## Islamic Finance news

GUIDE

**February 2014** 



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### **Editor's Note**

In this edition of the Islamic Finance news Guide 2014 we bring our valued readers a comprehensive summary of the peaks and troughs following an eventful year for the industry.

Over the year we have witnessed the rise (and fall!) of new markets such as Turkey, Indonesia and North Africa. We have seen a slight slump in Sukuk as Fed tapering hit, but a concurrent surge in Islamic equities which has boosted emerging markets and given the fund space a much-needed shot in the arm.

We have seen landmark issuances in the debt capital markets such as the IILM Sukuk, which should go a long way towards providing the industry with the tools it so desperately needs to self-regulate its liquidity; while new issuances from entrants such as Nigeria demonstrate the ever-strengthening scale of the industry.

While the core markets of the GCC and Southeast Asia remain strong, Islamic finance is escalating into every corner of the globe. The UK this year announced its debut sovereign Sukuk and other non-Muslim majority markets including Luxembourg, South Africa and Hong Kong may soon follow. Momentum is building, and the trend for international expansion shows no sign of slowing down, as crossborder transactions become easier and regulation and legislation across jurisdictions becomes increasingly standardized. And with the Sukuk market set to pick up this year and major growth expected across the MENA region, we can only hope for a continuation of this tremendous trajectory.

Covering 30 countries across every major Islamic market and asset class, this issue of the IFN Guide traverses the global Islamic financial landscape: covering the diverse sectors of debt capital markets, leasing, microfinance, regulation, securitization, Sukuk, Takaful, technology and tax. We hope, as always, that you find it a rewarding read, and we look forward to providing you with continued and unrivalled Islamic coverage throughout 2014.



Lauren Mcaughtry, **Managing Editor** 

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## GLOBALINDUSTRY ONE PUBLICATION

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## Islamic capital markets: Here to stay

In the backdrop of capricious global financial markets, 2013 was a year the Islamic capital markets were presented with the opportunity to demonstrate their resilience in the face of challenging economic conditions.

With US\$66.6 billion-worth of Sukuk issuance for the first nine months of 2013 (according to Dealogic), the Islamic debt sector missed the projections of optimistic bankers and analysts with its less-than-robust performance, particularly when compared to the record-breaking year of 2012 which saw total Sukuk offering of US\$140 billion. A major contributing factor to the slow-down in Islamic issuance last year was the uncertainty surrounding the tapering of the US Federal Reserve's quantitative easing program which sent shockwaves across markets shaking investor confidence, and in turn led to a three-month market "shutdown" from July to September.

Despite this, the year was nonetheless stage to a steady performance by the industry's leading markets (Malaysia and Saudi Arabia), which continued to enhance their positions as industry stalwarts, as well as an arena for the showcase of formidable strength by new entrants such as Turkey. Beyond the Sukuk sector, the overall Islamic funds sector demonstrated considerable growth in 2013 with the launch of at least 78 new Shariah compliant funds, marking an impressive 10.2% growth in assets under management (AuM), according to figures from Eurekahedge and KFH Research. Posting a cumulative annual growth rate of 9.41% since 2009, the Halal fund industry is valued at approximately US\$73.7 billion (as at the 9th December 2013) and has seen the number of funds grow four-fold, from 285 funds in 2004 to approximately 1,053 funds as at the end of 2013.

#### **Emergence of different asset classes**

Since the inception of Islamic banking operations in the 1970s, Shariah-seeking investor appetite has grown in its sophistication reflected in the innovative Islamic financial products available. Moving away from senior unsecured debt capital market instruments, which were most popular in 2012, 2013 saw the emergence of different assets classes and notably the rise of syndicated financing.

"Within the Sukuk space itself, we have seen the transition from pure debt capital instruments into hybrid and equity-like structures," elucidated Ahsan Ali, the head of Islamic origination at Standard Chartered Bank (Dubai), to Islamic Finance *news*. "This allows concepts such as Mudarabah and Musharakah to be applied instead of just Ijarah," added Ahsan.

Last year marked the debut of the Arabian Gulf's first-ever hybrid Sukuk issue by Saudi Arabia-based dairy producer Almarai followed by global private school operator GEMS Education. Facing a dearth of hard assets, companies and governments were more creative in the structuring of their products by utilizing non-asset-based or asset-light structures to back Sukuk as exemplified by Emirates Airline who came to market with a 10-year amortizing Sukuk.

Tier 1 Sukuk became an increasingly attractive cost-effective funding vehicle, as demonstrated by the launch of Tier 1 capital

Sukuk by Abu Dhabi Islamic Bank (at the end of 2012) and Dubai Islamic Bank; bearing testament to the appeal of Tier-1 issuances as means to reach a wider investor base without diluting shareholders.

Such offerings were not only driven by the growing demand among investors for equity-based products but also illustrative of the adaptive nature of issuers preparing themselves to meet Basel III standards

Such offerings were not only driven by the growing demand among investors for equity-based products but also illustrative of the adaptive nature of issuers preparing themselves to meet Basel III standards as financial institutions would require relatively high levels of capital adequacy to protect depositors and borrowers. And the move into hybrid capital instruments is expected to continue in 2014 especially among corporates.

#### Syndicated financing: On the rise

In the case of the growing popularity of syndicated financing, Ahsan said: "Issuers in the GCC and Malaysia are trying to maximize the investor base by carving out Islamic tranches either in the form of Sukuk or syndicated financing. Within the project financing and corporate financing areas, we saw more big ticket deals comprising both Islamic and conventional facilities."

Islamic syndicated financing will continue to be a major theme in 2014 especially in the light of massive infrastructure investment across key Islamic markets including Dubai, Saudi Arabia and Qatar, and in the broader Gulf region as economic growth in the GCC is expected to rise to 4.7% from 2013's 3.7%, boosted by expected non-oil sector infrastructure spending.

It is projected that the infrastructure sector could be worth up to US\$2.5 trillion as Middle Eastern countries commit themselves to development plans. These include: Kuwait with a US\$108 billion economic development strategy and Oman, which recently affirmed that it will continue its infrastructure projects in a bid to diversify its economy; the sultanate allocated US\$4.7 billion for development projects in its 2013 budget. Major projects are also in the pipeline for Qatar, as it will host the 2022 World Cup, and Dubai following its win of the World Expo 2020. This spate of infrastructure funding needs will indeed spur the Islamic capital markets in the region.

#### Longer-term funding appeal

Last year, Saudi Electricity Company carved a name for itself by becoming the world pioneer of an international 30-year Sukuk which was oversubscribed by over five times to the tune of US\$5 billion – a landmark deal that paved the way for longer tenor financing.

Latest data from Dealogic shows that more than half (65.9%) the Islamic financing facilities signed in 2013 carried tenors of at least

#### Case Study: Emirates

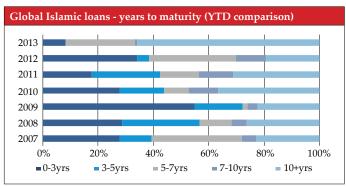
Issuer	Emirates/Medjool
Instrument	Regulation S/Senior unsecured amortizing Sukuk
Issuer principal activities	Airline
Issue size & pricing	US\$1 billion
Date	12 <sup>th</sup> March 2013
Profit Rate	3.875%
Spread vs mid-swap	Five-year mid-swap + 300bps
Joint Lead Managers	Standard Chartered Bank, Abu Dhabi Commercial Bank, Abu Dhabi Islamic Bank, Citigroup, Dubai Islamic Bank and Emirates NBD
Legal counsel for issuer	Allen & Overy
Legal counsel for arrangers	Linklaters
Listing	NASDAQ Dubai

In March 2013, Emirates Airline, a leading international air carrier, issued a 10-year US\$1 billion Reg S Senior Unsecured Sukuk due in 2023. The 10-year Sukuk has an average life of five years and was executed as a standalone issuance.

Standard Chartered acted as joint global coordinator and joint lead manager. The innovative issuance represents the first ever amortizing Sukuk executed in the international markets as well as the first Wakalah structure based on rights to travel and services relating to passenger routes operated by Emirates.

- Under the Islamic structure, Emirates sells to an SPV, out of Emirates' total available capacity measured in available ton kilometers (ATKMS), certain rights and services comprising (i) the right to travel on any passenger route operated by Emirates and (ii) services ordinarily provided by Emirates to passengers travelling on such route (the rights to travel) in each case in accordance with its normal terms of business and operating procedures applicable thereto. ATKM is the airline industry measure of total capacity calculated as the total tonnage available for the carriage of passengers and freight multiplied by the distance flown.
- The SPV subsequently appoints Emirates as its service agent to periodically sell passenger tickets corresponding to the rights to travel a minimum sale price sufficient to fund the periodic distribution amounts and principal payments payable to the certificateholders.
- Pursuant to a Purchase Undertaking or Sale Undertaking (as applicable) Emirates shall purchase, upon the occurrence of an event of default (or any other early redemption event as applicable), any unsold rights to travel at an exercise price sufficient to redeem any outstanding certificates in full.

Execution occurred amid a busy issuance window for the region's credit market and its success highlights the effectiveness of the overall marketing strategy and the continued appeal of Emirates credit in the international markets. The appeal of the issuance was also reflected by the pricing achieved on the transaction at US\$ five-year mid-swap plus 300bps for an issuance size of US\$1 billion. The Sukuk orderbook was well diversified and three times oversubscribed. Emirates was able to further diversify its sources of financing and capitalize on the strong Islamic liquidity to achieve its overall objectives.



Source: Dealogic

10 years, a significant leap from the 19.27% recorded in 2012. From the pool of Islamic financing issued in 2012, the largest share was held by facilities with maturities of 0-3 years (34%), however this figure fell to less than 10% last year reaching 8.2%.

This shift towards Shariah compliant papers of longer maturities is attributed to the increased number of long-term infrastructure projects underway and the lingering after-effects of the financial crises which opened the eyes of investors to the advantages of longer-term financing; and it is anticipated that this trend will continue in 2014.

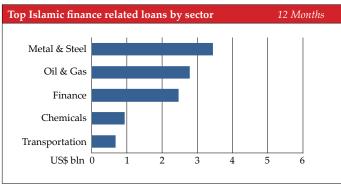
Malaysia and Saudi Arabia also led the Islamic funds market with both accounting for 63.1% (US\$46.5 billion) of the total industry AuM as at the 9th December 2013

#### **Reigning champions**

Heavyweights Malaysia and Saudi Arabia continue to dominate the Islamic capital landscape with Malaysia's domestic market accounting for 63.6% of the total global Sukuk market share (as at the end of last August) and also US\$54.33 billion of the US\$75 billion new Sukuk issued globally over the first nine months of 2013; while the Saudi domestic market continues to grow from strength to strength issuing US\$8.69 billion in the same period, followed by the UAE at US\$5.17 billion. Malaysia and Saudi Arabia also led the Islamic funds market with both accounting for 63.1% (US\$46.5 billion) of the total industry AuM as at the 9<sup>th</sup> December 2013.

In addition to that, almost half (48%) of the world's Islamic funds were domiciled in these two jurisdictions, proving again in 2013 that Malaysia and Saudi Arabia were the preferred Islamic funds domiciles. Analysts predict these two major players will continue to be the Shariah compliant fund origination destination for 2014 due to the availability of a diverse range of Islamic capital market instruments, comprehensive legal and regulatory frameworks and a ready pool of interested investors with high liquidity.

In terms of top Islamic finance-related financing by sector, the metal and steel sector topped the table with a 29.1% share according to January data from Dealogic (12 months rolling),



Source: Dealogic

followed by the oil and gas sector (24%), finance (21.3%), chemical (8.1%) and transportation (5.6%).

Ahsan predicts that the Islamic finance landscape in 2014 will see the emergence of the power and utilities sector, the continued dominance of the oil and gas industry and a spike in demand for Halal financing from the transportation and infrastructure as well as real estate sectors.

#### **Exciting markets**

Beyond the Middle East and Malaysia, industry participants have kept their eyes on Africa in recent years especially over the



INTRODUCTION

last year as countries such as Nigeria and Kenya reaffirm their Islamic finance ambitions through strong political will.

While Kenya may bear the torch for the Takaful sector in the African continent, Nigeria cemented its position in the Islamic capital market with its debut Sukuk, worth NGN10 billion (US\$62.53 million), out of the state of Osun. Following suit in Nigeria's landmark step, the government of Senegal in October signed a Sukuk agreement with the Islamic Corporation for the Development of the Private Sector, becoming the first country in the West African Economic and Monetary Union to do so. Other sub-Saharan nations including South Africa and Kenya have also been laying plans to issue Sukuk, with South Africa expected to join the market in the first quarter of this year.

The Sukuk market will continue to develop at a good rate of growth. There may have been some ups and downs, but the overall market momentum over the past 10 years has been quite positive. We believe this positive momentum and growth will continue in the foreseeable future

"Currently, most of the African countries are in early stages of Islamic finance and Islamic capital market development. We expect to see some issuances coming from this region in 2014, and we hope these issuances can act as catalysts to quicken the pace of Sukuk market development in this region," commented Ahsan.

Stepping out of African borders, the most exciting emerging market in 2013 could have very well been Turkey. The government's US\$1.25 billion sovereign Sukuk offering last October continued the momentum gained in the Turkish Islamic debt capital space which kick-started with a US\$250 million subordinated Sukuk issuance earlier in the year, followed by Bank Asya's application to the Capital Markets Authority to sell Sukuk worth up to TRY1 billion (US\$443.18 million); and Ahsan is optimistic on a corporate Sukuk issuance from Turkey this year. Yet despite the good record set, it will take more than Islamic debt issuances to keep the Islamic capital gears moving as the republic struggles to rebuild itself from the recent political scandals that have shaken the core of Turkish society and had an adverse effect to its economy.

Moving into the west, making headlines across the world in October was the UK with its long-awaited announcement of a sovereign Sukuk. The GBP200 million (US\$330.34 million) Sukuk, while a relatively small issuance, has and will continue to create waves in the industry as players are optimistic of the long-term impact this high quality instrument will have on the global Islamic capital markets including a spur in activities within the pensions and insurance space.



#### Growing pool of liquidity: Cannot be ignored

While the Islamic finance industry was relatively shielded from the global financial crisis, last year's issue with the US Federal Reserve quantitative easing program illustrated the interconnectedness of the Islamic capital markets with the international markets.

"The Sukuk market is tied to emerging markets as majority of issuers are from emerging markets. Hence, whatever that affects these emerging markets will affect Islamic capital markets as well," explained Ahsan.

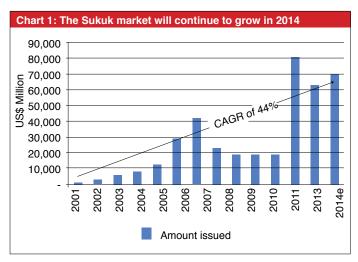
Unresolved challenges of the sector include relatively lower secondary market liquidity compared to conventional bonds, limited availability of risk management and liquidity tools, the lack of enabling regulations as well as discrepancies in Shariah standards.

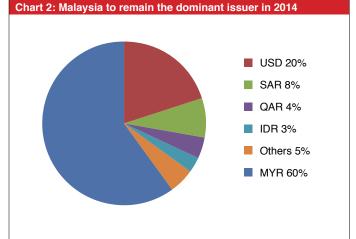
Yet despite these challenges and a subdued 2013, the Islamic capital market, in particular the Sukuk market, is here to stay. "The Sukuk market will continue to develop at a good rate of growth. There may have been some ups and downs, but the overall market momentum over the past 10 years has been quite positive. We believe this positive momentum and growth will continue in the foreseeable future," affirmed Ahsan.

Challenges will always be present including external funding challenges that are beyond the control of the issuers and investors; however the Islamic liquidity pool is also growing and issuers, both conventional and Islamic, cannot afford to ignore the immense opportunities that come with it. And the general sentiment is that 2014 will be a fruitful year for the Islamic capital markets. Experts' opinion is that issuers should complete all the required groundwork and be ready and prepared to issue when the opportune market window opens to tap into this vibrant space.

## Outlook for the Global Sukuk market in 2014

At the World Islamic Economic Forum held in London late last year, UK prime minster David Cameron announced that the UK government would become the first non-Islamic sovereign to issue a Sukuk in 2014. KHALID FERDOUS HOWLADAR explores the prospect.





Last December, the Luxembourg government has proposed to pip London to the post with its own Sukuk issuance. The prospect of Western stock exchanges jostling to establish themselves as a hub for Sukuk issuances is a striking illustration of how these Islamic "bonds" that adhere to Shariah law are starting to hit the global mainstream.

The Sukuk market is still a relatively small segment of global capital market instruments and remains concentrated within Muslim-populated countries, but it is growing at a rapid pace. Over the past 10 to 12 years, the market¹ has enjoyed a compound average growth rate (CAGR) of 44% (see chart), with issuance reaching US\$81 billion in 2012, up from US\$3.3 billion in 2002. Last year, however, fears over the cutback in quantitative easing by the US Federal Reserve dramatically affected the flow of capital into emerging markets and sukuk volumes dipped substantially to US\$63 billion as a result.

Moody's expects these investor fears to moderate somewhat in 2014, however the cheap funding levels available in 2012 are unlikely to return given the current macroeconomic picture and the policies of the Federal Reserve. As a result many of the potential Sukuk issuers in the GCC countries (that dominate US Dollar denominated international issuance) may turn to the local banks who are relatively liquid and more attractive lenders due to cheaper pricing. This will subdue expected volumes to around the US\$70 billion mark

### Malaysia is the dominant market player with GCC share likely to grow in 2014

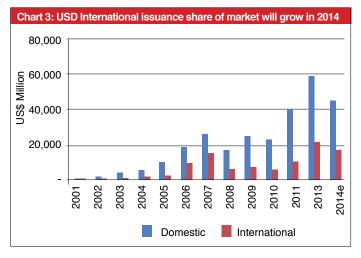
Malaysia will remain the dominant issuer. Malaysia dominates the Sukuk market, accounting for about two-thirds (US\$168 billion) of all outstanding Sukuk issued, most of it denominated in Malaysian ringgit. Malaysia was an early starter and has been the most active in promoting and creating a vibrant local-currency Sukuk market through the provision of supportive banking and capital markets legislation. The country also has a large base of domestic institutional investors such as pension and mutual funds. The long-term outlook and risk aversion of these funds are key growth drivers for the Sukuk market.

The Sukuk market is still a relatively small segment of global capital market instruments and remains concentrated within Muslim-populated countries, but it is growing at a rapid pace

GCC countries collectively run a close second in Sukuk issuance. The Gulf countries have stable local currencies pegged to the US dollar and so are the main issuers of US dollar denominated Sukuk. US dollar issuances are particularly attractive to international investors, many of whom have policies that limit their investment exposure to hard currencies like the dollar.

We expect the fast-growing economies in the Gulf region to fuel growth in the capital markets in 2014, with Sukuk forming a significant portion of that. Collectively, economic growth in Gulf

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countries will outpace Malaysia this year and public spending plans and infrastructure projects, particularly in Saudi Arabia, the UAE and Qatar, will require significant financing. Coupled with that, investor demand for Gulf credit is high given the relatively strong credit ratings of Gulf governments and of the region's banks. All this is pointing towards the Gulf countries gradually increasing their share of the Sukuk pie.

Within the Gulf region, Saudi Arabia has the most active domestic Sukuk market owing to its more insular banking system, abundant investment liquidity and large domestic economy. We expect the high activity in that country to continue in 2014, as local companies and banks take advantage of the strong demand and tight pricing to issue long-dated Sukuk.

Outside the Gulf, Turkey is also beginning to actively develop its domestic Sukuk market. The government is highly supportive of the sector and has taken steps to support it through specific legislation and large sovereign issuances. Turkey issued its first sovereign Sukuk in 2012, a key milestone in encouraging companies and financial institutions to seek international capital and diversify away from local lenders. Its second international Sukuk issued in October last year was seven times oversubscribed. We expect more issuance and regulatory developments this year.

### The global appetite and long-term trends for Islamic financial services remains strong

Further momentum for Sukuk issuance is brought by the recent events of the Arab Spring, which have focused the attention of regional governments on the cultural and religious sensitivities of their citizens and made them increasingly likely to support the growth of a Shariah compliant financial market. Retail demand is also being fed by the growing affluence and financial sophistication of Muslim populations. Islamic banks can now in most cases replicate the product offering of conventional banks and so meet customer preferences. As a result they are now growing at twice the rate of their conventional counterparts, albeit from a much lower base overall. Islamic banks are key issuers and buyers in the Sukuk market so their aggregate size has a direct impact on market volumes.

Also critical to the growth story is the increasing familiarity that conventional (such as non-Islamic) global investors have with Islamic financial products. While Shariah compliance is of little relevance to their investment decisions, Sukuk serve as a way to build exposure to the fast-growing credit markets of the Muslim world. While some of the structural complexity and opacity can sometime prove problematic, the market has seen some

standardization of the legal structures applied to create these instruments.

Indeed product variety is broadening with the emergence of innovative new instruments, such as amortizing structures and more equity-like features. For example, Emirates (unrated), the Emirate of Dubai's flag carrier, issued a US\$1 billion, 10-year amortizing Sukuk in March 2013 in which for the first time trust assets included rights to air travel miles.

Abu Dhabi Islamic Bank and Dubai Islamic Bank have both issued hybrid Tier 1 securities that are Basel III-compliant and much more equity-like when compared to the bulk of Sukuk issuances. Most recently, the Malaysia building society MBSB announced a 15-year covered Sukuk Murabahah to be issued in December. Such a structure would be the first of its kind with a dual recourse element that is expected to offer investors recourse to a pool of financing receivables as well as to the issuer itself.

Some US\$371 billion of Sukuk has been issued since 2001, with US\$274 billion currently outstanding, representing obligations of over 350 issuers. These issuers are broadly balanced — corporate, financial institutions and sovereigns — supporting the market growth.

Issuers do not need to operate in a Shariah compliant manner themselves in order to raise funding from Islamic sources, but they must have assets on their balance sheet that the relevant Shariah board deems compliant. This significantly broadens the pool of possible issuers

The announcements by the UK and Luxembourg that they intend to issue a Sukuk in 2014 have the twin goals of attracting more investment capital from Islamic countries and establishing themselves as global hubs for Islamic financial services. Other financial centers including Hong Kong, Singapore, Kuala Lumpur, Dubai and Bahrain have likewise expressed their ambition to become regional hubs for the sector.

While the growing competition is likely to provide a boost for Sukuk issuance in the months and years ahead, it will also cause fragmentation of what is still a relatively small, but fast-growing market. Once buyers and sellers are split across too many markets, liquidity is impeded.

While non-Islamic countries cite their mature, deep and developed capital markets infrastructure as advantages, centres that can establish a critical mass of domestic sukuk supply and demand will be more likely to succeed in their Islamic finance endeavors.

<sup>1</sup> In this article Sukuk volumes refer to Islamic bonds with tenors greater than or equal to 12 months. All data on unrated Sukuk are sourced from the Islamic Finance Information Service (IFIS).



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### Global Takaful: Pausing for breath?

Is the global market for Shariah compliant insurance and reinsurance — Takaful and re-Takaful — pausing for breath? EY thinks it may be. In its most recent update on the market, EY notes that having expanded at a compound annual growth rate (CAGR) of 22% between 2007 and 2011, growth decelerated to a more sustainable 16% in 2012. SOHAIL JAFFER shares his insight.

Industry participants have no misgivings about the continued growth prospects of the global Islamic financial services industry. As a recent report published by The CityUK points out, while Muslims account for almost a quarter of the global population, Shariah compliant assets still make up only about 1% of the world's total. This suggests there is still abundant room for expansion in an industry estimated by S&P to be worth "upward of US\$1.4 trillion."

Nor do analysts have any doubt as to the compelling growth potential of the Takaful (mutual guarantee) and re-Takaful components of the Islamic financial services industry. As EY observes in its most recent analysis, whereas the share of Islamic finance has reached 25% in the GCC and 22% in Malavsia, the share of the Takaful market in the two regions is still only 15% and 10% respectively. In other words, Takaful has been slower to develop than other Islamic product areas. According to The CityUK's report: "The global [Takaful] market remains at an early stage of development with premiums estimated to have reached over US\$300 billion in 2012. About a quarter of this was generated in Iran where Takaful is the compulsory form of insurance". To date, growth in the Takaful sector has been driven largely by a handful of countries, with four countries accounting for 90% of the total global market. Even in the GCC, however, which has been one of the fastest-growing regions for Takaful in recent years, growth has been uneven. Usage has been high in Saudi Arabia, underpinned by compulsory medical insurance, but take-up has been relatively modest in other GCC member

#### **Expanding into new markets**

This is changing, and one conspicuous theme of 2013 was the expansion in the Takaful sector outside its core markets. In the GCC, for example, the growth potential of the industry in Oman has been illustrated by the successful IPOs in 2013 of operators such as Al Madina Takaful and new entrant Takaful Oman. Competition is expected to be stiff, given that there are more than 20 insurance companies in the market, but Takaful companies are hopeful that they can capture a share of 5-10% of the market. Beyond the Middle East, Takaful has continued to increase its penetration in regions ranging from Africa and Asia to Europe. Nigeria, which aims to become a hub for Islamic finance in Africa, issued guidelines for the centralized oversight of its fastexpanding Takaful industry in 2013. In April, the vice-chairman of the Chartered Insurance Institute of Nigeria (CIIN), was quoted as saying that Takaful had now attained a 70% penetration level in the country's insurance industry.

In the UK, meanwhile, the London-based Cobalt — which was set up in 2012 — has continued to promote the growth of Takaful,



announcing the development of a new Shariah compliant insurance platform using a syndication model to spread risk more efficiently.

#### Formidable competitive challenges

More diversified geographical penetration of Shariah compliant insurance will support a continued rise in gross contributions in the Takaful sector, with EY forecasting that gross contributions will rise to close to US\$17 billion in 2015. The less positive feature of the sector's growth, however is that concerns have been rising about a lack of discipline in the Takaful market. Foremost among these misgivings are that intense competition within the industry has eroded profitability relative to the conventional insurance sector. These competitive pressures have been exacerbated by the number of newcomers to the fast-growing industry, many of them relying on aggressive and possibly uneconomic pricing in order to challenge established conventional insurers in a market where it is difficult to offer a differentiated product.

Take, as an example, a relatively small market like Kuwait, where 11 of the country's 23 national insurers are Takaful companies. The result of this fragmentation, according to research published by AM Best, is that the largest of the Takaful specialists, National Takaful, had a market share of less than 4% in 2011. The UAE's insurance industry is even more fragmented than Kuwait's, with 61 registered insurers active in the market, according to the AM Best report. The most frequently identified threat to the longer-term prospects of the Takaful sector, however, has been regulatory fragmentation and the absence of standardization in Shariah compliance globally. This has made cross-border expansion by the larger and more innovative operators prohibitively costly. That in turn has held back the economies of scale that could be generated by more effective internationalization of the Takaful industry.

The combination of competition and overcapacity were the reasons given by S&P in a report published in July 2013 for

the financial weakness of the sector in the UAE. "Overall," S&P noted, "Takaful fund deficits are increasing, at least in the UAE and Kuwait, thereby eroding capital strength and ultimately weakening the sector's financial strength." Its relative financial weakness is one reason why an encouraging feature of the Takaful sector in 2013 was the tightening of regulatory standards and capital and solvency requirements in a number of key markets, which industry analysts believe will allow the industry to generate increased efficiencies. This in turn will encourage more mergers in the industry, helping to strengthen Shariah compliant national champions that are better equipped to compete with the entrenched players on the conventional side of the insurance sector.

The emergence of larger, better capitalized operators in the Takaful sector would allow the Shariah compliant industry to play a more prominent role beyond the retail, motor insurance and small business markets. Takaful has yet to play a meaningful role in underwriting risks in big-ticket developments, such as the infrastructure projects that are planned throughout the Islamic world over the next decade. As one industry participant has noted, "this situation calls for creation of larger re-Takaful companies that have the capital size to cover larger size risks." Aside from restricted the role played by Shariah compliant finance in supporting infrastructure development, the relative small size of the re-Takaful sector has limited opportunities for Takaful insurers to lay off risks in other areas of the economy.

#### Consolidation helps to strengthen the sector

Already, a process of consolidation has begun to gather momentum in Malaysia, which has been catalyzed by the implementation of the Islamic Financial Services Act (IFSA) which came into force in July 2013. Among the comprehensive changes introduced in this Act is a requirement for all licensed insurers to split their businesses into separately licensed life and general units. According to a briefing published by the Singapore office of the international law firm, DAC Beachcroft: "The rationale for this requirement is that life and conventional insurance/Takaful businesses have different risk profiles and it is thought better for the long-term health of the industry if these risks are separated, particularly from a solvency perspective."

A notable recent example of consolidation in the Malaysian insurance sector has been the acquisition by Canada's Sun Life Financial and Khazanah Nasional of a 98% holding in CIMB Aviva Assurance and CIMB Aviva Takaful for RM1.8 billion (US\$545.43 million). Sun Life, which has 2.7% of the local market and has rebranded the Shariah compliant operation as Sun Life Malaysia Takaful, has ambitious growth plans. Through the development of a new multiple distribution center, the group is aiming to climb from 12<sup>th</sup> position in the ranking of Malaysian insurance companies to 8<sup>th</sup> by 2015. Industry analysts believe that the recent legislative change in Malaysia will encourage more mergers. In December 2013, Fitch Ratings said it expects to see further consolidation across the country's life insurance, general insurance and Takaful sectors due to the new regulations."

Elsewhere in Asia and the Middle East, similar legislative change is also expected to strengthen the Takaful movement. In Indonesia, for example, which is the world's most populous Muslim country, a new law is expected to be passed in 2014 which would require insurance companies to spin off their Shariah compliant units. It is believed that this will lead to a wave of consolidation among these units – of which there were 37 in late 2013 — as insurance companies explore ways of ensuring that they meet tough minimum capital requirements. Although assets in Indonesia's Takaful sector expanded by almost 43% in 2002, the sector's

2.3% market share remains modest, suggesting there is still considerable room for growth. More broadly, industry analysts believe the under-development of Takaful relative to conventional insurance will continue to underpin its long-term expansion, with a recent survey by Swiss Re finding that conventional insurance still accounts for about 83% of all premiums written in Muslim countries. This growth will be supported by robust economic growth, favorable demographics and increased financial awareness about the benefits of insurance.

#### **Government support**

In some regions, growth will also be supported by governments committed to promoting more widespread insurance penetration and to the growth of their Shariah compliant financial services sectors. A striking objective of Malaysia's Economic Transformation plan, for example, is that by 2020, 75% of the population will be covered by at least one insurance policy, which compares with a penetration rate of 54% at the end of 2012. Accelerated growth in the Malaysian Takaful market will be underpinned by initiatives such as the 1Malaysia Micro Protection Plan (1MMPP), which aims to give those on lower incomes access to insurance cover. Another market that has been identified by some industry analysts as a potential hotspot for growth in Islamic finance in general and Takaful in particular is Turkey, where gross insurance premiums are projected to grow by 16% between 2013 and 2015. The government has taken the lead in promoting the growth of Shariah compliant finance in Turkey, issuing a number of highly successful Sukuk in the last two years, serving as benchmarks for other issuers and providing an acceptable investment alternative.

#### The potential of Family Takaful

Another likely trend in the continued evolution of the global Takaful sector, think some analysts, will be the growing importance of its use as a savings vehicle through the growth of Family Takaful. This is a long-term savings and investment program with a fixed maturity profile, while General Takaful refers to protection for anything other than human life. The latest edition of the Milliman Global Family Takaful report forecasts that the Family sector will outperform General Takaful over the coming five years, expanding by 160% to US\$5.6 billion from US\$2.2 billion in 2011. Milliman, which advises that the underlying drivers of growth in Family and General Takaful are "markedly different", notes that Family Takaful is posting especially rapid growth in Asia. "In the Middle East," Milliman reports, "Family Takaful penetration has not been as rapid, though the region has all the necessary ingredients to make Family Takaful more viable and profitable than General Takaful."

In conclusion, Takaful continues to face a number of formidable challenges as it seeks to compete more effectively with its conventional counterpart. However, its longer-term prospects remain bright, given its importance within a broader Islamic financial services sector described by S&P as still being "at a formative stage". (3)



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## How Islamic investors can benefit from global resources

Nature provides us with resources and humans provide us with technology and innovation. Today some countries can provide us with both resources: technology and innovation, and Islamic investors can participate in their investment story. HENRIETTA LANCE tell Islamic Finance *news* how.

