna Sukuk is also waiting for the market to open the doors.

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Italy: Jumping into the future of Islamic finance

By Alberto Brugnoni

The shortcomings of conventional finance that are becoming more evident by the day across the globe, have not spared the 'Bel Paese' and sparked a nation-wide debate on the ways and means to overcome a crises that has become almost endemic. Though Islamic finance is still marginal in this debate, its understanding of the nature of money, its dislike of credit brokerage based on interest rate and its wealth redistribution and risk-sharing approach, coupled with its financing of only tangible transactions, have attracted the attention of enlighted bankers, the fair trade and ethical finance organizations, and the unions.

Besides, its exclusive dealing with those sectors of the economy that can actively contribute to a sound individual and societal development and its inclusiveness of all faiths and races, have made it a reasonable proposition to the church. Strategic perspectives and macroeconomic data as well, support the use of Islamic modes of financing. In the capital market arena, because Italy (in 2011, the 8th largest economy in the world) is a key trading partners with the MENASA region, and in the retail banking sector, because she hosts 1.7 million Muslims with estimated annual savings of US$6.5 billion (Deloitte and Pew Research Center).

2012: A review

This encouraging and friendly environment is well epitomized by the topics discussed at three acclaimed events. In March, Islamic Relief-Italy hosted in Milan a conference themed "Islamic Finance: Opportunities for an Inclusive Development" attended, amongst others, by the top-management of the largest Italian ethical bank and the largest microfinance institution. The conference highlighted how Islamic finance may provide solutions complementary to those advanced by social and ethical finance.

In May, a conference on "Islamic Finance and Business Ethics in the Social Doctrine of the Church" was held in Rome with the attendance of the managing director of the central bank of the Vatican. It meant to offer an opportunity for reflection on the common principles of financial ethics shared by diverse religions and cultures. In July, the annual summer school organized by 'Università di Tor Vergata' convened in Rome to discuss "Islamic finance and pluralism: Managing diversity as an opportunity for growth".

On the practical side, the use of Shariah compliant structures to source funding for the investments of Italian companies in the Muslim regions has become quite common and several investment banks are reasonably well-equipped to deal with the capital market requirements of their clients. Some top-tier commercial banks are also expanding or making acquisitions in the Mediterranean region taking advantage of the opportunities provided by the Arab Spring. Though these activities are conventional in nature, it is only question of time to see the appearance of windows that will gather under the same roof scattered with Islamic activities. And this, in turn, could be the harbinger of a fully-fledged Islamic bank.

On the domestic front, it is worth mentioning that new leasing products for home financing have been introduced by the law n. 220/2010. These products, though not specifically addressing the Muslim communities' requirements, bypass the well-known double taxation issue thus allowing in practice Islamic financing. This development has prompted Deloitte-Italy to author a report on "Shariah compliant home financing in Italy" where it highlights the business opportunity for a Gulf-based bank willing to start a retail operation in Italy and eager to tap the hefty savings of Muslim domestic communities. The housing market potential for Muslims is estimated at US$123 billion. 'Halalitalia' has emerged as a key player in the halal products (food, cosmetics and pharmaceuticals) market worth an annual US$5 billion. Italy is located at the centre of three key markets (EU, Balkans and MENA) with a pool of 800 million potential consumers.

The interest in Islamic finance and economics continues unabated in the academia as well. The studies often underline the similarities between Islamic finance tools and instruments dating back to Middle-Age banking institutions (Biasi, Università Cattolica, Milan 2012) as well as the growing gap between principles and praxis. The launching of "Alim-The Shariah Scholars' Journal", a quarterly publication that provide a forum for Shariah scholars, Islamic bankers and Islamic lawyers, bears testimony to the widening scope of Islamic topics.

2013: A preview

An ice-breaking project that seeks a new role for Islamic finance, dubbed "Rethinking Communication between Our Two Worlds", will see the light during 2013. Focusing on the increasing cultural and financial bearing of Islamic finance in Muslim markets, this initiative will use Islamic finance as a communication tool and help Italian SMEs that are world-leaders in their area of business, such as design, fashion, mechanics and arts, to better position their brands and widen their scope of action.

Finally, the increasing weight, in numbers but also culturally and socially, of the Muslim minority now in its third generation shall help to accelerate the process of demystifying Islamic finance across large layers of Italian society.

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Mapping the loyalty of retail customers of Islamic and conventional banks in Kuwait

By Naser Al Ziyadat

One of the misconceptions about Islamic finance is that all of us as Muslims in the GCC are very willing to do it in a Shariah compliant way. Of course, this misconception is subjective and is refuted objectively by the fact that the total assets of GCC Islamic commercial banks do not exceed 25% of the total assets of GCC commercial banks (based on M&R database, 2012).

Nonetheless, customer loyalty is an indicator that cannot be totally represented by the total assets or deposits of a bank, but by the degree at which a customer is willing to stay dealing with his/her bank. This is in addition to the factors like quality, price and profitability that maximise or minimise the degree of loyalty. But, when it is measured in a country that has both Islamic and conventional banks, customer loyalty is ideologically influenced. The aim of this piece of writing is to provide a descriptive analysis about the ideological loyalty of Arab retail customers for their banks in Kuwait.

Banking system in Kuwait

According to the Central Bank of Kuwait, there are 15 banks operating in the state, 10 of them are domestic and 5 are foreign. The domestic banks are divided equally between Islamic and conventional. Nonetheless, conventional banks have a larger market share in terms of assets (61% of the total assets), and deposits (62% of the total deposits). Additionally, the market value of Kuwaiti-listed conventional banks is larger (65% of the total market value) from that of Islamic banks.

The survey

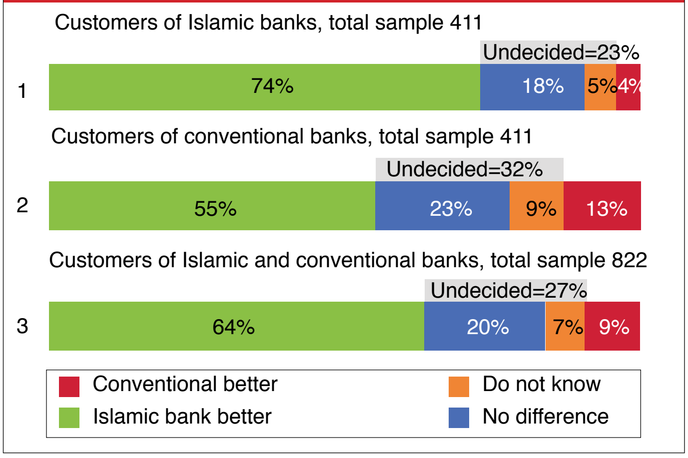
A survey study was conducted by Al-Mashora & Al-Raya for Islamic Finance Consulting (M&R) and the specialized field research firm (Ara). The survey targeted Arab retail customers of Islamic and conventional banks in Kuwait. The total sample was divided equally between the customers of the two types of banks (411 each). High level techniques have been followed to reduce the sampling error while taking into consideration the demographic characteristic of the population. The survey was conducted by telephone during November 2012 and respondents were asked to answer a questionnaire that contained several sections related to the customer satisfactions. However, in this piece of writing, only a specific part of the results is disclosed due to confidentiality. Nonetheless, the other parts that are not disclosed in this piece of writing have no impact on the part disclosed.

Ideological loyalty

To what extent do Arab retail customers of banks in Kuwait believe that Islamic banks are better than conventional banks? The respondents' answers to this question can provide a map for the ideological loyalty of the customers especially when taking into consideration that the general customer satisfaction about the services of all banks in Kuwait is 91.5% (92% for Islamic and 91% for conventional) for the same sample of the survey.

To facilitate the presentation of the answers, it is important to take into consideration that if we have two different ideologies, it is better

Figure 1: Do you think Islamic banks are better than conventional banks?



to position them on a straight line giving each one an extreme. This is because some of the people are loyal to one ideology while another people are loyal to the other one. Nonetheless, in the middle of the line there will be other people who are not loyal to any ideology. Currently 74% of Islamic banking customers believe that Islamic banks are better than conventional banks (see section 1 in Figure 1); 4% believe that conventional banks are better; and 5% do not know if Islamic banks are better (or not) than conventional banks; while, 18% believe that there is no difference between Islamic banks and conventional banks.

As for the customers of conventional banks (see section 2 in Figure1), 55% surprisingly believe that Islamic banks are better than conventional banks, and 13% believe that conventional banks are better. 23% of them believe there is no difference between Islamic and conventional banks and 9% do not know if there is a difference. The larger scene is explained in section 3 of Figure1. When combining the answers of the customers of both Islamic and conventional banks, 64% of the total sample believe that Islamic banks are better than conventional banks; 9% believe that conventional banks are better than Islamic banks. The total undecided formulate 27% of which 20% believe there is no difference and 7% do not know if there is a difference.

Zooming in: How these ideological beliefs can affect the customer retention

In light of the findings of the ideological loyalty, it is very important to investigate the attitudes of the customer regarding leaving or staying with their banks especially when the market is competitive. The competitiveness of the market is not limited to that between Islamic and conventional banks, but it includes competitiveness between banks from the same ideology. In this regard, a good question to ask is: to what extent is a customer of a bank in Kuwait is willing to stay dealing with his bank when there are other attractive offers from other banks?

For Islamic banks' customers (see section 1 in Figure 2), 47% of

Figure 2: Dealing with another bank in case of new attractive offers

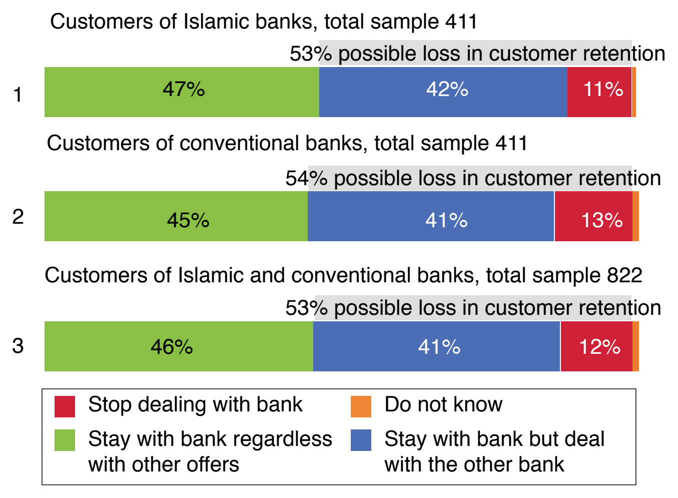
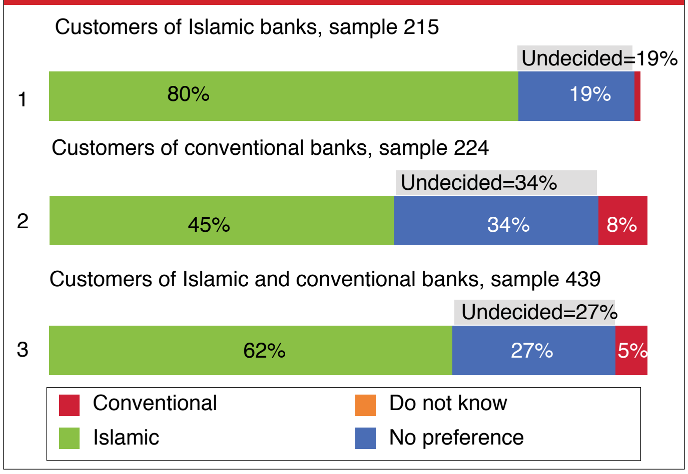


Figure 3: Preferences in case of agreeing to deal with another bank



the respondents indicate that they will stay dealing with their banks regardless of attractive offers from other banks; 11% indicate that they will stop dealing with their banks and move to other banks with attractive offers; 42% say that they will stay with their banks but deal with the other bank with attractive offers; and, 1% do not know what they will do. This means that Islamic banks in Kuwait are exposed to 53% of loss in customer retention when there are attractive offers from other banks. The case for conventional banks is almost the same (section 2 in Figure 2). They are exposed to 54% loss in their customer retention (41% + 13%). However, the general tendency of all bank customers in Kuwait represented by the sample of the survey (section 3 in Figure 2) that 53% of them will deal with other banks when there are attractive offers even by stop dealing with their banks (12%), or while stay dealing with their banks (41%).

These findings lead to a very important question: of the 53% customers who will deal with banks other than their main banks, what is the proportion representing those who will opt for Islamic banks in comparison to the proportion of those who will opt for conventional banks? The answer of this question will validate the ideological loyalty map illustrated in Figure 1.

Validating the ideological loyalty map

For customers of Islamic banks who say they will deal with other banks with more attractive offers (215 persons including those who will stay with their main banks and deal with the other banks in addition to those who will stop dealing with their main banks and move to the other banks with attractive offers) 80 % say they will move to another Islamic bank; 19% say that they have no preference; 1% will move to conventional banks; and less than 1 % say they do not know (see section 1 in Figure 3). These results indicate that the loyalty for the Islamic banking will increase if it is supported by attractive offers and services. Additionally, the ideologically undecided Islamic banks' customers formulate about 19% of the total Islamic banking customers in Kuwait.

As illustrated in section 2 of Figure 3, for customers of conventional banks who say they will deal with other banks with more attractive offers (224 persons including those who will stay with their main banks and deal with the other banks in addition to those who will stop dealing with their main banks and move to the other banks with attractive offers) 57% say they will move to an Islamic bank; 34% say that they have no preference; 8% will move to conventional banks; and less than 1 % say they do not know. For all the banks' customers in Kuwait (439 persons including those who will stay with their main banks and deal with the other banks in addition to those who will stop dealing with their main banks and move to the other banks with attractive offers), 68% say they will move to an Islamic bank; 27% say that they have no preference; 5% will move to conventional banks; and less than 1 % say they do not know as illustrated in section 3 Figure 3.

When comparing the results displayed in section 3 Figure 1 and section 3 Figure 3, it appears that the loyalty for Islamic banking is to increase by 4% (from 64% to 68%) for all customers of banks in Kuwait when Islamic banks has attractive offers and services than those in conventional banks. Although the 4% is a missed value for Islamic banks in Kuwait, the loyalty to Islamic banking in general is high amongst customers of both Islamic and conventional banks in comparison to the loyalty to conventional banking. In fact, the loyalty to conventional banking is exposed to a decrease by 4% if Islamic banks provide more attractive offers and services. As for the undecided customers, they represent about 27 % of the total customers of Kuwaiti banks, a matter that make it harder for conventional banks in terms of competiveness with Islamic banks.

