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Why Islamic finance prospered in 2014. Will it continue in 2015?

The past year was in many ways a game-changer for Islamic finance, not only in terms of growth and performance but regarding its steady confluence towards the mainstream. Awareness of the industry has grown across the globe, with both Muslim and non-Muslim markets sitting up to take notice. This trend has been driven by a number of factors: foremost of which is the reputation for strong corporate governance and a stable investing approach which has made the Shariah compliant industry increasingly attractive given the volatility of the global financial markets and the loss of faith in the conventional banking system left over from the financial crisis.

In addition, the growing popularity of socially responsible investing – one of the top trends of 2014 – and its compelling crossover with Islamic finance, has led a spurt of interest in the sector from a wider investor base as well as seeing a shift in attitude from providers themselves as they realize the opportunities inherent in its appeal and market themselves accordingly. Islamic asset management is still just a drop in the ocean in terms of comparative size, but with increasing interest from managers and investors and with a groundswell of new launches as well as existing funds reaching a bigger size and attaining longer track records, the trajectory looks promising.

Looking at the retail sector, one of the most obvious features in 2014 was the strong performance of Shariah compliant banks: especially in the Middle East although Asia and in particular Malaysia also put in a good showing. Leading GCC banks have all recorded excellent results for the year, with strong liquidity levels and profits rising by double figures (63% for Dubai Islamic Bank, 21% for Abu Dhabi Islamic Bank, 17.6% for Masraf al Rayan). Over in Malaysia there was much excitement over the potential merger between CIMB Group, RHB Capital and Malaysia Building Society, although this disappointingly fell through. However, new reports of a possible Indonesian Islamic megabank by the end of the year have emerged to replace it, as Indonesia works towards fulfilling its immense and hitherto relatively unfulfilled potential in the industry.

Another trend for the year is the entry (or re-entry) of major international banks, which has boosted its progression towards a globally accepted alternative financial system. While HSBC Amanah and Standard Chartered have pulled back their retail operations they remain active in the Sukuk sector, which also saw giants including Goldman Sachs and JP Morgan step up their game to take advantage of the strong returns and high liquidity of the market. 2014 was an excellent year for Sukuk (recovering from the lull of 2013) and we can expect the same this year: with a particular trend towards banking sector Sukuk and a growth in corporate issuance. With multiple non-Muslim majority nations such as the UK, Luxembourg, Hong Kong and South Africa making high profile sovereign stakes for the first time – and more expected in 2015 – these benchmarks will also work towards establishing, deepening and developing the Islamic capital markets globally.

Despite the global volatility in oil prices, the outlook for 2015 looks surprisingly positive: with economic conditions improving and markets in the Middle East demonstrating unexpected resilience: while the focus on developing the ASEAN economic bloc looks set to boost activity in Asia. The US is showing signs of renewed interest in Islamic asset management in particular, while real estate (the perennial favorite) shows no sign of abating and Islamic investment into Europe and the US continue to grow. The top trends to watch this year will of course be the falling oil prices (and their impact on OIC economies) as well as the potential increase in Fed rates and its effect on the US dollar. In summary however, the Islamic finance industry looks strong and stable, and based on its 2014 performance we should expect a year of sustained growth going forward. ☺

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Good prospects in 2015 for Sukuk despite potential turbulence

By Mohamed Damak and Samira Mensah.

Despite potential turbulence, the global Sukuk market is heading for another solid year in 2015. We see long-term growth potential in the sector, supported by good economic prospects in core countries, increasing interest from new countries, and regulatory developments. With Sukuk issuance reaching US\$116.4 billion in 2014, we expect volumes to exceed the US\$100 billion mark in 2015. We anticipate that positive economic performance in core markets such as Malaysia and the GCC will support Sukuk issuance in 2015. The implementation of Basel III liquidity coverage ratio will also drive growth in the next two years. What's more, we see strong interest from several countries to join the club of Sukuk issuers. However, headwinds are emerging and could result in lower Sukuk volumes in 2015 compared with 2014. The gradual increase of interest rates by the US Federal Reserve (Fed) may strain liquidity in global capital markets, including emerging markets. In addition, the continued drop in oil prices could disrupt economic growth and ultimately infrastructure-related borrowing in core Sukuk markets, especially if prices decrease further.

2014 was a good year

In 2014, the Sukuk market reached the second-highest year for Sukuk issuance with US\$116.4 billion in total issuance underpinned by the good economic performance of core markets and strong appetite from non-traditional Sukuk issuers. Sovereign and sovereign-related issuers have performed in line with our expectations in 2014 and accounted for about 80% of total volumes. While the GCC accounted for about 20% of total volumes in 2014, issuances from Asia (mainly Malaysia) were in line with last year's performance at around two-thirds of total issuances.

Five countries (the UK, Luxembourg, South Africa, Senegal and Hong Kong) and a major Western bank (Goldman Sachs) joined the club of Sukuk issuers in 2014 confirming the growing interest in Islamic finance beyond its natural clients. We think that this trend will continue in the future as more issuers are now looking at Islamic

finance as an additional source of financing of their economies or diversifying their investor base. We also recognize that this trend is unlikely to shift the market dynamics in the short term.