Natural resources are derived from the environment, it may exist as a separate entity such as fresh water and air as well as include living organisms; or it may exist in an alternate form which must be "processed" to obtain the resource such as metal ores, oil and most forms of energy. Processing requires technology and innovation: with oil and gas processing many forms of energy including LNG, shale oil and gas; with metal ore processing, we obtain all types of sophisticated manufactured goods. Cars are increasingly manufactured using aluminum and high performance plastics, which are replacing steel.

In today's economy the most prominent global resources are oil and gas (energy) with their subsequent impact on global manufacturing and economic growth, including the "Renaissance of American manufacturing". Worldwide, energy costs are dictating

global investment decisions. In an environment of growing geopolitical risk, all countries are seeking to secure independence and diversification of their energy supplies. While 80% of the global energy demand growth comes from Asia, in particular China and India, and other emerging markets, many of the largest multinational integrated oil and gas majors are quoted in North American and European equity markets. This factor confirms the global nature of the oil and gas sector for equity investors.

Rich in technological developments multinational oil and gas majors are making impressive discoveries today, changing the nature and more importantly the geopolitical and economic mix in the world. Shale oil and gas fracking in America is resulting in the Renaissance of American manufacturing and the movement of re-shoring as US industry starts to invest more significantly domestically to take advantage of the very competitive input costs

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in the world's No. 1 economy. Asian and European nations, who are currently very dependent on the Middle East for their energy supplies, are moving to invest more significantly in North America, both to diversify their energy supplies but also to take advantage of the manufacturing industrial growth in petrochemical, refining and other energy-related industries. Shale oil is changing the nature of world trade as Americans are investing in their export industry (refining, petrochemical and automobile etc). "Made in America" is fast becoming the national message.

Sophisticated technology is also resulting in multinational oil and gas majors making new discoveries in the North Sea and extending maturities of reserves previously destined to decline in two to three years. Technology is creating value in the mature North Sea reserves.

The world of global resources is in constant evolution. The most dynamic companies, well-positioned in the right geographical regions should surprise investors over the coming years with their capacity to generate growth in earnings and steady cash flow to pay regular and growing dividends

The changing global energy climate and modern technology are opening up significant investment opportunities both for multinational oil and gas majors, but also energy conscious manufacturing companies who are moving fast to maximize new opportunities. Raw materials are changing in the manufacturing sector as aluminium and high performance plastics increasingly replace other metals in particular steel in certain components of the auto, construction and capital goods sectors. Specialized chemical and industrial gas companies are moving fast with technology for coal gasification projects in China in addition to industrial plants to produce Ethanol from natural gas in America.

The world of global resources is in constant evolution. The most dynamic companies, well-positioned in the right geographical regions should surprise investors over the coming years with their capacity to generate growth in earnings and steady cash flow to pay regular and growing dividends. Within a flexible strategy, an investor can take advantage of these global investment opportunities to capture this value creation.

However contrary to most expectations there is no need for rising commodity prices to see an appreciation in the equity environment. If we take the energy sector as an example, the perfect environment for integrated oil and gas majors is one of low inflation, low interest rates and stable economic growth – as Goldilocks would have said: a global economic environment that is "not too hot and not too cold". Equities do not like inflation,

nor do they perform well in over-heating economies. Stability and good earnings visibility are the key words for equity markets and many corporate management would agree with this need for stability in the global economic climate. A world in which crude oil continues to stabilize at around US\$100-110 (the trading range for Brent over the last three years) enables corporate management to take long-term strategic investment decisions. Volatility of commodity prices however results in disastrous "stop and start" policies, job losses and capital spending reductions brutally following blockbuster investment projects.

But within integrated oil and gas majors there is not only upstream oil production, we also find LNG with its high Asian profitability and petrochemicals where cheap shale gas in the US, changing the global production picture. Oil and gas majors are also exposed to refining where the historic recovery of US refining margins still a considerably bright future as America, with its thriving shale oil and gas production, exports value-added oil and gas products to the rest of the world.

Indeed integrated oil and gas majors provide another way of participating in the American energy miracle and subsequent manufacturing renaissance in addition to Asia's thirst for LNG and other energy supplies. Another tight year for LNG exports from Qatar to Asia while the wide divergence in world energy prices reverses the 15-year manufacturing trend of outsourcing to developing emerging market economies. This reversal in the global manufacturing trend will result in both winners and losers in the investment world.

After the winners, who could be negatively impacted in this economic environment? In the energy sector it could be the oil services companies, those who benefit from oil and gas capital investment, as majors start to cut back costly projects — oil and gas services. High beta oil and gas exploration and production in risky geopolitical regions could also see less allocated capital. They will probably be the losers in this environment as the heavyweight oil and gas majors regain a more honorable rating against the market.

But what does this have to do with Islamic finance? Worldwide, as bank lending becomes more selective and capital allocation seeks sound returns, those companies with solid balance sheets will stand strong as they are less dependent on banks. Those companies with high gearing could find it tough to refinance and sell unwanted assets in a bumpy economic environment.

A premium for quality and long-term strategy should enable a rerating of those with healthy balance sheets, sound geographic diversity and a solid earnings outlook. In this environment the benefits of privileging equity investments with the more conservative balance sheets, a key criteria in Islamic equity investments, should be well rewarded. (5)



Henrietta Lance Senior Portfolio Manager at Amundi

Henrietta has more than 27 years' experience in asset management and has worked on a wide range of markets and geographical zones. She is managing the global resources Shariah compliant strategy at Amundi since May 2011.



## Technology trends in Islamic finance

In an exclusive interview with Islamic Finance *news* Mohammed Kateeb, the group chairman and CEO of Path Solutions, discusses the technological challenges and trends for Islamic finance in 2014.

The field of Islamic finance technology has undergone rapid changes much like its conventional counterpart and this is expected to carry over into 2014. In 2013, the focus was on mobility and advanced delivery channels; unlimited access to banking in terms of time and location.

One of the main trends in 2013 was the geographical growth of the sector, reflected in the industry's focus given the technological infrastructure available in some of Islamic finance's new locations as Kateeb explains. "More Islamic banks in many more new countries came into existence and more conventional banks started to offer Islamic banking products." Africa, as a continent, has seen an uptick in the number of countries that have adopted Islamic finance in the last few years, although the infrastructure in terms of technology has yet to catch up in some places. Kateeb elaborates, "In many countries in Africa, the mobile infrastructure is better developed than the fixed telecommunication infrastructure. In sub-Saharan Africa, which is the least developed part of the continent, almost 70% of the population has mobile phones. Therefore, delivering banking services through mobile and

branchless banking is key to penetrating this region."

#### **Development in Africa**

Africa's population is set to double to two billion in 40 years. The Muslim population of the continent makes up 50% of that population meaning that Africa represents a huge opportunity for Islamic finance. Kateeb is positive about the potential of development in Africa, but cognizant of the difficulties that will also crop up given the size of the continent and the many different regimes and regulatory frameworks contained within it. "With this tremendous opportunity comes challenges and of course, the biggest difficulty in Africa is the infrastructure and this reflects on the number of branches that banks have within the continent. To address this challenge, core banking systems should have an offline mode that allows banks to continue to function even if the connection between branches and headquarters are down. This is the way that our unique iMAL\*SAFE technology works; those of our customers that have branches in harsh geographical locations where electricity is not available after 5:00pm and unreliable WAN

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connections, are still able to run the iMAL core banking system." Kateeb believes that Africa is a market that can spur great developments in the Islamic finance sector with African economies such as those in Ghana, Ethiopia and Mozambique growing faster than any other region of the world. "Technology needs to play a key role in fueling and supporting this growth. Africa is increasing the need for new products; Islamic banks in Africa need to play an even a larger role as a market maker and not just a financial mediator. This requires new Sharia-compliant products. Microfinance is a great model to finance micro businesses in Africa. Local Islamic financial institutions are encouraging microfinance as an extension to their banking activities and technology providers need to offer their customers' end-toend functionalities that are Sharia-compliant and include microfinance solutions."

#### Technological challenges in the sector

Islamic finance technological solutions providers have had to continue enhancing offerings by incorporating in-demand advanced functionality, whilst maintaining a practical approach to upgrading the underlying technology, keeping in step with the latest technology trends and enabling clients to maximize their ability to compete in the marketplace. Kateeb explains one of the trends of last year. "2013 saw many conventional core banking providers dressing their conventional systems to appeal to Islamic banks. This strategy has failed in multiple banks and many banks that already have conventional core banking systems with Islamic interfaces came to us to help them with their Islamic business." Again, just as in the conventional segment, in Islamic finance investments are needed in technologies that focus on advances in analysis of data through data marts and data warehousing; leading to a better understanding of the customer, through successful implementations of CRM, advanced approaches in risk management, vertical assets and liabilities management.

#### **Industry challenges for 2014**

One of the most pressing issues in Islamic finance currently is the lack of product diversification. Kateeb predicts that depending on the capacity of the sector to absorb capital flows and create innovative and competitive products, this will be an area of focus in 2014, alongside new business development. "This year, new business development is likely to focus in particular on Shariah compliant investment funds and wealth management. None currently offer Islamic hedge funds but it is believed that many are planning to offer them within the next three years."

The struggle to become a mainstream form of banking is also a challenge that Kateeb believes will be broached in 2014. "The sector's progress to a mainstream form of banking will be fuelled by continuous growth. The penetration percentage of Islamic finance in major Muslim countries remains in single digits." The challenges to be addressed in this area are perennial: the lack of staff and expertise in Islamic finance; the lack of an overarching standardized regulatory framework; more regulatory and tax reforms to facilitate the entry of Islamic finance to new markets and the awareness and prevailing misconceptions of the public, that need to be met through education. "Copying conventional banking products will continue to increase misconceptions and reduce the borderlines between Islamic and conventional banking. The best definition heard lately to describe this is "identity replacement".

#### Standardization and Islamic finance technology

The development of industry standards has played a key role in the history of technology innovation and Kateeb feels that its role in the development and expansion in the usage of technology in the Islamic finance sector is no different. The questions that the standardization bodies attempt to clarify for the industry are the same no matter which market they originate from, however the implementation is where technology faces its challenges. "The basics of Islamic finance globally are all the same

and are based on the same principles that these international standards attempt to meet. The complexity comes from many banks not following these standards literally, as they have their own Shariah Boards to approve the structure of their business products, their own contracts, processes and procedures that modify these standards. This puts tremendous pressure on IT solution providers to have systems designed and built based on Shariah principals from the ground up, with the flexibility to allow the redesign of the structure of a specific product in a customized manner based on banks' specifications. This is where many conventional IT solution providers fail and the need for legitimate Shariah-based IT solutions are needed."

The need for new product structures is recognized and welcomed as the Islamic finance industry matures, and the aim of standardization bodies is to continue to keep abreast of the sector's advancements. "Often many financial institutions are running products and have processes and procedures without clear standards set by these standardization bodies," Kateeb shares. "On the other hand, many standards are set by these bodies that are not being followed by financial institutions. The standards development and adhering to these standards in our segment are issues that need to be addressed."

#### Outlook for 2014

When asked about how he believes the sector as a whole can develop over the course of the year, Kateeb is positive. "Islamic finance growth has been fueled in the past few years by increasingly gaining acceptance, especially in high-growth emerging markets, as an effective means to building an inclusive financial system and replacing the shadow economy. The industry as a whole needs to focus on the most important issue, which is to understand what makes Islamic finance unique, protect this uniqueness and not allow for identity replacement." The acquisition of new customers and the maintenance of what makes Islamic finance different are crucial for 2014. "Critical for continuing to acquire new customers is convincing them that Islamic banks are different from conventional ones in the soul and spirit of their business. If the only difference between Islamic banks and non-Islamic banks is the color of the logo or the brand, then it will continue to be a challenge to attract customers in the numbers needed, but if we succeed, many of these challenges we are facing today will find a resolution."



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### Debt capital markets: Weathering the storm

By all accounts, 2013 (as at the 6<sup>th</sup> December) has been a relatively volatile year from the perspective of factors influencing Sukuk issuances globally. In order to review and analyze global Sukuk issuances in 2013, it would be helpful to reflect briefly on the platform the end of 2012 provided. RIZWAN H KANJI shares his view.

By the year end 2012, there had been approximately US\$134 billion-worth of Sukuk issued globally. This reflected a growth of 57.64% in global Sukuk issuances compared to issuances of US\$85 billion for the year ended 2011. The major geographic contributor for Sukuk issuances in 2012 was Malaysia with US\$104 billion issued, a contribution of 77% of the total global Sukuk issued. This was followed by Saudi Arabia with US\$10.5 billion or 7.8% issuance followed by the UAE and Indonesia with just over US\$6 billion each.

In 2012, the highest ever aggregate value of Sukuk were issued globally. With a backdrop of a record-breaking year, below is a brief review of global Sukuk issuances in 2013 and the expectations for 2014.

#### 2013: A review

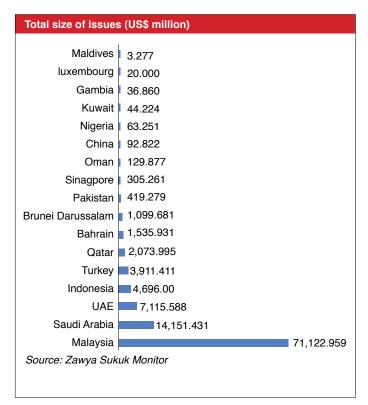
Total global Sukuk issuances in 2013 were lower compared to 2012, decreasing from approximately US\$134 billion in 2012 to US\$106 billion in 2013, a decrease of 20.9%. Whilst this may

This increase in the interest rate environment forced certain issuers with no particular urgency for funding to hold off issuing Sukuk

be a moderate reduction from the record-breaking year of 2012, 2013 can be carved into three general segments.

The first segment of the year reflected strong market activity with almost US\$11 billion of Sukuk being issued in January 2013. This was followed by a relatively subdued level of international Sukuk issuances during the second segment noting the concerns the market showed as a result of the announcement by the US

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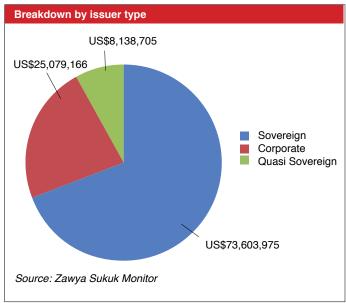


Federal Reserve that it may ease QE3 by tapering its bond buying program of US\$85 billion a month. The market reacted to this by pushing up interest rates which increased the cost of returns payable to Sukukholders. This increase in the interest rate environment forced certain issuers with no particular urgency for funding to hold off issuing Sukuk with a view to wait and see for a reduction in the interest rate environment.

The final segment, particularly the last quarter of 2013, reflected a flurry of successful issuances primarily as a result of the announcement in September 2013 by the US Federal Reserve that it was postponing the tapering of its bond-buying program. This in turn resulted in the market responding with lower interest rates and hence driving down the rates payable to Sukukholders. This provided an impetus for transactions on hold to approach the market and for other issuers to tap the market with relatively tighter pricing. Issuances from the GCC surged to US\$4.7 billion since the 30th September 2013 indicating that issuers' realized that they may be in a low interest rate environment that may not last for long.

Sovereign issuances will continue to contribute the bulk of Sukuk issuances in 2014 with a number of non-Islamic sovereigns issuing Sukuk

Malaysia continued to lead the market with US\$71 billion-worth of issuances, a contribution of approximately 67% of total global Sukuk issuances in 2013. This was followed by Saudi Arabia with US\$14 billion (13.21%) followed by the UAE with US\$7 billion, Indonesia with US\$4 billion and US\$3.9 billion from Turkey.



The bulk of the global Sukuk issuances were by sovereign states at US\$73 billion with corporates contributing US\$25 billion of issuances. Whilst corporate issuances still lag behind substantially compared to sovereign issuances, 2013 has been a year of capital-raising type issuances.

In March 2013, Bank Asya, the biggest participation bank in Turkey, debut a US dollar-denominated Tier 2 Sukuk. This was the first Tier 2 Sukuk out of Turkey and Europe which was then followed by Al Baraka Turk, another Turkish participation bank, with a privately-placed Tier 2 Sukuk. Additionally, the market also witnessed the first corporate hybrid Sukuk issuance out of Saudi Arabia by Almarai (a local currency facility) and by GEMS Education, the first international corporate hybrid Sukuk. These issuances have equity-type features which are much closer to the spirit of the definition of Sukuk.

#### **Expectations for 2014**

The US Federal Reserve's decision in relation to the slight reduction of its bond-buying program to US\$75 billion may in turn result in an increase in interest rates which may impact the cost of borrowing. This high interest rate environment may be a "new reality" that issuers may have to get used to.

Sovereign issuances will continue to contribute the bulk of Sukuk issuances in 2014 with a number of non-Islamic sovereigns issuing Sukuk. Offerings from corporates will continue to increase and we may also see the continued growth of capital-raising issuances and hybrid issuances. The various infrastructure needs, particularly in the GCC, may also prompt an increase in project Sukuk issuance.

#### Conclusion

The issuance activity in the early part of 2013 and at the end of 2013 have collectively avoided 2013 being a damp squib compared to 2012. The late flurry of stalled and new issuances coming to fruition near the end of the year has resulted in 2013 being a relatively decent year for Sukuk issuances. (5)

Rizwan H Kanji is a partner at the global law firm King & Spalding and is based in the firm's Dubai office. He has advised on numerous global Sukuk issuances frequently advising issuers, joint lead managers and sovereigns in relation to their debt capital market issuances. He can be contacted at RKanji@KSLAW.com.



## Islamic leasing: The more realistic choice

In recent years, the demand for Islamic finance and its Shariah compliant instruments have increased substantially. This increase can be attributed to the rise in the Muslim population across Asia, Africa, the Middle East and South America, which currently account for over 95% of the world's Islamic population. Another factor is the growing demand from the non-Muslim population who also has realized the benefits derived from these services.

Ijarah leasing has proven to be a more realistic product in terms of complying with Shariah requirements, hence the high popularity for this Islamic financial instrument. Analyzing countries in the GCC and Asia, it is observed that changes to legislation have enhanced total leasing Ijarah portfolio compared to conventional leasing. As far as the other regions are concerned, the UK, Europe, and South America, the Ijarah leasing market has not been able to capture a commendable market share due to contradictions existing between various elements within legislative frameworks that may prevent Ijarah leasing from being effectively implemented.

#### 2013: A review

The size of the Islamic leasing industry is generally small by international standards, although it may have been underestimated

due to the lack of reporting by countries involved in Islamic leasing and the poor coverage of sources of information. The top four leasing markets are the UAE, Iran, Kuwait and Saudi Arabia. Each of these markets has an annual leasing volume exceeding US\$2 billion. These four countries constitute 60% of the total leasing market in the Middle East and Africa. The dominant types of lessors are banks which constitute 65% out of the total number of lessors while 30% are standalone leasing companies. Leasing companies are often faced with the challenge of financing their business growth while competing with banks who offer relatively attractive lease installment.

In some Islamic countries, leasing is only allowed to banks and bank affiliates – posing a challenge for other leasing institutions offering Islamic financial services. Movable assets are the most common types of asset leased under Ijarah in many Islamic

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countries; leasing of immovable assets is very limited. This is mainly due to legislative constraints. In some countries there are no legislative constrains on the types of leased assets. In Jordan, real estate leases constitute of 66% of total leasing market and similarly, in the UAE, 80% of leased were directed to real estate.

In 2013, commercial aircraft leasing became more popular with several Middle Eastern countries utilizing the Ijarah concept to lease aircraft. According to market reports commercial aircraft leasing will continue to expand despite the sluggish performance of the global economy.

Sri Lanka is one of the growing Islamic markets in the Asian region. One of the more popular Islamic financial instruments is Ijarah which is mainly used to finance brand new/unregistered commercial vehicles. Volume of Ijarah transactions totaled to LKR8 billion (US\$61.05 million) as of October 2013, or 40% of the total Islamic portfolio in the industry.

A sound legal framework for Islamic leasing requires a well-written specialized Ijarah leasing law and appropriate changes in legislation with regard to repossession procedures of leased asset

#### 2014: A preview

It is expected that the Islamic leasing sector and the Islamic finance industry as a whole will continue to grow as new players enter the industry seeking to reap the benefits of the increasing demand. This potential increase in competitors will lead to intense competition among the Islamic leasing and finance providers as well as the conventional counterparts. This in turn might compel us to realign our strategy and move onto a differentiation perspective rather than just following conventional leasing providers.

Financial institutions will focus their strategy on innovation in order to provide more innovative financial products and services to gain competitive advantage in the industry. Micro-leasing, an increasingly attractive option for financing small equipments, may be another product Islamic leasing providers can consider.

Ijarah lease can be a source of financing to improve infrastructure facilities in developing countries including in their public transportation system and as a means for municipal authorities and local entrepreneurs to acquire quality construction and maintenance equipments.

A sound legal framework for Islamic leasing requires a well-written specialized Ijarah leasing law and appropriate changes in legislation with regard to repossession procedures of leased asset when a lessee default, effective treatment of lessors and lessee under bankruptcy and the enforcement of contractual proprietary rights and delay in meeting monetary obligation by lessee and compensation for lessor, etc.



#### Conclusion

The Islamic economies of the world represent more than US\$8 trillion in GDP, a 1.6 billion population growing at twice the rate of the global population and some of the fastest-growing global economies. More than 350 million Muslims reside as minorities in many nations, with largely affluent ones living in the West and large populations residing in the emerging nations of India, China, and Russia. The young population of Muslims is increasingly asserting their Islamic sensitivities and looking for Islamic financial instruments for their financing transactions.

In this context in 2014, the industry will witness an expansion of growth and undoubtedly, Ijarah leasing will become an innovative financial solution for the procurement of various types of assets which are needed for day-to-day business and to fulfill the working capital of organizations. Islamic leasing can play a role in fighting against global climate change through renewable energy projects and cleaner production equipments. Banks and leasing companies are also able use the Ijarah concept to raise capital for their expansion by way of issuing Sukuk. (3)

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## New trends in global Islamic microfinance

Microfinance has played a crucial role in eradicating poverty and empowering the private sector especially in previously slow economically growing countries with poor capital accumulation.

According to the International Food Policy Research Institute, approximately 100 million individuals have benefited from microfinance schemes. Several studies conducted in Asian countries such as Bangladesh, Pakistan, and others have shown that conventional microfinance such as the Grameen Bank model, Union model and Village Bank model has managed to contribute to poverty alleviation but a few deficiencies which prevent sustainability in social and economic development on the long-term remain. In comparison to conventional microfinance systems, Islamic microfinance finance systems which have evolved over the past few years have proven to be more resilient post the financial crisis as well as are more sustainable in terms of poverty alleviation and economic upgrade.

Such systems are based on the principles of Shariah such as risk sharing, and asset-based financing that is directly linked to economic activity. It facilitates financial inclusion of all segments of the society and suits the needs of both Muslims and nonMuslim communities. Several research studies conducted by international institutions such as International Financial Corporation showed that almost 20-40% of the poor in developing countries such as Algeria and Yemen respectively are not dealing with conventional microfinance due to religious reasons. The four most common Islamic microfinance products can be classified as partnership mode (Mudarabah and Musharakah), trade-based mode (Murabahah, Musawamah, Salam and Istisnah), rentalbased (Ijarah and diminishing Musharakah) mode as well as other models like, Qard Hasan, Zakah and Waqf.

#### 2013: A review

According to a recent research conducted in 2013 by the World Bank's Consultative Group to Assist the Poor (CGAP), there exist 255 institutions providing Shariah compliant microfinance globally. There exist 14 Islamic microfinance institutions versus 51 conventional counterparts in the MENA region – most of which

are classified as non-governmental organizations (NGOs) and non-banking financial institutions (NBFIs).

Approximately 44% of conventional microfinance clients worldwide reside in Muslim countries and almost one-half of the 56 IDB member countries in Asia and Africa are classed as United Nations Least Developed Countries (LDCs), so there is an immediate need to start Islamic microfinance in Muslim majority countries for financial inclusion. Currently, there are almost 250 Islamic microfinance institution, working globally in 32 countries.

However, a lack of donor Shariah compliant sources of funds has been a major challenge. Multilateral agency the IDB has approved US\$285.4 million-worth of development funding for new projects. For example, the IDB has been implementing a long-term mega project in its member countries such as Sudan, Yemen and Egypt among others to promote microfinance, alleviate poverty and unemployment and create jobs in order to improve the livelihood of poor/limited income families in less developed communities; and provide technical and financial support to create microenterprises and income-generating activities, such as industry, trade, agriculture, services, or livestock production and be part of the production cycle and the process of sustainable local socioeconomic development.

To achieve such objectives, IDB's projects enhance financial and institutional capacities by establishing and applying microfinance best practices and methods in ways compliant with the Islamic law, intermediate microfinance institutions and microfinance windows in banks. The IDB prioritizes poverty pockets in desert and rural areas, and encompasses groups such as unemployed youth and laid-off professionals, the retired, female head of households and conventional small farmers. For example, the IDB supported Bank of Khartoum in launching its microfinance and retail products offered to clients across Sudan.

IDB's projects enhance financial and institutional capacities by establishing and applying microfinance best practices and methods in ways compliant with the Islamic law, intermediate microfinance institutions and microfinance windows in banks

#### 2014: A preview

There is a lot of potential for Islamic microfinance to grow in sub-Saharan Africa such as Nigeria, Ethiopia, and Kenya. These countries have witnessed the world's most startling growth rates; reaching GDP growth rates of almost 7%. This trend has spilled over into other parts of Africa as well such as Yemen, Egypt, Algeria, Morocco, and into other countries of other regions such as Indonesia, Malaysia, Bosnia and others.



Still, there exist some challenges that need to be addressed. First, some microfinance segments are excluded from access to finance. Thus, the enabling environment for financial inclusion needs to be considered by African governments and multilateral agencies. This is to ensure the success of Africa's microfinance initiatives through the creation of an enabling environment with proper financial infrastructure and legal frameworks that support microfinance institutions and facilitating financial inclusion to poor micro segments. For example, the Egyptian Financial Supervisory Authority has initiated steps towards the issuance of a microfinance institutions law.

Investment in microfinance providers is constrained by the predominance of an NGO or association model. All key stakeholders (regulators, NGOs, donors, microfinance institutions) need to be engaged simultaneously to facilitate access to finance, information, services and entrepreneurship. Donors should support the initiatives of Islamic microfinance institutions by helping them to evolve and develop hybrid structures that include models such as micro-leasing, and Waqf. Micro-leasing shall not be developed only by traditional lending institutions but also by Islamic micro-finance institutions or micro-lease companies. Leasing has advantages by virtue of the separation of ownership from possession and economic use which enables assets owned by one party to come into the possession, and be employed for economic purposes by some other person. Thus, it solves the main barrier to investment and enables poor people to work themselves out of poverty without needing to own capital resources.

In addition, credit information should improve in quality and availability throughout MENA, in terms of credit registries and credit bureaus, and all microfinance institutions need to report to or have access to them. Finally, credit guarantee systems should permeate more to enhance financial inclusion.

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# Islamic finance regulatory developments point to positive growth

Historically, Islamic finance has been concentrated in Muslim-majority countries of the Middle East and Asia, but in the last decade has expanded to countries with smaller Muslim populations. AHMAD LUTFI ABDULL MUTALIP writes.

This includes a number of European and other countries which until recently have actively began to reform their tax, legal, and regulatory frameworks in order to attract Islamic investments. To date, there have been many new regulatory developments in Islamic finance across the world at national, regional and international levels, and which only contribute to the strength of the Islamic finance industry. These regulatory developments point the positive growth of the industry and that it will continue on this impressive growth trajectory and is set to reach US\$6.5 trillion in total assets by 2020.

#### Key developments in the MENA region

Egypt: Our journey in navigating through the regulatory issues and developments of 2013 takes us to Egypt which approved

a new Sukuk law that will allow the country to tap a new source of financing at the back of a soaring budget deficit. A number of Egyptian banks, such as Alex Bank Intesa Sanpaolo, Ahli United Bank, Industrial Development and Workers Bank of Egypt, Export Development Bank of Egypt and Barclays Bank Egypt, submitted applications to the Central Bank of Egypt seeking Islamic banking licenses.

Libya: The Libyan government announced plans to implement to enact a new Islamic banking law by the end of 2012. The new law was passed in May 2012 and further work has been carried on to amend legislations in order to attract foreign investments and stimulate the private sector following the civil war. On this front, the Libyan authorities have been looking at several options for Islamic banking services within the country; these include

allowing conventional banks to operate branches or Islamic banking windows and also permitting conventional banks to convert to fully-fledged Islamic banks. However, substantial resources still needs to be mobilized in Libya in order to activate various institutions, such as insurance companies, Islamic funds and investment instruments by the end of 2014 or the beginning of 2015.

In January 2013, the Libyan government approved a law that would ban all interest payments in Libya, in efforts to accelerate the move toward an Islamic banking system in the country. This law is expected to come into force in early 2015.

Bahrain: In Bahrain, the International Islamic Financial Market (IIFM) launched its global standard Inter-Bank Unrestricted Master Investment Wakalah Agreement and related guidance memorandum in June 2013. The Wakalah Agreement is a legal instrument that aims to help Islamic financial institutions manage their liquidity requirements through the Wakalah principal as an alternative to the standard Murabahah currently used in the market. The launch of the standard form Wakalah is the latest standard form document published by the Bahrain-based IIFM, pursuant to the launch of the ISDA/IIFM Tahawwut (Hedging) Master Agreement and the ISDA/IIFM Mubadalatul Arbaah (Profit Rate Swap) and IIFM Master Agreement for Treasury Placement in March 2010.

Oman: The sultanate introduced Islamic banking last year and initiated the process by developing the required legislation and issuing licenses to fully-fledged Islamic banks and windows. The Bank of Muscat, Oman's biggest bank by assets, received a license to offer Shariah compliant services in early 2013. The Central Bank of Oman announced in the first guarter of 2013 that the country is looking to issue OMR200 million (US\$520.2 million)worth of conventional bonds and Sukuk in line with its budget financing needs in what would be the country's first sovereign Sukuk issuance. Oman's Capital Market Authority completed the drafting of bylaw that regularizes the issuance of Sukuk and the proposed amendments to the Capital Market Law. Pursuant to this development, the sultanate celebrated the issuance of the first Sukuk by the private sector - Tilal Development Company (TDC) - worth OMR50 million (US\$130 million). Al Madina Investment acted as the principal advisor, joint lead arranger and joint lead manager for the Sukuk Ijarah on behalf of TDC.

**Qatar**: Qatar has one of the fastest growing Islamic banking sectors in the world and its Sukuk issuance has been very encouraging, with Qatar becoming one of the top five largest Sukuk issuance nations in the world in 2012. Islamic banks in Qatar have continued to post positive results owing partly to the directive issued by the central bank to disallow conventional banks from offering Islamic banking products and services via window operations earlier this year.

The Qatar Exchange (QE) also launched the Al Rayan Islamic Index. The index is based on QE listed stocks of minimum free float size and liquidity that are Shariah compliant. The index was launched with the view to support the creation of a Shariah compliant exchange-traded fund (ETF) by Al Rayan Investment.

#### Key developments in the Southeast Asian region

**Singapore**: At the tabling of the Singapore government's 2013 budget, the government said that it will tax Islamic finance businesses at the standard 12% rate, instead of the 5% concessionary rate, from the 1st April 2013.

**Malaysia**: On the 30<sup>th</sup> June 2013 the Islamic Financial Services Act 2013 (IFSA) came into force, ushering in a new regulatory and supervisory framework for Malaysia. The IFSA consolidates the provisions of the Islamic Banking Act 1983 and Takaful Act 1984 which were also repealed, into a single piece of legislation. The Act is a step towards global trends in financial regulation and aims to provide the regulator with greater powers to counter future risks to stability in the financial sector, increase consumer protection and promote competition in the broader financial services sector.

As the Malaysian regulatory and supervisory framework enters a new stage of its development, the IFSA will ensure the laws that govern the conduct and supervision of Islamic financial institutions in Malaysia continue to be relevant and effective to the financial system, while streamlining the regulation of financial institutions for the next ten to twenty years.

#### 2014: A preview

In Malaysia, the domestic bond market is the largest in Southeast Asia with a value exceeding RM1 trillion (US\$302.94 billion), and daily transaction value of more than RM30 billion (US\$9.09 billion) in the foreign exchange and money markets. In order to ensure efficient operations of financial markets, a clear regulatory framework is required. In this regard, Malaysia is expected to make amendments to existing laws and enact a Netting Act to protect enforcement rights of "close-out netting" under the financial contract. This will in turn reduce credit risk and contribute to a more robust derivatives market, thereby reducing systemic risks in domestic financial markets and reduce costs of doing business in Malaysia.