Strategic implications

- Since the loyalty to Islamic banking stems mainly from ideological belief, Islamic banks are required to invest more in their Shariah compliance systems to maintain credibility.
- Since Islamic windows in conventional banks are not legally allowed, conventional banks are to face greater competitiveness. In fact, undecided customers are the most viable prospective for greater competitiveness between Islamic and conventional banks.
- Conventional banks are under pressures of losing customers because more than 50% of their customers believe Islamic banking is better.
- Apparently, the customers of conventional banks have more weight than the customers of Islamic banks. The weight here is represented by the size of customer deposits and financing facilities. In this regard, there is an opportunity for Islamic banks to attract more of the weighty customers of conventional banks provided that the weighty customers are not governmental bodies who deal with banks based on political economic policies.
- Larger and older Islamic banks in Kuwait are exposed to a loss in their customer base to smaller and newer Islamic banks. In this regard, the quality of the service, pricing, and other customer attraction factors will be the core for competitiveness between Islamic banks.

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Lebanon: Unfulfilled potential

By Rita Ghanem

Lebanon first opened its financial market for Islamic finance in 2004 with the enactment of Law number 575 dated 11th February 2004 which established Lebanese Islamic banks. Though Lebanon was a welcoming market with high growth potential, Islamic finance has still not witnessed the boom that it has been witnessing all over the world.

Lebanese Islamic banks still do not hold a significant place in the domestic banking market. Only five full-fledged Islamic banks are currently operating, three of which are fully established in Lebanon- an extremely small number compared to 66 full-fledged conventional banks. This small proportion is also reflected in the breadth of their operations. According to the semi-annual data on the 31st July 2012, Islamic banking operations accounted for merely around 0.6% of the total number of loans granted by Lebanese banks. The most common product by far is Murabaha which accounts for 86% of all Islamic loans. Further, Sukuk and Islamic collective schemes are virtually non-existent in the Lebanese market.

In spite of their scarcity, Islamic banks have been slowly but steadily growing since their inception in 2004. They have however hit a standstill in 2012 while still maintaining a positive outlook for 2013.

2012: A standstill

Amid the volatile security situation and political unrest in Lebanon and its neighbouring countries, in addition to an unfavorable legal and regulatory climate, Islamic finance in Lebanon is at a stalemate. The industry continues to struggle behind conventional banks as it still needs to overcome various legal and financial impediments.

Islamic banks operating in Lebanon still suffer from excess of liquidity which burdens their balance sheet with excessive money costs. Pursuant to article 1 of Law number 575/2004, Islamic banks have to comply with all the regulations and directives issued by the Central Bank for both conventional and Islamic banks including applicable regulations on investing bank liquidity. These regulations fail to take into consideration the specificities and requirements of Islamic banks. The products available to Islamic banks to invest their liquidity are restricted to Shariah compliant products, yet Islamic banks are still bound by the same limits on investments and margins imposed on conventional banks.

Furthermore, the Lebanese legislation still lacks tax incentives for Islamic finance. Most importantly, the legislation has yet to address double taxation issues encountered in most Islamic finance products specifically the real estate registry fees in Ijara operations. The extra cost incurred due to double taxation is significantly maximizing the cost gap with conventional banking operations and preventing Islamic banks in Lebanon from benefiting from a cost-efficient competitive edge.

The challenges hindering the growth of Islamic banks are not only external, some are also internal. The Lebanese Islamic financial market still lacks the sufficient level of knowledge and understanding of Shariah compliant products. Though the retail banking consumers in Lebanon are aware of the existence of Islamic banks, they are still not familiar with the products and

services offered. This has significantly affected Islamic product development and innovation due to the lack of demand.

All these factors have hampered the ability of Islamic banks to offer competitive rates and products as compared to conventional banks. Islamic banks are thus primarily dependant on religiously-driven investors and fail to attract the profit-driven local or foreign investors, specifically investors from GCC countries.

2013: Moving forward

Considering 2012 did not bring any major legal or regulatory reform, much effort needs to be exerted in 2013 to mainstream Islamic finance. Islamic banks need to appeal for the enactment of a law that introduces fiscal stimulus and rebalance tax costs. They should also lobby for key improvements in the regulatory environment that would favor Islamic banks and deal with the issues that they face, especially that of excess liquidity.

Finally, Lebanon has issued a law establishing a capital markets regulatory authority in 2011 (Law 161 dated 17th August 2011). The Capital Markets Authority (CMA) is beginning to take shape and will be effective in the second quarter of 2013. The CMA's first order of business will be to review all the existing laws and regulations related to the financial market in order to either amend them or fill in any legal gaps. Hopefully, this process will include regulating the Sukuk market. This regulation, if enacted, will encourage Sukuk issuance in Lebanon and boost the place of Islamic finance within the Lebanese financial market.

In the end, despite all the hurdles, the Lebanese Islamic banking market possesses great potential to play a pivotal role in the future in the Lebanese banking sector.

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Luxembourg: A European bridge to Islamic finance

By Jean-Nicolas Durand and Sufian Bataineh

While the sovereign debt crisis increased distrust of the Eurozone, MENA investors renewed their confidence in the robustness and resilience of the Luxembourg financial center, recognizing its financial solidity coupled with its capacity to develop cutting-edge solutions. Historically speaking, support from political quarters in Luxembourg and attention to the needs of market players have resulted in one of the most welcoming legal and fiscal environments, offering an impressive diversity of investment vehicles. This trend, which has emerged in 1978, has again been confirmed in 2012.

2012: A review

Despite the ongoing difficult financial environment, Luxembourg has managed to capitalize on its unanimously recognized experience in the Islamic finance field (e.g. Luxembourg ranked fifth worldwide by number of Shariah compliant regulated funds with US$500 million AUM in 2011) and 2012 can be perceived as a promising transitional period for Islamic finance.

Funds: On the funds side, Luxembourg investment fund expertise and competitiveness continues to attract new promoters. Excellent examples can be found in SEDCO Capital (KSA) multi-assets SIF-SICAV which is expected to reach US$1.6 billion by December 2012, and Franklin Templeton Shariah funds umbrella (UCITS-SICAV). Also worth noting is the launch of the Salam PAX UCITS-SICAV, backing a Swiss Life Shariah compliant insurance product distributed on the French retail market. In 2012, Luxembourg regulated and unregulated funds AUM totalled US$4 billion and 41 Shariah compliant regulated funds were identified.

Conscious of the need to continuously improve transparency and to tackle operational constraints, ALFI published best practice guidelines aiming to provide professionals with a clear view on Shariah compliant funds set up.

Banking landscape: Between July and October Precision Capital, a Luxembourg company representing the interests of Qatari private investors, completed the acquisition of two Luxembourg banks: KBL European Private Bankers (99.9%) and Banque Internationale à Luxembourg (90%).

Sukuk: In 2012, no new Sukuk have been listed or structured from Luxembourg. However, it is worth noting that International Islamic Liquidity Management Corporation (IILM), an international institution based in Kuala Lumpur to create and issue short-term Shariah compliant instruments, has incorporated two vehicles in the form of securitization companies under Luxembourg law.

In the same vein, a new structured product issuing platform will be launched by the end of 2012. This orphan Special Purpose Vehicle also incorporated as a (regulated) securitization undertaking is aimed at issuing a full range of Shariah compliant investment products.

Promotion of Islamic finance

- **By public bodies**: Official economic missions were organized to Doha and Dubai. In addition, the agency, which promotes the Luxembourg financial center (Luxembourg for Finance), participated in various events dedicated to Islamic finance such as the IFN Asia Forum and WIBC 2012.

- **By private sector**: Luxembourg witnessed the creation of the Islamic Finance Professionals Association (IFPA), aiming at enhancing interactivity and knowledge sharing between professionals active in the Islamic finance field and thus developing this industry in and from Luxembourg.

2013: A preview

Subject to the usual reservations, 2013 could be a flourishing year for Islamic finance in Luxembourg.

Sukuk: Luxembourg should welcome several Sukuk initiatives next year. Luxembourg's sovereign Sukuk, aiming at financing various key projects, is expected to be issued at the beginning of next year and should be listed on the Luxembourg Stock Exchange. Besides, the IILM has announced that it expects to issue its first short-term Sukuk, which would be structured and issued through its Luxembourg subsidiaries, during the year 2013.

Regulatory

- **Funds**: Luxembourg expects to be one of the first countries to implement the Alternative Investment Fund Managers Directive (AIFMD). Among the main features of the directive, the new passport regime for EU AIF managers will undoubtedly increase the attractiveness of Luxembourg for Shariah funds domiciliation and also re-domiciliation from offshore jurisdictions.

- **Financial engineering**: Two draft regulations, one on the creation of a trust under Luxembourg law and the other on a private foundation intending to provide additional Shariah compliant wealth structuring opportunities, will be followed closely.

Product development: At the end of 2012, the market relayed a possible future offer from a Luxembourg bank of key products still missing for the sound development of Islamic finance in continental Europe, such as cross-border Shariah compliant financing facilities and Murabahah deposits. Similarly, some insurance companies are said to be launching Takaful products in the course of 2013.

Financial center: The press have announced Qatar's intention to further invest in Luxembourg by targeting a real estate service provider. The Middle East investors' increasing presence will undoubtedly result in Shariah compliant transactions and might even lead to the establishment of the first Islamic bank in Luxembourg.

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The Maldives: A unique breeding ground for Islamic finance

By Aishath Muneeza

The Maldives is a small island nation and also the lowest country in the world, with a maximum natural ground level of only 2.4 meters, situated in the Indian Ocean. The country consists of more than 1,900 coral islands which are geographically dispersed in the sea, spreading over some 90,000 square kilometers.

The Maldives is not only unique because of its geographical and natural features. It is a 100% Muslim nation; and the Constitution exclusively says that a person can only be a Maldivian or a citizen of the Maldives if that person submits to the faith of Islam. However, unfortunately the legal and financial systems of the country are not solely based on Islamic law. Therefore, Islamic finance is still a novel concept in the country as not many Islamic financial products are yet available and the awareness and educational level of the population over Islamic finance is limited.

The financial system of the country consists of two regulators. The banking and the non-banking financial institutions are regulated by the central bank of the country, the Maldives Monetary Authority (MMA), while the capital market and the national pension fund is regulated by the Capital Market Development Authority (CMDA). The economy of the country is small and fragile as it is heavily dependent on imports and tourism. The real estate industry is the most profitable sector; and a strong potential industry in the Maldives, as the price of land is very expensive in the city of Male', the capital, where one-third of the population resides.

The first form of Islamic finance that came to the country was Takaful in 2003 when Amana Takaful Maldives began its operations in the country under a conventional insurance license. It was only after eight years that the first Islamic bank of the country, Maldives Islamic Bank, began its operation and the Islamic Banking Regulation 2011 was introduced by the MMA. In the same year, 2011, the CMDA also embarked on its remarkable journey to establish an Islamic capital market in the country. As a result, the Maldives Shariah Stock Screening Methodology was introduced and the journey towards the creation of a Sukuk market in the country began. In 2012, the country also witnessed the inauguration of the first Islamic window, HDFC Amna, which is the Islamic wing of the Housing Development Finance Corporation, the only exclusive home mortgage financier of the nation.

2012: A review

The year 2012 has been a successful year in building Islamic finance in the Maldives. The government has increased its support to the development of Islamic finance in the country. Collaboration efforts with government agencies and the private sector have been made to create more Islamic finance players and Islamic finance products in the country. The number of awareness sessions on Islamic finance has also increased. The number of patrons of Islamic finance in the country has grown. The trading of the first Shariah compliant share in the stock exchange of the Maldives began this year. The establishment of the first Islamic window in the name of HDFC Amna and the announcement to issue the first Sukuk in the country also took place in 2012.

2013: A preview

Islamic finance in the Maldives definitely has a bright future. It is anticipated that the national bank of the Maldives, Bank of Maldives, will start to offer Islamic finance products by launching an Islamic window. This will definitely increase the take-up of Islamic banking as Bank of Maldives is the only bank in the Maldives that offers its services to other islands as well as the capital city, Male'. Hence, access to Islamic finance in the country will expand if this becomes a reality in 2013. Furthermore, it is anticipated that the government will introduce a National Hajj Saving scheme using the famous Malaysian Tabung Haji concept to provide the opportunity for citizens of the country who want to fulfil their religious obligation of performing pilgrimage to save and increase their money in a Shariah compliant manner.

In addition to this, it is perceived that the first sovereign and the first corporate Sukuk from the country may also be issued this year. And with cooperative efforts from the regulator of CMDA and the Ministry of Islamic Affairs, the Maldives Islamic Finance Center will hopefully be established to cultivate and promote Islamic finance in the Maldives. These anticipated developments will prove the viability and sustainability of Islamic finance in the Maldives and it is hoped that they will contribute to the creation of a fully-fledged Islamic finance industry which is vibrant and resilient.

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Mauritius: Why is Islamic finance not developing faster?

By Muniruddeen Lallmahamood

In general, the Mauritius economy has recorded positive growth rates in all the sectors with the exception of the tourism, construction and textile sectors in spite of the Eurozone crisis and malaise in the global conditions. In the banking sector, a continued expansion and solid profits were recorded. The Mauritius Commercial Bank, State Bank of Mauritius and Barclays remain the leading banks in terms of assets and profits. On the other hand, Mauritius, whose regulatory framework has been fully amended to accommodate Islamic financial services, has seen little development in the Islamic financial services area. Despite all the efforts to provide Islamic financial services by the Central Bank, sporadic development was noted by the private sector. Why Islamic financial services are not taking off at full speed remains the unsolved question for many.

2012: A review

The Mauritian financial sector continues to grow steadily, with total banking assets representing 10.7% of GDP at the end-June 2012 according to the central bank. At a time when most countries have been seeing their ratings downgraded, Moody's Investors Service upgraded Mauritius' foreign and local-currency government bond ratings to 'Baa1' from 'Baa2' with a stable rating outlook in June 2012. Inflation is on a declining trend and the rate of unemployment has remained virtually unchanged. Our public sector debt to GDP ratio has hovered below 60% over recent years.

In the Islamic financial industry, the Mauritius Leasing Company, a subsidiary of the British American Investment Group (BAI), which earlier introduced two Islamic products (Takaful and Ijarah) merged with another subsidiary, Bramer Banking Corporation. Bramer Bank, the new merged entity, is listed on the stock exchange of Mauritius. The bank continues to offer its Takaful and Ijarah services and no Islamic window was introduced. On the other end, the first private issuance of Islamic commercial certificates was launched in 2012 by Century Banking Corporation, the first Islamic investment bank (a joint venture between BAI Group and Qatari Investors) and was fully subscribed. The Central bank awarded another conventional banking license to Banyan Tree. There are a total of 21 banks in Mauritius as of today.

During the year, the Islamic Financial Services Board (IFSB) organized a workshop with the Mauritius Financial Services Commission and a seminar on the role of Islamic finance in the development of Africa to tap potential outlook for Islamic financial services on the continent. The central bank, co-host of the seminar, organized a forum for the Mauritian public on Islamic finance during the same period, as an awareness program.