Malaysia is expected to make amendments to existing laws and enact a Netting Act to protect enforcement rights of "close-out netting" under the financial contract

#### Conclusion

The Islamic finance industry is a fast-changing and dynamic industry with new developments taking place all the time. The development of Islamic finance in domestic economies will continue on a positive growth and will change to incorporate more productive structure that are more innovation-driven and knowledge intensive. The role of the regulator therefore will also evolve in order to remain current with these changes. The regulator will need to become an enabler of growth and development in this very young industry. This will lead to increased predictability and sound robust legal and regulatory framework.

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## Securities and securitization in Islamic finance

Sukuk, or Islamic bonds, which are structured to generate returns to investors in accordance with Islamic principles, including, in particular, the prohibition against the payment of interest, have formed a small but high profile part of the capital markets for over a decade. FARMIDA BI shares her understanding.

The Sukuk market grew very quickly from 2003-08 but was then halted by the global financial crisis, which tested the product through high profile defaults such as Golden Belt and near defaults such as Nakheel, resulting in greater familiarity and comfort for the investor market which was able to understand the nature of their rights in an asset-based deal. Sukuk are still mostly issued in the traditional hubs of the GCC and Malaysia but the market is extending into large Muslim majority countries, such as Turkey and Indonesia, with expected Sukuk issuances in 2014 from non-Muslim sovereigns such as the UK and South African governments.

#### 2013: A review

There has been commentary that because there have been fewer Sukuk issuances in 2013, compared to 2012, that this demonstrates a slowdown in the Islamic market. However, 2013 was affected by a general slowdown in emerging market issuances, following the announcement in May 2013 by the US Federal Reserve Bank that there may be a tapering of quantitative easing, which had a proportionate effect on Sukuk issuances, demonstrating again that Sukuk are affected by market conditions generally and are not delinked by virtue of the different principles which affect their structures.

The volume is therefore less significant than the fact that 2013 saw new structures such as hybrid Sukuk issued by GCC banks to strengthen their capital base and issues by IILM to better manage the short-term allocation of excess liquidity, both suggesting a maturing market. Corporates were also active in 2013 with an innovative hybrid Sukuk issue by UAEbased schools provider, GEMS Education, and issues by Saudi Electricity Company. The domestic Sukuk market in Malaysia remained strong, representing about two-thirds of Sukuk issued in 2013 but since the issuances are denominated in Malaysian ringgit, they are unlikely to appeal to international investors. Some Malaysian issuers did access the US dollar market, such as Malaysian Airlines and Sime Darby. The Saudi riyal market in Saudi Arabia also continued to grow, tapping into the deep pool of liquidity that is available to investors who do not need US dollar issuances.

#### 2014: A preview

2014 is likely to see the development of the trends which have appeared in 2013, boosted by a stronger global capital market. Both the Islamic finance market and the emerging markets, as a whole, are likely to grow faster than the conventional and developed markets, resulting in further issuances from the existing established markets for Islamic finance.

Both Indonesia and Turkey will continue to be active in the Islamic capital markets with hopefully more corporate issuers from all

jurisdictions tapping the international Sukuk market. The market has been dominated by sovereigns and financial institutions and it is time that more corporates looked to the Islamic capital markets to meet their funding needs.

New markets, such as in Africa, are likely to result in the expansion of the potential pool of issuers. Sovereigns such as South Africa, Morocco and Tunisia hope to access the Sukuk market in 2014 with issuers from Nigeria, Kenya and Senegal hoping to follow. Arab Spring countries, such as Egypt and Libya, had planned to move their economies into a Shariah compliant model with plans to issue sukuk which have been affected by further political developments. Iran may also benefit from the easing of sanctions in 2014 in order to raise international Shariah compliant financing for its many infrastructure projects.

Shariah compliant project Sukuk to finance social infrastructure is a natural development which is long overdue and the pressure in many Muslim countries to build roads, schools and hospitals may need to be met in the international capital markets, since bank finance is likely to remain constrained. The same issues face project financing in the conventional markets where various solutions are being found for the absence of monoline insurers, such as the European Investment Bank's project bond initiative, which is a role that could be met by the IDB in the Sukuk context.

#### Conclusion

The increasing sophistication of the Islamic capital markets may be reflected in a return to the securitization market following precrisis deals, such as the Tamweel residential mortgage-backed security and Sun Finance commercial mortgage-backed security issuances. Turkey has a developed covered bond market and may begin to develop an Islamic equivalent and Saudi Arabia, which has been working on the implementation of its securitization law, may move into the issuance phase to support its substantial housing needs. Malaysia has had a domestic securitization market for home finance agreements operated by Cagamas for some time, although an attempt to replicate that in the international markets would require the currency mismatch to be met with a currency swap.

The UK has announced that it will issue a Sukuk which will hopefully come to the market in 2014, to support London's position as the hub for international Islamic finance. The Sukuk is likely to result in other UK companies and, possibly, other non-Muslim sovereigns, exploring the potential opportunities that Islamic finance may offer, thus resulting in the further development and growth of what is still a very young alternative to the conventional markets. (5)

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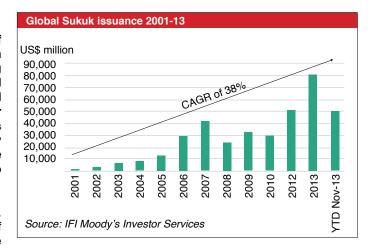
## Sukuk - Going steady

While issuance volumes were lower than 2012 levels, the global Sukuk market experienced a strong and steady year in 2013, confirming investor appetite for Shariah compliant instruments and the continued significance of Sukuk as a sector of Islamic finance and as a source of funding for issuers. DEBASHIS DEY and CLAIRE BARKER share their thought.

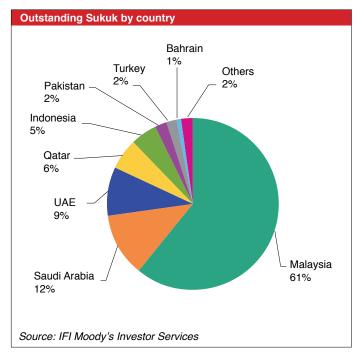
#### 2013: A review

As at November 2013, worldwide primary market issuance of Sukuk in 2013 amounted to over US\$51 billion, a decrease from the US\$81 billion of Sukuk issued in 2012, and total outstanding Sukuk reached approximately US\$274 billion. When considered in the context of the more challenging market conditions faced in the global capital markets in 2013, created by concerns over monetary policy in the US, the year's performance indicates the strength of investor demand for new issuance and thereby the resilience of the Sukuk market, with 2013 representing the second-highest annual issuance volume to date, expected to surpass that of US\$51 billion in 2011.

While 2013 saw the entry of some new issuers from the Maldives, Nigeria and Oman, the year is best characterized as one of continued, steady issuance from existing issuers (such as the republic of Turkey who issued their second international series of lease certificates) rather than any strikingly new developments



as regards new jurisdictions or asset classes. This is in contrast to 2012, where we saw some significant new developments in



the market, such as the first quasi-government Sukuk in Saudi Arabia by the General Authority for Civil Aviation, the first Tier 1 public Sukuk by Abu Dhabi Islamic Bank and the first Turkish sovereign Sukuk. Despite much talk of new sovereign Sukuk issuances from Jordan, Egypt and South Africa, discussion of North Africa as the next major region for Sukuk issuance, and the introduction of legislative changes intended to facilitate Sukuk issuance, for example in Hong Kong and Japan, no new issuances materialized from these sources.

Notwithstanding, there has been some innovation, for example the issuance by the International Islamic Liquidity Management Corporation of short-term Sukuk. Intended to meet market demand for highly liquid, investment-grade Shariah compliant financial instruments which Islamic banks can trade to manage short-term funding needs, the issue represented a new type of instrument in the Islamic finance sector, a shortage of which has been recognized as a barrier to growth. An expansion of asset class can also be seen in Ooredoo's inaugural Sukuk issuance, which represented the first Sukuk issuance backed by airtime on a GCC telco's network.

Issuance volumes in Malaysia decreased by around 25%, although Malaysia remained the largest market of issuance of Sukuk in 2013. Saudi Arabia remains the second-largest volume market globally, with issuance of more than US\$15 billion of Sukuk in 2013 across a variety of sectors. Sukuk issuance in the GCC in 2013 grew by around 11% to reach US\$14.8 billion by the end of the third quarter. Dubai announced early on in the year its plans to launch a drive to increase the development of its Islamic banking sector, with the ultimate aim of becoming the global center of Islamic finance, and subsequently launched the Dubai Center for Islamic Banking and Finance. The emirate has also successfully encouraged a number of local companies to list their Sukuk locally on NASDAQ Dubai.

#### 2014: A preview

The outlook for the market remains very good, with a healthy pipeline of transactions expected for the new year.

A recent report on Islamic finance by Moody's predicted that Malaysia and the Gulf will continue to dominate the Sukuk

market. In keeping with its aim to become the global center of Islamic finance, Dubai hopes to attract more international Sukuk issuances to its markets following the introduction of new standards for the issuance and trading of Islamic certificates.

Following the election of Dubai as the host city for Expo 2020, it is predicted that there will be significant spending by the emirate on infrastructure in the coming years, with Sukuk likely to be one of the preferred methods of financing. Infrastructure spending will provide a driver for issuance across the wider GCC region, for example in relation to the World Cup in Qatar in 2022.

A recent report by S&P cited refinancing requirements, a decrease in bank lending and supportive governments as providing the necessary support for the continued growth of the sector. Moody's, in their report, also noted that the increasing funding needs of sovereigns, corporate and banks across the Gulf and Asia, as well as the increasing familiarity of Islamic and conventional investors with Islamic finance instruments will also contribute to positive long-term growth.

#### Conclusion

Following the necessary reforms put in place during 2013, Turkey is also likely to continue to be an important new Sukuk market. We also note that other jurisdictions have expressed their ambitions to become regional hubs for Islamic finance, a move which could extend the sector beyond the currently established Sukuk centers. At the World Islamic Economic Forum in the UK in October, the first time it has been held outside the Muslim world, the UK prime minister announced plans for London to be a capital of Islamic finance. It was noted that Islamic finance has already played an important part in the funding of several London landmarks, including the financing of the Shard building and the Olympic athletes' village, with investments also in Battersea Power Station and the London Gateway. While such aspirations could stimulate issuance beyond the traditional Sukuk hubs, the largest issuance volumes are bound however to continue to originate from those jurisdictions with the stronger cultural connection to the sector.

Increasing funding needs of sovereigns, corporate and banks across the Gulf and Asia, as well as the increasing familiarity of Islamic and conventional investors with Islamic finance instruments will also contribute to positive long-term growth

Following a strong performance in tough conditions in 2013, the outlook for the global Sukuk market in 2014 is a very encouraging one, with positive long-term growth trends set to continue.

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### Real estate: Confident investment

Real estate has always been a cornerstone of Islamic finance, and whilst the casual observer may view Islamic investors' affinity with this asset class as being driven by ego, PHILIP CHURCHILL still firmly believes that it is 'return on equity' rather than 'return on ego' that is driving investment decisions.

Real estate provides something tangible. It is a store of wealth that will always be there, and whilst such quantum of wealth will ebb and flow, with relatively low barriers to entry it has always been a preferred choice for numerous wealthy individuals from across the world and across the faiths. Whilst investors into the Middle East property need not worry themselves with the tax consequences, across the US, UK, Continental Europe and beyond, tax efficient Shariah compliant structures are now well established, tested and proven.

At the same time, the number of professionals able to cement these transactions together has blossomed over the last decade or so. There are now sufficient lawyers, accountants, surveyors and tax advisers familiar with the requirements and structures to advise the investment professionals delivering opportunities to their clients. The flow of capital from such clients is dominated by those from the Middle East and Malaysia, seeking real estate opportunities across the globe.

2014 will see this flow rate grow, with a wider number of Malaysian participants looking for opportunities in London and the key cities of the US

#### 2013: A review

2013 was the year that confidence fully returned, not just with equity investors, but also with banks able and now willing to provide Shariah compliant finance. While the credit crunch had inevitably led to some names withdrawing from the Shariah market, 2013 saw many banks return to or discover the immense business opportunity that the Islamic finance industry offers.

However, investors remain cautious, and whilst "keen" they are not "desperate" to invest. Blind fund initiatives remain largely unsuccessful, with investors preferring individual transactions in countries they are familiar with and where they trust the legal system. I remain encouraged by the depth of questions asked by investors on each and every transaction that we undertake. Such diligence should ensure that only the most compelling of opportunities are supported. Meanwhile, co-investment by the investment adviser remains a key component of aligning interests for all involved.

The focus of such renewed confidence from my perspective was the UK and the UAE. Transactions within the UK inevitably

included Central London office investments and residential developments, but also student, industrial, care home, retail and office investments across the UK delivered by a number of investment advisers. Meanwhile, Dubai has been gaining from its relative stability and international perspective and transport links, with office and residential values showing a strong year of growth. Investment into the US continued at a slower pace, whilst memories of the Euro crisis of Summer 2012 dampened enthusiasm for Continental Europe.

#### 2014: A preview

From a global flow of capital perspective, I see different patterns for 2014 depending on the origin of such monies. The flow out of Malaysia is still at a relatively early stage, albeit with a number of significant transactions undertaken. I believe that 2014 will see this flow rate grow, with a wider number of Malaysian participants looking for opportunities in London and the key cities of the US. Middle Eastern equity has already familiarized itself with alternative real estate asset classes and locations outside the major cities. I see no let-up in this across the UK and US, and perhaps a move into infrastructure. Continental Europe, after a period of relative economic stability, has also come back to the attention of many investors, with Germany the most likely to benefit from such inward investment, although the familiarity of Paris and the key cities of Switzerland will also remain.

Meanwhile, my hope for 2014 is a stable regulatory and tax environment that will continue to encourage such international movement of capital for the benefit of all. The post-credit crunch era of increasing and often burdensome regulation seems to be reaching its peak, whilst tax systems work best when they are stable and predictable. However, for the Islamic real estate industry to fully flourish what is needed is further education of participants both young and older. As a graduate myself, my support for The Chartered Institute for Securities and Investment's Islamic Finance Qualification remains.

#### Conclusion

Barring any unexpected economic surprises, 2014 should provide a year of confident real estate investment. I would encourage investors to remain diligent and vigilant in their assessment of investment advisers and the underlying transactions themselves. Whilst global economic growth should improve prospects for the real estate asset class as a whole, for me the joy of real estate remains the ability to select individual transactions that will outperform on the upside and protect wealth on the downside. The foundations have been set. It's time to start building the walls and the roof. (2)

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## Global tax developments

2013 ushered in a number of developments, generally focused on the facilitation of bringing in foreign investors. Many countries passed laws equalizing tax consequences of issuing Sukuk with the issuance of conventional bonds.

A majority of the countries which introduced new laws were capital-importing countries and international financial centers, including Hong Kong and Singapore.

It should be noted that an absence in present reports of locations such as London, Kuala Lumpur, Dubai, Amsterdam, Luxembourg etc., in no way means the absence of relevant legislation, but rather that relevant amendments have been brought to local laws earlier, as is the case for e.g. London and Kuala Lumpur, or that that the environment is not discriminatory against Islamic finance solutions (Amsterdam, Luxembourg).

#### 2013: A review

Australia has not yet amended its legislation to encourage Islamic finance products, although the Board of Taxation has prepared a report on the current state of affairs regarding the relevance of such amendments.

In Azerbaijan it was ensured that certain financial institutions, such as International Bank of Azerbaijan may operate in a Shariah compliant way without experiencing adverse tax consequences.

In 2013 Hong Kong followed the example of Malaysia and Singapore and introduced legislation aimed at a level playing tax field for the issuance of Sukuk. The law was passed on the 19<sup>th</sup> July 2013 and covers Sukuk issuances after this date.

It should be noted that in the past some countries of the region, such as Kyrgyzstan, provided specific Islamic finance-friendly tax and regulatory regime only to specific institutions. When such institutions proved to be socially valuable, more general measures were introduced. For example in 2013 Kyrgyzstan introduced legislation to facilitate the issuance of Sukuk and opening of Takaful companies.

Neighboring Kazakhstan also introduced new legislation to support Islamic finance. Originally Kazakhstan introduced laws to facilitate Islamic finance, in particular Sukuk in 2009, but in 2013 enhanced the incentives and developed a road map for further development of Islamic finance legislation for the following years.

It has also been reported that South Africa is in the process of introducing legislation to facilitate the operations of Mudarabah, Murabahah and Musharakah.

Irish tax authorities issued specific clarification (guidance) on application of domestic tax provisions developed for Islamic finance transactions.

Some other countries are just starting. For example, Tajikistan indicated in May 2013, its interest in developing Islamic finance infrastructure.



#### 2014: A preview

In most or in all cases above, the purpose of the legislative body was to facilitate investment into the country. In 2014 we expect more and more new players entering this market. When it comes to retail products, however, governments and parliaments may be less motivated to make Islamic finance products available as they will compete with existing conventional products.

At the same time the number of world and regional financial centers willing to offer themselves as a platform for the organization of capital-raising is growing. We would expect this process to continue in 2014.

There will be developments in respect of retail products, though not as massive as capital-raising initiatives. It might be that the biggest European countries such as France, Italy and Russia will finally pass amendments to their tax laws, having been in discussion for several years already. In any case, investor-oriented incentives will be the general trend, even if the economy does slow down.

#### Conclusion

Islamic finance solutions are becoming an integral part of the financial industry, therefore specific regulations aimed at tax incentives or equal treatment is also an integral part of the legislation of a country willing to accommodate the needs of its financial sector. Most major financial centers have implemented specific legislation, and we expect to see remaining countries to follow the same route in the near future.

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## Islamic banking to boost Afghan financial system

By Manezha Sukhanyar

Afghanistan, located in Central Asia is considered as a land bridge in the region. Afghanistan is a Muslim country, where more than 99% of its population is Muslim. Out of a population of more than 30 million only 3-11% are using banking products and services as most are deterred by the presence of interest (Riba) in the financial system. Afghanistan is an emerging economy with great potential for the growth and expansion of Islamic banking, as people are very much religious and committed to the Islamic way of life, therefore they avoid deploying their fund in conventional banks.

The financial sector, one of the republic's main sectors, has developed rapidly in recent years. Total banking assets grew to US\$4.5 billion in June 2013 and total deposits also grew modestly in June 2013. Islamic banking was introduced in the country between 2009 and 2010. Currently there are 17 commercial banks (private, public and branches of foreign banks) operating in the country. There are no fully-fledged Islamic banks in Afghanistan, however, five banks have been providing Islamic banking services via window system. Presently all Islamic windows are offering Islamic financing including project financing, equity financing and house financing. Apart from the central bank's guidelines, Islamic windows in Afghanistan are following AAOIFI standard to ensure consistency with Shariah regulation and Islamic international standards.

It is noteworthy that outside the commercial banking sector, Afghans are also involved in Islamic financial arrangements including deferred payment, advance provision, interest-free financing, mortgage of agricultural land and business credit. Therefore not only banks, but a growing number of NGOs are also applying Islamic financing concepts such as Musharakah, Murabahah, Salam and Mudarabah.

#### 2013: A review

As predicted economic growth slowed down during the year 2013, likewise the banking sector was also adversely affected to some extent due to the overall economic factors. However, since the inception of Islamic banking, people have become more aware, conscious and educated about banking products and services and they are expecting banks to offer competitive and modern Islamic products.

Reviewing the activities of Islamic windows several developments can be observed. Ghazanfar Bank (GB) is the first Islamic bank in Afghanistan to sign a Wakalah agreement with Turkey's Aktif Bank to invest in the metal market of the UK. With the highest Islamic deposit and portfolio, GB is one of the few private banks with an Islamic window. In 2013, GB established correspondent relations with Aktif Bank and Malaysia's Bank Islam with plans to expand this network in 2014.

As for financing products, knowing that Afghanistan mainly depends on the importing of goods, trade financing is a major avenue of investment for banks, where Murabahah is mostly preferred. Besides this, the construction sector which is the

largest sector in Afghanistan with billions of US dollars being invested into it, can also be capitalized by Islamic banks.

As for non-funded facilities, Islamic windows are offering letter of credits and bank guarantees based on Shariah principles and international standards.

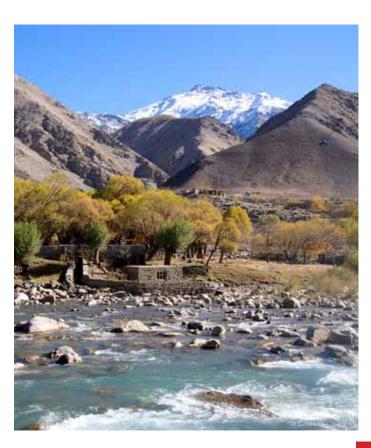
#### 2014: A preview

Regardless of the challenges, political uncertainty and volatile situation of Afghanistan, industry players are optimistic of the positive trend of Islamic banking in 2014 and they believe that, it will draw additional deposits into the formal banking system. After signing the Bilateral Security Agreement with the US, hundreds of new businesses will be launched by Afghans and foreigners in 2014, this will provide growing opportunity for Islamic financing. However, the main focus for 2014 is to tap the unbanked population, introduce new products, attract more investment and expand the network with foreign Islamic banks.

#### Conclusion

Regardless of obstacles, there is a high demand for Islamic banking in Afghanistan which is viewed as a reliable and stable alternative to the current conventional system. The move to Islamic banking will draw additional deposits from individuals who perceive the conventional banking as un-Islamic. (5)

Manezha Sukhanyar is the head of Islamic banking at Ghazanfar Bank. She can be contacted at islamic.head@ghazanfarbank. com



### Australia: Minimal reform needed

By Asad Ansari

Australia holds one of the greatest potential among the G20 nations for Islamic finance, but to date, that potential remains elusive. Its 'AAA' credit rating and low sovereign risk coupled with the resilience of its economy in the aftermath to the global financial crisis has made it an attractive destination for foreign investment. However, the strength of its banking sector which now comprises some of the most highly rated banks in the world and the considerable size of its domestic pension funds means that foreign direct investment competes directly with domestic capital for investment. This, and the volatility of the Aussie dollar, has made Australian Islamic finance deals trickle in rather than flood.

The government formed a number of expert panels to report on the potential of Islamic finance which included the broader mandate of the Johnson report in respect of Australia as a financial center and the Board of Taxation's enquiry into Islamic finance.

The prevailing view that there has to be a whole-scale review of taxation laws in Australia to facilitate Islamic finance is wrong. The reform needed is minimal and applies only to a small group of transactions.

The substance-based approach of Australia's laws related to issues such as tax and financial services and the system of advance rulings from regulators means that investors can proceed with certainty.

#### 2013: A review

In the institutional space there was some significant activity:

- One of the country's largest banks, the National Australia Bank (NAB) has been the most significant domestic entrant in Islamic finance. Imran Lum from NAB's debt capital markets has been charged with setting up the bank's first Sukuk portfolio and to provide bespoke Shariah compliant solutions for Islamic investors looking to diversify their investments into Australia; and
- Deloitte acted for a GCC-based investment bank in a successful AU\$250 million (US\$222.29 million) Islamic finance compliant transaction for the construction and development of a 500-unit apartment residential tower in the Melbourne central business district. This transaction was the first of its kind in Australia and one that was structured within Australia's existing tax framework with advance rulings sought from regulators for the GCC investors.

The domestic retail space has always been very active given the size of Australia's Muslim population. Highlights include:

- The Muslim Community Cooperative Australia (MCCA), which will be celebrating its 25<sup>th</sup> anniversary this year, recently reached \$200 million for its Amlak Shariah compliant mortgage product funded by FirstMac
- Over the September 2013 quarter, Australia was home to the world's best Islamic equities fund according to Bloomberg: the Crescent Australian Equity Fund which returned 23%;

 Barakat Properties employed an innovative use of Islamic finance investment to raise funds through domestic pensions to fund community infrastructure including Al-Siraat College which currently services 270 school students from Melbourne's outer north.

Australia's compulsory pension savings scheme (known as superannuation) which currently requires a compulsory contribution of 9% of income has meant that domestic pension funds continue to grow. The potential in Islamic finance in this space has seen participants such as Crescent Wealth, First Guardian, Barakat, Salic and MCCA compete for a share in this market. Crescent estimates that the size of the market is AU\$10 billion (US\$8.89 billion) comprising working Australian Muslims who pay superannuation.

#### 2014: A preview

Institutional investment into infrastructure, property and agriculture will be of great interest.

The strength of the Australian property market and low cost of funding will see the potential for residential mortgage-backed security and commercial mortgage-backed security issuances with several major players currently competing for the first Australian Sukuk issuance in 2014. The volatility of the Aussie dollar will play a critical role in achieving a base level of pricing that would make such an issuance commercially viable.

On the domestic front, 2014 will be about the rapid growth in the nascent Islamic superannuation industry as growing awareness is expected to result in the increase of Islamic super assets. The key success indicator for participants would be to break the AU\$100 million mark for funds under management to develop the scale required to grow.

Islamic finance technical expertise will continue to grow with the arrival in Australia of Amanie Advisors headed by Dr Mohammed Elgari and Dr Daud Bakar. Islamic finance programs continue to be offered by La Trobe University and course providers such as Australian Center for Islamic Finance.

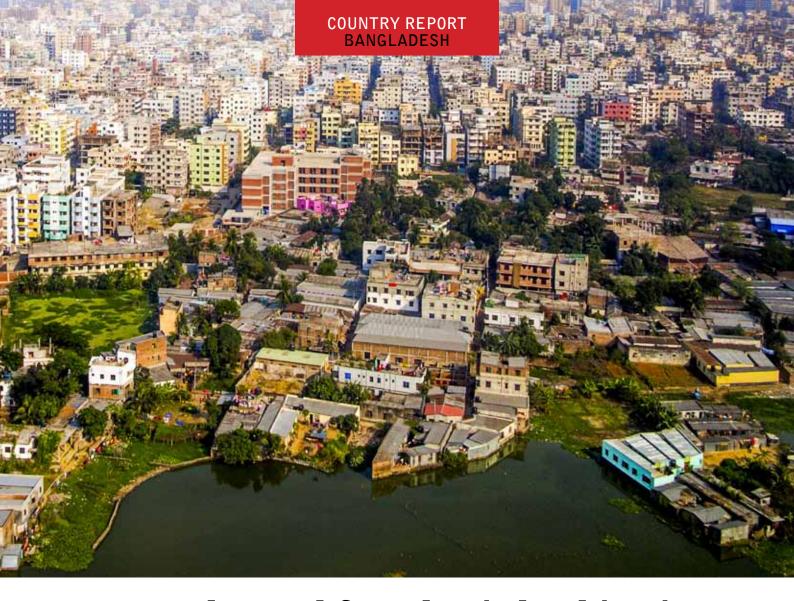
#### Conclusion

Investment capital from sovereign funds from Islamic countries has, and will, continue to be deployed in key investment sectors such as infrastructure, property and agriculture – however, Australia awaits a player who has the willingness to structure their investment in a Shariah compliant manner.

As noted above, where threshold investment criteria are met Islamic finance structuring can generally be accommodated within Australia's existing legal framework.

To date, those investments have been structured conventionally. A large scale Shariah compliant investment in 2014 from this kind of player would be the catalyst needed to spark the flood of investment. (3)

Asad Ansari is the director of Deloitte Australia and he was appointed by the government as a member of the expert panel of the Board of Taxation's enquiry on Islamic finance in Australia. The views in this article are his own. He can be contacted at asaansari@deloitte.com.au.



## Huge demand for Islamic banking in Bangladesh

By Md Touhidul Alam Khan

Bangladesh is the world's third-largest Muslim majority country, with Muslims comprising close to 90% of the nation's 160-million population. This has led to the emergence of Islamic banking as an attractive banking channel to meet the demand of Muslims for Riba-free banking services and this alternative is gaining momentum at an unprecedented pace. In Bangladesh, about 77% of this population live in the rural area; while 23% are from urban areas.

The country's economy, with a growth rate of 6.2%, is dependent on traditional agriculture and has an inflation rate of 15%. The growth potential for Bangladesh's Islamic finance industry is enormous, due in part to a steadily growing economy and financial reforms. With support from the Bangladesh government, financial regulators and the central bank, Bangladesh can be poised to become the next hub for Islamic finance in Asia and on a global scale.

Islamic banks have been operating in Bangladesh for three decades alongside conventional banks. Islami Bank Bangladesh (IBBL) is the first bank that introduced commercial banking based on Islamic Shariah with foreign shareholding in Bangladesh established in 1983. Since then Islamic banking has been growing

progressively together with the conventional banks. Currently, eight banks are operating as fully-fledged Islamic banks with more than 750 branches, and nine conventional banks are offering Islamic banking through setting up of 20 Islamic banking branches and eight more conventional banks are doing so with 30 Islamic banking windows. Islamic banks are now focusing on a wider horizon, encompassing not only conventional Shariah products but also involved with SME financing, microfinance and financing in agricultural sectors.

#### 2013: A review

In Bangladesh, the total banking deposit is US\$74.97 billion out of which US\$14.13 billion (18.84%) are Shariah-based deposit as at the 30<sup>th</sup> September 2013. On the other side, total loan and advance size of the country is US\$56.04 billion out of which Shariah-based investment commands 21.49% or US\$12.04 billion as at the 30<sup>th</sup> September 2013.

Islamic banks in Bangladesh have shown remarkable growth in the both 2012 and 2013 in terms of total assets, total liabilities, total deposits and total financing and advances. The Islamic banking asset base has been grown by 28.3% as investments (financing and advances) grew by 25%; and similarly the liability base has grown by 28.6% due to an increment of 22.9% in

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### COUNTRY REPORT BANGLADESH

deposits in 2012 compared to that of 2011. In addition to that, net profit demonstrated a 39% growth as compared to 2011. While conventional banks suffered declining profitability in 2012, especially towards the end of the year, Shariah banks showed their prudence and efficiency in managing assets and attaining profits, bucking the trend of increasing non-performing loans (NPLs) in the banking system in Bangladesh. It may be said that Islamic finance is one of the fastest growing sectors in the republic's financial industry.

The inclusive nature of Islamic banking is evidenced in their growth and already significant engagement in agriculture, SME and microfinance; without any refinance support like those available for conventional banks.

In October 2013, the central bank made a move to structure appropriate Shariah compliant SME refinance support lines for Islamic banks. Apart from Islamic banking, Takaful is also gaining ground in Bangladesh. A separate inspection department for Islamic banks has been formed, and Bangladesh was host to the IFSB-Bangladesh seminar on Islamic finance and Islamic Finance news Roadshow in 2013.

A daylong international conference on Islamic finance, titled "Islamic Finance News Roadshow" was held in February 2013 in Bangladesh. During the roadshow, Islamic scholars and panelists discussed on various issues on Islamic finance such as the challenges and opportunities of Bangladesh's Islamic finance sector, possibilities and opportunities for diversification of Islamic products, facilitating Shariah compliant investment flows in Bangladesh and South Asia through innovative products, structures and channels among others. During the roadshow, the panelists urged upon Sukuk as an alternative source of financing for infrastructure projects in Bangladesh. It has been suggested for the Bangladeshi government to raise required fund through cross-border Sukuk syndication in order to further boost the Islamic banking sector.

#### 2014: A preview

The central bank along with Islamic finance market participants are working jointly towards developing a fairly comprehensive set of the needed norms, guidelines and regulations. Presently, Bangladesh has a well functioning interbank Islamic money market for efficient day-to-day liquidity management by Islamic banks and a new Shariah compliant short-dated Treasury bill is anticipated. Sukuk is already in extensive use in the Middle East and Southeast Asia; this instrument is likely to be very useful for financing Bangladesh's much-needed infrastructure projects.

Realizing this importance, the central bank has introduced the 'Guidelines for Islamic Banking'. The regulator stated that as Islamic banking has become a part of mainstream banking in Bangladesh, it has become necessary to introduce proper guidelines to bring greater transparency and accountability to the industry.

During the IFSB-BB seminar on the prospects and challenges in the development of Islamic finance for Bangladesh held in Dhaka; Dr Atiur Rahman, the governor of the Central Bank of Bangladesh, said: "The Islamic banks in Bangladesh generally have higher capital adequacy ratios and lower non-performing loan ratios than their conventional banking counterparts. Aggregate assets and deposits of Islamic banks in Bangladesh have nearly doubled in the last four years; by the end of 2012 aggregate assets and deposits both crossed trillion taka threshold, comprising around a fifth of total banking

sector assets and liabilities. This share of Islamic banking looks set to grow further with time, given its faster growth than conventional banking."

"Challenges of course are also coming hand in hand with the ongoing growth trends and the emerging new growth prospects. Designing and introducing new Shariah compliant versions of conventional deposit and loan products tailored to needs of our financial market require ingenuity as well as thorough understanding of relevant Shariah principles and practices; appropriate risk management norms and standards are needed for the new Shariah compliant financial products and services, risk mitigation requires developing of new Shariah compliant variants or substitutes of their conventional financing equivalents," the central bank governor added.

Afzalul Haq, the vice-president and head of Islamic banking of Bank Asia, opined: "In Bangladesh Islamic banking is progressing steadily and it has immense potential. We have so far explored only a small portion of the demand for Islamic banking. As there is huge demand, the future of Islamic banking in Bangladesh is very bright in terms of its market share or its balance sheet size."

In Bangladesh Islamic banking is progressing steadily and it has immense potential. We have so far explored only a small portion of the demand for Islamic banking. As there is huge demand, the future of Islamic banking in Bangladesh is very bright in terms of its market share or its balance sheet size

#### Conclusion

The Islamic banking industry in Bangladesh will celebrate its Golden Jubilee in the year 2033 marking its 50th year. And the present shape of the industry is being modernized in terms of this changing scenario forecasting on the world economy in the year 2033. The government can help to explore the growth opportunities for Islamic finance, as well as tax and regulatory developments to boost the country's Islamic capital markets. With the proper implementation of regulations, education and understanding of Islamic financial products, and the provision of sufficient infrastructure, Bangladesh is set to become a major player in the field of Islamic finance of the world.

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# Islamic economy in Belgium: Evolution and perspectives

By Laurent Marliere, Zineb Bensaïd and Allaa Ridouan

Because of its multicultural background, Belgium has always been considered as a laboratory for various products. It is likely to be the case for Islamic financial products as well.

In Islamic countries, Muslim consumers consider a majority of their products Halal but with no real proof. Therefore, an attempt to establish Halal regulations is gaining interest. Generally, a government authority such as the Ministry of Religious Affairs, Mufti offices or standards institute, will be the initiators of a Halal policy.

In Europe – and Brussels being the capital of Europe – many Halal certification institutions can be found but no standardization has been achieved yet. The Halal market in Europe represents approximately EUR60 billion (US\$82.72 billion) of turnover a year. Several initiatives have taken place in different European countries. Belgium is a strategic place for Halal development due to its proximity with European institutions. In this context, the European Committee for Standardization (CEN) created different committees in various countries, named "mirror committee", composed of scientists, specialists, etc. Their role is to agree on a European Halal standard which could take effect within two years.

#### 2013: A review

In Belgium, the Halal market generates EUR1.7 billion (US\$2.34 billion) per year, according to the Flemish department of agriculture and fishing. In Wallonia (the French-speaking part of Belgium), this market represents EUR620 million (US\$854.78 million), as mentioned by the Wallonia Foreign Trade and Investment Agency (AWEX). The Walloon region was a pioneer in this sector and as such created the Halal Club several years ago. This club represents a network of 80 Halal companies. Its goal is to provide its members with the possibility to share their experiences and to provide a strong visibility on the Islamic market worldwide.

In December, the first Halal Week was organized and presented the 1st Convention of European Halal Certifiers, the 1st European Scientific Symposium on Halal Technologies & Markets, the opening ceremony of PICCTRA (Applied Knowledge Center on Muslim Economy and Culture) and its IRTI CORNER, created by the Halal Club with the support of the IDB. During this Halal week, several foreign delegations were present explaining how the Halal process was carried out in their countries (e.g. Iran, Malaysia and Tunisia).

Islamic finance in Europe finds itself in a steady pattern of increase. In fact, different European countries have adapted their fiscal and legal policies to introduce some Islamic finance products into the market. Belgium represents a specific market, as stated by ADEFI (Association for the Development of Islamic Finance) and IFAAS (Islamic Finance Advisory and Assurances Services).

These associations carried out a poll determining whether or not Belgian consumers were interested in Shariah compliant banking products or not. The study, based on a sample of 500 people, showed that 70% answered positively and showed interest in these types of products. Belgium therefore represents a strategic location for the establishment of Islamic banking. Companies have already started to offer Islamic banking products to Belgian consumers, such as the Moroccan bank Chaabi, which will soon open an Islamic-based account product named Harmonis (already present in France) in the coming months.

#### 2014: A preview

The entire Halal industry and more particularly the Islamic finance sector received a resounding affirmation in the global landscape following the UK's announcement of a sovereign Sukuk during the World Islamic Economic Forum in London last year.

Nevertheless, political incentives and policies are still cautious and risk averse regarding this new niche market. As mentioned earlier, investors should take the lead for inbound and outbound investments.

The absence of restrictive regulations or a complex bureaucracy allows Halal business to be developed in Belgium. Therefore, the BECI (Brussels Chamber of Commerce) is able to export and import Halal certificated goods with low administration fees.

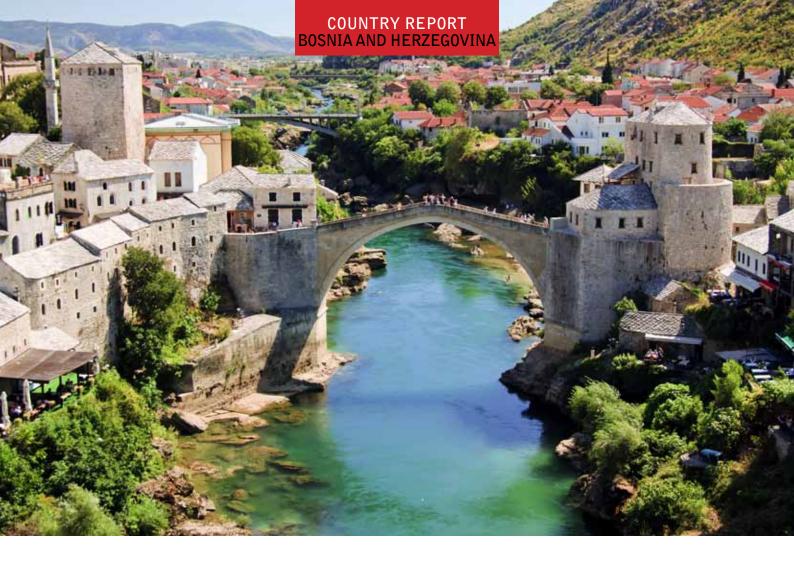
Belgium has seen significant initiatives by investors willing to invest in Belgium and local companies willing to invest in Islamic markets, such as AWEX, Club Halal, ISFIN, and certifying organizations among others.

For instance, AWEX: the Belgium exportation agency, with a clear objective to promote, invest and import Halal products and services, organized an event called "Halal Week 2013" and will organize it again in 2014. This suggests that Islamic finance is a key prospect in Belgium but has to be preceded by the development of the Halal industry in order to thrive. Belgium is a major exporter of Halal-labelled products such as FMCG products, cosmetics, packaging, and environmental products among other. This allows Belgium to be a credible stakeholder in this market.

With 600,000 Muslims in Belgium and 1.6 billion worldwide, Halal exported goods is a key market segment for exporters. Worldwide, this market represents approximately EUR600 billion (US\$820.7 billion) which is four times what the organic BIO labelled products generate annually.

Islamic finance and the Halal industry have a significant opportunity to grow in Belgium in 2014. Public regulators and private initiatives have to join forces to shape, enhance and facilitate the Islamic market in Belgium. Legal and tax regime are inherently well suited to shelter Islamic finance transactions. Belgium with its central European position and a large retail opportunity could become a reference in the market of Islamic products in a near future. (5)

Laurent Marliere is the CEO and president, Zineb Bensaid is the project manager and Allaa Ridouan is the international sales executive at ISFIN. They can be contacted at Im@isfin.net, zb@ isfin.net and ar@isfin.net respectively.



# Bosnia: A pioneering Islamic banking model in Southeast Europe

By Amer Bukvic

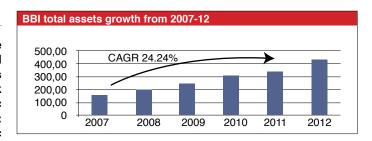
Since its very beginning in the early 20<sup>th</sup> century, the Islamic finance industry in Bosnia and Herzegovina faced many challenges and stringent entrance barriers. This has been the case until October 2000, when Bosna Bank International (BBI), the first and currently the only Islamic bank established by its founders and today shareholders: the IDB, Abu Dhabi Islamic Bank (ADIB) and Dubai Islamic Bank (DIB). BBI supported by its shareholders, pioneered the non-interest banking model despite a deeply-rooted conventional banking environment, laws that were not supportive and a lack of Islamic banking experts.

Today, Islamic banking trends in Bosnia and Herzegovina are reflected through the results of BBI as it remains the only Islamic-compliant bank operating in the country. The bank itself defines a learning model for expansion of Islamic banking in the heart of Europe.

#### 2013: A review

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Being the sole Islamic bank in the country, BBI results reflect Islamic banking trends in Bosnia and Herzegovina. BBI was ranked ninth in 2012 and was one of the fastest growing banks in Bosnia and Herzegovina. The past five years have been marked by extraordinary growth of total assets and business volumes.



Compound annual growth rate (CAGR) of BBI's total assets for the period 2007-12 was 24.2%. According to October 2013 financial results and comparing it to the end of 2012, growth of total assets was 21.5% while the Bosnian banking market in general grew by 3.2%.

The new capital increase of BBI in 2013 from its existing shareholders who kept the same ownership percentages, enabled the bank to strengthen its position in the mid-bank segment and provided new opportunities for growth continuance.

The bank is also very strong in documentary business with a market share of 4% in the banking market, thanks to its strong ties with Middle Eastern countries and traditional business links of Bosnian companies with these markets. BBI VIP Business Club, whose mission is to foster collaboration and partnership among regional and international business entities, plays a crucial role in this segment. The most successful project implemented by

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### COUNTRY REPORT BOSNIA AND HERZEGOVINA

VIP Business Club is the Sarajevo Business Forum (SBF), an annual investment conference which since 2010 represents the most successful platform for business networking of regional and international business figures. Each year the conference gathers approximately 1,000 participants from more than 30 countries worldwide.

Since its early beginnings, BBI has strategically promoted Islamic banking benefits via: a) raising public awareness through PR articles and participation in media shows and b) education and creation of experts in Islamic finance through the formation of BBI Academy and launching three cohorts in a Master's program at State University of Sarajevo.

In 2013, BBI set up a unique Master's program in Islamic banking and finance that now connects London and Sarajevo through joint degrees from University of Bolton and State University of Sarajevo. With this collaboration, Sarajevo is prepositioned to become a hub for Islamic banking in Southeast Europe. Until today, considering all three cohorts of MA students in Islamic banking and finance who attended these programs, BBI is proud of having 50 of them working for the bank and each one developing and implementing marketable non-interest banking products and services.

#### 2014: A preview

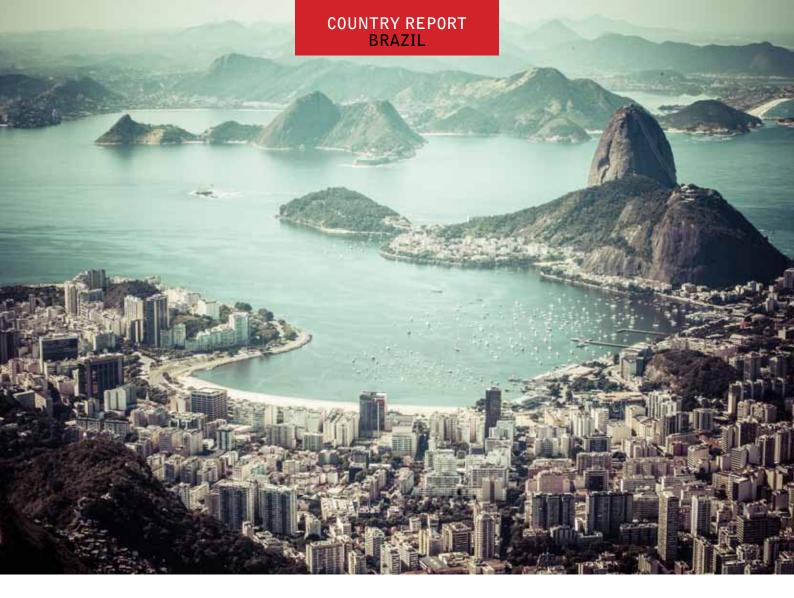
Presently, the potential for Islamic finance has been untapped and the Islamic finance market in Bosnia and Herzegovina is essentially equivalent to BBI's market share of 2.4%. Although the BBI management team is actively seeking legal inclusion, there is still no legal framework for Islamic finance in the country. The plans for 2014 are to continue the trend of growth of previous years, and further raise its market share. Expansion of branch network, implementation of favorable financing lines from renowned financial institutions, product innovations are a guarantee that the bank will succeed in becoming one of the most relevant financial institutions in the country.

Total assets						
Growth rate						
	2010	2011	2012	2013		
BH market	1.8%	3.9%	1.9%	3.2%		
BBI	26.7%	10.2%	26.7%	21.5%		
Total deposits						
Growth rat	Growth rates					
	2012		2013			
	BH market	BBI	BH market	BBI		
Corporate	-4.6%	11%	4.29%	-1.3%		
Retail	8.6%	39.8%	6.39%	31.6%		
Total	2.6%	20.3%	5.49%	11.1%		
Total financings						
Growth rates						
	2012		2013			
	BH market	BBi	BH market	BBI		
Corporate	6.3%	32.8%	0.73%	16.6%		
Retail	1.3%	31.8%	3.29%	20.8%		
Total	4.1%	32.5%	1.82%	18%		

The focus for 2014 will be to continue with the successful implementation efforts in promoting the benefits of Islamic banking operations. With preparations for the 5th annual Sarajevo Business Forum well underway and increasing confidence of retail customers, BBI is creating new generations of internationally recognized experts in the field. Additionally, liquidity pressures and the rise in consumers' lack of confidence in the conventional model, creates market share opportunities for BBI and the Islamic finance industry in Southeast Europe. (3)

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### Brazil in evidence

By Alvaro Taiar Jr and Felipe A Bitar

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Over the last 10 years, Brazil has shown itself to be a positive foreign investment alternative for three reasons: (i) its diversified economy, (ii) a population with increasing purchasing power, and (iii) a well regulated financial system.

The international sporting events to be hosted by Brazil represent further potential attraction for foreign investments. There is significant investment opportunity, thanks to the World Cup (2014) and the Olympic Games (2016), chiefly in the areas of infrastructure, construction, oil and gas, and the retail market.

Regarding Brazil's relations with Arab nations, the country has always sought a lead position as a global food exporter. Over the last few years, the Brazilian government has significantly intensified its efforts in international trade, mainly in exports of food products bearing the Halal seal of approval and in imports of energy-related products (oil and its by-products).

Despite a substantial increase in the economic and trade relations between these countries (see table below), Islamic finance is still embryonic in Brazil and, as is the case with most of the western world, the country is challenged by a series of regulatory and cultural obstacles. Given that most business and trade activities require financing structures to enable business leverage, an expansion in trade relationships has the potential to create opportunities for developing Islamic finance, despite

all the challenges that must be overcome, which we discuss below. In addition to that, Arab-based investors are looking for opportunities of financing the huge investments in infrastructure planned to be developed in Brazil in the forthcoming years.

#### IFRS in Brazil and Islamic finances

Since 2007, after the enactment of Law No 11.638, Brazil has drastically amended its accounting models as part of its adoption of IFRS (International Financial Reporting Standards). As an integral part of this project, via Law No 11.941/90, the regulatory authorities introduced the RTT (Transition Tax System) aimed at maintaining tax neutrality based on the application of IFRS, until new tax legislation was introduced governing the tax impacts of IFRS in Brazil. This RTT is expected to be extinguished and new relevant tax rules will be implemented as commented below.

These recent key amendments introduced a new ingredient into the discussion of the feasibility of banking transactions based on Islamic finance governed by Shariah law in Brazil, particularly, in respect of their regulatory, accounting and tax aspects. These aspects have been tackled by a number of western countries subject to IFRS and now have considerable experience in Islamic finances. Brazil will have to deal with issues such as (i) substance over form, (ii) the value of money over time, and (iii) liability for credit risk exposure. These matters are all being examined in international discussion forums over the chief differences between IFRS and Islamic finances.

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#### Regulatory aspects

As yet, Brazil has not fully developed its approach to Islamic finances, since Brazil is still a potential market which could produce excellent opportunities, despite the inherent challenges.

One example of challenge is the need of the Brazilian central bank to amend some limits imposed on financial institution in acquiring non-financial assets.

The positive side is that the Brazilian government is showing a trend to increased flexibility, enabling the involvement of new players in the market. One example is a leading Shariah-based private equity fund that finances agricultural producers in Mato Grosso, and another is a representation office of an Islamic bank that was opened this year in Sao Paulo.

As part of Brazil's economic and social development policy, the government actively seeks associations with the private sector in a program entitled PPP (public-private partnership) directed towards supplying Brazil's infrastructure needs, which features as a potential Islamic finances investment prospect.



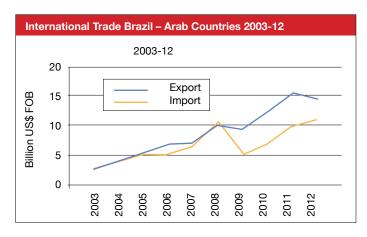
#### **Taxation**

Over the next few years Brazil will see the maturing of its new tax laws arising from the recent introduction of Provisional Measure No. 627/13 (MP 627/13), which cancels the RTT and seeks to standardize tax regulations as of the adoption of IFRS. With its optional regulations for 2014 which, as from 2015, will become mandatory, MP 627 has stirred up controversy over the tax treatment of payments of profits and dividends, asset and liability adjustments to fair value, and of tax benefits of goodwill. Other matters are also on the agenda for discussion until such time as the MP becomes law.

Global discussions on the discrepancies between today's western and Islamic models tend to emphasize only those on which interpretations differ. However, in the many circumstances where there is total agreement on conventional models, the taxation of Islamic finance transactions will be identical for similar non-Islamic finance operations. Brazil also needs to update some indirect tax legislation. One example would be to avoid indirect taxes when Brazilian companies are buying and selling tangible assets in order to finance them, giving the same treatment of a regular loan.

#### Conclusion

Brazil still offers huge economic and trade attractions whose potential has been significantly increased by the forthcoming sporting events. Halal trade ranks high on the Brazilian economic agenda, and represents a favorable aspect for the development of Islamic finances in Brazil. In a regulatory and tax context, Brazil's adoption of IFRS and the recent discussions of its tax impacts will almost certainly bring new challenges. These, in turn, will be accompanied by opportunities such as Islam-



based financing. There are still some additional changes on the Brazilian legislation necessary to push Islamic financing locally.

However the recent entry of new Islamic finances players into the Brazilian market signals the country's welcome to new financing sources, including alternative investment sources, such as Islamic finances. These players will help us to make the necessary adjustments to our legislation to leverage Islamic finance opportunities and important to highlight that the first players to arrive will have the advantage to develop local relationships in this enormous and growing market. (5)

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# Canada: Islamic finance potential lies in Toronto

By Walid Hejazi

There is a sense that Islamic finance in Canada lags in development as compared to other western nations, particularly the US, the UK and Australia. This is not lost on the Canadian government, particularly with the latest moves by the Cameron government to make the UK a global hub for Islamic finance. The question that immediately comes to mind: why can't Canada be a North American hub for Islamic finance? As discussed below, awareness in Canada of Islamic finance has increased dramatically in the past few years, and there is optimism within the financial industry and government that Toronto can become a North American hub for Islamic finance. However, there remain several obstacles to the further development of Islamic finance in Canada.

#### 2013: A review

#### Increased awareness in Canada

There have been several attempts over the past few years to increase awareness within Canada of Islamic finance, and to better understand how Shariah compliant financial structures can fit within the broader Canadian economy. A 2010 Canadian Mortgage and Housing Authority report entitled 'Islamic Housing Finance in Canada' found there are no legal hurdles to Islamic financing in Canada, and "Islamic financial products should not present any particular difficulties under Canadian accounting standards".

The Toronto Financial Services Alliance (TFSA)'s Islamic finance working group wrote a report entitled 'Making Toronto

the North American Center for Islamic Finance: Challenges and Opportunities'. The report provides a summary of Islamic finance activity in Toronto and identifies tax, regulatory and legal issues that need to be addressed to ensure the growth of Islamic finance in Toronto and Canada. As the title of the report states, the report addresses Toronto's potential of being the North American hub for Islamic finance.

The Canadian initiative to attract Shariah compliant capital increased significantly in 2013 with the Canadian government's sponsorship of the 20th Anniversary World Islamic Banking Conference (WIBC) in Bahrain. In attendance from Canada were Janet Ecker, the president and CEO of the TFSA; Canada's ambassador to Saudi Arabia and Bahrain, Thomas MacDonald; Claudio Ramirez, the counselor for economic and finance; Cindie-Eve Bourassa, the trade commissioner; Jeff Graham, TFSA board member, and myself. There was an overflow crowd for the Canada country presentation, reflecting tremendous interest in Islamic finance in Canada.

### The question is, why? Why should Canada be a hub for Islamic finance?

First, Canada has a population of over one million Muslims, many of whom are highly educated. By 2030, Canada's population of Muslims is expected to grow to 2.7 million and account for about 3% of Canada's population. The largest concentration of the Muslim population is in the greater Toronto area. Many are seeking Shariah compliant solutions to their personal finances. There remains a significant void in Canada when it comes to these offerings – part is a lack of supply, but also a lack of

understanding on the part of Muslim consumers. While products are available, the uptake is slow. There are a number of smaller and less well known institutions in Canada offering Shariah compliant mortgages (and other products), which are offered at a premium over conventional mortgages.

There is at least one of Canadian major bank major banks offering Shariah compliant solutions. For example, Khaled Sultan is an investment advisor at CIBC Wood Gundy, and offers his clients Shariah compliant solutions. As the mainstream financial institutions continue to grow their offerings, so too will the confidence Muslims have and with that the uptake of Shariah compliant solutions. Furthermore, there are several indications that there is excess demand, as reflected in the waiting lists for Shariah compliant mortgages at several cooperatives. Nevertheless, the collapse of one Shariah compliant financial institution offering Islamic mortgages has sent shivers throughout the community, hence driving the need for larger and more credible players to enter this market.

# Shariah compliant financial structures fundamentally are more similar to the Canadian banking and financial market structures than in many other countries

Second, during the financial crisis, Shariah compliant financial institutions performed better than conventional institutions. This has raised questions intellectually as to why? What is it about Shariah compliant structures that make them more resilient in the face of financial difficulty? Related directly to this is Canada's financial system. While not Shariah compliant, the World Economic Forum has ranked Canadian banks and financial system as the most sound in the world for the sixth consecutive year. The conservative nature of Shariah compliant banking is more akin to Canada's banking system than it is to the banking systems in many other countries. That is, Shariah compliant financial structures fundamentally are more similar to the Canadian banking and financial market structures than in many other countries.

Third, Canada is very well-endowed in natural resources. The latest estimates indicate that Canada has 12% of the world's proven oil reserves, third only to Saudi Arabia and Venezuela. The Canadian government has put the figure at CA\$650 billion (US\$585.44 billion) in capital investments in the next decade alone to develop the energy reserves in Canada. Canada is in need of foreign investment and an important source of foreign capital is the GCC whose investors prefer to invest in a Shariah compliant way, therefore Canada must accommodate and become more amenable to such structures.

#### 2014: A preview

As the theory of international business predicts, much of the world's foreign investment is intra-industry. Canadian companies invest extensively abroad in natural resources and energy, and at the same time, Canada attracts much investment in these same industries. By opening more to Islamic finance, Canada will be able to attract significant amounts of Shariah capital into



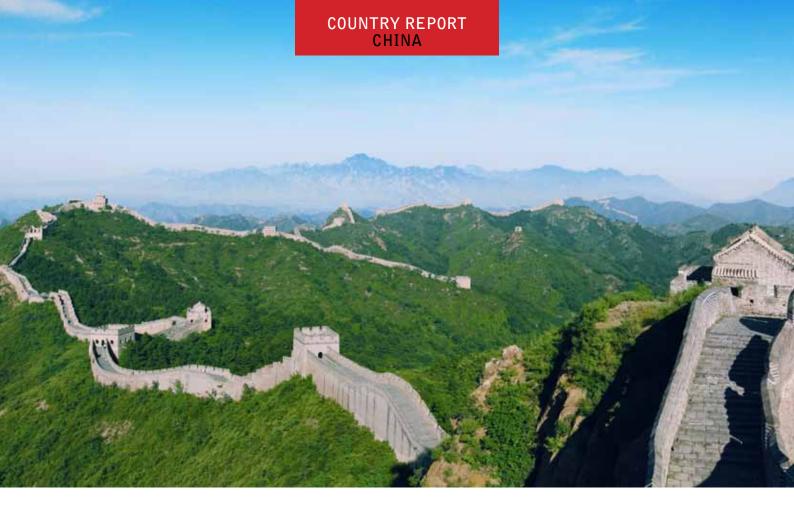
its energy and natural resources sectors – on a win-win basis.

Part of the eco-system for Islamic finance is education. The Rotman School of Management at the University of Toronto has an MBA course in Islamic finance. Demand for this course and other Islamic finance offerings is extensive. There are also several graduate students doing research in Islamic finance. Topics include standardization of Sukuk structures, liquidity management within Islamic financial systems, and regulatory changes to further enhance Islamic finance in Canada.

#### Conclusion

As we enter 2014, awareness of Islamic finance in Canada will continue to grow, and with the federal government's efforts in this respect, Canada's attractiveness to Islamic finance will grow. Current regulatory reviews at the federal and provincial levels — together with an apparent political will — is making Toronto more likely than ever before to become North America's hub for Islamic finance

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# Greater China & Islamic finance: A perspective

By Jeffrey Kirk

There has been renewed interest in Islamic finance in Greater China (encompassing the PRC, Hong Kong, Macau and Taiwan), particularly in Hong Kong. This renewed and growing interest may surprise some but the reasons for the growth in the importance of Greater China in the context of the global economy have been well documented. As the sophistication of each of the Greater China financial centers develops (and new ones added, such as the Shanghai Free Trade Zone), so do the goals of these centers grow with the intention to expand their offerings into new markets with new specialist products and services.

#### 2013: A review

Trading between China and the Middle East has increased dramatically over recent years. Trading activities between China and the UAE have alone grown more than 10 times over the past decade. Evidence of this greater cooperation was seen in the sixth China Hui Merchants Fair (which aims to promote economic and cultural cooperation and exchange between China and Arab states) held in September 2013. The Hui people are a predominantly Muslim ethnic group in China. This fair is held as part of the China-Arab States Expo in Wuzhong, Ningxia Hui Autonomous Region and reflects the strengthening ties between these states and the growing importance of Islamic finance in the PRC. The nexus between Hong Kong and the mainland in the context of Islamic finance is reflected by the fact the special administrative region is the largest source of foreign direct investment into the Ningxia Hui Autonomous Region.

Finance professionals speculate that the PRC government is focussed on building a good relationship with Middle Eastern states and as a result hereof, Beijing is keen to see the growth in Islamic finance both in the mainland and in Hong Kong.

The launch of the Shanghai Waigaoqiao Free Trade Zone in the latter half of 2013 has generated a great deal of interest as to the growth possibilities of financial services generally, including Islamic finance. The continued stated intention and actions of Islamic banks to open in China continues unabated. Bank Muamalat Malaysia in partnership with Bank of Shi Zui Shan of China and Affin Holdings in partnership with Hong Kong's Bank of East Asia Bank are leading examples of the growth of Islamic banking in China.

Hong Kong continues to be regarded as the gateway into China. This viewpoint was repeated in 2013 by the Kuwait Finance House (KFH) in a research report. Notwithstanding its PRC gateway role, Hong Kong has itself had a busy 2013 in developing its environment and framework to grow the special administrative region as a hub for Islamic finance.

The high liquidity, free economy, strong presence of foreign banks and simple tax system, coupled with its existing cooperation agreements in place with Dubai in the arena of Islamic banking, were identified in the KFH report as reasons that would make Hong Kong an ideal candidate to become a major Islamic finance hub. Further evidence of Hong Kong's potential was illustrated following an agreement reached in August 2013 between the

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Hong Kong Monetary Authority (HKMA) and Bank Negara Malaysia to strengthen collaboration between the two parties in the area of Islamic finance. During the first meeting of the Joint Finance Forum (which included the HKMA, the Financial Services & the Treasury Bureau of the Hong Kong government, the Securities and Futures Commission and the Hong Kong Exchanges and Clearing), held in Hong Kong in December 2013, this agreement was discussed with a view to encourage, in particular, the spheres of Sukuk and Islamic fund management industries. This development will build on the established mutual recognition framework in place between Malaysia and Hong Kong for Islamic funds.

In July 2013 amendments were introduced to Hong Kong's Inland Revenue and Stamp Duty legislation, which have the effect of levelling the tax framework playing field to facilitate the Sukuk market in Hong Kong. Consensus is that this development in respect of Sukuk is likely to lead to expansion in other Islamic finance products and services such as Takaful and Islamic investment funds. Indeed, the Hong Kong secretary for Financial Services and the Treasury, Professor KC Chan, noted that the intention in introducing these changes is to "...help establish a conducive platform for the development of Islamic finance in Hong Kong, thereby diversifying the types of products and services available..." Similarly the director of the Hong Kong Economic and Trade Office, Subrina Chow, noted during a visit to Brunei, that "...we're trying to see if we can further increase the volume and diversify the kind of [Islamic finance] products that are available in Hong Kong."

An additional impetus to developing the Hong Kong Sukuk market is the new international banking requirements introduced under Basel III. Under Basel III, international banks are required to hold more high-quality equity, therefore requiring greater investment in highly rated government bonds. Due to the restrictions on Islamic banks from buying conventional government bonds, this will mean these Islamic banks will have to invest in government-issued Sukuk. In October 2013 the UK government announced that it would issue a Sukuk in 2014 and, not to be outdone, the Hong Kong government has announced that it will likewise issue a Sukuk in 2014, making use of its 'AAA' credit rating.

The Hong Kong government-led drive to grow the Sukuk market has not been followed with great relish in the Hong Kong companies sector. Whilst the Hong Kong-based Noble Group issued a Sukuk in 2012; this was issued in Kuala Lumpur rather than Hong Kong. It remains to be seen how active the local Hong Kong debt market will become and whether this will translate to issuances of Sukuk. It is this question, combined with a lack of a large Muslim population and experienced Islamic finance professionals in Hong Kong, coupled with the proximity of Malaysia (which handles the vast majority of Sukuk issuances worldwide) as a competitor in the Islamic finance sphere, that has led some market commentators to question whether, in fact, Hong Kong will realize its stated aim of becoming an Islamic finance hub in the near future.

The development of a Sukuk market in Hong Kong is likely to act as the catalyst for the growth of Islamic funds. New Hong Kong-domiciled Islamic funds to rank along the likes of the Hang Seng Shariah Compliant China Index Fund would be a welcome addition to funds offerings, particularly in light of Hong Kong's large yuan liquidity pool (the largest outside of the mainland).

Taiwan has maintained and grown its export share to external markets, including the MENA region, Malaysia and Indonesia. In



the Middle East Taiwan has a strong mutually beneficial trade relationship with Saudi Arabia in terms of which technology products are exported into the kingdom and crude oil and natural gas are imported into Taiwan. Further, the Taiwanese Stock Exchange Corporation has established exchange-traded funds with both the Abu Dhabi Securities market and the Dubai International Financial Center and has also established a Taiwan Shariah Index.

In the context of other Islamic financial services and products, whilst there is limited data available as to the gross premium flows of Takaful and re-Takaful in China (PRC and Hong Kong), it is market consensus that these premium flows are currently negligible in comparison to the GCC region.

The PRC reinsurance market generally, and re-Takaful market in particular, remains a challenging market to foreign reinsurers, re-Takaful providers and investors. However, the world's second-largest economy with the largest population remains a market that cannot be ignored by international reinsurers and re-Takaful providers.

#### Conclusion

In the final analysis, much has been said in the preceding five years as to the predicted growth of Islamic finance in China. The 21<sup>st</sup> century has been dubbed the "Asian Century" and indications over the past year, particularly in light of the substantial developments in Hong Kong, bode well for Islamic finance in China going forward. (5)

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# Croatia: An emerging market struggling to emerge

By Sasa Divjak and Ema Mendusic Skugor

The year coming to an end has, at first glance, marked an important milestone for Croatia. The 1st July 2013 signified an end to over a decade of formidable negotiations, as Croatia signed the accession treaty and became the 28th member state of the European Union (EU). However, EU accession has not been accompanied by many real life changes. Croatia has not entered the European economic area or the monetary union and it continues to be one of the weakest emerging markets of Southern and Eastern Europe. The year 2013 marks the fifth recession year, with no growth. Current forecasts for 2014 show there is little room for optimism.