Mauritius is among the five countries where HSBC Amanah is closing down its activities. HSBC Amanah was part of the HSBC Mauritius which is mainly an offshore bank. HSBC, one of the oldest domestic banks, offered to sell its retail banking services.

Budget 2013, under the theme 'A World in Transition', was presented by the finance minister, Xavier Duval. It is believed that the budget correctly identifies the challenges but falls short of providing certain initiatives to address the main issues facing our economy. A couple of proposed amendments were announced during the budget for the banking act and financial services commission act in respect to governance and supervision.

In the global business, there are currently four Shariah compliant funds with a total of US$100 million assets under management; and a Sukuk Murabahah which was issued for the island jurisdiction.

2013: A preview

Since 2007, we have not seen any major commercial developments in the industry. It appears that no sovereign Sukuk will be issued in the island any time soon, on the basis that the government has another alternative to borrow from international agencies at a competitive rate. We would anticipate an issuance when the international Islamic Liquidity Management Corporation (IILM) issues its first Sukuk.

We should be expecting the Board of Investment to play a bigger role to promote Islamic financial services as part of the island's main objective to become the financial hub in the region and a bridge to the African market. The global business is currently under-utilized and an excellent platform for the structuring of funds, trusts and SPVs in the Islamic financial services arena. While all 21 banks have showed profits with exception of the newly set-up ones, is a retail Islamic bank a success or myth? My conclusion is that the only way for Islamic financial services to kickstart in Mauritius is to have a domestic commercial Islamic bank in the island. Islamic retail banking products and services will be launched in 2013 as part of the banking business evolution.

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Morocco: A gradual integration into the country's economy

By Mohamed Rachidi

As everyone is waiting on the parliament to approve the banking law reform, there is little to report. Nevertheless, the country is witnessing favorable dynamics that should help the establishment of the first Islamic Bank later in 2013.

Morocco's US$90 billion economy counts 19 banks authorized to operate in Morocco, with eight banks essentially sharing the financial market: Attijariwafabank, Banque Populaire, BMCE, BMCI, Crédit du Maroc Crédit Agricole, CIH, and Société Générale. The Moroccan financial sector also includes a strong presence of foreign banks (including six offshore banks) that each hold shares in the major Moroccan private banks. In addition, one financial institution, branded Dar Assafaa, a subsidiary of Attijariwafabank, capitalized at MAD50 million (US$5.7 million), is marketing so-called alternative banking products. These products have entered the market after Morocco's central bank (Bank Al Maghreb) allowed banks to market them in order to make banking services available to a wider population and to improve the low rate of banking (currently 47%). The first products, available through a network of nine branches, are based on Murabahah agreements, and intended to offer real estate and vehicle financing.

Unfortunately, the alternative products have faced criticism from experts, and have been considered to be just a swapping of the conventional financial language with a specific terminology. Moreover, the absence of any Shariah compliant label makes it difficult to explain their characteristics to potential clients.

2012: A review

Allowing Islamic banks to start their operation in the kingdom has been at the center of large public debate, which has gained momentum since the last parliamentary elections. The government showed a real willingness to build a solid ground that will help Islamic finance to integrate into the Moroccan market. Recently, an official declared that the government is working on finance reforms, and he expects that parliament will approve a bill related to Islamic finance before the end of the current year.

After that, the king urged the government in July to drive financing from Gulf sovereign wealth funds and to encourage Gulf investors to access the investment opportunities offered by the Moroccan economy, which has been historically dominated by European firms. Furthermore, in October (in parallel with the GCC decision to extend financial support to Morocco and Jordan) the monarch visited the Gulf countries accompanied with a large delegation, to give a boost to the bilateral cooperation and to seek funds for the country's ambitious projects.

Besides attracting foreign funds, the draft banking law will add a chapter dedicated to regulating and governing Islamic finance products, and allowing local banks to partner (51/49) with foreign Islamic banks, in order to set up the first Islamic financing institutions by 2013.

Training

Many private institutions, such as Al Maali Islamic Finance and Optima Finance Consulting, are active in the field of training. Their offerings include two well-attended programs: the Certified Islamic Banker certificate, awarded by the Council of Islamic Banks and Financial Institutions (CIBAFI), and the Mini-MBA in Islamic Banking and Finance. These programs qualify professionals to enter the Islamic finance industry. Similarly, other institutions are preparing to offer postgraduate courses and seminars in Islamic finance subjects.

2013: A preview

The current reform – which still needs to be approved by the parliament - to authorize Islamic banks to operate in Morocco, and the choice to go step-by-step while evaluating the efficiency of only one Islamic bank set-up experience, as underlined by some newspapers, risks the country lagging behind the rest of the region and potentially missing the potential of this industry.

Public interest is reportedly over 90%, so we don't need to re-invent the wheel; it is all about sharing the flourishing experience. In other words, in order to develop a strong Islamic finance industry in Morocco, we need to raise awareness and the general understanding of the subject among the public. Also as the Moroccan banking sector, known for its maturity, is fully dominated by conventional institutions, it is inevitable that any newcomer will drive some psychological stress unless these fears have been allayed by building a bridge between both systems. Finally, particular attention must be paid to Shariah compliance, as the independence and integrity of the Shariah board play a big role in establishing and maintaining customer trust and developing the competitiveness of this emerging industry.

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Islamic finance in the Netherlands: 2012 and beyond

By Kees Hooft and Niels Muller

Over the last decade, the Dutch Islamic finance market has been intermittently active but at a relatively modest level. Due to the Netherlands being a jurisdiction with a significant amount of holding and financing activities, there has been regular Islamic finance activity on a cross-border level. There have also been a number of investments made into the Netherlands, mostly in real estate and energy-related assets, which have been financed on an Islamic basis. On the consumer market, there is less activity. The Netherlands has a significant Muslim population, but demand for Islamic finance products, whilst probably on the increase, is still relatively low according to various studies.

2012: A review

During 2012, there have been various Islamic finance transactions involving Dutch investment structures. One such transaction involved the acquisition of a Dutch company financed by means of a commodity Murabahah financing. In another transaction which is close to being finalized, parties are proposing to use a Dutch foundation as the issuer of a Sukuk Ijarah.

Dutch parliamentary elections were held in September 2012, which has resulted in a new government being installed which is pragmatic and business-like, and appears to be more supportive of Islamic finance than the previous government. Holland Financial Center, a public-private initiative to strengthen the financial sector in the Netherlands, is seeking to re-establish Islamic finance as an area of interest.

For the past several years, Dutch social housing corporations have been pushed to sell more of their houses to tenants. Various social housing corporations have been looking into whether Islamic mortgages would assist in selling houses to their Muslim tenants. So far these initiatives have not yet come to fruition, partly in view of the general political discussion on the tax deductibility of mortgage payments discussion.

The conventional domestic financial market is still very much affected by the credit crisis, and therefore financial institutions remain very conservative and are holding back on entering into new markets or putting out new financial products.

2013: A preview

The outlook for Islamic finance in the Netherlands in the near future is hopeful. The Netherlands has a legal and tax regime which from the outset has been inherently very well suited to accommodate Islamic finance transactions and therefore has not required any amendments to accommodate Islamic finance transactions (like in various other jurisdictions).

The existing Dutch tax system is very suitable for setting-up (cross-border) Islamic financing transactions, particularly since it widely accepts a substance-over form approach in tax matters and the generic nature of the rules for profit determination. Another benefit is that the Dutch Revenue Service can be asked to agree in advance on an interpretation of the contractual relations (through an advance tax ruling).

The Dutch foundation (stichting) continues to provide a particularly well suited solution for a facilitating role in cross-border Islamic finance transactions as a trustee or agent (Wakeel), particularly in respect of assets governed by civil law regimes which do not provide for the common law trust concept. It is recognized as an efficient vehicle to act as trustee or agent in conventional structured (asset) finance transactions and has been used in various cross-border Islamic finance transactions (see the Saxony-Anhalt Sukuk). The Netherlands is therefore a very good alternative to offshore regimes which are often inherently more unstable.

One important disturbance for the consumer market is that conventional mortgage payments are tax deductible whilst the tax authorities have not yet agreed to payments under Islamic mortgages receiving equal treatment. The latest Dutch government installed in October 2012 has set out plans to limit tax deductibility of mortgage payments in the long term. This would create a more equal playing field for Islamic finance over the long term. It may mean that the tax authorities may become more agreeable to providing equal treatment with conventional mortgages.

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The Halal food industry offers opportunities in Islamic finance

By Mohamed Nalar

It has been an interesting twelve months or so in New Zealand, where we are beginning to see a very promising engagement with the wider Islamic economy and opportunities both in terms of finance and industry; especially in the Halal food industry.

New Zealand gaining recognition in the World Halal Forum 2011 in Malaysia for the introduction and implementation of New Zealand Halal legislation (Halal Notice) has given the ideal momentum that was required to capitalize on the opportunities available for people in the Middle East and Asia Pacific regions. This has definitely created an important platform for New Zealand in the Islamic world and as a result has opened up doors for Islamic investors to get a closer look at New Zealand and what it can offer over here in the South Pacific for the first time. New Zealand continues to be a stable economy despite the struggling global situation, with strong sovereign ratings compared to most developed economies.

2012: A review

On the back of the achievements mentioned above we have seen a number of conferences organized by industry groups, universities and business associations to promote opportunities for New Zealand firms to capitalize on the estimated US$2 trillion Halal economy including educational and promotional articles in mainstream media in New Zealand over the last year.

New Zealand is also taking a leading role in the promotion and the development of the Awqaf sector using New Zealand's unique reputation for public sector reform and public entity performance management as a model. AWQAF New Zealand was formed in 2011 as a charitable trust and has been promoting the concept of Awqaf Farms and the potential opportunity available for the Muslim charitable sector to invest in New Zealand linking the Qurbani (Sacrifice) Projects in particular and through the aid/relief industry in general within the Islamic world. Through this extensive promotional work this project has gained momentum within the sector globally specially amongst Islamic countries and institutions. A number of MoUs and strategic partnerships have already been formed in 2012 to implement various trial projects over the next year or two. We will see some significant development over the coming months and years in this area so watch this space.

A number of high profile delegations and institutions visiting the country and engaging with government and private sector stakeholders over the past 12 months to explore opportunities in both the finance and various industry sectors are quite encouraging. There is evidence of strong interest in developing a Sukuk product offering in the region given the public sector investment opportunities both here in New Zealand and in Australia.

In terms of investment opportunities there are a number of areas that will be of interest to potential investors. These range from investing in the privatization program of state owned enterprises to opportunities in debt financing and public private partnerships projects in some critical sectors within the economy. There are investment opportunities in green field developments such as affordable housing projects and large scale public infrastructure projects in the area of transport which is ideally suited for Islamic financing principles.

2013: A preview

The future looks promising and exciting. I am confident that we will see tangible results over the next 12 months on the back of this new momentum we have seen over the last year. However, we need to create more awareness and focus on building initial infrastructure to promote both the opportunities available here in and outside New Zealand for potential stakeholders and investors on both sides. In this respect we will see many conferences and workshops both here in New Zealand and in the Middle East focused on opportunities linked to Islamic finance and the food sector, where New Zealand has a unique advantage compared to many other destinations.

This will be further boosted by the fact that New Zealand was in November 2012 ranked as the best country in the world to do business by Forbes Magazine.

Citing New Zealand's stability, entrepreneurial flair and dedication to transparency, Forbes ranked New Zealand at the top of four of its eleven ranking criteria - 'personal freedom' and 'investor protection', as well as a 'lack of red tape' and 'corruption'.

New Zealand was ranked first overall, ahead of traditional business powerhouses Hong Kong and Singapore, with Denmark and Canada rounding out the Top five places.

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Nigeria's Islamic finance industry: The journey so far

By Auwalu Ado

Nigeria is the most populous black nation in the world with an estimated 150 million people according to 2006 census. More than 80 million are believed to be Muslims mostly dominant in the Northern region. This made the country attractive towards Islamic finance. It is rich with abundant oil, mineral and agricultural resources. Nigeria is the sixth largest oil producer in the world. There are about 22 banks in the country, one of which is a fully fledged Islamic bank. The market has a great potential to drive Islamic financial products and services.

2012: A review

The year 2012 was a landmark in the history of Nigeria's financial industry with the commencement of operations of the first non interest financial institution; Jaiz Bank in January. Having secured license earlier in 2011 from the central bank, it commenced operation with three branches in Kano, Kaduna and Abuja. Stanbic IBTC; owned by Standard Bank of South Africa, also commenced operation of Islamic banking business via a window. One major achievement of Jaiz Bank was the private placement of NGN8 billion (US$50.29 million) in September which was successful and aimed at meeting the NGN10 billion (US$65 million) capital requirement for a national license. Islamic Development Bank is one of the subscribers with a significant percentage.

In the areas of insurance business, the regulator is yet to publically come out with the operational guidelines on Takaful which has become necessary to support the emerging Islamic finance industry. However, three conventional insurance companies continue to offer Takaful products on a window basis. In order to ensure successful Takaful take off in the country next year, the country's watch dog, National Insurance Commission has been admitted as member of the Islamic Financial Services Board (IFSB) in December.

The major achievement in the capital market was the introduction of an Islamic Index in July which was the result of a collaboration between Lotus Capital and Nigeria Stock Exchange (NSE) to provide Shariah compliants stocks. The long awaited sovereign Sukuk is yet to be issued by the regulators: Debt Management Office (DMO), Securities and Exchange Commission (SEC) and Federal Inland Revenue Services (FIRS) have yet to come up with a Shariah compliant framework.

Another area that recorded low achievement in the preceding year is Islamic microfinance. Although some of the microfinance banks offer products that are tagged non-interest, such are not backed by any law as the apex bank is yet to come up with guidelines on Islamic microfinance. To address the growing interest by bankers and other professionals in seeking Islamic finance knowledge, Bayero University Kano established, in collaboration with INCEIF and Insaniah University College, Institute of Islamic Banking and Finance offering postgraduate courses.

2013: The year of consolidation

It is expected that 2013 will witness improvement and consolidation of the Islamic Financial Institutions in Nigeria. Despite the challenges that include lack of public awareness, supervisory bottlenecks, shortage of experts, lack of competition and the non availability of liquidity management instruments, the country's Islamic finance industry has a promising future.

More banks are likely to come up as foreign banks and investors are keenly watching the development, while the central bank has to introduce Shariah compliant instruments if the industry is to move ahead. Additional licenses may be given to new entrants both on full-fledged and window basis. United Bank for Africa, Ecobank, Sterling Bank and Diamond bank have all indicated interest to offer non interest banking products.

> "The year 2012 was a landmark in the history of Nigeria's financial industry with the commencement of operations of the first non interest financial institution; Jaiz Bank in January"

Furthermore, Jaiz Bank and Stanbic IBTC; the only banks offering Islamic products have to expand their reach and products offering. Seven more branches are expected to commence operations this month (2013) for Jaiz and its national license is expected by end of the first quarter.