#### 2013: A review

After the initial zest, Croatians came to realize that EU membership will not have any immediate benefits in helping the Croatian economy in recovering. Quite the contrary, the initial membership years could easily incur losses due to Croatia exiting CEFTA (Central European Free Trade Agreement). Even though preferential conditions are up for negotiations, CEFTA countries are not eager to renounce the preferential trade regimes and lose a potential competitive edge against Croatian products.

Tourist trade remains Croatia's strongest export product, with revenues growing even in the recession years, but there have been no significant improvements in the sector during 2013. With that in mind, both experts and entrepreneurs hope that an EU membership will attract investments in the tourism sector since Croatia is currently unable to aggregate the necessary investment.

The Croatian government has taken an effort in raising Croatia's competitiveness in the large EU market, especially with regard to the absorption of available EU strategic and investment funds. However, it is questionable whether Croatia has the necessary knowledge to absorb these funds and many agree that EU funds will have only limited positive effect.

The global economic crisis has brought numerous difficulties to the Croatian economy, some of which seem to have taken full effect only recently. Poverty has increased, with more than a fifth of the population now living below the general poverty line. Unemployment is continuously rising in substantial percentages, while youth unemployment is one of the highest in Europe. The private sector has sustained a massive impact with investment opportunities deteriorating and problems collecting receivables rising.

The Croatian government has decided to tackle the negative effects of the global economic crisis through stronger legislation. Taking that into account, together with the legislation entered into due to complying with EU law meant an abundance of new legislation in 2013.

Primarily, the Financial Business and Pre-bankruptcy Act was entered into in the final months of 2012, introducing pre-bankruptcy as a measure of restructuring companies undergoing financial difficulties. Pre-bankruptcy is deemed the most

important legislative change in Croatia as it transformed domestic insolvency law, with more than a hundred entrepreneurs filing for pre-bankruptcy every week. The Croatian government has also introduced measures in order to minimize the losses it sustains in cash flows, by introducing the Cash-Flow Fiscalization Act and a centrally-wired financial system directly connected to the Tax Administration. The year 2013 has also been marked with the strengthening of consumer rights, since Croatia has lived to see its first collective action in the field of consumer protection. The "Swiss Frank" case, where a second degree decision is still awaited, has signified substantial changes in awarding consumer credit lines and led to the newest amendments of the Consumer Crediting Act. However, previously mentioned laws and regulations have yet to show their strength in practice, expedited legislation proving to often cause more problems than it solves.

#### 2014: A preview

Based on available forecasts, the possibilities for growth in 2014 remain weak. External debt and public debt are expected to continue growing. Although its public debt rates are not the highest in Europe, the inability of the Croatian government to sustain growth could lead to Croatia being forced to enter the excessive deficit procedure within the EU. Also, an unfavorable domestic climate may continue to decrease investment opportunities and further lower the living standard for households. Namely, the state budget entered into in the beginning of December shows that the Croatian budget deficit will not be decreased as expected due to the minimizing trend in public spending, but increased, amounting to 5.5% of the GDP. The government claims that the increase is a consequence of EU membership, since Croatia has "acceded in an economically inopportune moment".

#### Conclusion

However, the effect of the EU accession followed by the continuing trend of entering into supportive legislations should not be disregarded. Several large privatization projects regarding Croatia's most important assets have been initiated in 2013 and are expected to uncoil during 2014. The Croatian government is also optimistic in its predictions, stating that 2014 will mark the first growth year, with an expected growth rate of 0.2%.

All this could influence Croatia's economic situation and perhaps ameliorate the otherwise grim projections for the upcoming years. Although it might be too early for predictions, the only thing we can be sure of is that 2014 will be full of new and, possibly, surprising challenges for the newest star on the European sky. (5)

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# Czech Islamic finance - not quite there

By JUDr Ivana Hrdlickova

Although Islamic finance is still a very new phenomenon in the Czech Republic, the awareness within the public and professional sphere of this alternative financing system has been increasing with more people curious of what it can offer. Comparing to the past, when there was absolutely no information and awareness about this method of financing, the situation has since then changed tremendously.

There are a significant number of entrepreneurs, who are interested to get information concerning Islamic finance and also a significant number of students, including law and economics students, who base their theses on Islamic finance. Nevertheless, no real Islamic finance practice has started, but interest from professionals of different financial institutions and the public is Indeed promising for its future development. Czech Republic still needs to overcome many past prejudices, as a result of communist dictatorship.

#### 2013: A review

Although no Islamic finance operations have started in a practical way, the public's awareness about this instrument has been changed and enhanced considerably. The students of Anglo-American University, University of Economic in Prague and the law faculty of Charles University in Prague conduct research on Islamic finance and banking.

A book, explaining Islamic finance concepts from the theoretical and practical paradigms, was published in the Czech language in November 2013.

There were many presentations, public lectures and professional discussions relating to Islamic finance in Czech Republic in 2012 – a huge step forward to spread the knowledge about Islamic

finance. Czech law firms also showed keen interest in the area of Islamic finance.

#### 2014: A preview

There is considerable effort to push for Islamic finance awareness among the public in the country, particularly through lectures, presentations and education. The Prague branch of International Commercial Chamber (ICC Czech Republic) does pay attention to the financial practice and also keeps itself abreast with Islamic finance news. Export and import is a very important industry in the Czech Republic and Islamic finance is a vital instrument to the export and import activities with Islamic countries all over the world.

There is a significant change in the Czech legislation, which may harness the potential for Islamic finance businesses. On the 11<sup>th</sup> January 2014, new regulations are expected to come into force including: an amendment to the Czech private law and a new Civil and Commercial Code.

This new legislation, adopted after more than 10 years of hard professional work, harmonizes the private law legislation and the legal instruments and therein lays the promise for Islamic finance to prosper. This new legislation guarantees also a much higher level of investment protection, execution of rights and promotes the rule of law bases of business and investment.

Areas that affect conventional finance including: inefficient and weak legislation implementation and low investment protection, would most also likely pose a risk to the initiation and eventual growth of the Islamic finance industry in the republic.

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# Egypt: Remaining strong in the face of heated political battles

By Walid Hassouna

Islamic banking in Egypt remains to be a victim of political conflicts however the introduction stage of Islamic finance is nonetheless currently being built upon solid pillars. The pace is not fast but we can at least assume a 'slowly but surely' paradigm is in place.

#### 2013: A review

Another active year in Islamic finance was witnessed here in Egypt on all fronts including the banking sphere, capital market and microfinance arena. Despite political instability and the ousting of the Muslim Brotherhood president, Islamic finance in Egypt did show some promising developments.

Although the regulatory environment did not witness any major changes from the year before (the CBE did not approve any new Islamic license to commercial banks), it is worth mentioning that a number of commercial banks have requested a license to provide Shariah compliant products under a separate set of branches. However, the CBE has not authorized any of them yet in efforts to encourage reasonable growth of current existing players and market size. The Sukuk law approved during Mohamed Morsi's presidency term was cancelled and another document is being prepared following the political decision made on the 3<sup>rd</sup> July. We expect to have it approved this year.

The Sukuk law was always a prey of political fronts whether liberals or Islamists. We witnessed the most controversial discussions when this law was passed during the Muslim Brotherhood era; political parties used it for their own political gain rather than as a finance tool for economic growth. During our discussion countries like Yemen, Kenya and the UK have issued their first sovereign Sukuk. Also Oman will have its first issue in 2014.

The mortgage law is currently under review to include Musharakah and Ijarah as means of financing, which will create a level playing field for Shariah compliant home financing players including mortgage companies and banks. The current Murabahah structure has eliminated any long-term financing for housing due to the inherited interest rate risk with this kind of long-term financing.

Shariah compliant lease companies are currently growing at a rate almost doubling their digits annually. Clients who used to consider lease as Shariah compliant regardless of the provider, now understand the differences and know that they are not all the same as they look closer into the details of each contract and how Riba-free structures are being applied. Banks have also started competing with lease providers by providing ljarah facilities including ljarah Mawsufa Bil Dhimma (forward lease). This product when combined with Istisnah has successfully provided an attractive means for project financing and paved the way for the closing of the first project finance syndication in 2013.

The year 2013 was an active year for funds as two funds were launched: one money market fund sponsored by United Bank, while the other was a balanced fund by Bank Audi. This fund

aims to invest in Sukuk once issued. Both funds have raised the current number of Shariah compliant funds to 13.

The syndication market witnessed the first project finance syndication closing under the concepts of Istisnah and Ijarah led by Bank Audi for EGP1.07 billion (US\$153.32 million). This adds to the Abu Dhabi Islamic Bank (ADIB) Egypt-led Ijarah transaction used to refinance an existing conventional debt of US\$150 million.

This year has also seen for the first time the issuance of covered cards; the Islamic alternative for credit cards that is based on commodity Murabahah. This is another improvement that will allow retail customers to acquire Islamic financing.

The newcomers namely ADIB, Bank Audi and Banque Misr are still in the leading position when it comes to innovative solutions, meanwhile the previous main players have tried to adapt by increasing their advertisement for the same set of products.

#### 2014: A preview

2014 will definitely be a better year for Islamic banking as active banks will remain to acquire market share and will introduce new products built on the success witnessed in 2013.

Currently, the market has responded very well to Al Nouran Sugar Islamic syndication which is expected to close during the first quarter of 2014 .The IDB is among the shareholders of Al Nouran. More than 11 banks have committed to the transaction covering more than 150% of the financing required, or EGP1.5 million (US\$21.49 million).

Despite the Egyptian Islamic finance market being initiated and led by Islamic banks, a majority of participants were from the conventional side; an indication that the old guards of Islamic banks are not happy with the momentum of the market and how dynamic it has become. Egypt is witnessing also great SME and microfinance growth via funds from the World Bank and the IDB under a Shariah compliant basis. The number of practitioners has increased to support this growth but detailed figures are not available due to the consolidated reporting for banks with dual licenses.

I believe in 2014, all fronts will grow especially with the syndication market and microfinance. We shall witness a Sukuk law coming into action, the implementation of new mortgage law and the participation of more banks.

#### Conclusion

Despite political imbroglio, 2013 nonetheless saw some major improvements in terms of Islamic finance. 2014 will be a year of more growth and the current government is providing enough support to Islamic finance evidenced by the EFSA resolutions and action plan regarding Sukuk issuances following the review of the current law and the application of Ijarah in the mortgage financing sector. (2)

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### India: Towards a more inclusive growth story

By H Abdur Raqeeb

The approach of the India's 12th five-year plan (2012-17) is for faster, sustainable and more inclusive growth. The issue of financial inclusion is emerging as the new paradigm of economic growth in the country. Financial inclusion is the delivery of banking services at an affordable cost to the vast sections of the disadvantaged and low income group. But even after 40 years of nationalization of banks, 60% of the people do not have access to formal banking services and only 5.2% of the villages have bank branches. Marginal farmers, petty traders, landless laborers, self- employed and unorganized sector enterprise, ethnic minority and women of the country continue to form the financially-excluded class.

For financial inclusion, several committees were constituted by the government. Significantly a high level Committee on Financial Sector Reforms (CFSR) of the Planning Commission headed by Dr Raghuram Rajan, former chief economist of IMF and recently appointed Reserve Bank of India (RBI) governor, recommended interest-free finance to be introduced in the banking sector for inclusive growth with innovation. Recently RBI has constituted a panel headed by Nachiket Mor, the director of Central Board of RBI to frame the vision for financial inclusion which is due to submit its report at the end of this year. Institutions like Indian Center for Islamic Finance (ICIF) and others have submitted to the panel that interest-free participatory finance should be included in the report as recommended by Dr Rajan.

India's first Shariah compliant non-banking financial company (NBFC), Cheraman Financial Services (CFSL), set up with an authorized capital of INR10 billion (US\$161.37 million) of which Kerala State Industrial Development Corporation (KSIDC) contributed 11% of the equity capital, with contributions from several distinguished non-resident Indian (NRI) investors based primarily in the Gulf region.

CFSL has been authorized to operate in the areas of equity finance and leasing including the construction and the medical equipment sector. It intends to focus on infrastructure development, particularly Waqf land in association with the State Waqf Board and also provide for major infrastructure projects initiated by either the state government or the federal government. It plans to support major commercial projects in the private sector with equity finance. Another Shariah compliant NBFC — Alternative Investment & Credit — still has a case pending in the high court of Mumbai.

Based on the Malaysian Tabung Haji model, Rahman Khan, the minister of minority affairs, has submitted a Shariah compliant pilgrimage Hajj fund project to the prime minister, if accepted it would be the first Shariah-based central government venture in the country.

The father of green revolution in India, Dr Swaminathan suggested interest-free Islamic banking as a solution to the suicide crisis of small farmers in Vidharba region of Maharashtra. Owing to the agitation of big sugar cane growing farmers the government has announced an interest-free financing scheme of INR72 billion (US\$1.16 billion) recently. Interestingly, BASIX, a well-known microfinance institution, executed Bai Salam in Mewat district to purchase barley and wheat from small farmers. Infrastructure giant Larsen & Tourbo Projects's subsidiary — L&T Infrastructure Development which has a portfolio of highway projects, power



transmission and metro, is seriously exploring the option of Shariah compliant financing for their projects.

TASIS, a Shariah advisory institution, reports 1,127 stocks out of 6,773 in Bombay Stock Exchange and 543 out of 3,411 in the National Stock Exchange to be Shariah compliant. Interest in them has been growing in recent years.

Tata Ethical Fund and Taurus Ethical are equity-based schemes with consistent growth. Similarly Secura Venture Capital Fund in real estate and Pure Stock Pension Plan (PSPEN) by Bajaj Alliance are Shariah compliant schemes worth mentioning.

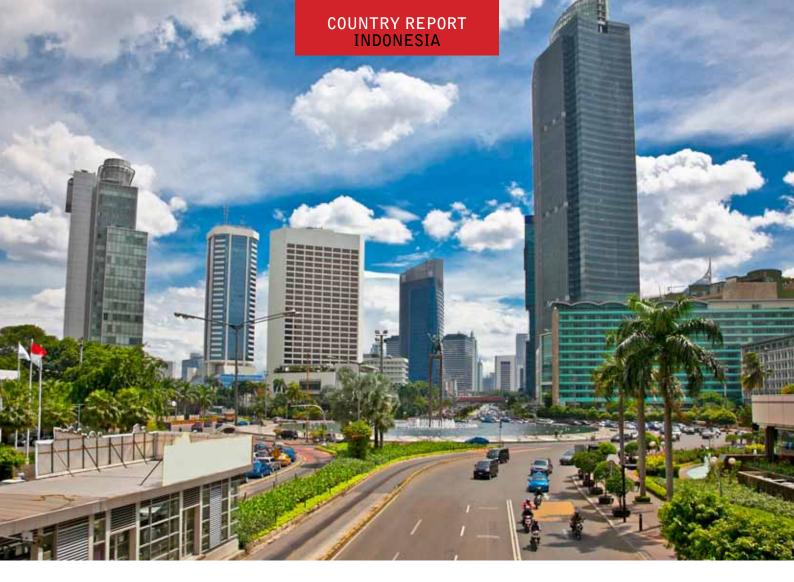
Delhi-based Sahulat Microfinance Society is supporting multistate co-operative societies like Sangamam and Khidmat for interest-free microfinance in southern states and another credit society called Janseva, has started similar activities in a few states.

The recent World Islamic Economic Forum (WIEF) conference in London covered widely in the Indian media has created great impact and even those who considered Islamic banking to be a myth like First Post, has come out with a different and supportive narrative on Sukuk and the lessons India can learn from the UK.

The speech by the Prince of Wales at WIEF and the UK prime minister David Cameron of issuing a sovereign UK Sukuk and more particularly the report of the British Muslim Council ('Muslim pound rocks British economy') has enthused many Muslim institutions to learn from the British experiences and serious discussion has begun in many quarters how the same can be translated in India as well.

Parliamentary general elections are due early 2014 and all the political parties are eager to enlist the support of various groups, particularly Muslims who constitute about 15% are being lured as evidenced by the inclusion of their demands in politicians' vision document and manifestos. Influential Muslim groups are urging mainstream political parties to include the introduction of participatory Islamic finance and banking in the national agenda and hopefully any government formed after the election is sure to concede this demand of the marginalized and the minorities for an alternative system of banking in the country. (3)

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# The development of the Indonesian Islamic finance industry: Restraining growth and reinforcing business foundation

By Farouk Abdullah Alwyni

Major areas of the Indonesian Islamic finance industry are Islamic banking, Islamic capital markets (including Sukuk and Shariah compliant equities), and Islamic insurance. There are other Islamic financial players such as Islamic multi-finance company, Islamic rural banks, and Islamic microfinance institutions, known as Baitul Mall wa Tamwil (BMT), but their sizes are still relatively smaller compared to Islamic finance players mentioned earlier.

In general, the Indonesian Islamic finance industry in 2013 has shown consistent growth although it is slower compared to 2012. Some contributing macro factors to the slowdown in growth include, among others, the inflationary effects of the energy subsidy removal in August 2013 affecting the country's domestic demand and the Indonesian rupiah's over 20% currency depreciation affecting the trading sector which includes import.

These factors may still affect the growth of the industry in 2014, but this can be leveraged through internal improvements within the Islamic finance industry itself. These improvements can be initiated by regulators as well as players.

2013: A review

Islamic banking and government Sukuk dominated the Indonesian Shariah compliant financial landscape in 2013. Total Islamic banking assets and total government Sukuk issuance up to the 11<sup>th</sup> December 2013 accounted for over 90% of total activities of the Islamic finance industry. The issuance of sovereign Sukuk has contributed significantly to the growth of the industry in Indonesia.

The average growth of government Sukuk issued between 2010-13 was around 56%. Excluding the growth in 2013, the average growth was approximately 70%. Like any other component within the Islamic finance industry, the year 2013 witnessed another slowing down of the Islamic finance industry. Till the 11<sup>th</sup> December 2013, the growth of Sukuk issuance was only 34.3% compared to the growth in previous years (Table 1).

Despite the slowing down in 2013, the issuance of sovereign Sukuk was still much bigger compared to corporate Sukuk, which lagged behind. Although a 20% growth in corporate issuance was recorded in the first quarter of 2013, and with further possible

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growth till the end of the year, the issuance amount only stood at around 6% of sovereign issuance. Some regulatory hurdles including taxation issues, 'grey area' on SPV-related matters, and lack of fiscal incentives like those applied in Malaysia, seems to have hampered the growth of the corporate Sukuk in the country.

Similarly with sovereign offerings declining in growth, the same could be said for the Islamic banking sector. Till the end of September 2013, the overall growth of Islamic banking assets was only at 16.8%. Unless there is a major impetus in the last quarter of 2013, the year 2013 recorded further decline in the growth of Islamic banking assets compared to its growth in 2011 and 2012 at 50% and 34% respectively.

Due to further slower growth in 2013, the central bank estimated that the Islamic banking industry will not reach the 5% threshold of total banking asset in the country by the end of 2013. According to the central bank, the market share of Islamic banking reached 4.8% in October. However the growth of the Islamic banking industry has been consistently faster (more than twice) that the overall industry as a whole in the last six years, this is the reason that its market share has increased steadily from only around 2% a few years back.

Unless and until, the Financial Services Authority conducts some major reforms in addressing regulatory hurdles including the simplification of the issuance procedures of corporate Sukuk, sovereign Sukuk will lead the market

Although the Takaful industry is still relatively much smaller compared to the Islamic banking industry, its growth has started gathering the momentum in 2013. According to the Indonesia Shariah Insurance Association (AASI), the Islamic insurance industry has grown by 30-40% in 2013. The official data for 2013 however still was not available at the time this report was written.

#### 2014: A preview

It is projected that 2014 will present challenges to the growth of financial sector including the Islamic finance industry. Moreover, Indonesia's currency has been bearing the brunt of the Federal Reserve's quantitative easing plan. The depreciation of the currency, contributed also by persistent current-account deficit (CAD), has created imported-inflationary impact.

It is expected that the monetary authority will further increase its benchmark rate in 2014 to prevent the further decline of the currency that will impact the banking sector's financing expansion. Since the middle of 2013, Bank Indonesia has increased its benchmark rate of 175bps.

However, Bank Indonesia plans to launch initiatives to keep and/or support the growth of Islamic banking. The initiatives will include: allowing Islamic banks, which are the subsidiary of conventional banks, to open outlets within its parent conventional

Table 1: Indonesian Islamic finance industry figures (in IDR trillion)					
	2009	2010	2011	2012	2013
Islamic banking assets	66.09	97.52	145.48	195.02	227.71*
Sovereign Sukuk issuance (cumulative)	21.25	48.22	81.53	138.62	186.22**
Corporate Sukuk issuance (cumulative)	7.02	7.82	7.92	9.79	11.92***
Islamic mutual funds (Net asset value)	4.63	5.23	5.56	8.05	8.54#
Islamic life insurance (premium)	1.90	2.12	4.08	4.82	N/A
Islamic general insurance & re-insurance (premium)	0.51	0.67	1.00	1.64	N/A

Sources: Central Bank, Capital Market Supervisory Body and Financial institution/Financial Services Authority, MES, Thohuri (2013) and calculated further

Notes: \*As of the 30th September 2013; \*\*As of the  $11^{th}$  December 2013; \*\*As of the  $30^{th}$  June 2013; #As of the  $30^{th}$  March 2013; US\$1 = Around IDR11,750 (in February 2013)

vast network. This will help fully-fledged Islamic banks dealing with the high cost of opening their own branches as a result of capital-charged regulation.

In addition, this policy is expected to create stronger retail presence by making Islamic banks more accessible to customers all over the country, which in turn could bring down the cost of funds further. At the moment, in general, the Islamic banks cost of funds are still higher compared to its conventional counterparts due to the source of funds coming mainly from corporates and institutions. Other initiative will be to entitle Islamic banks to access all the strengths and benefits had by its conventional parents.

On the capital market side, unless and until, the Financial Services Authority conducts major reforms in addressing regulatory hurdles including the simplification of the issuance procedures of corporate Sukuk, it seems the sovereign Sukuk will still lead the market.

On the insurance industry however the growth is expected to be solid due to the recent issuance of two new Islamic industry regulations relating to minimum capital and Shariah insurance company spin-off business units. AASI even predicted that 2014 will see the industry's peak growth in Indonesia.

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# Iranian capital market: Considerable growth, looking at new horizons

By Majid Pireh

Iran is a country in which all financial instruments are required to comply with Shariah rules and regulations. For this, it is not lawful in the capital market to trade any conventional financial instruments and/or establish any financial institution which operates in contradiction to the Shariah. However, the capital market is facing some challenges that need to be overcome, especially in issuing new Sukuk. On the other hand, the market was honored on the equity side with more than 140% growth in total index from 36,000 in the beginning of the year to 87,000 at the end of 2013.

#### 2013: A review

2013 was an important year for many Iranians. This was mainly because of the presidential elections and the new financial strategies made available. These changes contributed to significant capital market growth and were welcomed by many new investors. Generally speaking, 2013 was a year of significant attempts for capital market development. Iran has a long way to go before being able to claim itself as a developed market, but the steps towards that goal are being taken. Challenges for the issuance of new Sukuk Ijarah may be an important point to overcome. In this regard the cooperation of the banking system and the capital market is vital. The Securities and Exchange Organization (SEO) has structured some new Sukuk issuance models which will be briefly discussed in this article.

#### Sukuk market: New horizons for development

The Iranian capital market struggled in opening the financing doors to potential capital absorption. While Sukuk Musharakah has been the main case for Sukuk in the Iranian banking system since 1994, now the capital market has welcomed new models such as Ijarah and Murabahah. In this regard, the capital market faced some challenges in guaranteeing the issued Sukuk by some commercial banks and some problems arose as a matter of the central bank trying to control the profit rates and the capital market doing its best to use its financing potential. In totality, the capital market succeeded in issuing over five new Sukuk Ijarah programs. Nevertheless, the market for the first time, saw over IRR300 billion (US\$12.04 million)-worth of Sukuk Murabahah in 2013 - used to finance Butan Company which carried a 20% rate of return and a two-year maturity. Additionally, Sukuk Musharakah in the Iranian capital market were more vibrant. Farabourse Company placed over 10 cases of Sukuk Musharakah and Tehran Stock Exchange (TSE) marketed two offerings in 2013. The figures only applies to the capital market; considering that the banking system was going its own way in the matter of issuing and financing via Sukuk Musharakah.

#### **Derivatives**

Derivatives are among the most controversial issues in any Islamic financial system. The Iranian Shariah board in 2009 permitted commodity derivatives on the basis that the amount of underlying assets do not exceed the real ones available. Two years later, it also approved single stock futures. Moreover, in 2013 the Iranian capital market placed two markets for both

gold coin futures contract and single stock futures. To improve single stock futures, the SEO permitted online trading using two approved software. The SEO also implemented a new model for derivatives that is embedded in option for equities. This instrument is limitedly applied in cases in which the market were to collapse.

#### Funds and investment banks

Islamic investment funds as in the past years were actively managing a number of investors' wealth in the capital market. In 2013, over 110 Islamic mutual funds were operating within the Iranian financial system. Some of them were able to gain considerable profit rates of over 150% annually for their unit holders. In addition, real entities accounted for more than 60% of unit holders in Iranian Islamic mutual funds. Charity funds were making lower position in numbers. But they were placing some positions in the market too. A new market entry in 2013 was exchange-traded funds (ETFs). While the previous Islamic mutual funds were based on the issue/redemption model, ETFs make it easier for liquidity and trading purposes. In 2013, Iran witnessed two ETFs entering the market. For investment banks, there were no new players in 2013 and the total number of investment banks remained at seven.

#### **Education**

As with the previous years, those who wish to enter the Iranian capital market are required to pass a professional qualification examination which is held by the SEO on a semi-annual basis. Islamic finance is among the topics tested. The SEO also conduct other courses to improve market practitioners' awareness on Islamic capital markets.

#### 2014: A preview

#### Sukuk Istisnah

The SEO ratified the regulation for Sukuk Istisnah issuance in 2013. While there has not been any real case of Sukuk Istisnah in Iran, however based on the current average profit rate for Sukuk in Iran of 20%, in my personal opinion, the real profit rate for Sukuk Istisnah could exceed that figure this year.

#### Construction funds and ETFs

We can anticipate hopefully for investments in construction funds in 2014. However, it may not be easy for market authorities to handle both construction companies and unit holders. ETFs continue to hold much promise and hopefully fresh capital shall be invested into capital market instruments indirectly via ETFs.

#### Conclusion

I believe that both the banking system and the capital market are moving ahead and while there are surely some elements of competition between the both, the capital market is much younger and more flexible. This is in comparison with a relatively more matured banking system. Many new instruments are in the line to become available, but ultimately it is how the financial system intends to manage it. (5)

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# Iraq: Changes in the banking system needed

By Khaled Saggaf

Since Islamic banks started surfacing in Iraq in the 1990s, more than 40 Islamic banks offering Shariah compliant services have been established. Of Iraq's 46 commercial banks, 11 are Islamic banks.

The Central Bank of Iraq (CBI) is the key financial regulatory body in Iraq and the Iraqi Banking Law of 2004, annexed to CPA Order No 56, (the Law) is the leading legislation of banking law. Unfortunately, the Law lacks the detail required to cover the intricacies of Islamic finance. While the restrictions provided by the Law are vital in providing the safeguards necessary to ensuring that investment risks are kept to a minimum, the Law seems to provide stricter obligations on Islamic banks than the regular commercial banks. This is because unlike regular commercial banks, Islamic banks are not permitted to profit from interest, meaning that they are usually dependent on the profits derived from their investments. This shortfall in legislation will need to be addressed by Iraqi law makers, as Islamic finance grows in the country and continues to become the choice of banking for many individuals.

#### 2013: A review

Iraq's economy continues to expand, with estimations of GDP having increased by 9% in 2013. The main Islamic finance products offered by Islamic banks are: Murabahah, Musharakah, Mudarabah, Ijarah, Istisnah and assets and liquidity management. Generally speaking, Islamic financing covers a longer-term than that of commercial banks.

The main development seen in the Islamic finance market is the passing of the law of The Islamic Bank of Mesopotamia, Law No 95 of 2012 (the IBM Law). The IBM Law establishes a state-owned Islamic bank under the name Islamic Bank of Mesopotamia. Under Article 2 of the IBM Law, the bank is to "provide financial and banking services consonant with the rulings of the Islamic Shariah and the development of the Iraqi economy".

This development is a reflection of Iraq's commitment to Islamic finance as the Islamic Bank of Mesopotamia is directly linked to the Ministry of Finance. The IBM Law regulates the Islamic Bank of Mesopotamia, and covers everything from the allowed capital to the composition of the Board of Directors. Article 1(3) of the IBM Law requires that the director general of the bank have college qualifications in addition to experience in banking. This experience, however, does not necessarily need to be in Islamic jurisprudence generally or Islamic finance specifically. The same is true for four of the six members of the board of directors.

One may contrast this against the recently enacted laws administering the Waqf, or Islamic charitable trusts. There are two such laws for Muslims — one for the Shi'a and one for the Sunnis. The head of the bureaus administering Sunni and Shi'a Waqfs respectively cannot even be appointed unless approved by the relevant non-state religious authorities. In the case of the Shi'a Waqf Bureau, this gives Grand Ayatollah Ali al-Sistani formal veto power over the appointment of a state official. Each law moreover requires three other members of the board of the



relevant Bureau to be jurists of sound reputation selected by the head of the bureau, who is, as noted, already vetted by the highest relevant religious authorities.

In addition to the above, Iraq has recently seen the operation of 12 microfinance institutions in all 18 provinces; moreover, trends suggest that this will continue to grow. This increased development of Islamic finance in Iraq has led to an added global effort aimed at the development of related local legal framework. As a result, Iraq has been increasingly taking part in forums and conferences designed at the development of local Islamic micro financing. An example of this is the Global Islamic Microfinance Forum which recently took place in Dubai and saw the attendance of over 27 countries, including Iraq.

#### 2014: A preview

Iraq continues to see tremendous growth in comparison to many other economies, making Iraq an idea market for investments. The Kurdistan region in particular is experiencing a large amount of interest from foreign investors. Potentially, the government may pass more laws establishing Islamic finance banks linked to the Ministry of Finance. Continued development of Islamic microfinance is highly likely due to untapped depth and underserved rural markets.

#### Conclusion

In addition to new legislation to further regulate Islamic finance in Iraq and minimize confusion in this area, the Iraqi government needs to drive a change in the banking system. Currently, over 80% of Iraq's bank assets are held with state-owned banks, limiting the government's capacity to act as regulator rather than player. Looking to the future, some form of insurance system should be developed, to reassure bank customers that their investments and hard earned money is in safe hands.

Creating transparent regulations and reassuring the public are both necessary proponents to maintain Iraq's economical growth.  $\ \ \, \bigcirc$ 

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# Kazakhstan: No buzz despite attractive prospects

By Adlet Aliyev

Kazakhstan has become the first state among post-Soviet countries who has shown interest in developing Islamic finance. By the initiative of the president of the republic of Kazakhstan, the Kazakh Parliament in 2009 adopted the legislation on Islamic banking and finance with amendments to a number of national laws such as the Civil Code, Tax Code, the Law on Banks and Banking Activity, the Law on Financial Markets and the Law on Investment funds.

#### 2013: A review

Currently the Kazakh Islamic financial sector is represented by three companies: Al Hilal Islamic Bank, which is a 100% subsidiary of Abu Dhabi's Al Hilal Bank; mutual insurance company Takaful Halal Insurance; Kazakhstan Ijara Company established by the ICD and other foreign financial companies.

Al Hilal Islamic Bank started its banking activities in the Kazakh market in 2009. As of the end of 2013 the bank's capital reached US\$70.7 million, total assets stood at US\$161 million, and net income was US\$2.9 million. Al Hilal has applied a conservative approach in active operations of financing its customers as well as in investment operations. Nevertheless the bank has managed to become profitable in 2012. Today the bank renders its services in three cities of Kazakhstan: Almaty, Astana and Shymkent. Al Hilal is the first and still the only Islamic bank in Kazakhstan. Notwithstanding the very attractive outlook for the development of Islamic banking in Kazakhstan whose population is predominantly Muslim, there is no buzz among private local and foreign investors aimed at development of this new niche of banking service.

Mutual insurance company Takaful Halal Insurance was founded in early 2010 to provide Islamic insurance services and to facilitate the development and popularization of the Takaful system in Kazakhstan. The company provides services on health insurance of persons traveling abroad, voluntary medical insurance and accident insurance.

#### 2014: A preview

Due to the absence of a special law on Islamic insurance in Kazakhstan, the company had to be formed as mutual insurance company. The company in cooperation with a special committee of the National Bank, which is responsible for Islamic finance development, have been drafting the legislation for Islamic insurance activity. It is expected to come in force early 2014.