Takaful guidelines is also expected to be publically ready early this quarter while SEC, FIRS and DMO are all expected to finalize the regulatory framework in order to give room for Sukuk issuances by industry players. Some state governments have already indicated interest to issue Sukuk. There will be an increase in patronage of Islamic financial products and services as more and more people become more aware of the existence of Islamic banks which offer services based on profit and loss and non- interest.

Conclusion

Nigeria offers great potential in the Islamic finance industry. The sector provides alternative to the unbanked people in the North who avoid conventional banks because of interest. It also provides a different mode of financing away from the conventional banking which is yet to recover from the financial crisis. There is a strong indication that more players are to be licensed.

However, the apex bank has to step up its efforts in providing a level playing ground for banks offering Islamic financial products and services. This will enable them to favorably compete with conventional banks.

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A promising market for Islamic finance

By Muhammad Shoaib Ibrahim

Pakistan, with a large Muslim population of over 180 million, remains at the forefront in promoting Islamic finance. The country has important strategic endowments and great potential growth. Located in the heart of Asia, Pakistan is a gateway to both the energy-rich central Asian states, financially liquid Gulf states and economically advanced Asian region. This strategic advantage, coupled with rich source of minerals and a large and highly productive agricultural region makes Pakistan a marketplace with ample business opportunities.

The evolution of Islamic finance industry in Pakistan started on the same path as the global Islamic financial industry in 1977, when the local Council of Islamic Ideology submitted its report along with recommendations. As a result the Government of Pakistan (GOP) started its journey towards practicing Islamic finance and took various steps for the Islamization of the economy. One of the major decisions of the GOP was the promulgation of the Modaraba Companies & Modaraba (Floatation & Control) Ordinance 1980, through presidential orders. After the issuance of said Ordinance, the Modarabas started their operations as pioneering Islamic financial institutions. Modarabas were allowed to operate as corporate entities under the regulatory framework of the Security Exchange Commission of Pakistan (SECP). This is a unique model and no such example exists in the rest of the world. The model gained widespread popularity and by the 1990s the total number of Modaraba entities had reached 52.

In 2002 the State Bank of Pakistan (SBP) allowed the establishment of commercial Islamic banking institutions (IBIs) and introduced a comprehensive Shariah compliance framework. At present the market consists of commercial Islamic banking institutions, Islamic microfinance banks, Islamic mutual funds, Modarabas and Takaful companies. Commercial Islamic banking institutions and Islamic microfinance banks operate under the SBP while the rest of the sector is controlled by the SECP. Besides the above institutions, the Islamic capital market operating under the SECP is also expanding.

2012: A review

In Pakistan, Islamic finance institutions are gradually enhancing their market share. Islamic banking institutions have been growing at an average rate of 30% over the past six years. Currently Pakistan has five fully-fledged commercial Islamic banking institutions and 12 standalone Islamic banking branches within conventional commercial banks. The total branch network of the 17 Islamic banking institutions is around 960 branches. The asset size of all Islamic banking institutions has reached around US$8 billion, or almost 9% of the overall banking industry's assets. It is expected that the industry will double its market share over the next five years. The growth of non-banking Islamic financial institutions is also very encouraging. Within the non-banking sector, the performance of Islamic mutual funds and Mudarabah has also been excellent. At present, 30 Islamic mutual funds and 26 Mudarabah are operating in Pakistan. The asset size of Islamic funds has witnessed considerable growth. The Mudarabah sector, which is a unique model in Pakistan's Islamic financial market, has been showing a good performance despite the challenging and highly competitive banking and non-banking business environment within the country.

During 2012 the Islamic finance market showed an expansion in asset base due to high growth of investment in Shariah compliant government securities. Following the global financial crisis the Pakistani economy saw a significant slowdown, and financing in the private sector started declining due to risk averse behavior from Islamic financial institutions, resulting in a shift of private sector financing towards investment in Shariah compliant government securities. This growth is in line with the trend of the overall banking industry to invest in government securities. The continuous high growth in investments has resulted in an improvement in the Islamic banking institutions share of overall assets.

Challenges

In Pakistan, despite the impressive growth, the industry is facing a number of challenges that are preventing it from attaining an even higher pace of growth. Some of the challenges are identified below.

- Management of short-term liquidity due to non-availability of short-term Shariah compliant government securities;
- Limited financing to private sector due to economic slowdown;
- Taxation issues due to non-availability of some necessary tax exemptions for Islamic financial institutions and non-availability of separate tax computation for Islamic financial institutions;
- Scarcity of well-trained human resources in Islamic finance due to absence of efforts in capacity-building;
- Non-availability of Islamic profit benchmarks which has resulted in negative marketing for Islamic financial institutions;
- Lack of awareness regarding Islamic banking practices which has resulted less acceptance of Islamic banking practices among masses.

The financial literacy of the masses is also one of the main hindrances of the overall growth of financial sector, particularly Islamic finance. Widespread public financial literacy and awareness is now considered an important tool to promote savings and expand financial security. Pakistan is characterized as having very low rates of savings and investments and low penetration of financial products and services. In order to cope with this issue, the SBP has taken an initiative to encourage a Nationwide Financial Literacy Program (NFLP). This program will work towards improving financial inclusion and also serve the interests of financial institutions and support for enhancement of financial awareness at root level.

The way forward

Recently the SBP issued a standardized framework on the distribution of profit and pool management mechanisms for Islamic banking institutions in Pakistan to achieve uniformity and transparency in profit distribution; and to streamline the procedures of financial reporting and general disclosure. The new guidelines will support public confidence in Islamic banking. Efforts are also being made for the development of a comprehensive liquidity management solution that includes the development of an Islamic interbank money market, and the development of an Islamic Interbank Offered Rate (IIBOR) for use as a benchmark for pricing of Islamic finance products.The SBP also plans to develop a five-year plan between 2013-2017 for Pakistan's Islamic banking sector. According to the SBP, the new plan will set the strategic direction for the Islamic banking industry. Target areas include SMEs, the agricultural sector and the development of Islamic finance in the non-banking financial sector and capital market. Recently, the SECP also issued draft regulation on the issuance of Sukuk bonds. The regulations will facilitate issuers and provide comfort to Sukuk investors. Sukuk is a very important instrument for liquidity management. During the last two years sovereign Sukuk worth around US$4 billion have been issued, and have largely addressed the liquidity management issue in the industry. Furthermore, the revised Takaful rules of 2012 (draft) have also been issued. The revised rules will support the enhancement of Takaful business in the Pakistan market.

Conclusion

Islamic finance has made impressive progress globally and domestically. However, it is still in an evolutionary phase and more efforts are required to confront challenges in keeping the growth momentum of the industry. Pakistan is the world's second most populous Muslim nation and has great potential for expansion of Islamic finance as it is largely untapped. There is a need for a diversification of assets and the tapping of non-traditional sectors. In light of the rising demand, and the increasing acceptability of Islamic finance among both providers and users, the growth prospects of the industry in Pakistan are very promising.

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Qatar: Infrastructure driving Islamic finance to the fore

By Amjad Hussain

Qatar's march to put its Islamic finance house in order for the anticipated infrastructure spending requirements leading up to the 2022 World Cup continued in sync during 2012.

Despite widespread concerns that the Qatar Central Bank (QCB)'s ban on the operation of Islamic windows by the country's conventional banks would harm their business, profits at the conventional banks continue unabated and Qatar's Islamic banks, freed from competition from their conventional sisters, continue to develop their bench strength through product development, diversification of funding sources, and geographic expansion.

Meanwhile, the Qatar Financial Center Authority (QFCA) has signalled that it might be sensing the wisdom of the QCB's policy by releasing a consultation paper proposing to carry out the same separation of Islamic and conventional banking within the QFC. If the proposal is implemented (as I envisage it will be), the result will be regulatory certainty, balance and stability throughout Qatar's entire banking market.

2012: A review

Capital markets were the name of the game in Qatar during the second half of 2012. The government's US$4 billion sovereign

"The Qatar Financial Center Authority (QFCA) has signalled that it might be sensing the wisdom of the QCB's policy by releasing a consultation paper proposing to carry out the same separation of Islamic and conventional banking within the QFC"

Sukuk issued in July set a new benchmark, achieving a record profit rate – the lowest ever for a sovereign Sukuk – as the world's largest dollar-denominated Sukuk. Appetite for the Sukuk was so large that the issue was more than six times oversubscribed.

The government Sukuk was followed in October by consecutive

Sukuk issued by two of Qatar's Islamic banks, both taking advantage of strong liquidity for regional issues. Early in the month Qatar Islamic Bank, the country's largest Shariah compliant bank, issued a US$750 million five-year Sukuk. This was followed a week later by Qatar Islamic Investment Bank which launched a five-year US$700 million Sukuk. Both issuances were more than six times oversubscribed, indicating the likely success of future rumoured issuances by Qatar's other Islamic banks in 2013. Qatar's Islamic banks, as well as its conventional ones, will continue to look to the capital markets in order to diversify their investor base and lengthen the maturity profiles of their liabilities in order to ramp up their books for Qatar's anticipated funding requirements.

We are also seeing continued positive developments in Qatar's stock market as the Ministry of Economy and Finance (MEF) transferred regulatory oversight for the market from the Qatar Financial Markets Authority to the QCB, thereby providing the market with the stability and certainty of a single regulatory body. The MEF is also encouraging Qatari-owned companies to list their shares on the Qatar Exchange, thereby providing them with capital and increasing market liquidity and activity. Finally, we're seeing positive steps being taken to facilitate the access to capital by small and medium-sized enterprises (SMEs) by the creation of a junior bourse, QE Venture Market, which has lighter and more flexible regulations designed to provide the opportunity for SMEs with a minimal track record and a higher risk profile to be listed.

"Notable examples of product expansion are the launch by Masraf Al Rayan of a subsidiary brokerage firm to buy and sell Shariah compliant financial instruments"

There was a steady stream of financings this year for Qatari companies. Notably, Doha Festival City procured QAR3.7 biilion (US$1.01 billion) in financing for the development of one of the largest multi-use developments in Qatar. The financing package represented the largest private sector financing in Qatar and consisted of both an Islamic facility (based on Istisnah / Ijarah) and a conventional facility, with most of Qatar's banks participating. And recently Qtel signed an Islamic financing facility, securing US$500 million under an 18-month revolving Murabahah facility with Qatar Islamic Bank.

As Qatar's Islamic banks grow, they are developing new products and expanding geographically. Notable examples of product expansion are the launch by Masraf Al Rayan of a subsidiary brokerage firm to buy and sell Shariah compliant financial instruments for investors, and the launch by Barwa Bank of its first fund, The First Investor GCC Equity Opportunities Fund, which invests in a diversified portfolio of equities and equity-related securities listed on exchanges within the GCC countries.

Geographically, we saw expansion by Masraf Al Rayan into the UK when it purchased the Islamic Bank of Britain, and of course the deal that everyone was talking about for months, the acquisition of 60% of the shares of EFG-Hermes, the biggest publicly traded Arab investment bank, by Qatar's QInvest. The new investment banking joint venture will be formed by the combination of EFG-Hermes' investment banking, asset-management and brokerage business and QInvest's local reach and capital. This will greatly expand QInvest's limited geographical reach while giving EFG-Hermes the ability to source Qatari capital and clients. This comes right around the time that we are waiting to hear if Qatar's dominant banking player, QNB, will finalize a purchase of Société Générale's 77.17% stake in Egyptian lender, National Société Générale Bank.

2013: A preview

While the headline economic growth that we saw in Qatar in 2011 slowed in 2012 (GDP growth of 6.3% is expected in 2012, down from 14.1% a year earlier), it is anticipated that Qatar will remain the fastest-growing economy in the GCC due to the government's capital spending on major multi-year infrastructure projects.

Qatar will continue to set the stage for regulatory certainty in 2013. If the QFCA implements measures that match the QCB's 2010 announcement to separate Islamic finance from conventional banking, the playing field will be leveled for Islamic banking in Qatar across all regulatory regimes. And the issuance just this month of a law that clears the way for setting up an umbrella regulatory body for banks, financial services companies, exchange houses, and insurance providers (including those registered with the QFC), bolstered by the QCB's steps to ensure proper implementation of Basel III and FATCA, will take us into 2013 with increasing confidence across all sectors.

For the Islamic banks, the 2012 runaway success of Sukuk issued by both the government and the Qatari Islamic banks suggests that we will see more of the same in 2013. We have already heard Qatar Petroleum and Masraf Al Rayan announce that they are preparing to issue, and Barwa Bank itself is rumored to have one in the works. Taking advantage of the demand in the market for high-grade paper is just what Qatar's Islamic banks need to grow their balance sheets in order to take advantage of anticipated infrastructure funding requirements.

In short, both Qatar and its Islamic banking sector are preparing themselves for the enormous opportunities for infrastructure project financing that are on the books. Time is running out, things need to be done and Qatar is developing its muscle to get the job done.

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Russia: Continuing success

Russia saw some break-through Islamic finance deals in 2011 and in 2012 this success was developed further, increasing both the scope of Islamic finance deals, as well regional coverage and variety of industries involved. Undoubtedly, there will be more serious deals to follow in 2013 to support and develop this success further.

2012: A review

As has been reported earlier, in September 2011 AkBars Bank executed the first corporate Islamic finance deal worth US$60 million. In September 2012 the facility has been successfully repaid and at present AkBars is working on the renewal of this financing facility.

This success encouraged a number of other banks and financial institutions to consider Islamic finance as a real instrument of attracting funds for medium and large projects. While these projects are yet to see the light in 2013 and beyond, in the eyes of many businesses Islamic finance turned from a rather exotic and hypothetical option into a real business opportunity, being seriously considered by decisionmakers.

However, without providing top quality service at the retail market Islamic finance will never become a really integrated sector in the national Russian economy. It is important that not only corporate finance solutions, but also retail operations and Islamic insurance continue to develop further.

Vostok Capital, a Shariah compliant window of conventional bank operating in Ufa, Bhashkortostan, successfully developed its operations in competition with local conventional banks and in particular was awarded the best internet banking service provider in Bashkortostan in 2012.

In 2012 the first Shariah compliant insurance service (Takaful) was launched in Kazan (Tatarstan), where insurance company Euro-police started selling Shariah compliant insurance policies. A similar service was offered by a partner of Vostok Capital in Ufa (Bashkortostan).

The involvement of governments into Islamic finance projects is another important development of 2012. SmartCity, a larger and ambitious project to develop a business suburb in Kazan, Tatartsan, was presented to the President of Tatarstan in July 2012 and upon approval has been successfully promoted among investors. SmartCity is aimed at the creation of a regional and international business hub in Tatarstan, as well as to become a major exhibition and conference center. Islamic finance is going to be one of major sources of financing of this project. The project has a significant Malaysian element, whereby AJM Planning and Urban Design Group and Amanah Capital Group participated in the project. From Tatarstan's side, the project is supported by the Governmental *Tatarstan Investment Development Agency and* JSC "Tatarstan Development Corporation"

2013: A preview

As demonstrated by the developments in 2012, Russian financial institutions, businesses and government agencies became more involved in Islamic finance projects.

To date, Islamic finance projects in Russia have not faced any prohibitive restrictions. As such, the development of the industry in Russia should begin with the following: (1) facilitation and assistance of businesses which are willing to be involved in Shariah compliant activities; (2) knowledge dissemination and (3) efficient cooperation between investment banks and funds prepared to invest in such projects.

Following the success of Islamic windows in Kazan and Ufa, it is expected that in 2013 we will see an opening of such Islamic windows in Moscow.

As a result of the success of Islamic finance in Russia, businesses from neighboring countries with less experience in the industry such as Ukraine, are interested to discover opportunities to enter the Islamic finance market. Following Russia's WTO accession in 2012, the Russian market will become more open for foreign products and services, so more halal products and services may be imported.

Within Russia, it is reasonable to expect that not only Tatarstan and Bashkortostan, but more other Russian regions, including non-Muslim parts of Russia, will become more involved in Islamic finance projects as well.

Overall, the Russian business community and retail customers will receive access to a larger volume of products and services, while foreign players become more active in the Russian market and may enter it with retail services in the coming year(s).

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Big spending and new regulations drive the industry forward

2012 has been a year of significant achievements in terms of landmark legislative changes in the Kingdom of Saudi Arabia.

New legislation for 2013

Arbitration legislation

The month of April 2012 saw the arrival of new arbitration legislation in the kingdom. The new arbitration legislation represents a significant step in the reconciliation of the kingdom's domestic arbitration process with international arbitration standards. The most significant improvements have been in relation to the enforcement of arbitral awards, as well as the substantial clarification of domestic arbitration procedures.

Under the new arbitration legislation, the courts must either issue the arbitral award within a deadline agreed between the participating parties following resolution of the dispute or, alternatively, within one year from the date of the commencement of arbitration. Once the award has been issued, it then becomes enforceable following the issuance of a court enforcement order.

Parties who elect to pursue arbitration in the kingdom now have the ability to refer to the international arbitration rules issued by external arbitration institutions such as the International Chamber of Commerce. For those parties wishing to conduct proceedings in another language, such as English, the legislation also caters for the parties to elect to do so.

Capital Markets Authority regulation

Following a public consultation in 2011, the Saudi Arabian Capital Markets Authority published a revised set of Listing Rules in January 2012.

The revised Listing Rules now sanction the public listing of convertible debt instruments, contractual securities and warrants. Going forward, all issuers must now appoint both independent financial and legal advisers and all listed securities must be fully underwritten.

The most significant revision to the Listing Rules was the amendment to the market access rules governing foreign securities. Foreign securities can now also be jointly listed on the Tadawul exchange.

Enforcement regulations

The Enforcement Regulations form part of a group of real estate and financial regulations passed on the 2nd July 2012 and are intended to assist lenders with the procedures and rules regarding the enforcement of security which, going forward, should also be registered appropriately so as to facilitate asset recovery.

Financing lease regulation

The Financing Lease Regulations were also issued on the 2nd July 2012. These regulations are intended to cover a wide scope of finance leases from real estate leases to leases of immovable or movable assets, utilities or other rights such as intellectual property. Similar to the Real Estate Registered Mortgage Regulations mentioned below, the Finance Lease Regulations also cater for the establishment by the Saudi Arabian Monetary Agency of an official registry for such leases and will establish a platform for the use of electronic lease contracts.

Real estate finance regulations

The Real Estate Finance Regulations, which were also passed on the 2nd July 2012, provide a provisional framework for both secured and structured finance transactions pertaining to real estate assets. This is a positive indicator in respect of the development of the kingdom's asset backed securitization market.

Real estate registered mortgage regulation

The eagerly anticipated Real Estate Registered Mortgage Regulations were issued on the 2nd July 2012. The regulations provide the foundation for the creation of all mortgages in the kingdom. This legislation also represents a significant milestone in the registration, prioritization (ranking) and enforcement of security rights within the kingdom.

The Real Estate Registered Mortgage Regulations have also provided for a Real Estate Register which is due to be safeguarded by notary publics.

> "The Real Estate Finance Regulations, which were passed on the 2nd July 2012, provide a provisional framework for both secured and structured finance"

Saudi Arabian Monetary Agency regulation

On the 1st July 2012, the Committee for the Settlement of Banking Disputes and the Committee of Appeal name and mandate were revised to implement, supervise and monitor the recent changes to both real estate and financial regulation. Both committees have wide enforcement powers, including the power to freeze a debtor's bank accounts, restrict the debtor from dealing with governmental bodies and banks, and issue travel bans.

King Abdullah Economic City

In November 2012, it was announced that another SAR5 billion (US$1.33 billion) would be injected into the King Abdullah Economic City. It is expected that this will lead to a number of new regulations for the new economic cities.

Areas of interest for 2013

In light of the legislative developments during 2012, we expect 2013 to be another dynamic year in multiple sectors in the kingdom. With the government's continued desire to diversify the economy and depart from a reliance on oil sector revenues, the Supreme Economic Council has sought to highlight a number of sectors for privatization and development.

For the purposes of this article we have sought to highlight some sectors that will continue to attract private sector investment in 2013:

- **Defense sector**
  In light of ongoing and recent developments in the region, there has been a measured and tentative exploration of market opportunities by both UK and US defense contractors. This commitment was recently emphasized by UK prime minister David Cameron on his visit to the kingdom and high level delegations from the US.

- **Education and training**
  The kingdom's education system has demonstrated continued accelerated growth in 2012 and now has more than 30 public and private universities, more than 26,000 primary schools and approximately 5 million students enrolled in the system. Of particular interest in 2012 has been the aggressive drive to increase the number of female students with more than 600,000 female students currently enrolled in universities and colleges in the kingdom.

  The education sector has also seen an increase in international bilateral agreements such as those signed between the University of Taibah and Purdue University, the Faculty of Medicine of Imam Muhammad bin Saud Islamic University and both the University of Pennsylvania and George Washington University and Prince Mohammed bin Fahd University and the University of Central Florida.

  These developments have all served to offer opportunities in a number of public-private joint ventures not only in education but also in vocational training in the accounting, banking, computer, hospitality, tourism, security and financial services sectors.

  Moreover, we see a strong interest in venture capital and an interest in commercializing the research being conducted at universities such as KAUST and KFUPM.

- **Funds**
  In 2013 we expect the Capital Markets Authority to release a new funds law for public consultation which will pertain to funds domiciled in the kingdom. This legislation is likely to take into consideration this year's regulatory developments in the real estate and financial sectors.

  Going forward, we also expect that kingdom-based funds will have further investment options in respect of real estate assets such as pubic and private projects, middle income housing developments and residential compounds.

- **Healthcare**
  In 2012, the kingdom had a budget of SAR690 billion (US$172.5 billion) for the healthcare sector and we expect a similar level of investment next year following the issuance of a number of contracts to establish medical colleges in government universities.

  The health insurance sector will also see an increase in investment with the ongoing expansion into small and medium sized private businesses. There may only be moderate continued growth in the pharmaceutical sector due to tight regulation, however we do expect a gradual increase in the presence of foreign investors in this competitive market and growing interest in manufacturing generic and biosimilar pharmaceuticals.

- **Infrastructure and construction**
  In 2013 the kingdom will continue to require assistance in the completion the construction of the economic cities project in Madina, Hail,and Rabigh (King Abdullah Economic Cities). There will also be continued investment in joint venture project such as the Sadara Chemical Company (a joint venture between The Dow Chemical Company and the Saudi Arabian Oil Company) which will ensure that there is continued growth in the petrochemical, infrastructure and construction sectors. Moreover, we see continued interest in acquisitions of stakes in pharmaceutical companies. Saudi Arabia will likely continue to be challenged in WTO proceedings in regards to its growing petrochemical sector based on favorable feedstock pricing.

- **Real estate**
  The legislative developments in the real estate sector will inevitably lead to the expansion and diversification of the kingdom's real estate finance market in 2013. The real estate market is currently monopolized by the kingdom's Real Estate Development Fund, however with the introduction of a formalized system for the provision of mortgages and other financing arrangements, there will be an increase in independent private financial institutions within the sector.

Conclusion

In August 2012, the Council of Ministers endorsed the Ninth Five-Year Development Plan which plans to increasing development spending over the next five years by 67%. This places development spending in the kingdom over the next five years in the region of US$385 billion.

We expect 2013 to continue to provide a diverse range of opportunities in the kingdom and further encouraging signs of the development of a more favorable investor environment and infrastructure.

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Senegal takes steps to become west Africa's leader in Islamic finance

By Dr Abdou Diaw

Senegal is a member of the West African Economic and Monetary Union (WAEMU) which regroups the Francophone countries (except Guinea Conakry) in West Africa. In 2010 according to IMF data, the size of the Senegalese population was 12.4 million with a GNP per capita of US$1,090; making Senegal the second-largest economy in the region (accounting for 19% of WAEMU's total GNP) behind Côte d'Ivoire (32.3% of total GNP). Senegal appears to be one of the most stable countries in Africa, as testified by the regularity of its various elections for more than three decades, and the occurrence of democratic changes in power whereby the ruling party lost the presidential election in 2000 and in 2012. Even though the vast majority of the population is Muslim (around 95%) Islamic finance is underdeveloped in Senegal. There is only one Islamic bank, Banque Islamique du Sénégal, which has yet to make all its products and operations Shariah compliant; and one Islamic window for a microfinance institution, PAMECAS (Partenariat pour la Mobilisation de l'Epargne et du Crédit au Sénégal).

2012: A review

Over the last few years, Senegalese authorities have shown a particular interest in Islamic finance. This interest has been translated into several initiatives that aim to promote an effective implementation of Islamic finance in the country. In the next few paragraphs we present some important initiatives related to Islamic finance that took place in the country during 2012, at public and private levels.

Public level

An international consulting firm was commissioned by the Senegalese economic and finance ministry, in collaboration with the IDB, to study the compatibility of the common regulatory and fiscal system with Islamic finance. The study was completed and a seminar was held in Dakar on the 22nd-23rd June 2012 to present the results to the stakeholders. An ad hoc committee is to be established to follow up the implementation of the needed reforms as recommended by the study.

Furthermore, on the 7th September 2012 the Banque Centrale Des Etats de l'Afrique de l'Ouest (BCEAO), which is the common central bank of the WAEMU countries, signed a master agreement with the IDB for the promotion of Islamic finance in the Union. According to this agreement, the IDB will provide technical assistance to BCEAO for a smooth development of this alternative finance in WAEMU zone and will facilitate cooperation and exchange between BCEAO and the standard-setting bodies in the Islamic finance industry. During the signature ceremony, the governor of BCEAO expressed the commitment of his institution to implement the necessary adjustments in the regulatory framework to take into account the specificities of Islamic finance.

In the same period, the president of the IDB, Dr Ali Mohamed Ali, came to an agreement with the Senegalese minister of economy and finance to establish a fully-fledged Islamic microfinance institution that shall cover several countries in West Africa. It is worth noting that this initiative will be the second initiative of its nature as the IDB has already collaborated with the Senegalese state to finance PALAM, a project which aims at reducing poverty among the rural and women population through microfinance and alphabetization.

Another major Islamic finance-related event concerning Senegal is the signing of a tripartite MoU on the 19th September in Kuala Lumpur, between the International Center for Education in Islamic Finance (INCEIF), the Islamic Corporation for the Development of the Private Sector (ICD) and the Centre Africain d'Etudes Supérieures en Gestion (CESAG), the Dakar-based training arm of BCEAO, to set up an Islamic Finance Academy to provide capacity-building in Islamic finance in French-speaking West Africa.

Private level

Many private business schools in Dakar have introduced Islamic finance as a subject in their Master of Finance programs. Similarly, there are several consultancy firms that were set up in Senegal to provide advisory and training services for professionals. Thus, during 2012 many seminars on Islamic finance were held in different hotels of Dakar.

2013: A preview

With the IDB-BCEAO master agreement one may expect, for the coming year, some adjustments in the regulatory framework to accommodate the specificities of Islamic finance. This is particularly plausible if we take into consideration the fact that many demands for license to establish Islamic financial institution are coming on the table of BCEAO inside as well as outside Senegal. For instance, the ICD's CEO, Mr Khalid Aboodi, has announced the launch of new Islamic banks in two WAEMU countries, Mali and Benin, in 2013. He has also announced the issuance of US$200 million worth of Sukuk by the State of Senegal in 2013.

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Forging ahead — Singapore's Islamic finance story

By Yeo Wico and Suhaimi Zainul

2012 marks yet another important year in the Islamic finance growth story for Singapore, as the Singapore market witnessed a number of significant and historic transactions, alongside encouraging growth in interest in Islamic finance among the financial and investment industry.

In his opening address at the 3rd Annual World Islamic Banking Conference: Asia Summit, Ravi Menon, managing director of the Monetary Authority of Singapore stated that "Islamic finance must become more integrated with the global financial system…. This means that Islamic finance must strike roots in the key international financial centres of the world. These centres can contribute to Islamic finance in several ways".

Singapore is certainly commonly regarded as one such international financial centre. Increasingly, Singapore's role in the global Islamic finance marketplace is evolving into an intersecting node where Islamic financial institutions collaborate with their conventional partners to jointly grow the industry.

In November 2012, it was reported that Singapore investors accounted for 23% or US$3.5 billion of the US$15.6 billion order book for Abu Dhabi Islamic Bank's Tier 1 perpetual Sukuk, although allocations were scaled back to 18% of the issue. The strong interest and participation by Singapore investors in this transaction signifies a solid appetite among Singapore investors for Islamic financial instruments, and willingness to partake in Islamic financing transactions on the international stage, notwithstanding its small domestic market.

Singapore issuers have also been venturing out to tap the Ringgit Malaysia Sukuk market. Singapore mainboard listed Golden Agri Resources, the world's second largest palm oil plantation company announced the issue of a RM1.5 billion (US$481.98 million) Islamic medium term note program in the middle of November 2012. Singapore listed palm oil company First Resources tapped the ringgit Sukuk market twice in 2012, issuing first a RM600 million (US$192.79 million) Sukuk in July and later in December a RM400 million (US$128.52 million) Sukuk under its RM2 billion (US$642.58 million) Musharakah Program established in July 2012. This could very well be a sign of a more regular pattern of Singapore issuers taking advantage of the depth of the Malaysian Sukuk market which is buoyant with ample liquidity.