The company has established a special club aiming at the development and popularization of Islamic insurance named Takaful Club. Activities of the club include: the popularization and promotion of Takaful in Kazakhstan; consulting on Islamic insurance; conducting seminars and trainings on the fundamentals and principles of Takaful.

The company intends to transform into a joint stock company after the local insurance law is amended. The company's management believe that Islamic insurance in Kazakhstan has a

good opportunity as it is needed for practicing Muslims, who tend to use Islamic insurance; Islamic banks, Ijarah companies, Hajj travelers; and people who prefer ethic insurance.

The first Islamic leasing firm, Kazakhstan Ijara Company, was registered in 2013 with a capital of US\$39.3 million. The company was created by an alliance of a diverse group of international financial companies including the ICD and one local investor – the owner of Zaman Group. The company's major shareholder is ICD (Islamic Corporation for the Development of the Private Sector, member of the IDB). The company intends to offer Shariah compliant leasing services in Kazakhstan in 2014.

Moreover, the ICD has built a strategic alliance with commercial Zaman Bank. ICD announced on the 23<sup>rd</sup> May 2013 its footsteps in the Islamic banking sector of Kazakhstan with a mandate of converting a leading regional bank into an Islamic bank with expected investment of up to 35% of the subscribed and paid-up capital of the bank. Accordingly, it will become the second Islamic bank in the country. Zaman Bank was established in 1991 with headquarters in Ekibastuz. As at the end of 2013, the bank's capital was US\$60 million and total assets stood at US\$120 million. ICD stated that this strategic initiative reflects ICD's continuous effort to play a catalyst role in the promotion of Islamic finance and private sector development in Kazakhstan. Moreover ICD has extended US\$20 million for real estate development projects and committed US\$40 million in financing facilities for the SME sector in the country.

Kazakh state authorities continue to work on creating attractive conditions for the development of Islamic financial institutions. This primarily refers to the creation of a legal framework for the organization of Islamic financial institutions. Some existing laws will be amended in 2014 enabling the functioning of Islamic insurance and Islamic leasing, as well as perfecting the legislation on the activities of Islamic banks. Thus, Kazakhstan is planning to create a fully-fledged Islamic financial system.

It should also be noted that the next year, within the technical assistance (grant) provided by IDB, National Bank of Kazakhstan (NBK) is planning to attract international consultants to develop a mechanism for incremental development of Islamic finance in Kazakhstan.

#### Conclusion

In 2014 NBK will continue to work on international cooperation. Thus, NBK has agreed with IFSB that these two will hold international seminars and workshops for CIS and EurAsEC in Almaty in 2014. Moreover, NBK within the agreements reached with the Indonesian and Kuwaiti parties, is planning to strengthen cooperation with the central banks of Indonesia and Kuwait to learn the best practices for the development of Islamic finance. The work under the 2020 Road Map for Development of Islamic Finance, approved by the government of Kazakhstan on the 29<sup>th</sup> March 2012 No 371, will continue in 2014.

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# **Kuwait: Advancing through regulation**

By Alex Saleh

Kuwait currently has 22 operating local and foreign banks. Of those 22 banks, more than 10 have been established to offer Shariah compliant services within Kuwait. Furthermore, out of the more than 10 Islamic banks operating in Kuwait, five are Kuwaiti banks, the first of which was opened in 1977.

The Central Bank of Kuwait (CBK) is the key financial regulatory body in Kuwait and Law No 32 of 1968 (the Banking Law) is the leading legislation of banking law within Kuwait. The CBK has issued further rules and regulations in the form of Law No 30 of 2003 (the Islamic Banking Law), amending the Banking Law, for Islamic bank branches. While the restrictions provided by the Banking Law are vital in providing the safeguards necessary to ensuring that investment risks are kept to a minimum, the Islamic Banking Law seems to provide stricter obligations on Islamic banks than the regular commercial banks. This is because unlike regular commercial banks, Islamic banks are not permitted to profit from interest, meaning that they are usually dependent on the profits derived from their investments.

#### 2013: A review

Kuwait's economy continues to expand, with estimations of GDP having increased by 4.5% in 2013. Further, among the many changes to the recently passed Law No. 25 of 2012 (the New Companies Law), published in the Official Gazette on the 29th November 2012, and approved by the Kuwait Parliament on the 23rd January 2013, as amended by Law No 97 of 2013, in 2013 the Kuwait government attempted to provide some corporate regulations regarding the placement of onshore issuances of conventional bonds and Sukuk, detailed within Chapter 6 of the New Companies Law. Additionally, Article 14 of the New Companies Law provides for the establishment of special purpose vehicles (SPVs). However, the New Companies Law does not provide guidelines for the establishment of such SPV for purposes of acting as a trustee on behalf of Sukukholders for purposes of issuing Sukuk, an instrumental aspect in the structure.

Following the passing of the New Companies Law, on the 13<sup>th</sup> September 2013 the Ministry of Commerce and Industry in Kuwait released the Executive Regulations to the New Companies Law. The Executive Regulations were issued to clarify and set out certain requirements necessary for the enforcement of the Companies Law, including, among other matters, the issuance of Sukuk. Articles 30 through 34 of the Executive Regulations discuss the issuance of Sukuk. The said articles provide details on companies that may be established with special objectives such as for the issuance of Sukuk. In accordance with the relevant regulations provisions, the objectives of such a type of company, shall include, the ownership of the Sukuk assets on behalf of the Sukukholders, protection of the Sukukholders' rights and, the distribution of the Sukuk net profits to their respective holders.

Further, the provisions offer practical solutions, such as stating that it is not necessary for the aforementioned type of company's capital to match or be greater than the total amount of the issued Sukuk. Such a provision should encourage investors to use these establishment options by alleviating concerns where the company's capital would have in the past become a limiting factor.



Notwithstanding the importance of the above provisions, the Executive Regulations still leave some unanswered questions. We anticipate that the relevant authorities will issue instructions and circulars to address unanswered questions in the future, given that the relevant authorities and governmental bodies are taking positive steps in Kuwait to reflect the ongoing changes occurring within the industry globally.

#### 2014: Looking ahead

Kuwait continues to see a much more efficient market with lower operating costs in comparison to many other economies. Furthermore, the Kuwaiti government is engaged in efforts to increase positive economic activity through various development plans that will encourage investment within Kuwait, particularly after the successful closing and completion of the Az Zour North Independent Water & Power Project in Kuwait, many more PPP projects in the pipeline are expected to proceed more expeditiously.

It is also anticipated that further instructions and circulars will be issued with respect to the New Companies Law that will hopefully lend clarity to the issuance of Sukuk in Kuwait.

#### Conclusion

Kuwait's economy is projected to see more growth in 2014. This growth is reflected through development and increased credit opportunities within Kuwait.

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# Luxembourg: A confirmation of the leadership position in Europe

By Jean-Nicolas Durand and Sufian Bataineh

Generally speaking, investors have renewed their confidence in the Luxembourg financial center, thus recognizing its financial solidity coupled with its capacity to develop cutting edge solutions.

The new Luxembourg government has assured its support to promote Luxembourg attractiveness as an international financial center in all domains. We expect the new government to give even more attention to the needs of market players and to modify the legal and fiscal environments to make them more attractive for more investors from all around the world.

#### 2013: A review

2013 constitutes a cornerstone in the development of the Luxembourg Islamic finance industry. Thanks to the constant efforts of private and public players, 2013 achievements demonstrate that the attractiveness of the Luxembourg financial center does not exclusively reside in the excellence of its investment fund industry. Sukuk structuring, Takaful and even banking activities may also benefit from an international legitimacy.

Sukuk: On the 26<sup>th</sup> August 2013, the International Islamic Liquidity Management Corporation (IILM) successfully conducted the auction of its inaugural US dollar-denominated short-term Sukuk of US\$490 million. These Sukuk, structured and issued through IILM Luxembourgish subsidiaries, had a tenor of three months and were fully subscribed by the seven primary dealers appointed by IILM, among which a Luxembourg bank (sole western institution involved in the distribution). This landmark issue was successfully rolled over for a new three-month tenor Sukuk in November 2013. Thanks to the flexibility of the Luxembourg legal environment, IILM Sukuk's structuring constitutes a real technical innovation resulting in a new class of Shariah compliant asset.

The dense regulatory agenda and the anticipated legislative election forced to postpone the issuing of Luxembourg's sovereign Sukuk scheduled for early 2013. Nevertheless, on the 17<sup>th</sup> December 2013, the new Luxembourg minister of finance submitted to the Luxembourg parliament a bill to approve a decision to issue Sukuk backed by real estate projects. As the bill was launched at the initiative of the former government (now the opposition), we expect the Luxembourg parliament to approve the bill without difficulties.

We expect, considering the flexibility of the Luxembourg authorities, that the Luxembourg sovereign Sukuk will be issued before the UK sovereign Sukuk, declared on the 29<sup>th</sup> October 2013 during the World Islamic Economic Forum held in London, to keep leadership position in this market in Europe, as Luxembourg was already the first European country to list Sukuk in 2002.

**Takaful**: On the 27<sup>th</sup> November 2013, Vitis Life, a Luxembourg insurance company, publicly announced the release of 'Amane Exclusive' a Takaful contract designed for French high net worth individuals. The Fatwa was procured by the Conseil Independent de la Finance Islamique en Europe (CIFIE). This product entitles policyholders to invest in a range of selected Shariah compliant

investment funds.

Banking landscape: The Global Islamic Economy Summit 2013 (GIES 2013), which was held in Dubai in November 2013, witnessed the public announcement of the forthcoming creation of the first Eurozone Islamic bank (to be named Eurisbank). This institution, supported by a consortium of Gulf-based investors including members of the royal family, will be headquartered in Luxembourg and intends to develop Shariah compliant wealth management and investment banking services.

**Funds**: In July 2013, Luxembourg was the first country to fully implement the Alternative Investment Funds Manager Directive (AIFMD). The new passport regime for EU AIF Managers is now available increasing the attractiveness of Luxembourg for Shariah funds domiciliation and also re-domiciliation from offshore jurisdictions.

The business volumes in terms of Shariah compliant funds remained stable during the year 2013. Attention should nonetheless be paid to the Cygnus Real Estate project to set up a Shariah compliant fund (to be named Bluestone Real Estate Fund) aiming at investing into residential German real estate projects. The CSSF approval is expected to be obtained by early 2014. Besides, Saudi Arabia's SEDCO Capital multi-assets SIF-SICAV has increased the volume of its portfolio considerably in Luxembourg during the year 2013.

#### **Promotion of Islamic finance**

Official economic missions were organized to Doha, Riyadh and Dubai. In addition, the agency, which promotes the Luxembourg financial center (Luxembourg for Finance "LFF"), participated in various events dedicated to Islamic finance such as IFN Asia 2013 in Kuala Lampur and WIBC 2013 in Bahrain. LFF representatives were also invited, as speakers, to the Islamic finance summer school at the University Tor Vergata in Rome.

#### 2014: A preview

Sukuk: IILM will continue to issue Sukuk through Luxembourg on an ongoing basis to roll over the existing positions. Due to the lack of Shariah compliant assets available in the market, a substantial increase of the nominal issued in the course of 2014 may reach market expectations.

Banking landscape: The contemplated Islamic bank, announced at the GIES 2013, should start its banking license application process in January 2014, expecting a successful achievement by middle of the year. Based on this assumption, the first Eurozone Islamic bank may welcome its first clients in the fourth quarter of 2014.

Besides, Luxembourg is likely to welcome other Islamic banks or financial institutions in the coming years as potential transactions are under study. (9)

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### Malaysia: A continuous evolution

By Raja Teh Maimunah

Malaysia continues its leading role as a center for Islamic finance being supported by political and economic stability, high levels of technical competence, and a robust legal and regulatory environment.

The Islamic finance industry in Malaysia continued its rapid evolution with the introduction of the Islamic Financial Services Act 2013 (IFSA) which became effective in June 2013 and allowed for a holistic approach to the codification of Shariah governance. This had resulted in strengthened Shariah compliance and risk management, and at the same time worked to encourage clear differentiation between Islamic and conventional products.

To help manage the implementation of these new regulations the Central Bank of Malaysia introduced a series of new Shariah standards to increase harmonization and alignment of the Malaysian Islamic finance industry to international standards, some of which were introduced in 2013 with the remainder being planned for release in 2014. These include exposure drafts addressing the contracts of Wakalah, Wadiah, Waad, Bai' Inah, Tawarruq, Kafalah and Hibah, concept papers on Mudarabah and Musharakah, as well as new guidelines on the practice of Murabahah.

Efforts have also been made to strengthen the Islamic asset management industry through revisions in the Shariah compliant screening methodology for securities listed on Bursa Malaysia. This undertaking by the Securities Commission reaffirms Malaysia's commitment towards improving its alignment to international standards and practices. Currently at 16% of total industry assets, it is foreseen that Malaysian Islamic funds under management would achieve double-digit growth rate over the next decade, up from the RM80 billion (US\$24.24 billion) registered in 2013 (The Malaysian Reserve, July 2013).

The Malaysian Takaful industry has also seen significant growth over the years and has registered a respectful 21% growth rate in 2012. As a significant regional market it currently commands a 71% share of ASEAN Takaful contributions, which in turn has collectively registered a CAGR of 22% from 2007-12 (EY). Implementation of new regulations such as the Takaful Operating Framework provide detailed guidance for Malaysian Takaful operations, the IFSA which requires the separation of Family and General Takaful licenses provides more balanced development between these two segments, and the Takaful Risk Based Capital Framework which allows for a more even playing field between Takaful operators and their conventional counterparts position the industry towards greater development and expansion.

However, with gross domestic product (GDP) hovering in the estimated 4.5-5% range for the full year of 2013 and an expected 5-5.5% in 2014 (Economic Planning Unit), these developments had unfortunately come at a most challenging time for the industry. Growth, although visible, is generally un-stimulating owing mostly to lackluster global economic climate despite the seemingly synchronized recovery seen in major economies. Inhibited by this restrictive backdrop, the industry continues to see net income margin (NIM) compression, a function of competitively priced yields as opposed to high cost of funds.



Despite the challenging business environment, Islamic banking assets had continued to grow at a respectable rate and totalled RM527.2 billion (US\$157.71 billion) as at end-June 2013, contributing 24% of the Malaysian banking system – double that of its contribution in 2006 (Malaysian International Islamic Financial Center, August 2013). Similarly, Islamic banking industry deposit levels had grown at a 20% CAGR from 2006 to 2012; double that of its conventional banking counterpart. This reflects the increasing dominance of a robust Islamic finance industry in the Malaysian economy, under the ever-watchful eye of its proactive regulators.

From an Islamic capital markets perspective, in spite of a largely subdued first quarter in terms of issuances Malaysia continued to dominate the Sukuk market in 2013, issuing about 72% from the US\$75 billion of new Sukuk issued globally as at end-September 2013. This further solidified its position as market leader with a 64% share of outstanding global Sukuk as at August 2013. In pushing the boundaries of development, its technical maturity allowed the Malaysian Islamic finance industry the innovative drive to achieve world-class innovations such as in the structuring and execution of cross-border issuances, thereby increasing the mobility of regional funds.

Naturally, year 2014 comes with its own set of challenges. Although the new Shariah standards would foreseeably improve alignment between Malaysian Shariah requirements to the rest of the Muslim world, it is possible that these same requirements would hasten the need to develop replacement or even new products to ensure continued compliance. Such drastic changes would further pressure already thin margins in a challenging economy. On the other side of the gold dinar, however, this realignment may well be the catalyst needed to bolster the levels of international collaboration and further improve acceptance of the Malaysian Islamic financial industry, both on the local and foreign fronts.

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# Maldives proved that nothing is impossible

By Dr Aishath Muneeza

The Maldives is a 100% Muslim nation where Islamic finance is emerging as a proxy to the existing conventional system which has been in the country from an immemorial time. The first form of Islamic finance that was adopted in the country was Takaful. In 2003, the first Takaful company was established in the country under a conventional insurance license. In 2011 only, Islamic banking and Islamic capital market services were introduced to the country. Since then Islamic finance in the country has been spreading like wild-fire. The government has also realized the importance of Islamic finance in resolving economic and financial problems. As such Islamic finance has been considered as an integral part in the development of nation and the evergreen future of Islamic finance is evident in the country now.

#### 2013: A review

2013 has been a very successful year for the Islamic finance industry in the Maldives. So far, this is the year in which the highest number of Islamic finance services is given and new innovative Islamic finance instruments have been introduced to the country by corporations and the government. During this year the first sovereign private Sukuk deal was successfully signed and also the first Islamic Treasury bill was issued by the Central Bank of Maldives for the government of the Maldives solving the short-term liquidity management problem facing Islamic financial institutions in the country. Not only this, to strengthen the Islamic finance legal frame work in the country, four pieces of regulation were introduced: Sukuk issuance regulation, Islamic securities regulation, registration of Shariah adviser regulation and regulation to regulate Capital Market Shariah Advisory Council. These four regulations were issued by the Islamic capital market regulator, Capital Market Development Authority.

The first corporate Sukuk was also issued during this year by Housing Development Finance Corporation (HDFC). Not only this, but the country also witnessed the first Islamic hire-purchase product introduced by a private company, Alia Investment Maldives. The government also formed the Maldives Hajj Corporation which is the first pilgrimage fund of the country. Halal Certificate Issuance Regulation and the process to issue Halal certificate to fish processed products exported from Maldives have been inaugurated. Also for the first time in the history of the country, a company, MTCC has announced to hire a Sukuk adviser to develop Sukuk for real estate projects they intend to develop in 2014. Furthermore, regulatory consents have been given to the Islamic banking window of Bank of Maldives and the Takaful window of Allied Insurance Maldives to start their operations. Some products of these companies have been given consent by the Maldives Monetary Authority. The government is also working to form a national-level technical committee to monitor and supervise sovereign Islamic finance issues. Definitely, 2013 is a super duper hit year for the growth of Islamic finance industry.

#### 2014: A preview

2014 is a potential year for Islamic finance industry. The official



inauguration of the Islamic windows of Bank of Maldives and Allied Insurance Maldives will happen. This will be a landmark growth for the whole Islamic finance industry in the Maldives as Bank of Maldives is the largest conventional banking provider and Allied Insurance Maldives is the largest insurance provider of the country. It is anticipated that a large number of customers will switch from conventional banking to Islamic banking when this takes place.

Furthermore, Islamic fund management will be introduced to the country. The growth of this area will be supported by Waqf and Zakat funds. It is hoped that more competition will be created among the existing industry players making the Maldivian Islamic finance industry viable and a resilient. The government has plans to introduce an Islamic finance center that will not only provide offshore Islamic financial services, but this center will act as the Islamic finance hub for the whole South Asia region. Launching a South Asian Association for Regional Corperation (SAARC) Sukuk to finance projects in the SAARC countries maybe a dream that will realize in 2014.

#### Conclusion

Islamic finance has gained confidence in the Maldives. More awareness on the role of Islamic finance to eliminate Riba in the economic system has been understood and comprehended by the citizens of the country. Demand for Islamic finance is evident and has proved that there is inherent demand for Islamic finance as the Maldives is a country with a 100% Muslim population. It is hoped that in the upcoming years the Maldives can be used as a global case study to prove the success of Islamic finance. Two years ago no one would have even predicted that Islamic finance will grow at this speed in the Maldives. But today, once what has been perceived as impossible has been proven to be possible.

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# Nigeria: Making waves

By Basheer Oshodi

The Nigerian Islamic finance industry was unknown 10 years ago and now creates top news in the media. Nigeria had just one Islamic financial institution — Lotus Capital in 2004 which was registered by the Securities and Exchange Commission (SEC) while some commercial banks attempted to offer non-interest liability products. An insurance company also stated to offer Takaful window around this period. Since end-to-end Shariah compliance is seen as the main pillar behind Islamic finance, financial regulators started to quickly put in place guidelines. 2013 witnessed the release of most of these guidelines while Islamic financial institutions also started becoming more innovative with better understanding of the Nigerian customer value architecture.

#### 2013: A review

Jaiz Bank and Stanbic IBTC Bank — a member of Standard Bank Group — started Islamic banking (known as non-interest banking in Nigeria) operations in January and February 2012 respectively. By the end of 2013 Jaiz Bank had over 11 products: six liability products and five financing products. As a regional bank with presence in only the northern part of the country, the bank has enjoyed patronage from the northern population including state governments. Stanbic IBTC started in a very conservative manner with two liability products by the end of 2013. Stanbic IBTC Asset Management on the other hand is a conventional asset management company with an Islamic fund management window.

By the end of 2013, the product has attracted huge investment in screened equities. The Sukuk part of the fund is however vet to kick-off. ARM also has a window for Islamic funds which comprises of equities, real-estate and other investments. Lotus Capital, a standalone Islamic fund management company, was very innovative in 2013. The company introduced Sukuk to the Osun State government and issued a NGN10 billion (US\$60 million) Sukuk which was oversubscribed. Lotus Capital has several unique products and supported Securities Exchange Commission in Islamic fund management policies and product master plan in 2013. They are also building partnership relationship with commercial banks with a new focus on Sterling Bank. Sterling Bank is a conventional commercial bank that got license to operate as an Islamic window in December 2013. The bank has developed over 10 liability products with five financing products. The bank expects to leverage on its structured finance, corporate banking and SME financing competence in providing unique Islamic finance options to various segments of the market.

Niger Insurance, Cornerstone Insurance and African Alliance Insurance are the three conventional insurance companies with Takaful windows as at the end of 2013. They all have similar products covering family plan, education plan, pension plan, Hajj plan, mortgage plan and other Mudarabah investments. National Insurance Commission (NAICOM) in November 2013 released the Takaful guideline which allows standalone Takaful companies to operate in Nigeria. The Islamic Finance Council (IFC), UK, played major roles in the drafting of this guideline under EFInA's sponsorship. EFInA seek to promote financial inclusion in Nigeria and is sponsored by DFID and Bill & Malinda Gates Foundation. EFInA set up the Nigerian Islamic Finance Working Group in

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2009 and its members include financial regulators and some Islamic finance institutions. This group has been instrumental to the release of several Islamic finance guidelines in Nigeria.

#### 2014: A preview

Jaiz Bank now has a new managing director/CEO from its technical partner — Islamic Bank of Bangladesh. They also want to become a national bank in 2014 so that it can operate in every state in the country. In 2014, a lot of innovation is expected from Jaiz Bank who wants to be the market leader. Stanbic IBTC is expected to add an Ijarah contract and treasury Mudarabah product to its product line. This carries the hopes of becoming an asset class for Takaful companies, pension fund and other Islamic banks to invest in since there are no Islamic Treasury bills and other short-term liquidity instruments.

Sterling Bank is set to fully start operation in January 2014 with much determination to lead this market. The bank projects that it would breakeven its 2013 implementation cost and also record acceptable profit. Sterling Capital, a conventional asset management company, is expected to launch its unique Islamic fund with several asset classes. At least two standalone Takaful companies would also be licensed while the list of Islamic asset management companies will increase. Existing ones will upsurge their product lines and be more competitive. Kord Capital is an Islamic financial institution registered with SEC as corporate investment advisors and they will want to play more in the area of acting as agents for Islamic banks. The Sukuk market would grow very fast considering that Nigeria suffers from huge infrastructural deficit and the fact that more Islamic financial institutions will start operation in 2014. The commercial hub of the country is Lagos State with two major projects - Eko Atlantic City and the Lekki Free Trade Zone. These projects are expected to attract fresh non-debt Sukuk that are attractive to international communities. The federal government may also consider Sukuk for some of their rail projects while new power generation companies and power distribution companies may also start to structure propositions along these thoughts.

The Sukuk market would grow very fast considering that Nigeria suffers from huge infrastructural deficit and the fact that more Islamic financial institutions will start operation in 2014

EFInA's Access to Finance result at the end of 2012 stated that: 30.5 million adult Nigerians were very likely/somewhat likely to use non-interest banking products, of which 23.6 million were interested in savings account, 15.3 million were interest in financing (risk assets), 9.5 million were interested in trading and 7.9 million were interested in current account. Sterling Bank's Islamic window is expected to take advantage of the retail segment and expand its operations very quickly. Jaiz Bank would want to take advantage of the 63.8% and 59.5% adult population from the northwest and northeast respectively that are financially



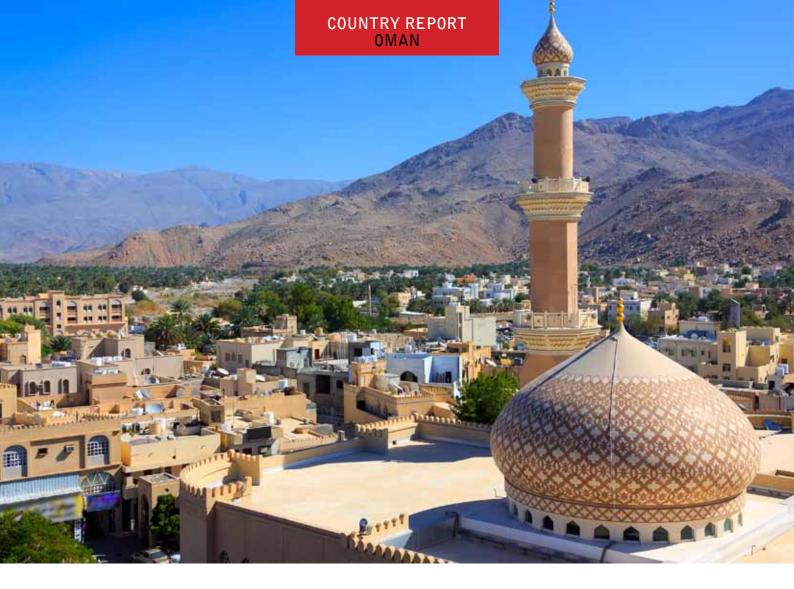
excluded and offer them Islamic banking products since they are mainly Muslims.

Financial regulators are expected to monitor Islamic financial institutions more closely in 2014 since the CBN will have a dedicated non-interest banking department. The CBN short-term liquidity instruments developed in 2012 were never used by Islamic banks mainly because the contracts used were unfavorable with hardly any returns. The CBN may however be come up with more competitive instruments in 2014 just like how conventional banks enjoy favorable rates from Treasury bills. This would perhaps encourage more investors and conventional banks to seek for an Islamic banking license. The Federal Inland Revenue Service (FIRS) released the tax neutrality draft guidelines and framework in December 2012 and is expected to release the final policy in 2014.

#### Conclusion

The success of Islamic finance in Nigeria is dependent on a systemic interplay of effective regulation, competitive products and good customer service. It is therefore important for the stakeholders to consciously make efforts towards achieving this within the context of the Maqadis Al Shariah — which seeks to achieve human wellbeing and communal good life rather than just Shariah compliance and competitive pricing. (2)

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# Oman - Catching up fast

By Riza Ismail

The launching of Islamic finance in Oman during the last quarter of 2012 and its subsequent development has been closely scrutinized and followed with much interest by the financial market. With each piece of news celebrating the development of Islamic finance in the country, Oman further secures its place on the Islamic finance map. The general consensus by observers and analysts is that the Islamic finance market looks promising and Oman is catching up fast with its other counterparts.

The groundwork for Islamic finance started long before its official launch and has been carefully planned. The legal and regulatory frameworks have been considered in depth and at length. Being the last of the Gulf country to launch Islamic finance, Oman had the advantage of evaluating the laws and regulations and market practices of other Gulf countries in similar legal system. Oman also benefited from a mature global Islamic finance market and had access to the experience of tried and tested approaches by other countries in implementing Islamic finance, allowing it to cherry pick the best practices. This is evident by the issuance of the Islamic Banking Regulatory Framework (IBRF), said to be among the most comprehensive in the world. Simultaneously, separate sets of legal and regulatory framework governing the Sukuk and Takaful sectors are also being considered.

In addition, several Islamic finance players took the initiative to introduce and educate its community on the intricacies of Islamic

finance through several conferences and smaller scale seminars. Oman hosted its first Islamic finance conference in January 2012 and this was followed by a series of other international Islamic finance conferences that brought into the country well-known and prominent Islamic finance figures from across the globe.

A series of incentives and assistance by the government have also being introduced and are planned for the future. The groundwork provides the Islamic finance industry in Oman with a strong foundation in which a steady and consistent growth can be achieved.

#### The beginning of a new era

The official implementation of Islamic finance in Oman commenced in late 2012 with the issuance of a royal decree amending certain provisions of the existing banking law which allows the establishment of Islamic banks in Oman. Soon after, the Central Bank of Oman (the CBO) issued the IBRF that comprehensively covers, among others, the Islamic banking licensing requirements, capital adequacy, Shariah supervisory board, accounting standards, audit and other operational requirements as well as providing detailed guidelines on each Islamic principle transaction. Such comprehensive guidelines not only meant that Islamic banks will be monitored closely by the CBO, but it also enhanced the corporate governance and transparency of Islamic banks in the eyes of the public.

Around the same time, Bank Nizwa, the first fully-fledged Islamic

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bank in Oman, launched its operations after floating its shares on the Muscat Securities Market (MSM). Later in the year, Al Izz Islamic Bank, another fully-fledged Islamic bank, followed suit. In addition, six Islamic windows of local Oman banks offering Shariah compliant products and services were opened during the year. Until today, the country continues to be flooded with news of these banks opening up new branches throughout the country and launching new Shariah compliant products for retail and corporate customers. To accommodate and facilitate the development of Islamic banking in the country, the authorities introduced certain measures which included provisions in the law permitting Islamic banks to own, sell, invest and rent real estates and exemption from certain tax on transactions carried out by Islamic banks. The CBO also granted a one-year relaxation on the limit of foreign investments allowed to be held by Islamic banks/windows, which enabled these banks to utilize its cash surplus while the domestic market develops.

In another move, the first corporate Sukuk in Oman kicked start the Sukuk market in October 2013 with a OMR50 million (US\$129.5 million) Ijarah Sukuk issuance by Tilal Development Company and subscribed by local investors such as Bank Nizwa and Bank Dhofar. In the area of investment funds, three Shariah compliant funds have been launched in the country. All three funds are open-ended and largely invest in Shariah compliant equities and fixed income securities within the GCC.

These developments took place in spite of the absence of separate local legal and regulatory framework governing Sukuk and Shariah compliant investment funds. This was made possible through the co-operation from the Capital Markets Authority who granted approvals and guidance and the fact that Oman's existing laws and regulations are flexible enough to cater for Shariah compliant structures to be issued (for example, against the backdrop of companies law and the capital markets law), although certain legal issues have to be considered and innovative solutions provided.

A further milestone was reached in July when the Muscat Securities Market launched its Shariah Compatible Index, providing a platform upon which fund managers and investors can rely in determining the Shariah compliance of companies in Oman.

The last of the major development took place during the last quarter of 2013 upon the establishment of two Takaful companies. Al Madina Takaful and Takaful Oman Insurance floated their shares recently, indicating the opening up of Takaful industry in Oman. Currently, Oman is an untapped Takaful market and the launching of these Takaful companies is timely as Islamic banks/ windows are looking to Takaful to support its Islamic banking products.

#### 2014: A preview

In one short year, Oman's achievement has been impressive. More is yet to come. A number and range of Islamic retail and commercial products is likely to continue to be developed by Islamic banks. As commodity Murabahah is not allowed under the IBRF (except for very limited circumstances), Islamic banks/ windows are forced to come up with other innovative products to meet the financing needs of its customers and remain competitive with its conventional counterparts.

A number of infrastructure projects are in the pipeline and public spending is said to be budgeted at OMR18 billion (US\$46.62 billion) for infrastructure and other projects, which currently



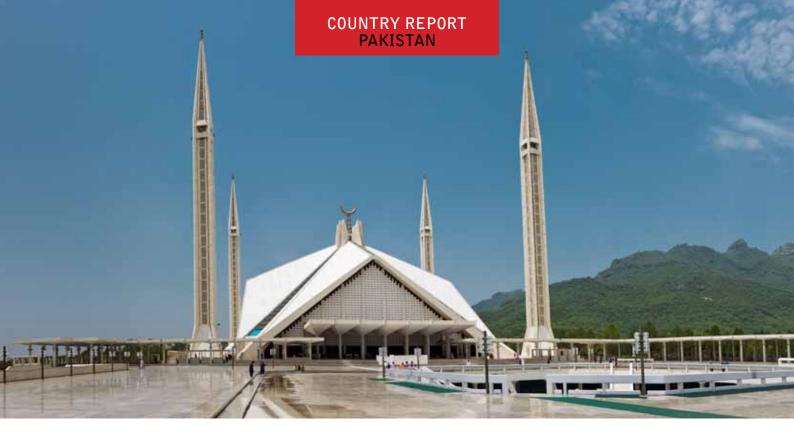
includes the new Muscat International Airport, gas and power generation and road network projects. While the government may not be in need of funds, it has indicated that it would utilize Sukuk structures to fund these projects and support the Islamic finance industry in its initial years. The government recently announced the formation of a working committee for the purpose of issuing an international sovereign Sukuk in a move to fund infrastructure projects. With surplus cash and ample liquidity faced by Islamic banks, the move by the government is welcomed and a sovereign sukuk will also serve as a tool to manage liquidity domestically.