In what was perhaps the most significant Islamic finance transaction in Singapore in 2012, Sabana Shariah Compliant Real Estate Investment Trust ("Sabana REIT"), the first Shariah compliant real estate investment trust ("REIT") to be listed in Singapore and currently the largest Shariah compliant REIT by market capitalization worldwide, issued the first ever Sukuk to be convertible into REIT units. The transaction involved a combination of Murabahah, Ijarah and Wakalah, tailored specifically to facilitate the acquisition of new real estate assets by Sabana REIT, and of course includes complex features allowing convertibility into REIT units. The Sukuk issuance facilitated the acquisition by Sabana REIT of new real estate assets in Singapore, which were then used to create Ijarah cashflows for the purpose of the Sukuk. This transaction heralds a return to the international Sukuk market of convertible Sukuk, which was last seen in 2009, and signals the acceptance by the market of sophisticated and hybrid Sukuk structures.

Apart from Islamic capital market transactions, there appears to be significant growth in interest in Islamic finance in Singapore in 2012, with Islamic financial institutions like CIMB Islamic strengthening their Islamic retail banking business offering in Singapore with the launch of new Islamic retail banking products. These are encouraging signs of the gradually evolving Islamic finance ecosystem in Singapore. Having said that, there are still many opportunities for product offerings in the Islamic retail banking space, with the areas of home and auto financing and credit cards being the most obvious gaps to fill.

Singapore's strategy has always been based on the adage that it cannot be a truly global financial centre if it does not offer Islamic financial services. Singapore's strengths are well documented - as an international financial hub, it has a wealth of human capital, a transparent tax structure, and a solid regulatory regime, with the necessary legislation and regulation in place to ensure conduciveness for Islamic finance. Add to that Singapore's strategic position between two natural harbours for the growth of Islamic finance - Malaysia and Indonesia.

> "Increasingly, Singapore's role in the global Islamic finance marketplace is evolving into an intersecting node where Islamic financial institutions collaborate with their conventional partners to jointly grow the industry"

Singapore Deputy Prime Minister Tharman Shanmugaratnam, in his speech at the 8th World Islamic Economic Forum held in Malaysia in early December mentioned that the next 10 to 15 years is expected to offer significant opportunities for the growth and diversification of Islamic finance. It is imperative for Singapore to participate in, and contribute to this growth. To do so, it must stay tuned and plugged in, to the quickly evolving Islamic finance market globally, as well as facilitate and encourage Islamic finance in and through Singapore. The Sabana convertible Sukuk issuance is the latest milestone for Islamic finance in Singapore, and a vivid demonstration of her potential as an Islamic finance hub.

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South Africa: Infrastructure amendments and long-awaited Sukuk push industry forward

By Amman Muhammad

The Muslim population is considered to be a minority in South Africa. However, size should not be confused with affluence and influence when it comes to this small group. There are no reliable statistics that accurately reflect religious affiliation in South Africa, but estimations place the number of Muslims to be around 1.5-2.5 million people, roughly 2% of the total population of the country. It is not the volume but rather the value of contribution that this community makes towards the national GDP that has resulted in progressive legislative and fiscal amendments that now for the first time will consider Islamic finance as a valid alternative to conventional or main stream banking and investment options.

Over and above the local Muslims that operate in this industry, South Africa has in the recent years attracted immigrant Muslim communities, and now it is becoming a commonplace to see Muslims from the world over. Just this year Johannesburg, South Africa's commercial capital, saw the president of the country officially open, not just the largest mosque, but largest religious complex in the Southern hemisphere right here. The mosque designed in traditional Ottoman architecture, serves not just as a place of worship but it is seen to promote religious tolerance and aims to build on enhancing economic and tourism development between Turkey and South Africa. This together with other key developments in the economic front bode well for the Islamic finance industry going into 2013.

2012: A review

The year 2012 can be summarized rather promptly when considering the Islamic finance landscape in South Africa, with the most prominent emphasis being placed firmly upon the impending launch of the country's first ever sovereign Sukuk. The Islamic finance industry saw the new year in with a deep sense of anticipation awaiting news on who the short-listed bidders would be to successfully tender for the right to assist the National Treasury in marketing this debut Sukuk to investors, indicate underwriting and market making appetite, facilitate the book building process and provide any additional services to successfully launch the Sukuk. After sufficient deliberation, the South African National Treasury appointed six companies, including Standard Bank, BNP Paribas (SA), Albaraka Bank, Nova Capital Partners, and Liquidity Management House for Investment Co and Regiments Capital to advise on its sovereign Sukuk issuance.

This development, when considering South Africa's status as an emerging economy, and last member to the BRICS cooperation, would make its Sukuk issuance attractive for investors seeking to diversify their portfolios outside the traditional investment destinations of the Middle and Far East. All indications are that the debut Sukuk would in all likelihood be a US dollar-denominated, five-year Sukuk underpinned by an Ijarah structure.

Not to be overlooked, but of significant importance to the South African Islamic finance landscape, are the long awaited national taxation amendments. The South African government issued the first draft of an amendment to the national taxation laws during May 2010, which called for the provision and inclusion of Islamic financial transactions. The final draft amendment is prepared and awaits the minister of finance to announce its inclusion in the Act and is expected by most to be gazetted by early 2013. These amendments will impact positively on bulk of the current and future underlying Islamic banking structures, critical to tax efficient and attractive banking product sets.

2013: A preview

Given the build-up to all the developments that we have seen in the last few years, 2013 is certainly setting itself up to be one of the most momentous year's in the time-line of the Islamic finance industry in South Africa.

All the key indicators point toward the historic amendment of the National Taxation Act which for the first time ever, would include clear interpretation of Islamic financial structures and pursuant to the taxation break-through, would undoubtedly be the issuance of the country's first ever Sukuk issuance.

These important developments have attracted the interest of prominent local Muslim businessmen who now seriously are considering Islamic finance as a real alternative to conventional banking and are showing real keenness in switching over to Islamic banking in its entirety.

On an international front these developments have certainly captured the imagination of the bigger Islamic finance players across the globe and could also herald the start of many a new opportunity not just in the banking industry but also within the Takaful and asset management industries as well.

Given South Africa's highly developed infrastructure and sophisticated banking system, this country could just well be the launchpad that international players use to catapult themselves into the highly lucrative market that is Africa.

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Sri Lanka: An eventful year for the Islamic banking & finance industry

By Athif Shukri

Sri Lanka's upward trajectory in recent times has been marked by impressive economic growth as the country enjoys the dividends of peace following the end of a 26 year-old civil war. Whilst the final growth in GDP of 6.5% was below most analysts' expectations of between 7% and 8%, this is still very impressive in comparison to what most countries experienced in 2012, when many economies underwent what proved to be a tumultuous year.

The growth in the economy was largely spurred by the double-digit growth experienced in the services, tourism and construction sectors. Tourism, in particular, is expected to continue to feature prominently, with Lonely Planet announcing Sri Lanka as the No. 1 Tourist destination for 2013. Foreign investors have also recognized Sri Lanka's potential with Shangri-La, Sheraton and Hyatt, among others that have initiated plans to enter the Sri Lankan market.

"The growth momentum of the local industry continued in 2012 with the number of licensed players offering Islamic products and services reaching double digits"

While Sri Lanka continues to achieve economic milestones, the local Islamic banking and finance industry has gradually gained momentum over the years. The pace accelerated post-2005, as the Government of Sri Lanka passed amendments to the country's Banking Act, thereby formally recognizing Islamic banking as a viable alternate method of finance.

The demand for Islamic banking and finance products and services has continued to grow unabated. Some estimate the market potential at US$2.5 billion, although there are definite indications that this could reach much higher proportions if, for instance, Sukuk issuances could feature as part of the product offering. However, present regulations are still incompatible with the formal issuances of Sukuk by corporates.

2012: A review

The growth momentum of the local Islamic banking and finance industry continued in 2012 with the number of licensed players offering Islamic products and services reaching double digits. The newest entrants to the foray in 2012 by setting Islamic windows were the country's commercial banking giant, Hatton National Bank, followed by CDB, a licensed finance company that caters to the small and medium segments of the market. Adl Equities Limited, a market intermediary regulated by the Securities and Exchange Commission (SEC), also commenced operations in 2012. The company, which is a subsidiary of Adl Capital Limited, is the first provider of margin trading facilities on a Shariah-based platform.

The year also witnessed the entry of several new products. A significant milestone was achieved with the US$175 million syndicated debt financing of Sri Lanka Airlines, the first such initiative undertaken in Sri Lanka, with Mashreq Bank as the lead manager. The syndicate of financiers also comprised several UAE based banks. Other pioneering endeavours included the launch of Sri Lanka's first ever open-ended Shariah compliant income fund – Comtrust-Adl Mudaraba Fund, a joint initiative of Adl Capital and Comtrust Asset Management, the same partners that pioneered Sri Lanka's first open-ended Shariah compliant Equity fund – the Crescent I-Fund.

The Amana-Heraymila Sharia Fund, a balanced fund, was jointly launched by Heraymila Capital and Amana Capital. This was followed by the launch of a second Shariah compliant fund – 'NAMAL Sharia Fund' by National Asset Management in a joint collaboration with Dar Al Sharia Legal and Financial Consultancy of the UAE. This took place in December 2012, culminating what proved to be an eventful year for the Islamic banking and finance industry in Sri Lanka.

2013: A Preview

Whilst 2012 was completed with nine players in the mainstream banking and finance areas (under the purview of the Central Bank of Sri Lanka) and three companies licensed by the SEC, the Takaful industry has still remained the sole prerogative of Amana Takaful. However, there are indications that more players would enter this fledgling market in 2013. Given the potential entry of other commercial banks and specialized financial institutions, it is estimated that the number of licensed financial institutions in 2013 could easily double from the end-2012 figure.

There are also several product initiatives in the offing and industry analysts are hopeful that the first Sukuk issuance would take place in 2013. A sovereign Sukuk would prove the ideal catalyst to the development of Sukuk, since it could provide a benchmark for future issuances.

On a macro level, the number of players entering the market should result in greater competition. This, in turn, should result in smaller spreads between borrowing and lending rates, which, rather astoundingly, has reached even double digits in certain cases. For instance, lending rates have increased beyond 20% in many cases and, coupled with PSRs in the region of 50:50 for shorter-term term deposits, the margins have simply ballooned beyond what would be deemed rational levels by international standards.

The year 2013 could also witness a more structured approach in terms of regulations, especially from a Shariah perspective. There are plans afoot to inculcate a greater degree of consistency in documentation as well as overall regulations. Whilst 2012 has been a watershed for the Islamic banking and finance industry in Sri Lanka, 2013 could prove even more eventful.

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Legislative updates and new Sukuk issuances

By Burak Gencoglu and Aytug Büyükatak

Turkey has been able to continue its stable and strong economic growth while making a number of substantial changes in its legislation and financial sector. As planned, the New Turkish Commercial Code and the New Turkish Code of Obligations entered into force on the 1st July 2012. These two laws repealed their predecessors which were in force for decades. The commercial code and code of obligations may be defined as the fundamental codes which create the structure of whole financial and economic transactions in Turkey.

Another legislation change is made concerning real estate acquisition by foreigners. The procedure and requirements concerning the foreigners' real estate acquisitions have been changed and reciprocity principle has been repealed. This latest amendment has made immovable acquisitions easier for foreign nationals.

In terms of the financial sector, Turkey successfully carried out a sovereign Sukuk issuance in 2012 for the first time. As a result of its successful economic performance in 2012, Turkey's credit score was increased by credit institutions such as Fitch Ratings.

2012: A review

The banking sector

Turkish participation banks' net profit (for the first nine months of 2012) reached TRY718 million (US$401 million) which showed a 21% increase when compared to the previous year. Additionally, participation banks strengthened their relations with foreign Islamic banks and the Participation Bank Association of Turkey (TKBB) signed an MoU with the Association of Islamic Banking Institutions Malaysia (AIBIM) to collaborate and establish a basis of cooperation between Malaysia and Turkey in further promoting the establishment, development, self-regulation and promotion of Islamic banking, Islamic capital and money markets on a global scale.

Russia's top lender Sberbank has accomplished the biggest acquisition in its history. Sberbank has agreed to buy 99.85% of DenizBank from French-Belgian Dexia Group. Sberbank will pay US$3.5 billion for Denizbank, the fifth largest private bank in Turkey, as well as its subsidiaries in Russia and Austria.

Developments in the Sukuk market

A landmark US$1.5 billion sovereign Sukuk issuance on the 18th September 2012 set a benchmark for future issuances.

The issue was oversubscribed by more than five times, with a yield of 2.8% and maturing in 2019, bringing in more than US$8 billion. It is noted by the bankers that US$8 billion in demand was highly impressive for a first-time sovereign Sukuk issue.

The treasury issued the Sukuk with the mediation of Citigroup, HSBC and Kuwait Finance House. Kuwait Finance House's subsidiary Kuwait Türk, meanwhile, has two Sukuk issues worth US$100 million and US$350 million, which are trading on the London Stock Exchange.

Real estate sector

As a result of the government's motion the Turkish parliament enacted the Law on the Amendment of Land Registry Law and Cadastre Law on the 3rd May 2012 which made immovable acquisitions easier by foreign nationals. The previous form of the Land Registry Law No.2644 used to restrict the foreigners by reciprocity principle and by the real estate's acreage. Namely, a foreign national had to be a citizen of a country which should have reciprocity with Turkey and secondly the acreage of the real estate should have an acreage of up to 2.5 hectares. These obstacles caused time and money waste for both seller and buyer and additionally discouraged foreign investors to invest in the Turkish real estate market.

2013: A preview

The banking sector

Regardless of global financial crisis, the banking sector in Turkey looks fundamentally positive, and is expected to witness fast growth in 2013.

Additionally, Islamic banking in Turkey has evolved in the past year. In 2012, new regulations regarding Sukuk were introduced to the Turkish market. In 2013, it is likely that the Turkish banking sector will participate more actively in issuing Sukuk bonds.

The Sukuk sector

In 2013, it is expected that conventional banks will issue Sukuk in addition to the participation banks. Akbank's vice-general manager, Saltık Galatalı, stated that Akbank plans to issue Sukuk in an amount of TRY500 million (US$279.3 million). He also stated that they expect the private sector to issue Sukuk worth up to TRY10 billion (US$5.6 billion) in the next year. This improvement in Sukuk issuance can be defined as an outcome of the successful sovereign Sukuk issuance by the Turkish treasury.

The Turkish Capital Market Board published a statement on the Official Gazette dated the 24th November 2012 concerning an amendment to the Investment Funds Rules. According to the recent amendment it is now possible to include Sukuk in investment fund portfolios. This amendment may contribute to Sukuk sector's development in 2013.

The treasury was able to finance its external debt within the first six months of 2012 and will use the Sukuk to finance its 2013 needs, translating to a lower Eurobond supply in 2013.

Real estate sector

Removing the reciprocity requirement and increasing the total purchasable acreage will attract more investors from the Middle East region and consequently Islamic instruments, such as Sukuk, will likely to be used for financing such real estate investments in Turkey. It should be noted that investors from all income levels have the opportunity to directly invest in different real estate projects. Therefore, the Turkish participation banks will play an important role on financing such investments from the Middle East.

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Islamic finance in Tunisia takes a new direction

By Karim Amous

Islamic finance is certainly a small niche in the global system as it is a recent phenomenon (only 20 years in Tunisia) compared to conventional finance, which has more than four centuries. But that does not prevent Islamic finance carrying considerable hope for humanity.

2012: A review

Islamic finance has taken a new course in Tunisia. The national commission of the legal system of Islamic finance, established in February 2012 as part of the development of Islamic finance in order to better integrate into the economic and financial sectors of Tunisia, has presented the results of its work during an information day held on the 29th September 2012 by the Ministry of Finance in collaboration with the Ministries of Justice and Religious Affairs and the Central Bank of Tunisia (TCB).

A new investment structure has recently started its activities. It is a Tunisian Islamic mutual fund with a budget of TND50 million (US$31.6 million). Its task is to co-finance Halal high added-value and complement financing schemes and launched projects in the areas of regional development. This was announced on the 29th June by the head of the fund. This new fund is the result of a public-private partnership, PPP, with technical assistance from the IDB, and the support of institutions including the Al Baraka Islamic investment fund and Kuwait. Our base is still in AL AMANA constitution with a budget of TND100 million (US$63.2 million). Several institutions will be present among the participants of this fund of funds, including the IDB and several renowned Tunisian industrial groups. The subscription to this fund remains open to any person or foreign institution wishing to take advantage of the high rate of return generated by the projects we handle. Tunisia plans to create hundreds of new major projects in agriculture, agribusiness, infrastructure, health, tourism and industry.

SMARTECO, the first Tunisian service firm dedicated to assisting versatile investors and developers, plays a very important role in linking and people who do not have the ability to interbreed naturally. SMARTECO recently opened an office in Malaysia with newly established partnership ISI Corporation, and plans to forge strong relations between Tunisia and Malaysia.

S&P encourages Islamic finance

In a report on Islamic finance in North Africa, the rating agency Standard & Poor's (S&P), highlighted the improvements of the prospects of Islamic finance in the countries of North Africa, provided that regulators, policymakers and banks work together to create a climate of trust.

The legislative framework for Takaful is ready

The acting Minister of Finance, Besbes Slim, recently announced the completion of the preparation of the new legislative framework for the establishment of Tunisia insurance plan 'Al Takaful' in accordance with the principles of Islamic law.
The minister of finance noted that this new framework will apply the Insurance Takaful Al or through the creation of an insurance company specializing in Takaful or through the offices of classic insurance companies.

2013: A preview

"A first in Tunisia, the draft budget of the State, under the year 2013, will be financed by Islamic Sukuk amounting to about TND1 billion (MTD) (US$632.55 million)," announced the minister of finance, indicating that this would be part of the development of a legal framework for Islamic finance.

A key step forward is the provision of tax incentives for undertakings for collective investment in transferable securities and tax benefits to investors, individuals and legal entities, in addition to the tax exemption of savings invested in the stock market, through savings accounts in shares and dividend exemption.

As for transparency, it should be consolidated through incentives for firms to comply with legal requirements for the publication of periodicals and occasional information while preserving consistency, clarity, sincerity and comparability of financial information.

The governor of the central bank stated that Islamic finance in Tunisia has not yet achieved the desired objectives. There are only two banks in Tunisia including Islamic Al Baraka, a non-resident bank that is expected soon to launch onshore. The assets of these two banks (Al Baraka and Zitouna) do not exceed TND1.4 billion (US$885.57 million), or 2.5% of total sector assets.

The governor of the central bank explained this growth of Islamic finance and its nature, based on risk sharing through the use of innovative approaches and investment according to customer needs and requirements, in a recent speech. He also explained that Islamic finance will encourage conventional banks to be more competitive.

For his part, the acting minister of finance has indicated that despite the relatively early introduction compared to our neighboring countries (as the first Islamic bank was established in Tunisia in 1983), we have seen many delays in the development of the industry and Islamic accounts make up only 2.5% of the entire financial system. "[We have] a lot of work ahead of us. We must put in place structures to mobilize resources and attract capital, "said the minister. According to him, until now, Islamic finance is an opportunity to capture capital currently held in conventional banks.

Besbes has recommended, in this context, to address the main challenges preventing the development of Islamic finance in Tunisia; including the lack of an adequate legal framework. Once this challenge is raised, much work remains to be done, particularly through training and job creation. "Do not settle for a legal framework to stimulate the sector, but also requires that operators be creative field and provide the public with attractive products and efficient," Besbee explained.

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UAE: Strategic shifts or is there more to come?

By Moinuddin Malim

The year in the passing has seen a rationalization of projects, a continuation of restructuring of financial transaction, consolidation efforts and going back to basics of prudential banking.

UAE banks are in a healthy and strong position with many positive financial indicators that reflect their good performance and clients' confidence in spite of the political chaos in the region which badly affected the economies of many countries.

"The banking and financial institutions are insulated from the current turmoil in financial markets and political chaos in the region," said the UAE central bank in a statement following its board's seventh meeting for the year 2012 in Abu Dhabi. Banks in the UAE are well capitalized and profitable and their balance sheets have been strengthened recently due to the strong economic performance and high government participation in financial institutions.

2012: A review

Being one of the key oil producing nations, the UAE has ramped up oil production as it aims to meet its target of producing 3 million barrels/day by the end of 2012. Dubai's focused approach on non-oil foreign trade, re-export, tourism, travel, retail and other services made it bounce back quickly. On the other hand, Abu Dhabi continued its efforts to attract tourism from neighboring countries.

As a result of improvements in the institutional framework and macroeconomic stability, UAE was able to move up three places to rank 24th in the 2012 Global Competitiveness Report produced by the World Economic Forum.

The banking industry in general had a slow growth this year. The central bank proactively started to push prudential lending policies both at retail as well as wholesale levels. A retail lending cap was introduced to lower retail clients' leverage that also narrowed banks' spreads and brought the retail lending growth at 2-3% year-on-year in 2012. The decision to bail out local retail borrowers by the president showed the desire to maintain stability in the country. On the other hand, the ratio of the banks' provisions to their bad, classified or suspected loans grew by 18.3% during the first three quarters of 2012 as compared to last year, while the total loans given by these banks grew by no more than 3%.

The merger/takeover of Dubai Bank by Emirates Islamic Bank gained momentum this year and while the consolidated bank will become the third-largest Islamic bank in UAE by size, it should also address the inherent issues which led to this event.

The year also saw world's first Shariah compliant hybrid Tier-1 Sukuk issued by Abu Dhabi Islamic Bank, that was also the region's first publically issued perpetual and Tier 1 instrument. This strategic transaction marks a key milestone for the global Islamic finance industry and a major and rare innovation by an Islamic bank. The US$1 billion perpetual non-call six-year issue was priced at an expected profit rate of 6.375%, which is one of the lowest rates achieved for any perpetual instrument by a global bank.

2013: A preview

Despite regional economic and political issues, the federation will remain stable next year. The federal government will continue to pursue an expansionary fiscal policy, supported by high oil prices. The fiscal surplus is expected to rise in the second half of next year as the government reins in spending, averaging 4.8% of GDP in 2013-17. UAE growth forecast for 2013 could be lower owing to a slower growth forecast in emerging-market economies in Asia and a slowdown in world trade.

Expenditure at a federal level is projected to increase in 2013, although the proportion of spending as a percentage of GDP will decline steadily. The Abu Dhabi government is expected to maintain an expansionary fiscal policy throughout the forecast period. The Dubai government, in contrast, while reining in the spending might start on selective value added projects. Further restructurings by Dubai GREs may put pressure on the federal budget; however, it is unknown whether additional support from Abu Dhabi will be required or forthcoming.

Though the banks may report decent to strong margin improvement at year end, increased liquidity and corporates' low borrowing appetite might pressurize lending spreads in 2013. The banking sector in the UAE will experience slower but more sustainable growth due to tough central bank regulations aimed at controlling excessive lending. The rise in lending duration is also pushing banks to go for longer period fixed-income liabilities, which will negatively impact margins for both Islamic and conventional financiers. The CAGR of Islamic banking will continue to outpace conventional finance due to a shift in consumer demand at all levels. 2013 through 2015 will see the UAE Islamic banking industry looking at all avenues for growth including geographic expansion. Services standards and price suppression will drive the industry, while a few institutions will do well; others will see steadier and slower growth levels.

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UK: A tough year for Islamic finance

By Mohammed Amin

The UK has led non-Muslim majority countries in the establishment of Islamic financial institutions and changes to tax law and regulatory policies to facilitate Islamic finance.

Since the global financial crisis struck in 2008, with a recession in the UK and falling real estate values in the Gulf, the UK Islamic finance industry has struggled. The UK's first standalone Takaful operator closed due to having insufficient capital, and no new Islamic bank has been opened since June 2008.

2012: A review

For the UK as a whole, and for the UK Islamic finance industry, 2012 has been another tough year. From late 2011, the UK economy fell back into recession before emerging in the third quarter. Despite the boost to morale from the Queen's Diamond Jubilee and a very successful Olympic Games, the 'feelgood' factor has been scarce in the UK.

It is worthwhile looking at the UK's standalone Islamic banks in detail. As some of them do not publish half year results, I have summarized their results for the year ended the 31st December 2011 below. This gives a complete and comparable set of figures.

The banks are ranked by their shareholders' equity. In the writer's view, this is the single best measure for assessing the size of a bank. The accounts show that 2011 was a difficult year for all the banks, with QIB making a small profit (GBP264,000 (US$423,251) before tax) and the others all making significant losses. The 2012 figures will become available mid-2013.

From a business perspective, it is essential to look at the retail market and the wholesale / corporate market separately.

The retail market

Islamic Bank of Britain (IBB) is focused on the retail market. The results since it opened in 2004 have shown that the retail Islamic finance market in the UK is very small, and hard to serve profitably. Indeed IBB has made losses in each year of operation. The writer considers that the reason why retail Islamic finance has not taken off in the UK is that the addressable market is very small. There are only about 2.4 million Muslims in the UK, many of who are too young to need banking services, and many others are too poor to be profitable customers for Islamic banks. The remainder divide into three groups:

1. Those Muslims who do not have a fundamental objection to conventional finance, even if they may object to some conventional financial practices on a case-by-case basis.
2. Those Muslims who do regard conventional banking as impermissible but consider Islamic banking as practised today to be acceptable from an Islamic perspective.
3. Those Muslims who consider that both conventional banking and Islamic banking as practised today are impermissible.

Only group (2) are the addressable market for Islamic finance, since retail Islamic finance is not cost competitive with conventional finance due to lacking economies of scale and having higher transaction costs due to contractual complexity. While the writer has no statistics, his view is that this addressable market is tiny.

The gloom about the retail market was deepened in 2012 when HSBC's retail Islamic finance division, HSBC Amanah, closed in the UK as part of a global retrenchment to core markets.

The wholesale market

The UK remains an attractive location for wholesale / corporate / investment banking, asset management and wealth management aimed at high net worth individuals. The strategies of the four non-retail Islamic banks focus on these areas, with the specific strategies varying amongst the banks.

2013: A preview

There are hopes that during 2013 the UK economy will complete its emergence from recession, although much depends upon events elsewhere. In particular how the US deals with the 'fiscal cliff' due to impact upon US taxation and spending on the 1st January 2013, and how the Eurozone deals with its continuing sovereign debt crises. If both go well, the UK economy should improve significantly.

It is possible that 2013 may see new Islamic financial services providers being established, particularly to serve as a bridge between investors in Muslim majority countries and the UK. At the same time, the existing UK Islamic banks will continue with their individual strategies while in certain cases working through historic non-performing or under-performing financing positions.

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Name	Shareholders' equity GBPm (US$m)	Total assets GBPm (US$)	Profit (loss) before tax GBPm (US$m)
Bank of London and the Middle East (BLME)	239 (383)	807 (1,293)	(9) (14)
European Islamic Investment Bank (EIIB)	129 (206)	159 (254)	(11) (17)
Gatehouse Bank	115 (184)	164 (262)	(4) (6)
Islamic Bank of Britain (IBB)	17 (27)	217 (347)	(9) (14)
QIB (UK)	17 (27)	131 (209)	0

Islamic Finance news Awards
Best Banks
Poll 2012

Best Overal Islamic Bank
Abu Dhabi Islamic Bank

Best Central Bank In Promoting Islamic Finance
Bank Indonesia

Best Islamic Leasing Provider
Amanah Leasing

Best Islamic Private Bank
National Bank For Development

Best Islamic Retail Bank
Abu Dhabi Islamic Bank

Best New Islamic Bank
Alizz Islamic Bank

Most Innovative Islamic Bank
Bank Muamalat Indonesia

Best Islamic Trustee/Custodian
Deutsche Bank

Best Private Equity House
Qatar First Investment Bank

For the first time in eight years, Bank Indonesia has been voted Best Central Bank in Promoting Islamic Finance; stealing the title from longstanding champions Bank Negara Malaysia. Over the last year, Bank Indonesia has made significant progress in boosting the republic's Islamic finance efforts, being at the forefront of regulatory changes and capital market movement, as well as making headway in promoting Indonesia's retail banking sector.

With a growth projection of 40% per year and a Muslim population exceeding 200 million, Indonesia, which was previously dubbed the industry's sleeping giant is clearly on the fast track to becoming a major force to be reckoned with in the global Islamic finance sphere. This year, we received an unprecedented number of votes totalling at 12,505, and after due diligence, 9,883 votes were counted towards the final results. The reason for the 2,622 votes being rejected was due to self voting, duplicates, as well as dubious sources. The surge in votes by over 3.5 times this year is also attributed to our new voting system, which allows subscribers of the newsletter and the Daily Alerts to vote for their preferred bank with just a click of a button.

We received 160 nominees over 36 categories; illustrating yet again the growing size and reach of the Islamic banking and finance industry. Covering all major and emerging Islamic finance markets, the IFN Best Banks Poll received overwhelming response from industry players across the globe, including Australia, Syria, the UK, Lebanon, Iran and Kenya.

Deutsche Bank grabbed the title of Best Islamic Trustee/Custodian yet again this year due to its significant presence in the market and involvement in the years' standout deals, including the State of Qatar's US$4 billion sovereign Sukuk. Time and again, the bank has continuously armed its commitment to delivering world-class trustee and custody solutions to its clients in the growing Islamic finance market across the globe. Sriram Iyer, regional head of global transaction banking in the middle east and North Africa at Deutsche Bank said: "Through our expertise in ISlamic finance we have been able to steadily grow our award winning trustee and custody business. We are dedicated to deliver world-class Islamic finance solutions to our client."