We can also look forward to the issuance of Sukuk laws and Takaful regulations as they are under consideration. A separate law regulating Shariah compliant investment funds is also a welcoming move. It will be a step towards strengthening the current legal and regulatory framework in Oman and an opportunity to directly address any legal gaps or specific risks inherent to such instruments. For instance, putting in place an explicit framework governing Sukuk issuances and their management would encourage their use by companies and investors alike. It will also provide a more inviting environment to international investors and would increase competitive edge visà-vis other countries in the region. Perhaps, we should also look forward to Oman introducing an array of trust vehicles as Islamic finance products can benefit through the use of sophisticated trust structures, such as the Sukuk.

We can also look forward to Oman producing more Shariah scholars. The fit and proper criteria under the IBRF impose strict requirements of members of the Shariah boards of Islamic banks/windows. For instance, a Shariah scholar cannot be a member of more than two Islamic banks or a maximum of four Islamic financial institutions such as Takaful or fund manager. Traditionally, most prominent Shariah scholars sit in a number Islamic financial institution due to the shortage of qualified Shariah scholars. If the regulatory requirements are not relaxed in this respect, Oman is forced to make efforts at a national level to institutionalize and develop systematic training programs to meet the demand of Islamic finance industry.

Oman has the potential to emerge as an attractive Islamic finance center in the future. According to Thomson Reuters Zawya Sukuk Perception and Forecast Study 2014, Oman is perceived to be the most attractive emerging market for Sukuk investments. On the heels of a successful 2013, we look forward to some important milestones in the Islamic finance industry in Oman in 2014.

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## Pakistan: A growing Islamic finance market

By Muhammad Shoaib Ibrahim

Islamic finance has emerged as a rapidly growing industry with an increasing global presence. The industry's growth has remained strong in 2013 despite uncertain recovery elsewhere in the world's financial markets. As instruments that adhere to Islamic principles seek to promote inclusive growth, equitable risk-sharing, social balance and equality, the expansion of this industry is coupled with a better and more transparent regulatory environment which is demand driven.

South Asia is home to well over one-fifth of the world's population making it one of the most populous geographical region in the world. In the South Asian context, Pakistan is the second-largest country with important strategic endowments and development potential. The country is located at the crossroads of South Asia, Central Asia, China and the Middle East and well connected with regional markets of vast population, large and diverse resources, and untapped potential for trade. The increasing proportion of Pakistan's working-age population provides the country with potential demographic support. This strategic advantage linked with an agriculture base structure makes Pakistan a market place of real goods which are the core requirement of the Islamic finance industry.

The unprecedented growth of the Islamic finance industry can be associated to efforts with dedicated regulatory, Shariah and academic institutions along with the presence of diversified players in the field. Pakistan has remained at the fore front in promoting Islamic finance by being a key member of international Islamic finance institutions established to develop necessary legal, regulatory, supervisory and Shariah compliance infrastructure for Islamic finance institutions. The first move to achieve Shariah compliance in Pakistan was made in the mid 1980s by allowing Modaraba (or Mudarabah as known within the pages of IFN) companies to start their operations as pioneering Islamic financial institutions under the regulatory framework of the Securities & Exchange Commission of Pakistan (SECP).

At present the Islamic financial services industry of Pakistan, consists of Islamic banks, microfinance banks, Islamic mutual funds, Modarabas and Takaful companies. Commercial and microfinance banks operate under the State Bank of Pakistan (SBP) while the rest of the sector is controlled by the SECP. Besides the abovementioned institutions, the Islamic capital market is also operating under the SECP.

#### **2013: A review**

Islamic banking is the fastest growing segment of Pakistan's financial services sector. The Islamic part of the banking industry has been growing at an impressive annual growth rate of over 30% over the last five years with sustained growth momentum. Currently Pakistan has five fully-fledged commercial Islamic banking institutions and 14 standalone Islamic banking branches of conventional commercial banks. The total branch network of the 19 Islamic banking institutions is around 1,200 branches spread across the country. Islamic banking assets presently constitute almost 10% of the overall banking system in the country while in terms of deposits the share is above 10%. The stability and resilience of the Islamic financial industry had attracted wider acceptability of this system as a viable alternative to conventional financial system. No doubt, the SBP has been playing a leading role in the promotion and development of Islamic banking in the country on sound footings.

SBP continuously improves and strengthens the legal, regulatory, and supervisory frameworks and also is also active in creating awareness within the masses. The SBP is also engaged in refining and improving the legal and regulatory framework to ensure its responsiveness to the evolving industry dynamics and its effectiveness in identifying, measuring and mitigating the risks associated with Islamic finance.

During the year SBP has also launched a mass media campaign during which the whole Islamic banking fraternity joined hands under the ambit of SBP to target the challenge of misconceptions

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related to Islamic banking business model and practices. This exercise greatly supported awareness building within the masses.

In the recent past SBP has issued detailed instructions for profit and loss distribution and pool management to bring standardization, improve transparency and safeguard interests of investors. SBP has also conducted a survey-based research, 'Knowledge, Attitude and Practices of Islamic Finance in Pakistan', focused on quantifying the demand and its nature for Islamic finance in the republic. This was firsthand information collected through survey from both retail and corporate, both banked (Islamic and conventional) and un-banked from all provinces including the capital.

Likewise, SECP has also taken various initiatives for the promotion of Islamic finance and Islamic capital market during the year. The most important steps were the formation of the Shariah Advisory Board within the SECP in order to harmonize Islamic financial institutions and the Islamic capital market in Pakistan. In recent past SECP has also issued draft guidelines on Sukuk issuance and it is expected that this will finalize very soon.

During the year the excellent growth of non-banking Islamic financial institutions such as Islamic mutual funds, Modarabas and Takaful have been observed. The issuance of detailed Shariah Compliance and Shariah Audit Mechanism (SCASM) for Modarabas by the Registrar of Modarabas in 2012 has supported well the efforts to build a positive image and promoting the Modaraba sector in Pakistan. For the year ended on the 30th June 2013, it was an excellent and turnaround year for the Modaraba sector and very successful in the context of overall performance. The Modaraba sector, which is a unique model in Pakistan's Islamic financial market, has been continuously showing a good performance despite the challenging and highly competitive banking and non-banking business environment within the country.

The non-bank financial reform is also currently under process at the SECP and recommendation for non-bank financial reform committee has been finalized. The regulator is in the process of finalizing the regulation in light of recommendations. It is expected that the implementation of suggestions would make a significant contribution in providing the impetus for growth of non-banking financial institutions sector particularly the non-banking Islamic financial institutions.

Recently for the first time in Pakistan, the office of Registrar Modaraba, SECP in collaboration with Islamic Research and Training Institute (IRTI) arranged a two-day training workshop on Islamic financial products and risk management with the theme of 'Sharing Knowledge and Experience'. The overall objective of the training program was to create awareness and share knowledge and experience of experts from the Islamic finance sector. The conference was very successful and well attended by eminent local and international Islamic scholars, professional and industry practitioner.

#### Challenges of the industry

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:

- Low Islamic banking literacy;
- Taxation issues due to non-availability of some necessary tax mechanism on some Islamic financial products;
- Low investment in non-traditional but strategically important sectors like agriculture and SME;

- · Low product innovation and diversification; and
- Lack of developed Islamic money market and capital market

#### Way forward

The future outlook of the industry is very positive with bright prospects. Both the regulators i.e. SBP and SECP are playing their due role for the growth and promotion of the Islamic finance industry within the country. SBP over the years has introduced and implemented key regulatory reforms and prudential measures to ensure financial stability and to meet the evolving needs of the industry. A detailed Shariah Governance Framework is in its advanced stage of discussion and will further strengthen governance and the Shariah compliance culture of the Islamic banking sector.

Considering the demand for Islamic microfinance, SBP has offered various options to offer the services of Islamic microfinance at grass root level. Similarly efforts are being made to enhance the base of agriculture finance since Pakistan has huge potential for developing Shariah-based agriculture financing through various Shariah compliant products, as it is an agro-based economy.

SBP has recently developed a five-year strategic plan for the Islamic banking industry in consultation with key stakeholders. It is expected that this strategic plan will take this industry to the next level of growth and development. Within the plan it is targeted that through the deepening and broadening of product offerings by Islamic banks, branch networks of Islamic banks will double during the next five years and Islamic banks will see their market share increase to 15%. Other areas are also focused including widening the reach to rural areas, the development of Islamic low cost housing schemes and liquidity management framework for short-term liquidity problems.

Recently the government of Pakistan constituted a 10-member Steering Committee for the promotion of Islamic banking, which would submit its recommendations. The committee would formulate a comprehensive policy framework for the Islamic financial system and would suggest practical steps needed to be taken to implement Shariah-based financial system, find out practical ways and means to maximize equity-based financing instead of the widespread debt-based system.

#### Conclusion

Islamic finance has made impressive progress globally and domestically. It is expected that this industry will grow at the same pace and hit the US\$2 trillion mark (in terms of assets size) by the end of 2014. Pakistan is the world's second-most populous Muslim nation and has great potential for the expansion of Islamic finance which is largely untapped. Despite significant improvement during the last decade, a large segment of the country's population still does not have an adequate understanding of Islamic finance and is unable to comprehend its distinction over conventional finance. 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 Islamic finance industry in Pakistan are very promising. (3)

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## Qatar, a year of change

By Amjad Hussein

The past year has definitely been a year of major developments for banking in Qatar, driven by structural changes within the finance sector as well as by outside influences such as the increased political instability in the Middle East and most notably the transition of power to Sheikh Tamim Hamad Al Thani and his new government.

In anticipation of the impact of US shale gas and other major gas discoveries elsewhere in the world on global energy prices, the leadership in Qatar has taken steps, driven by the boost to the economy generated by the FIFA World Cup 2022, to diversify the economy and to decrease its reliance on hydrocarbon revenue. Qatar has set itself the goal of generating more than 50% of its GDP from non-hydrocarbon revenues by 2015.

There is wide acknowledgement that in order to diversify the economy, private sector investment in Qatar needs to be promoted and for this to happen, a robust regulatory framework for the financial sector would need to be put in place to support the growth of the non-hydrocarbon economy. The new Qatar Central Bank Law (QCB Law) that came into effect at end of last year was a major step in updating the regulatory framework for conventional finance, Islamic finance, financial markets and insurance for both Qatar and the Qatar Financial Center (QFC).

A key feature of the QCB Law was the consolidation of regulatory authority under the Qatar Central Bank (QCB). As a result, the QCB is now the supreme authority with a wide mandate, responsible for regulatory oversight of the financial and insurance sectors, promoting financial stability and expanding the scope of regulation and supervision to include areas that require financial structuring. Prior to the QCB Law, insurers and reinsurers were regulated by the Ministry of Business and Trade, while the Qatar Exchange came under the Qatar Financial Markets Authority.

Banks and financial services companies as well as exchange houses were regulated by the QCB, while the QFCRA regulated foreign bank branches and financial services companies registered within the QFC. Despite the wider mandate for the QCB, the QCB Law retains the previous regulators who will continue to be responsible for their respective portfolios, however this will now be under the oversight of the QCB with the aim of enhancing cooperation and coordination among the regulators with regard to the development and implementation of the regulatory and supervision policy.

The increased regulatory oversight of the QCB has been felt by Qatari banks who have been visibly taking measures to comply with the QCB's directives in anticipation of Basel III. The QCB has also sent a draft circular on new Basel III capital rules to conventional and Islamic banks that include the requirements for the issuance of instruments such as hybrid bonds which can include perpetual debt and Sukuk. The final version of the capital rules will be completed once a quantitative impact study is undertaken for all Qatari banks. It will be interesting to see how these rules will impact on the Islamic banks, which are already closely regulated in Qatar.

Qatari banks have been raising funds by way of share issues, Sukuk as well as Tier I bonds in order to improve their capital adequacy ratios. Notably in 2013 Qatar National Bank (QNB) sold US\$3 billion-worth of three and five-year bonds as well as three and five-year Sukuk totaling US\$1 billion, while Doha Bank and Commercial Bank both recently announced plans to raise QAR2 billion (US\$548.84 million) in Tier I capital.

Going forward, industry analysts predict that more Qatari banks will follow by issuing bond issues, Sukuk and other measures to raise additional funds in 2014. Qatari banks are not expected to rely heavily on international debt markets for their bond and Sukuk issues in 2014, but rather more by way of private placements to Qatari institutions, government-related entities or other institutional investors in Qatar and primarily for purposes of financing major infrastructure projects in Qatar and for managing their liquidity more effectively.

Strong government support such as the ban on Islamic windows in Qatar has had a positive impact for Qatari Islamic banks, who have made significant gains in their market share and have outpaced their conventional counterparts in terms of growth. Qatar's Islamic banks are estimated to hold a combined asset base of US\$54.4 billion and now represent 25% of Qatar's banking system in terms of assets and are expected to continue to gain market share and become the third-largest in the Gulf region.

The World Cup 2022-fueled infrastructure boom continues to drive growth in the Qatari banking sector. During the first half of 2013, it was estimated that a total of 35 mega contracts with a combined value of approximately US\$27.5 billion were awarded in Qatar.

It is no wonder that total assets for Qatar's banking industry increased at a compound annual rate of 30% in the last 10 years to total almost US\$225 billion. Public sector spending continues to rise to support the nation's growth, with bank lending set to grow around 20% by the end of 2014 (from the end of 2012) and the Qatari economy expected to grow by 6.5% in 2013.

"Sustainability" has therefore been a popular slogan over the past year as the government has taken steps to curb inflation and to avoid unsustainable debt levels. Under a recent government directive, public sector entities in Qatar will now be required to obtain approval from the Ministry of Finance prior to undertaking any borrowing activities.

The new government borrowing rule is expected to somewhat restrict lending in an environment where the public sector continues to be the largest borrower in the market. Nonetheless, certain analysts suggest that although Qatari lending will slow as a result of these measures, it will retain one of the fastest rates of loan growth in the Middle East.

It is likely that the foundations laid in Qatar this year will help to make 2014 a strong year for the Islamic banking sector. Islamic banks are well positioned to benefit from the growth in infrastructure spending and in the spin-off economic activity that is expected. (5)

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# Russia and Islamic finance: A brief 360-degree review

By Vladislav Zabrodin and Anna Leksashova

The Russian Federation is one of the largest and most diverse world markets due to a number of economical and geographical factors. As regards financing, it is true that financial instruments in Russia have been recently developed following the European pattern, but since 2010 market participants have been showing interest in other financial mechanisms. A volatile economic environment and the global financial crisis created a need to search for, implement and develop brand new financial instruments for the Russian market.

As a result, the dynamically expanding Islamic finance market has been gaining increasing attention from Russia and many other counties. Banking development originating from Shariah principles is of particular interest for Russian regions where Muslims form a majority of the population. This is rather logical because there is no need to integrate on the market a rather peculiar product embracing cultural and religious features. The application of Islamic financial instruments has caught the attention of the central part of Russia, in part due to the successful use of such instruments.

During the last year, Islamic finance in Russia has become more pronounced, although it is too soon to be saying that Shariah-based financial instruments are already fully implemented in the market. Let us recall the most notable events that took place in Russia and CIS in 2013.

#### 2013: A review

The largest and the most significant event for Islamic finance in Russia in 2013 was the Kazan Summit 2013 which is an important international economic event both for Russia and member countries of the Organization of Islamic Cooperation (OIC). The summit was established in 2009 and has been held under the patronage of the government of the Republic of Tatarstan since 2010. Kazan Summit 2013 aimed at improving and strengthening economic and trade relations between the Russian Federation and OIC countries.

This year the summit offered an open dialog regarding business trends, investment prospects and trade areas in Russia and OIC countries. This year's summit saw the establishment of an SPV for the Smart City Kazan project for the purpose of Sukuk issuance in the amount of US\$100-200 million. The charter capital of Eurasian Leasing Company was also increased to US\$10 million. The company is promoting a new leasing product – Ijarah – which is consistent with the requirements of both the Russian legislation and Shariah principles.

Another important event in the world of Islamic finance in the Russian Federation was the Moscow Halal Expo established to develop and support the Halal industry in Russia and to create a separate professional platform for demonstrating its opportunities both in Russia and worldwide.

Since 2010, the Moscow Halal Expo has become an annual event growing significantly each year, 2013 not being an exception. In addition to products consistent with Halal requirements and uniting everything that is permitted and good from the Islam point of view, the expo arranges seminars and forums presenting services of Islamic financial companies and instruments of Islamic financing.

It should be noted that according to the information provided by Moscow Halal Expo, the Halal industry and Halal services are currently at the stage of active development due to several factors: the growth of religious consciousness of Muslims in Russia, the growing desire of Muslims to respect the rules of Islam in all aspects of life, the growing interest toward companies manufacturing products under the Halal brand. The V Moscow Halal Expo 2014 will take place in June at the All-Russia Exhibition Center and is expected to unite more than 250 companies.

In addition to such big events as the Kazan Summit and Moscow Halal Expo, there are other events held in Russia of a smaller scale, but also important and dedicated to certain areas or services of Islamic financing.

Speaking about development of the Halal industry in Russia and financial mechanisms under Shariah norms, we should mention another important event held in December 2013 in Casablanca: the Russian-Moroccan Business Forum where over 40 Russian companies participated. This forum resulted in the signing of an agreement on bilateral cooperation in the sphere of development of the Halal industry between ASMEX and Russia Muftis Council.

Fast-growing interest in Islamic financial instruments in Russia has contributed to their dynamic development and active implementation on the Russian market.

At the end of November 2013, the International Bank of Azerbaijan announced a possibility of implementing Islamic financing instruments in Russia and the CIS. In particular, it was noted that there are great opportunities in Russia, Kazakhstan and Ukraine for implementing and developing Islamic banking and that is why the International Bank of Azerbaijan in cooperation with the Bank IBA-Moscow established a working team to implement instruments of Islamic financing in Russia. Serious intentions of the bank are supported by the Central Bank of the Russian Federation having given preliminary approval for such works.

To summarize, the future development of Islamic financial instruments in Russia appears to be not only possible, but advisable due to the long-term nature of the instruments on the one hand and Russia's need for long-term money on the other hand. (5)

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# Saudi Arabia: Potential in the non-oil sector, Zakat and Waqf

By Hylmun Izhar

The fact that Saudi Arabia (KSA) has become one of the most promising economies in recent years, particularly in the context of G-20, is not really unexpected. As suggested by the IMF in its country report No 13/229, KSA's real GDP grew at an average 6.25% per year over the last three years, with the non-oil sector growing at an even faster average rate of 7.75%. High oil process and increased oil production have resulted in an enormous increase in oil revenues and substantial external and fiscal surpluses, while government debt has declined to less than 4% of GDP. Inflation, however, has generally been fairly moderate.

#### 2013: A review

Despite such promising economic indicators aforementioned, a research on economic diversification conducted by the Saudibased Arab Petroleum Investment Corp (Apicorp) found that KSA has the least diversified economy in comparison to the sixnation GCC, with the UAE being the most diversified economy. The research analysis was based on three main categories the oil sector's contribution to GDP, its share of total exports and share of government fiscal revenue. Testing the hypothesis on the economic reliance on the oil sector, it shows that KSA still appears considerably to be dependent upon oil production, which signifies that other channels of economic operations have not been sufficiently utilized. It is argued that it would eventually affect the magnitude of economic progression in the years to come. As such, it is viewed that the penetration level of Islamic finance to other non-oil sectors might also be hindered although the potential of non-oil sectors cannot simply be taken lightly, especially from the economic regional perspective.

In this respect, Cashin, Mohaddes, and Raissi (2012) show in their GVAR model that there are sizeable positive spillover effects from non-oil activity in KSA. The model demonstrates that a 1% increase in Saudi non-oil GDP is estimated to increase GDP in its neighbor countries such as Jordan, Lebanon, Syria, and in other GCC countries by between 0.2-0.4%. This also shows an enormous potential in which Islamic finance can play its role in the non-oil sector, especially when taking into account its faster growth average as stated in the introduction. In spite of the fact that enthusiasm for Islamic banking within global banks has been somewhat less visible in recent years, a promising figure, however, still prevails in the Takaful sector. KSA by far has the most insurance operators, 34 cooperative insurance operators. than other countries and it still dominates global contributions which account for approximately 51% of the global contributions. Furthermore, KSA's cooperative insurance contributions were estimated to reach US\$6.35 billion in 2013 and forecast at around US\$7.15 billion in 2014. With regard to retail Islamic banking activities, the operations have been wound down in the Middle East, Bangladesh, the UK, the US, and beyond. This is largely a post global financial crisis effect and linked to concerns about profitability in a more cost sensitive environment.

#### 2014: A preview

Notwithstanding some facts and figure, in 2014 KSA may consider capitalizing the potential of three areas, namely Islamic

project finance, Islamic asset management, and Islamic social finance sector.

The Islamic project finance market for instance, has grown significantly over the past decade. Whilst the past couple of years have proven to be more challenging, there was renewed optimism in 2013 with an increased global need for infrastructure expenditures, especially in KSA. The demand for Islamic project finance, hence, is expected to grow.

KSA continues to lead the Islamic project financing market, with limited deal flow within the rest of the GCC and MENA region. There were also some notable achievements for the industry during 2013, including the largest ever Sukuk project of US\$2 billion for a Greenfield project and fully Shariah compliant financing of the Polysilioin Technology Company renewables project. There is no reason; therefore, for not capitalizing the momentum since it will attract not only conventional financiers, but it will definitely capture the attention of Islamic financiers. However, a set of effective legislative, regulatory, legal and Shariah compliant frameworks should further be established to nurture and optimize the potential of this sector.

Furthermore, it is viewed that since there is a dire need for more infrastructure development in KSA, there will certainly be opportunities for Islamic project finance. To put it simply, the potential demand is clearly vivid; on the condition that proper legislation, regulation, legal and Shariah frameworks can be further developed and enhanced. The other potential is on the segment of asset management. KSA is among the prominent sources of Shariah compliant investment products apart from Malaysia. KSA is currently hosting around US\$12 billion in Shariah compliant asset under management (AUM).

In KSA, Islamic funds captured a more impressive 50% share of total AUM, but this should be seen in the context of total savings. Managed AUM in private equity funds equals one-third of mutual fund AUM, or three times the ratio of global private equity AUM to global mutual fund AUM (11%). Finally, the sector which cannot be overlooked but has huge potential is the social finance sector comprising Zakat and Wagf. These are not only unique but have historically been vital entities of the Islamic economy and a critical means for the achievement of various socio-economic goals and objectives. Unfortunately in recent times Zakat and Waaf are seen as primitive, inefficient and have widely been perceived to have failed to deliver to their beneficiaries effectively. Indeed, there are a number of challenges pertaining to legal and regulatory in order to rehabilitate these institutions. Nevertheless, the immense potential that these institutions could bring about in terms of reach, diversity and inclusion may outweigh any efforts that may be required to bring these back to the mainstream.

#### Conclusion

In this regard, visionary policies and solid initiatives need to be set out to promote an institutionalization of these redistributive instruments so that the modernization and rehabilitation of Zakat and Waqf as formidable institutions of Islamic finance can be attained.

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### Growth of Islamic finance in Singapore

By Yeo Wico and Jeanne Ong

The past year bears testimony to the continued expansion of Islamic financing products and activities in Singapore. New market participants, together with familiar names, have contributed to an overall positive trend in Islamic finance in Singapore.

Amidst the market activity, the fourth World Islamic Banking Conference: Asia Summit was successfully convened in Singapore in June, with speakers and delegates from all over the world. In his speech at the conference, the deputy chairman of the Monetary Authority of Singapore (MAS) Lim Hng Kiang, announced that the MAS was conducting a review of the regulatory and tax treatment of Islamic finance instruments, an initiative which could further boost Singapore's attractiveness as a conducive environment for Islamic financial activity.

#### 2013: A review

**Sukuk:** In the Islamic capital markets space, corporate Sukuk programs and issuances emerged at a steady pace throughout the year.

In the second quarter of 2013, CIMB Bank arranged a SG\$500 million (US\$396.24 million) multicurrency Islamic trust certificates issuance program for Sabana Shari'ah Compliant Industrial REIT (Sabana REIT), which continues to be a flag-bearer for Islamic finance in Singapore. The property-based Wakalah structure for the Sukuk program developed from the structure adopted by Sabana REIT for its multiple-award winning SG\$80 million convertible Sukuk deal. issued a few months before.

The third quarter was ushered in by the establishment of a US\$500 million multicurrency Islamic trust certificates issuance program by Swiber Holdings, an offshore marine company listed on the Singapore Exchange. This program was based on the Shariah principle of Wakalah Bi Al-Istithmar. The inaugural issuance of SG\$150 million (US\$118.87 million) was fully subscribed (within a week of program establishment) by investors from Brunei, Singapore and Malaysia, and (according to media reports) achieved a more competitive pricing than conventional bonds. The concluding quarter of 2013 was rounded off by a similar Sukuk program established by Vallianz Holdings, an integrated offshore marine solutions provider listed on the Catalist board of the Singapore Exchange. Swiber is a substantial shareholder of Vallianz.

The vessel-based Wakalah structure for Vallianz's Sukuk program is a first for Sukuk issued out of the Singapore market, which has in the past typically witnessed the use of Shariah compliant real estate or shares. Equally interesting are the built-in options for certain series of Sukuk issued under the program to benefit from a Kafalah guarantee and/or certain security arrangements (including mortgages over the vessels forming part of the Wakalah venture). Credit enhancement features are unusual for sukuk but the options for guarantees and security under this program could provide flexibility to increase the attractiveness of Vallianz's Sukuk to potential investors on a deal-by-deal basis.

Maybank Kim Eng Securities (Maybank KE) was the sole lead arranger, bookrunner and global coordinator for both programs by Swiber and Vallianz. Maybank KE and Malayan Banking were the program dealers, and Maybank Islamic acted as the Shariah advisor for both programs.

**Equity-linked:** The Singapore market also witnessed a number of Sukuk and other Islamic-compliant instruments which are intended to offer investors an element of equity-linked exposure or which facilitate equity investments in the relevant companies.

In October 2013, CIMB Bank, Deutsche Bank and Standard Chartered Bank acted as joint lead managers in the issuance of SG\$600 million (US\$475.49 million) exchangeable trust certificates for which Khazanah Nasional is the obligor. The trust certificates are exchangeable into the shares of IHH Healthcare, an international premium healthcare services provider dual-listed on both the Malaysian and Singapore stock exchanges. The sizable issuance is notable for being Khazanah's first equity-linked Sukuk in Singapore dollars, and also the first Sukuk in Singapore to offer exposure to the healthcare industry.

In December 2013, Ley Choon Group Holdings, an underground utilities infrastructure service provider listed on the Singapore Exchange, announced that it had entered into a non-legally binding term sheet with the Islamic Bank of Asia (IB Asia) for the proposed issue of convertible instruments worth approximately SG\$15 million (US\$11.88 million), structured under the Shariah principle of Murabahah and convertible into shares of the company. IB Asia is a joint venture partnership between DBS Bank (one of the largest financial services groups in Asia) and prominent investors based in the GCC. The completion of the transaction is subject to conditions, including shareholders' approval, but is expected to be one of the first Islamic private investment in public equity deals done in Singapore.

**Broadening:** The use of Islamic finance by corporates and individuals alike was broadened in 2013.

In May 2013, Atlantic Navigation Holdings (Singapore), a company listed on the Singapore Exchange, announced that Maybank Singapore had extended a commodity Murabahah acquisition financing facility to one of its subsidiaries. The facility was structured specifically for the acquisition of vessels which will then be used to secure the financing, and is understood to be one of the first of its kind in Singapore. Earlier in the year, Maybank Singapore also launched two new Shariah compliant products for Islamic home financing and Islamic commercial and industrial property financing, specifically for Singapore buyers to finance the purchase of properties in Malaysia.

#### 2014: A preview

The pipeline of deals and transactions is expected to continue into 2014. Specifically, the recent development of Islamic financing structures and instruments offering equity-linked exposure or facilitating equity-type investments will continue to add to the width and depth of the Singapore market as it gains momentum.

#### Conclusion

The wide-ranging developments in the Islamic finance space in Singapore in 2013 are indicative of a growing Islamic finance market in Singapore, and the momentum generated in 2013 is expected to continue into 2014.

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## Turkey: A rising star

By Atila Yanpar

Having historically been a low-key player in Islamic finance, Turkey has become the rising star in recent years. As Turkey sets itself apart from other countries competing to become a hub for Islamic finance, its strong economic growth record and political stability as well as the presence of established Islamic banking and a Muslim-majority population have caught the eye of investors who see Turkey as the next big thing for Islamic financial opportunities. On the other hand, despite finding a significant place in the foreign press, Islamic finance has not yet brought about a significant change to the financial structure of the Turkish economy.

#### 2013: A review

Promoting Islamic finance in Turkey – the world's 17<sup>th</sup> largest economy with a predominantly Muslim population of 76 million – has always been part of the Turkish government's plans to boost commercial ties with the Gulf and diversify the country's investor base. In the last five years the current government's progress in moving Islamic finance in Turkey forward has been impressive. As a result, it could be said that 2013 was the start of structural changes in the Turkish Islamic finance industry.

The first and most surprising event of 2013 was the government's announcement that state-run banks, Ziraat Bank and Halkbank, would establish two participation banks and enter the market. As of now, four banks are operating in the participation banking landscape: Bank Asya, Türkiye Finans, Albaraka Türk and Kuveyt Türk. They constitute 5.3% of the Turkish banking industry. The government's aim is to triple the share of Islamic banking assets in Turkey by 2023 (100th anniversary of the republic) with the help of state-owned participation banks.

The most significant event of 2013 was the opening of the World Bank's first Islamic finance center in Istanbul. As the financial capitals of the world race to lead the Islamic finance sector, it is still unclear exactly which country will dominate the fast-growing sector, currently valued at around US\$1.6 trillion. Turkey secured its place in the race when it received the support of the World Bank.

Without doubt Sukuk is the most attractive area of the Islamic finance industry for foreign investors in Turkey. The Turkish government continued to issue sovereign lease certificates, as Sukuk is known colloquially, which were first issued in September 2012. Meanwhile, following the Capital Market Law, the Capital Markets Board of Turkey (a dominating institution of the Islamic finance industry in Turkey) prepared new regulation on lease certificates. Besides introducing new Sukuk types in Turkish legislation, the new regulation has some new features such as broadened asset types. With new legislation, Sukuk issuances in the private sector in Turkey will become more feasible.

#### 2014: A preview

With the announcement of the new participation banks, the target set for participation banks to double their share of the total banking sector to as much as 15% by 2023 from the current 5.1% now seems more feasible. The establishment of new state-owned participation banks will be the most important development in the market. As 38% of non-participation bank consumers would



consider using a participation bank, a dominant factor for the future of Islamic finance in Turkey would be the marketing and growth strategies of these new banks.

As there is still a significant need to educate Turkish consumers – over 80% of non-participation finance customers and 40% of participation finance customers said they had little to no understanding of Islamic finance concepts – it will come as no surprise if there is a nationwide education initiative.

#### Conclusion

Turkey has undergone profound economic transformation since 2001. It has recorded a remarkable GDP growth rate of almost 6% in average during the 2002-11 period. Thus, per capita income has increased from the modest figure of US\$3,500 recorded in 2002 to US\$10,500 in 2011. Today, Turkey is the 17th largest economy in the world with a GDP of about US\$800 billion in 2012.

Now, Turkey is facing a new challenge. Due to the global crisis, the majority of the emerging markets suffered a significant slowdown in economic activity. Being an open and free market economy, integrated into the global economic and financial system, Turkey was no exception. Turkey was also adversely affected by the declining external demand and falling international capital flows which it needs to sustain economic growth. The effects of the financial crisis caused Turkish policymakers to seek new methods of financing including Shariah compliant financial instruments.

It seems that with the beginnings of structural changes in 2013, we will witness in 2014 the rise of Turkey as the intellectual capital of the Islamic financial world, supported by new Shariah compliant banks and new companies in the sub-financial sectors like Takaful, asset management and Islamic funds. (5)

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# Dubai steps up, lifting the UAE in the eyes of the industry

By Rima Mrad

The Islamic economy witnessed a substantial growth in the last few years and has emerged as a strong alternative financial model in the UAE finance industry. Last year witnessed a number of accomplishments and developments in the Islamic finance industry that are visible and promising.

#### 2013: A review

A quick look at the financial performance of Islamic players in the UAE, as reported at the end of 2013, will show that despite all the attention given to the development of a sustainable Islamic economy, the numbers are still below expectations.

We note that the Islamic finance industry is still facing several material challenges on different aspects. The main obstacles reported are relating to the following:

- Limited Islamic products and services that are not competitive:
- No clear awareness highlighting the differences between these products from the conventional ones;
- · Lack of qualified human resources; and
- · Weaknesses in the regulatory and legal framework.

The above has been highlighted in numerous reports relating to the assessment of the conditions under which the Islamic economy is operating in the UAE.

Since mid 2013 the government of Dubai started actively looking at ways to improve the performance of Shariah compliant firms, and the steps they need to take to improve their position among the Islamic capitals.

Sheikh Mohammed Rashid Al Maktoum, the ruler of Dubai, announced at the end of 2013 the set up of the Dubai Islamic Economy Development Center. Dubai government further announced their plan to create a global hub for Islamic economy.

This is the first time a commitment from a GCC government has taken effect and will set the steps for Dubai to enhance the operational and legal conditions relating to the Islamic finance industry within the emirate.

#### 2014: A preview

These announcements will without a doubt pave the way for the progress of a competitive and reliable Islamic economy in Dubai and the rest of the UAE in 2014. We are expecting a number of regulatory and legal changes that will affect the framework for the set up and operations of Shariah compliant entities. Those changes are expected to include:

- New structures to introduce innovative and diverse Islamic financial products; and
- Prudential regulations for Takaful, including capital adequacy calculation, technical provisions, solvency margins and investments parameters.

In addition, the introduction of new regulations for the Halal industry is expected this year. Halal is an Arabic word that means 'lawful under Islamic Shariah'.

Reviews are being carried out on special policies highlighting standards and parameters to define Halal products. In this context, there is news relating to a project that has not yet been officially announced, on the possible inauguration of a new Halal City, which will be built next to Jebel Ali Free Zone. This city will be able to service the region from Dubai, by offering a platform for Islamic industries and traders.

Another initiative is being assessed by a number of private local Islamic financial institutions on the establishment of an arbitration center, dedicated to govern disputes relating to Islamic finance and Islamic Shariah transactions. Although still in the early stages, if materialized it will provide an alternative dispute resolution forum that can attract international attention from leading Islamic institutions.

This year will also witness the launch of an international accreditation center for Halal food in Dubai, under the supervision of Dubai Municipality. This will enhance Dubai's expected role in servicing the world as an authorized center to issue Halal food compliance certificate and accredit Halal conformity for other products such as medicine, leather and cosmetics.

#### Conclusion

The steps taken so far are not expected to reflect on the financial performance of Islamic players in the UAE anytime soon, however they will give additional comfort for investors and stakeholders in the eventual progress and profitability of this industry in the coming years

Apart from the initiatives of the government of Dubai, the Islamic finance market still lacks material investments from private investors that are essential to the growth of this sector. This is mainly relating to the long-term expected return on Islamic products and the legal and regulatory uncertainties that Islamic firms usually face during their operations.

There are high hopes that this year will observe the launch of a number of positive changes to encourage investors and customers to consider Islamic products as a profitable and consistent alternative.

We have started to see a growing interest by a number of existing conventional players in the UAE and in other neighboring countries, in assessing the value of entering this industry. The interest will be evident if supported by serious efforts from regulators and other stakeholders to improve awareness, and to foster the trust in the financial position of Islamic firms. (3)

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# UK: Stepping up its game

By Mohammed Amin

2013 was the year that the shadows of the global financial crisis began to lift, both in the UK generally and also in the UK Islamic finance industry.

The crisis which began in fall 2008 led to several planned establishments of Islamic banks in the UK being cancelled or put on hold. Although the problems of dealing with the crisis were never cited as a reason for not proceeding with a UK government Sukuk, they have seriously curtailed the amount of attention that the government could give to the Islamic finance industry given the industry's relatively tiny size in the UK as compared to the conventional finance industry.

In 2013 economic conditions in the UK began to improve noticeably, especially in the latter part of the year. That has led to greater business confidence generally. Islamic finance got a particular boost in visibility in October 2013 when the UK became the first country outside the OIC to host the World Islamic Economic Forum (WIEF).

#### 2013: A review

Key statistics from the financial performance of Islamic banks in the UK for the 12 months ending the 31<sup>st</sup> December 2012 are summarized on table 1.

Five of these six banks were in operation before the global financial crisis. Newcomer ADIB (UK) is a wholly-owned subsidiary of Abu Dhabi Islamic Bank of Abu Dhabi and only started operations in April 2012. Therefore it was in start-up phase in the period covered by the accounts. Like IBB it is a retail bank, while the others are wholesale banks.

The results illustrate the difficulty in making profits in the UK Islamic finance market. Even the most profitable bank in terms of return on equity, Gatehouse, achieved only a 2.04% profit growth which is unacceptably low from any shareholder's perspective. There are several factors which contributed to the poor results above:

- ADIB was in a start-up phase, when costs tend to arise before revenues;
- The UK retail Islamic finance market is relatively small. IBB has been focusing on this market since its inception, yet it is still making losses of this scale every year of its operations. HSBC's decision announced in late 2012 to exit this market looks entirely rational;
- The Bank of England, like the European Central Bank and the Federal Reserve System, is keeping interest rates very low for economic reasons. This interest rate environment makes it much harder for banks to be profitable. While Islamic banks do not offer interest-bearing loans, their finance pricing depends on market interest rates;
- Even the largest of the Islamic banks, BLME, is tiny compared to mainstream UK retail or wholesale banks. Many of the overhead costs that banks face, such as having appropriate accounting systems and regulatory controls, bear disproportionately heavier on small banks which have less business to spread them over.

The highlight of the year was the following announcement by prime minister David Cameron in his speech at the opening of the WIEF in London:

Table 1					
Name	Shareholders' equity GBP million	Total assets GBP million	Profit (loss) before tax GBP million		
ADIB (UK)	7.5	68	(2.5)		
Bank of London and The Middle East (BLME)	239.6	1,038.9	3.8		
European Islamic Investment Bank (EIIB)	128.9	171.9	(11)		
Gatehouse Bank	117.4	205.2	2.4		
Islamic Bank of Britain (IBB)	20	261.1	(6.9)		
QIB (UK)	13.9	168.6	(3.4)		

"This government wants Britain to become the first sovereign outside the Islamic world to issue an Islamic bond. So the Treasury is working on the practicalities of issuing a bond-like Sukuk worth around GBP200 million (US\$330.61 million) and we very much welcome the involvement of industry in developing this initiative which we hope to launch as early as next year."

A few weeks earlier the prime minister hosted his annual Eid reception at 10 Downing Street and announced that the government planned to introduce Shariah compliant student financing and start-up financing packages to ensure that these schemes could be taken up by Muslims without religious impediments.

#### 2014: A preview

The key development to expect in 2014 is for the UK sovereign Sukuk issue to take place. The GBP200 million size appears to have been set at a level where the government can be confident that demand from domestic UK Islamic banks will be sufficient to absorb the entire issue, so that is seen to be a success.

#### Conclusion

I believe people will look back at 2013 as the year when the UK Islamic finance industry finally recovered from the global financial crisis. The prime minister's Sukuk announcement has been a significant boost to practitioners' morale and should ensure that the UK maintains its Islamic finance lead over all other non-OIC countries.

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# US: Halal investing, gaining currency

By Joshua Brockwell

Islamic finance in the US is growing organically, albeit slowly. From its early history in the 1980s responding to immigrant Muslim demand for religiously acceptable investments and mortgages to today's interaction with the socially responsible investor class, Islamic finance has shown itself capable of adapting to meet changing needs.

To date, however, development has been uneven. The Islamic banking sector is constrained by asset ownership restrictions on banks and imperfect alternatives to interaction with the US Federal Reserve, a central bank organized according to the Islamically frowned-upon principles of fractional reserve banking and interest-based lending. Other sectors, like Halal mutual funds, enjoy popularity among a subset of investors.

Overall, the US still lags behind East Asia, GCC nations, and much of Europe in terms of its relationship with Islamic finance. It is, at its core, is a market still waiting to be fully tapped.

#### 2013: A review

If Islamic finance is a vast ocean, then 2013 was the year that the US began to wade into deeper waters. From strength in the Shariah compliant mortgage finance industry to the methodical growth of Islamic mutual funds, the year's achievements created what many hope will be enduring momentum.

Certainly, the Islamic mortgage industry continued to enjoy relative success in 2013, maintaining its upward trajectory in the wake of the Great Recession.

The second-largest provider of home-loan financing, Freddie Mac, maintained its support of Islamic home financing products for Muslim borrowers, despite calls to dismantle the government-sponsored enterprise by those who accuse it of precipitating the sub-prime mortgage crisis of 2007-08. Thanks to a combination of new and old players, Shariah compliant mortgage companies stayed the course in 2013.

The Islamic asset management space hit several important milestones during the year. One notable highlight: The Azzad Wise Capital Fund, US's first Islamic fixed-income mutual fund investing in Sukuk and Islamic bank deposits, marked its three-year anniversary in April.

Azzad Asset Management, investment advisor to the Azzad Wise Capital Fund as well as its equity counterpart, the Azzad Ethical Fund, pushed the mainstream acceptance of Islamic finance further in 2013 by adding institutional money manager Kayne Anderson Rudnick to its wealth management platform, the Azzad Ethical Wrap Program.

With its wrap fee program, Azzad has pioneered a unique, collaborative effort with conventional investment firms like Kayne, combining Islamic and ethical screens with the strategy-specific expertise of participating portfolio managers.

These conventional managers risk their own track records by implementing Azzad's Halal screens. Attesting to the positive contribution that Islamic investing can bring to traditional finance, participants in the Azzad Ethical Wrap Program have discovered

that they can, at times, enhance their track records during certain market conditions using Islamic criteria.

The year 2013 culminated in the inaugural Islamic Finance Conference held in November in Washington, DC. The conference, whose agenda included sessions exploring everything from how to source Islamic capital in the US to the relationship between socially responsible investing and Islam, was organized by the Malaysia-US Chamber of Commerce and sponsored by Islamic Finance *news*. It was intended to serve as a meeting place for interested parties to come together and advance the cause of Islamic finance in the US. In many respects, the conference did just that, in addition to showing the resilience of Islamic finance in a post-9/11 America.

#### 2014: A preview

The coming year 2014 could be witness to several noteworthy advances. Seeds planted at the Islamic Finance Conference could bear fruit as US-based Islamic financial firms look to facilitate access to Malaysian financial products and services. In addition, the increasing popularity of socially responsible investing (SRI) and the SRI community's recognition of Islamic finance as a new and untapped source of social good bode well for the ethical investing space — both Islamic and otherwise.

The 25<sup>th</sup> annual SRI Conference in October 2014 could be the moment when Islamic finance takes center stage as special events aimed at promoting Islamic finance and Halal investing are planned in conjunction with this event.

#### Conclusion

As awareness of the specific advantages of Islamic finance spreads in the coming years, it is reasonable to assume a greater adoption of Islamic financial products and services in the US. In the asset management space, this presumes that the products and services in question remain faithful to the notion of Halal investing, a concept that is gaining currency in the US market.

Indeed, if one were to identify the single most important determinant of the success of Islamic finance in the US, it would most likely be an acceptance of the "why" of Islamic finance — why it should matter to a values-conscious investor, why it serves as an ethical alternative, and why it is unique. The internalization and connection to this simple idea matters perhaps more than anything else.

The development of the Islamic investor demographic into one that appreciates the proposition of Halal investing and proactively selects the Islamic alternative in a marketplace of seemingly endless choices is not a pipe dream. In some quarters it has already happened.

This, combined with seven million American Muslims representing an estimated US\$200 billion in spending power and a trajectory aimed at deeper market penetration, should give investors grounds for cautious optimism about the prospects for Islamic finance in the US.

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Category	WINNER	RUNNER-UP
Best Overall Islamic Bank	Abu Dhabi Islamic Bank	CIMB Islamic
Best Central Bank in Promoting Islamic Finance	Government of Dubai	Bank Negara Malaysia
Best Islamic Leasing Provider	Gulf International Bank	Lanka ORIX Finance - Al- Falaah, Islamic Business Unit
Best Islamic Private Bank	Standard Chartered Saadiq	Al Rajhi Banking & Investment Corporation
Best Islamic Retail Bank	Al Rajhi Banking & Investment Corporation	Abu Dhabi Islamic Bank
Most Innovative Islamic Retail Bank	Abu Dhabi Islamic Bank	CIMB Islamic
Best Islamic Trustee/Custodian	Deutsche Bank	AmanahRaya Trustees
Best Private Equity House	Abraaj Group	Fajr Capital

The results are in and, perhaps unsurprisingly given the attention and encouragement the country has given to Islamic finance over the last year, UAE institutions have surged ahead to claim some of the top awards in the contest. However, the impressive array of categories and countries and the number of nominees in each closely fought contest demonstrates unequivocally the exceptional growth that the industry has enjoyed over the previous year: with a strong theme of cross-border and international activity.

Covering all major and emerging Islamic finance markets across 38 categories, the IFN Best Banks Poll received an overwhelming response from industry players across the globe: including new and emerging markets such as Australia, Syria, the UK, Lebanon, Iran and Kenya as well as the more established jurisdictions of the GCC and Southeast Asia. This year saw a record number of 13,480 votes (over 1,000 more than in 2012) and after a comprehensive process of due diligence 11,117 of these went towards the final results.

And these results, while perhaps not throwing up any major surprises, clearly reaffirm not only the reassuringly consistent growth of the industry despite the global economic challenges faced by the wider financial industry; but also highlight key themes of cross-border expansion, global reach and international cooperation and collaboration that provide hope and promise for 2014.

This year we received 264 nominations, over 100 more than in 2012. Six of the top eight general categories had nominees well into the double digits, while out of 30 country awards none had fewer nominees than three and the majority saw between five and 10 banks competing for the award.

One of the biggest winners of the year was Abu Dhabi Islamic Bank (ADIB), which came out top in a hard-fought contest with CIMB Islamic to achieve Best Overall Islamic Bank to build on its previous win. ADIB also came a close second in the category of Best Islamic Retail Bank, which it also won in 2012, but was pipped at the post by Saudi Arabia's Al Rajhi Bank.

However, the bank came top for Most Innovative Islamic Retail Bank (beating last year's winner Bank Muamalat Indonesia as well as runner-up CIMB Islamic) as well as taking home the prize for Best Islamic Bank in the UAE (in a close contest with Dubai Islamic Bank) and Best Islamic Bank in Egypt (edging out Al Baraka Bank Egypt).

The bank has posted an impressive performance in 2013 with total income of US\$912.7 million and profit of US\$301.3 million for the first three quarters. With a focus on international expansion including core targets of Iraq and the UK, 2014 looks set to be another exciting year for one of the brightest stars in the Middle Eastern Islamic finance firmament.

#### IFN AWARDS BEST BANKS POLL

A close competitor to ADIB and fighting a tight battle to come runner-up in two of the top categories of Best Overall Islamic Bank and Most Innovative Islamic Bank, CIMB Islamic also cemented a stellar performance in 2013.

While its position as one of Malaysia's leading Islamic groups is longstanding, the group has extended its reach and established its position across the key markets of Southeast Asia to cement its position as one of the region's powerhouses in terms of both retail and institutional banking, with a particular nod to its sterling asset management performance.

Demonstrating its unrivalled strength in the ASEAN region, CIMB Islamic in 2013 scored the full hat-trick: not only reclaiming the award for Best Islamic Bank in Malaysia from 2012 winner Bank Islam Malaysia but achieving Best Islamic Bank in Singapore and Best Islamic Bank in Thailand; as well as coming a close second to Bank Muamalat Indonesia for Best Islamic Bank in Indonesia.

The Singapore win is of particular interest, with CIMB Islamic winning out over the incumbent Islamic Bank of Asia (IBA), who have won the award every year since inception: demonstrating CIMB's capital market influence as well as its strong entry into the Singaporean retail market.

The group identified Indonesia and Singapore as focus markets as long ago as 2010 and efforts to establish these markets have clearly been successful: with profit before tax from its Indonesian operations increasing by 24% in the first nine months of 2013 and total profit contribution from Singapore growing by 28% to RM160 million (US\$48.67 million).

Also showcasing the strength and success that a strong global footprint can bring, the Bahrain-based Al Baraka Bank is another institution that flexed its international muscles in 2013. Renowned for its extensive geographical presence, the group has subsidiary banking units and offices in 15 countries with over 450 branches.

As of September 2013 the group held assets of US\$19.89 billion, with total income of US\$206.21 million and net profits of US\$57.21 million. This year Al Baraka took home Best Islamic Bank in Bahrain, Best Islamic Bank in Lebanon and Best Islamic Bank in Sudan (all of which it won in 2012). Its subsidiaries also came runner-up for Best Islamic Bank in Egypt, Pakistan, Syria and Turkey.

The Bahrain win was a particularly interesting achievement, given that despite technically being a Bahrain bank Al Baraka positions itself as a global Islamic banking group. This highlights another theme this year: of local banks losing votes to 'outsiders' or foreign banks.

While Al Baraka won in Lebanon and Sudan, Egypt was taken by UAE-based ADIB and Malaysia's CIMB Islamic won Singapore over the local IBA as well as taking the Thailand award from leading domestic player and last year's winner, the Islamic Bank of Thailand.

In one of the sturdiest strongholds of Islamic finance however, Saudi Arabia, the domestic banks still retain their dominance. Al Rajhi Bank, one of the largest Shariah compliant banks in the world with assets of US\$71.2 billion, this year took home not only the award for Best Islamic Bank in Saudi Arabia (winning out over another domestic giant, National Commercial Bank, to build on its 2012 success) but also won the category of Best Islamic Retail Bank in one of the hardest-fought battles of the year with the most nominees of the entire poll.

Another tight fight came in the category of Best Islamic Private Bank, in which Al Rajhi came runner-up. However, Standard Chartered Saadiq eventually beat out the other 14 competitors, including last year's winner National Development Bank (now ADIB Egypt) to take home the prize.

Best Islamic Leasing Provider saw a win for Bahrain-based Gulf International Bank (GIB), with the runner-up being Al-Falaah, the Islamic unit of Lanka ORIX Finance.

Deutsche Bank won out over Malaysia's AmanahRaya Trustees to take home the title of Best Islamic Trustee/Custodian for the fourth consecutive year, based on its commitment to delivering world-class solutions to its impressive array of global clients. As one of the most experienced specialists in the administration of financial instruments, the bank's trust and securities services can be relied upon to provide support, leadership and excellence.

In the category of Best Islamic Private Equity House, the UAE once again comes to the fore with Dubai-based Abraaj Group taking the crown, closely followed by runner-up Fajr Capital (also based in Dubai), superseding last year's winner Qatar First Bank. Abraaj Group has taken full advantage of Dubai's focus on building its Islamic economy to deliver a sterling performance over the past year. The group has developed its own unique approach over the last decade, and is now known as one of the leading private equity houses both in the Middle East and globally. With a focus on growth markets, Abraaj should be applauded as a pioneer, leading the way where others only follow and combining deep experience with innovation and adventure.

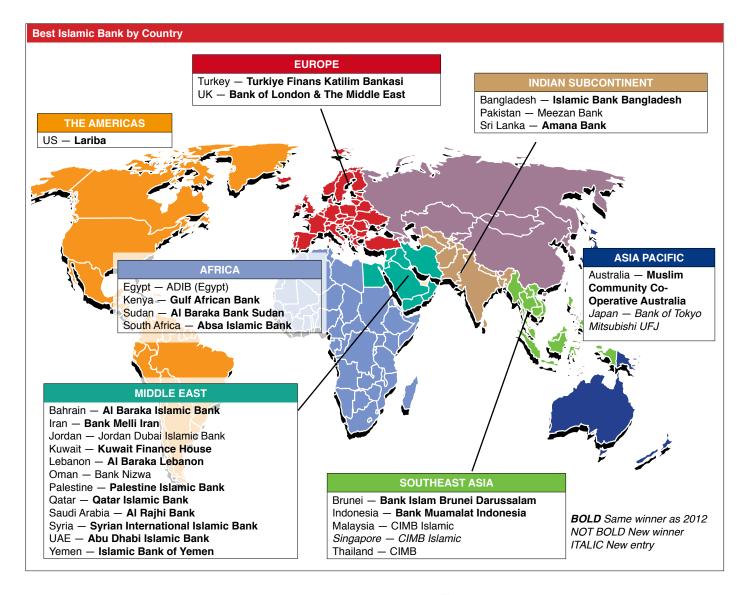
Its network of 25 offices over six regions gives it the strength and capacity to provide both a local and global approach, and its most recent win highlights the potential the group holds for the next generation of Islamic equity investment.

We finish with one of the biggest awards of the poll: and one of the most influential. It will come as no surprise to our readers that following a year of extraordinary progress, impressive goals and exceptional dedication to the industry, the government of Dubai takes the title of Best Central Bank in Promoting Islamic Finance (beating last year's winner Bank Indonesia as well as runner-up Bank Negara Malaysia).

In 2013 the emirate confirmed its ambition to become a major player in the market but, unlike many new entrants, its authorities have placed their money firmly where their mouth is: making real strides forward and taking material action to actively develop the Islamic economy: starting with the launch of the Dubai Center for Islamic Banking and Finance in July 2013 and continuing with the proposal for a center for Islamic corporate governance to be set up in 2014.

And not only has Dubai's commitment to the industry made an impact within the Muslim world. Its highly publicized action plan has also had an undeniable effect on other markets around the world who have been toying with the idea: and subsequent to the January announcement of its intention to promote Dubai as an Islamic finance center both the UK and Hong Kong also took the plunge.

The government of Dubai must therefore be congratulated not only for its own admirable efforts, but also for its invaluable role as a catalyst stimulating wider global participation.



# Country winner

### AUSTRALIA: Muslim Community Cooperative Australia (MCCA)

#### Runner-up: KFH Australia

MCCA has been in business since 1989. Twenty five 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**

#### Runner-up: Bahrain Islamic Bank

Incorporated in Bahrain 30 years ago in 1984, Al Baraka Islamic Bank has pioneered the development of Islamic banking in the kingdom. Rated 'BBB-' by S&P, it 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.

#### BANGLADESH: Islami Bank Bangladesh

#### Runner-up: Al Arafah Islamic Bank

Islami Bank Bangladesh, launched in 1983, is a pioneer of Islamic banking in Bangladesh. It has 37% local ownership and 63% foreign shareholders including the IDB, JPMorgan, Dubai Islamic Bank and Kuwait Finance House. The firm is the largest private banking network in Bangladesh with 285 branches and over 11,000 staff. The bank claims to be the first Shariah-based bank in South Asia, and operates both consumer, corporate, investment management and international divisions. As of the 31st December 2012 the bank had US\$526.34 million in equity. In the first three quarters of 2013 the bank saw net profit before tax of US\$87.2 million, down 37% from US\$137.4 million in the same period the previous year but a continued recovery from the US\$17.3 million low the bank saw in 2011; and currently holds total assets of US\$6.59 billion.

#### **BRUNEI: Bank Islam Brunei Darussalam**

#### Runner-up: Maybank

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.

#### EGYPT: Abu Dhabi Islamic Bank (Egypt)

#### Runner-up: Al Baraka Islamic Bank Egypt

Founded in 1980 as the National Bank for Development, Abu Dhabi Islamic Bank (Egypt) is one of the largest Islamic banks in the region with 19 subsidiaries operating across Egypt and the UAE. Based in Cairo, the bank has a nationwide network across Egypt of 69 branches, 39 microfinance units and 67 ATMs across 21 governorates.

In 2007 Abu Dhabi Islamic Bank acquired 49% of the National Bank for Development (NBD), which it subsequently restructured to comply with Shariah.

Since 2007 the bank's paid-up capital has increased seven-fold from around US\$40.1 million to over US\$286 million by the end of 2010.

In April 2013 the bank was rebranded from NBD to Abu Dhabi Islamic Bank (Egypt) As of September 2013 the bank held US\$2.18 billion in assets, up from US\$2.01 billion in 2012.

The bank has built an exceptional foundation based on its strength in multiple core markets across personal banking, microfinance, wholesale banking and treasury, and remains one of the leading lights of the North African Islamic finance industry.

#### INDONESIA: Bank Muamalat Indonesia (BMI)

#### Runner-up: CIMB Niaga Syariah

Bank Muamalat Indonesia was founded in 1991, endorsed by the Indonesian government, and was the first institution to offer Islamic banking in the country. The bank has continued to play an innovative and groundbreaking role in the industry, with over 400 branches across 33 provinces as well as over 3,800 online post office outlets offering wide-ranging access to financial services for all segments of society. Shareholders include the IDB, Boubyan Bank Kuwait, and SEDCO Group. The bank holds an 'AA Shariah Quality Rating' from IIRA Bahrain and Fitch Ratings affirmed a rating of 'A (idn)' in 2010. In 2009 BMI launched its first branch in Kuala Lumpur, becoming the first foreign Islamic bank to open a branch under Malaysia's International Islamic Banking (IIB) license.

#### JAPAN: Bank of Tokyo Mitsubishi UFJ

#### Runner-up: Sumitomo-Mitsui Banking Corporation

This was a new category for this year, looking at the best Japanese bank offering Islamic services rather than at the best Islamic bank in Japan. The 2013 winner, Bank of Tokyo Mitsubishi UFJ, was the runaway winner in a field of four. The bank is the largest in Japan and serves as the core retail and banking arm of the Mitsubishi UFJ Financial Group. The bank has focused on building up its foreign operations, and saw overseas corporate lending increase by 40% in 2011 alone.

Bank of Tokyo Mitsubishi UFJ Malaysia was the first Japanese bank to offer Islamic services, entering the industry in 2008 with its International Currency Business Unit aiming to attract Japanese business transactions to Malaysia. The bank is active in the Islamic capital markets, including a recent syndicated Istisnah and Ijarah financing to a major producer of LNG vessels based in Brunei, and is the first Japanese bank to have an inhouse Shariah committee.

#### IRAN: Bank Melli Iran

#### Runner-up: Bank Al Jazira (Jeddah)

Bank Melli Iran currently has assets worth US\$67.14 billion, ranking it among 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 87-year old bank has over 3,300 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 Dubai Islamic Bank**

#### Runner-up: Jordan Islamic Bank

Jordan Dubai Islamic Bank is a subsidiary of Dubai Islamic Bank, one of the largest Shariah compliant banks in the UAE. Islamic banks hold over 12% of the total Jordanian banking sector and Jordan Dubai Islamic Bank is a key player, opening its 15<sup>th</sup> branch in August 2013. The bank was established in 2010 and has grown rapidly and offers a variety of predominantly retail services to cater to the growing domestic demand: including personal Murabahah finance, Ijarah home finance, savings accounts and online banking. In 2012 the bank's total assets grew by 35.6% to reach US\$3.1 million, with a promising future of sustainable profitability and an impressive capital adequacy ratio of 43%.

#### **KUWAIT: Kuwait Finance House**

#### Runner-up: Bank Boubyan

Kuwait Finance House was 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 Australia, Bahrain and Malaysia. 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. In 2012 the bank held US\$51.9 billion in total assets and saw revenues of US\$3.29 billion.

#### **KENYA: Gulf African Bank**

#### **Runner-up: First Community Bank**

Gulf African Bank is the first and largest Shariah compliant bank in Kenya, and one of the fastest-growing banks in the country. Launched in 2006 and starting operations in 2008 under the country's first full commercial banking license for an Islamic bank, the bank has total assets of over US\$112 million and as of 2012 held shareholder's funds of US\$31 million. The bank has future plans to expand into Uganda and Tanzania. Asad Ahmed, CEO of Gulf African Bank in Kenya is optimistic on the bank's future, 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."

#### LEBANON: Al Baraka Lebanon

#### Runner-up: Arab Finance House

Al Baraka Bank Lebanon 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. As of September 2013 the bank held total assets of US\$19.88 billion and total net income of US\$57.2 million.

#### SAUDI ARABIA: Al Rajhi Bank

#### **Runner-up: National Commercial 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.

#### **MALAYSIA: CIMB Islamic**

#### Runner-up: Bank Muamalat Malaysia

CIMB Group is Malaysia's second-largest banking group, and CIMB Islamic is one of the most influential Islamic institutions in the Southeast Asian region. A full service Islamic financial solutions provider, the bank offers investment banking, consumer banking and asset management services catering to financial institutions, governments, corporations and individuals, and has cemented its position as an industry leader and global presence.

#### **OMAN: Bank Nizwa**

#### Runner-up: Bank Muscat

Bank Nizwa is Oman's first dedicated Islamic bank and has demonstrated an exceptional growth story since its launch in January 2013. The bank provides a full range of banking solutions to individuals, small and medium size enterprises, corporations and government institutions. It currently operates three branches with an extensive expansion program planned for 2014 as well as a significant investment in technology. As of the first half of 2013 total assets reached US\$440.2 million, an impressive achievement in just six months.

#### **QATAR: Qatar Islamic Bank (QIB)**

#### Runner-up: Barwa 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 Islamic 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 30 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.

#### **PAKISTAN: Meezan Bank**

#### Runner-up: Al Baraka Islamic Bank

In one of the most strongly contested categories of the awards, Meezan Bank wrestled the top Pakistani position from 2012 winners Al Baraka Islamic Bank Pakistan. The bank was launched in 2002 and is the first and largest Islamic commercial bank in Pakistan, celebrating its 10-year anniversary in 2012. Key shareholders include the IDB and Kuwait's Noor Financial Investment Co. It operates a branch network of over 300 across 99 cities. As of the third quarter of 2013 the bank held total assets of US\$2.9 billion and saw deposits increase by 16% and net profit grow by 8%.

#### **PALESTINE: Palestine Islamic Bank**

#### Runner-up: Arab 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. In 2012, 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 15 branches across the country.

#### **SINGAPORE: CIMB Islamic**

Runner-up: Islamic Bank of Asia

(See Malaysia)

#### IFN AWARDS BEST BANKS POLL

#### **South Africa: Absa Islamic Bank**

#### Runner-up: Al Baraka Bank

Absa Group, listed on the JSE, is one of South Africa's largest financial services groups. Absa is a subsidiary of Barclays Bank, which owns 55.5%. The bank offers 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 the 31st December 2012, the group had assets of US\$75.98 billion, 10.9 million customers and over 33,000 employees.

#### SRI LANKA: Amana Bank

### Runner-up: Lanka ORIX Finance — Al-Falaah, Islamic Business Unit

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.

#### SUDAN: Al Baraka Bank Sudan

#### Runner-up: Al Salam Bank

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

#### **UAE: Abu Dhabi Islamic Bank (ADIB)**

#### Runner-up: Dubai Islamic Bank

Abu Dhabi Islamic Bank swept the board this year winning some of the biggest categories including Best Overall Islamic Bank as well as Best Bank in the UAE. The bank in 2013 cemented its position 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 Abu Dhabi Islamic Bank (Egypt), Burooj Properties, ADIB Securities and recruitment consultancy Kawader Services; and is focusing on Iraq and the UK as key growth areas for the future.

Established in 1997, the bank is 29% owned by the ruling family of Abu Dhabi and the Abu Dhabi Investment Authority. For the nine months ending September 2013 the bank saw total income of US\$912.7 million, and profit of US\$301.3 million. As of September the bank holds assets of approximately US\$26.23 billion.

#### **SYRIA: Syrian International Islamic Bank**

#### Runner-up: AlBaraka Syria Bank

Syrian 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 launch 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.



#### **THAILAND: CIMB Islamic**

#### Runner-up: Islamic Bank of Thailand

(See Malaysia)

#### UK: Bank of London and The Middle East (BLME)

#### Runner-up: Gatehouse Bank

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 challenging economic climate in Europe, and is expected to continue on a positive run as demand for Islamic 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. The bank saw total operating income of US\$41.5 million for the first six months of 2013, and as of June 2013 held total assets of US\$1.86 billion. In 2013 the bank had an exposure of around 28% to real estate and a 57% concentration on the UK.

#### **TURKEY: Turkiye Finans Katilim Bankasi**

#### Runner-up: Al Baraka Turk 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, National Commercial Bank, charted a capital adequacy ratio of 14.24% last year; higher than a majority of the other participation banks.

#### **US: Lariba American Finance House**

#### Runner-up: Devon Bank

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 Ribafree financing model.

#### **YEMEN: Islamic Bank of Yemen**

#### Runner-up: Saba Islamic Bank

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.





Khalij Islamic is an Islamic finance investment and advisory boutique with a presence in the United Kingdom & the United Arab Emirates.

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