The National Bank for Development won Best Islamic Private Bank, maintaining its win for the second consecutive year, while Abu Dhabi Islamic Bank (ADIB) was voted Best Islamic Retail Bank; superseding last year's popular choice Al Rajhi Bank. Apart from its growing reach across the UAE Islamic retail banking sector, ADIB was also the first Middle East bank to issue a perpetual Sukuk last year to fund its capital requirements in line with Basel III. The bank's bold move spurred a trend in the Sukuk market, which is expected to continue throughout this year.

Oman, a new entrant onto the Islamic banking scene saw its first win with alizz Islamic Bank garnering the title of Best New Islamic Bank. Sayyid Tainur As'ad bin Tarik Al Said, chairman of alizz Islamic bank said: " We are exceptionally honored to receive this coveted award at this early stage in our journey. This is an exciting time not for alizz Islamic bank but also for Oman as we look forward to launching a comprehensive suite of Shariah compliant financial solutions in the near future."

The country, which is in the midst of finalizing its Islamic banking and Sukuk regulations is expected to create significant momentum on a global scale with an influx of talent and capital, as well as increased issuer and investor interest amongst the Islamic banking and finance fraternity. Industry players currently involved in the set up and consultation of the Omani Islamic banking and finance industry believe that a robust banking system will allow for accelerated capital market growth in the coming years.

Bank Muamalat Indonesia won Most Innovative Islamic Bank this year, beating last year's winner CIMB Islamic in yet another Indonesian triumph over Malaysia. The bank, which was the first Indonesian commercial bank to introduce Islamic banking principles, is said to be planning an IPO in 2013. This year's winner for Best Private Equity House was Qatar First Islamic Bank, trumping 2012's winner Fajr Capital. In the individual country 'Best Islamic Bank' categories, the award winners were all established Islamic financial institutions in their respective jurisdictions, with some repeat winners from last year's poll such as Muslim Community Co-operative Australia, Qatar Islamic Bank, Abu Dhabi Islamic Bank and the Syrian International Islamic Bank.

Country Winners

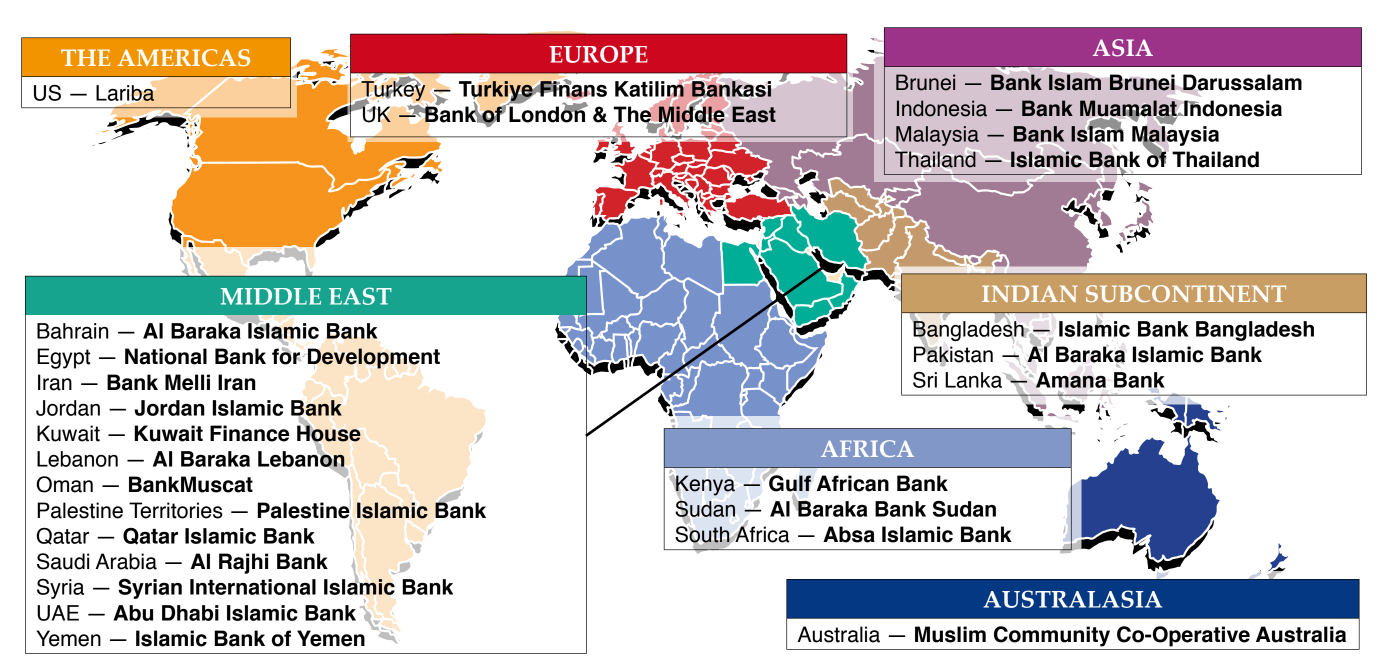
Turkey—Turkiye Finans Katilim Bankasi

Turkiye Finans Katilim Bankasi was selected as the best participation bank in Turkey due to the bank's growing reach across the country. The bank, which is majority-owned by Saudi Arabia's biggest lender, the National Commercial Bank, charted a capital adequacy ratio of 14.24% last year; higher than a majority of the other Participation banks.

UK — Bank of London & The Middle East

Known for its active involvement in the real estate sector, as well as its structuring expertise and treasury products in the UK, the Bank of London & The Middle East has continued to persevere despite the dismal economic climate in Europe, and is expected to continue on a positive run as demand for Shariah compliant real estate investment solutions grow in the UK. The bank also has a property advisory service which was launched in 2012 to provide its private clients support in sourcing and acquiring property.

Best Islamic Bank by Country



Brunei — Bank Islam Brunei Darussalam

Bank Islam Brunei Darussalam is the largest Islamic bank in Brunei, and provides consumer and corporate banking services to the country's population. The bank, which has the largest network of ATMs across the country was formed in 2005 through a merger of the Islamic Bank of Brunei and the Islamic Development Bank of Brunei. The bank's total assets stood at US$4.8 billion as at 2011, and is committed to growing in tandem with the country's Vision 2035, to achieve a developed nation status.

Pakistan — Al Baraka Islamic Bank

Al Baraka Islamic Bank Pakistan was formed after Al Baraka Islamic Bank Bahrain and Emirates Global Islamic Bank (Pakistan) merged, forming the first merged Islamic banking entity in Pakistan on the 1st November 2010. The bank, which currently has assets in excess of PKR67 billion (US$685.35 million) and over 94 branches across Pakistan is rated 'A'/'A1' with a stable outlook by the Pakistan Credit Rating Agency.

Sri Lanka — Amana Bank

After winning the Best Islamic Bank in Sri Lanka for the second consecutive year, Faizal Salieh, the bank's managing director and CEO said that the win confirms the institution's steadfast commitment and leadership in growing the country's Islamic banking sector. The bank, which is a pioneer in the country's Islamic finance sector has been instrumental in initiating changes to the Banking Act 2005 to incorporate Islamic banking. Since its establishment in 1997, the bank became the first commercial bank to receive an Islamic banking license in August 2011 and has been successful in bringing in a substantial amount of foreign equity investments into the country's nascent Islamic banking sector despite the global financial crisis.

Australia — Muslim Community Co-Operative Australia

MCCA has been in business since 1989, first registered as a cooperative in the inner suburb of Burwood in Melbourne. 24 years on, the cooperative has proven itself as a leading provider of Islamic financial and wealth management services to the country's Muslims. Although the institution currently only has a 2% market penetration rate, it is looking to expand its services from being a mortgage provider to extending a wider suite of Islamic banking business to its existing clientele and potential customers.

Bahrain — Al Baraka Islamic Bank

Incorporated in Bahrain almost thirty years ago in 1984, Al Baraka Islamic Bank operates as a retail and investment Islamic bank and currently operates six branches in the kingdom. Despite being indirectly affected by the harsh operating environment in Bahrain stemming from political and economic uncertainty since 2011, the bank has managed to record double digit growth across its banking assets and profitability.

Egypt — National Bank for Development

The National Bank for Development of Egypt, which is majority-owned by the Abu Dhabi Islamic Bank has soared to greater heights following the 49% acquisition in 2007. Nevine Loutfy, CEO and managing director of the bank commented upon receiving the IFN Best Islamic Bank in Egypt award: "Receiving this award from such a prestigious international institution reaffirms that we are on the right track and proves the success of our strategic restructuring plan, which was set and executed after Abu Dhabi Islamic Bank's acquisition of NBD in 2007. Winning such awards surges our sense of responsibility towards our customers and gives us greater impetus to excel and set ourselves even loftier goals and targets, so that we are constantly fulfilling our aim of providing a unique Shariah compliant banking experience."

Iran — Bank Melli Iran

Bank Melli Iran currently has assets worth US$67.14 billion, ranking it amongst the top Islamic financial institutions in the world, by Shariah compliant assets. The bank is also actively involved in the country's development plans and is currently one of the largest financiers to the government. The 79-year old bank has over 3300 branches in Iran and employs over 43,000 personnel. The bank has grown to become the largest bank in Iran in terms of assets, deposits and credit facilities.

Jordan — Jordan Islamic Bank

Established in 1978 under a special decree, Jordan Islamic Bank is the oldest Islamic bank in Jordan, and controls the lion's share of Shariah compliant financing and deposits in the country.

The Bank is listed on the Amman Stock Exchange and 66% of its capital is held by Al Baraka Banking Group. JIB undertakes financing and investments through Murabahah, Mudarabah, Musharakah and Ijarah. As at the end of June 2012, the Bank had total assets of JOD2.95 billion (US$4.16 billion), and a total capital of JOD217 million (US$305 million).

Kuwait — Kuwait Finance House
Kuwait Finance House is the first Islamic bank to be established in Kuwait in 1977. Since its inception, the bank has grown into a robust banking and financial institution, with a presence in Malaysia and Australia. The bank currently provides a diverse suite of Shariah compliant products and services covering banking, real estate, trade finance, investment portfolios, as well as corporate, commercial and retail financing.

Lebanon — Al Baraka Lebanon
Al Baraka Bank Lebanon S.A.L. was founded in 1991 and operated under a commercial banking license until 2004 when an Islamic Banking Law was instituted and the Bank obtained an Islamic banking license. An Islamic banking pioneer in the country, the bank's activities comprise of retail and commercial banking in accordance with Shariah principles, and currently has seven branches across the country.

Oman — BankMuscat
After thirty years of market presence, BankMuscat received an Islamic banking license in January this year, in line with the establishment of Oman's Islamic banking and finance regulations permitting for the set up of Islamic banks. The bank is rated A- by Standard & Poor's and A1 by Moody's, and expects its credit growth to reach 15% this year, driven by high government spending and higher wages for local citizens.

Palestine Territories — Palestine Islamic Bank
Palestine Islamic Bank was established as a joint venture public limited institution and received its Islamic banking license from the Palestinian Monetary Authority in 1997. Last year, the bank recorded a surge in profits by 268.4% to US$5.37 million, despite a continuously uncertain political and economic environment. The bank has fifteen branches across the country.

Qatar — Qatar Islamic Bank
Qatar Islamic Bank was established in 1982, making it the first Islamic financial institution in Qatar. Since then, the bank has emerged as a force in the local and international markets, and today, the bank plays a leading role in developing competitive and innovative Shariah compliant financial products and services worldwide.QIB currently holds 37% of the Islamic banking market in Qatar, and an overall market share of 11% in the banking sector as a whole. This makes QIB the biggest Shariah compliant bank in Qatar and one of the top five globally. For the past thirty years, QIB has played a pivotal role in Qatar's development and growth. Backed by a dedicated team, the bank has successfully established a foothold in the UK, Malaysia and Lebanon.

Saudi Arabia — Al Rajhi Bank
Al Rajhi Bank is Saudi Arabia's largest private bank by assets, worth US$59 billion. The bank, which has a firm foothold in Saudi Arabia and in international markets such as Malaysia and Jordan, is continuously looking to expand its retail and corporate banking suites, and is also actively involved in the market as a lead arranger for some of the landmark deals in the industry.

Syria — Syrian International Islamic Bank
Syria International Islamic bank was established as a Syrian private anonymous joint stock company under a strategic partnership between the private sectors in the Syrian Arab Republic and the State of Qatar. In 2006, the Syrian cabinet approved the license to launch SIIB under Decree No. 35 (2005). The bank's set up was led by Qatar International Islamic Bank and is considered the largest private bank in the country in terms of paid capital and number of shareholders.

UAE — Abu Dhabi Islamic Bank
Abu Dhabi Islamic Bank is fast making its mark across the global Islamic finance landscape, having been recognized as a major issuer in the Islamic capital markets following its innovative Tier-1 perpetual Sukuk issuance in 2012. The bank is also expanding its network across Abu Dhabi and the Middle East, with four subsidiaries under its patronage including the National Development Bank of Egypt, Burooj Properties, ADIB Securities and recruitment consultancy Kawader Services.

Yemen — Islamic Bank of Yemen
Following internal political turmoil in Yemen in 2011, the Islamic Bank of Yemen, along with other Islamic banks in the country were directly affected by the unrest. The bank, which came under direct rocket attack, saw up to 80% of its banking activities paralyzed. However, some banks from the GCC had pledged their support towards rebuilding the bank's infrastructure.

Kenya — Gulf African Bank
Asad Ahmed, CEO of Gulf African Bank in Kenya is positive of the bank's future, moving forward, stating: "We are proud that after only four years in operation, the bank has achieved tremendous growth and profitability and contributed well to the economy of this country. Gulf African Bank was the first Islamic Bank to be set up in East Africa and today, is the largest Islamic bank in this region. Gulf African Bank has been established to provide a full suite of Shariah compliant products and services to its customers in Kenya and beyond."

Sudan — Al Baraka Bank Sudan
Al Baraka Bank Sudan was established in 1984 and its activities comprise retail, corporate, commercial and investment banking. The bank's operations currently spans across 25 branches.

South Africa — Absa Islamic Bank
Absa Group Limited (Absa or the Group), listed on the JSE Limited is one of South Africa's largest financial services groups. Absa is a subsidiary of Barclays Bank PLC (Barclays), which owns 55,5%. We offer a complete range of retail, business, corporate and investment banking, insurance and wealth management products and services. The Group's business is conducted primarily in South Africa. It also has equity holdings in banks in Mozambique and Tanzania, representative offices in Namibia and Nigeria and bancassurance operations in Botswana and Mozambique.

At 31st December 2012, the Group had 718,2 million shares in issue and a market capitalisation of R117,79 billion. The Group had assets of R807,9 billion, 10,9 million customers, 9 929 automated teller machines and 33 717 permanent employees.

US — Lariba
American Finance House LARIBA is the oldest community-owned, Shariah compliant finance company in the US, serving communities across the country since 1987. The company has been recognized by, and has collaborated with the Fannie Mae organization, the largest home mortgage company in America and the world for its Riba free financing model.