In contrast, the corporate and infrastructure sectors have underperformed in 2014 with volumes falling by around 12% in 2014 relative to 2013. Various factors have impacted volumes in this space. We have observed that corporate and infrastructure issuers are increasingly turning to conventional issuance over Sukuk, based on the issuance levels in the second and third quarters of 2014 relative to levels in the fourth quarter of 2013, when Sukuk predominated. For example, corporate and infrastructure Sukuk issuance has decreased to about US\$6.5 billion in the third quarter of 2014, while corporate bond issuance has increased by approximately the same amount. We note that possible reasons for the switch could be that the bond market remains relatively more established than the Sukuk market beyond a certain size and tenor of issuance. Another factor is the small pool of corporate issuers, which means that if a few key issuers do not need to access the capital markets in a given year or have already refinanced their debt, the volumes will decline accordingly. Low-priced bank debt continues to be an attractive option for corporate issuers in the GCC. According to various market sources, loans as a proportion of total GCC funding have increased from just under 50% in 2012 to just over 60% of total funding in the third quarter of 2014.

Will the trend continue in 2015?

In 2015, we expect Sukuk issuance to again exceed US\$100 billion and reaching US\$100-115 billion. We see three factors supporting continued strength in new issuance. First, the still-positive economic performance of the main Sukuk markets in Malaysia and the GCC nations.

Second, we think that new sovereigns could join the club of Sukuk issuers in 2015. Tunisia, Nigeria, Egypt, Kazakhstan, Kenya, Philippines, and Thailand figure among governments that

announced issuance plans in the past, but have yet to actually issue Sukuk. We remain mindful that new entrants in the Sukuk market are not changing the game as far as the epicenter of issuances is concerned but the geographic expansion of the market provide a diversification play to investors.

Sukuk issuance give governments access to a new investor base and diversify their sources of funding. For some countries, Sukuk could provide fiscal funding, as well as help cover external financing needs and support reserve-building. This is important for countries with sizable external funding needs. In some cases, governments issue sovereign Sukuk with a view to establish a benchmark for the development of their domestic Sukuk market.

Third, the implementation of Basel III could spur Sukuk volumes. There is an inherent lack of high quality liquid assets (HQLA) in the Islamic finance space adding challenges to the compliance with the liquidity coverage ratio (LCR). An initial IFSB quantitative impact study of 32 banks in seven countries highlighted that Islamic banks can meet the LCR, based on cash and central bank reserves that are present in their assets. The IFSB reported an average LCR for these banks of 241% and an average net stable funding ratio (NSFR) of 120%. HQLA consisted primarily of cash and central bank reserves. Most governments' Sukuk are either not listed on developed markets or not actively traded reducing the probability of their classification as HQLA. Sukuk issuances from the International Islamic Liquidity Management Corporation (IILM) remain small compared with the overall size of the market.

We think that Basel III creates a window of opportunity for the industry to resolve long-standing weaknesses related to the lack of liquidity management instruments. We are of the view that regulators, the IILM, and the IDB could play an important role through the issuance of Sukuk that may qualify as HQLA. This could also prompt sovereign issuers and corporates with high credit quality to list their Sukuk in developed and liquid capital markets. A concrete example could be found in what the central bank of Malaysia did a few years ago, becoming the largest issuer of Sukuk in the world. We believe that central banks in core Sukuk markets may follow the Malaysian example. In 2014, the central bank of Malaysia issued US\$46.2 billion, or about 40% of the total Sukuk issuances.

In the GCC, other regulatory changes could positively influence Sukuk volumes in the next two years. In 2013, the Central Bank of the UAE revised regulations governing concentration limits on the amount of credit (loans and other credit exposures) that domestic banks may extend to borrowers, especially aimed at reducing their exposure to local governments and their related entities. More specifically, the regulator exempts certain rated bonds and Sukuk, which should support the development of the country's nascent debt capital markets. In addition, we believe the regulation indirectly gives banks an incentive, as they aim to reach compliance, to issue non-dilutive hybrid securities.

Lower oil prices and tightening liquidity could cause turbulence

That said, we believe 2015 will be marked by episodes of turbulence that could cause Sukuk volumes to decline compared with 2014. The significant drop in oil prices over the past few months, could lead to a drop in confidence and impact negatively on Sukuk issuance. We continue to adjust our macroeconomic forecasts in line with our oil price assumptions, already resulting in lower expectations of growth and public expenditures for some GCC countries. We could see a direct impact on volumes if some

GCC countries were to reconsider their capital expenditures in 2015 because of a reduction of their revenues from oil.

Lastly, the normalization of the US interest rates will likely reduce global liquidity. A preview of such risk took place in 2013 and to a lesser extent in 2014 when the Fed announced the tapering of its bond-buying program. That said, the market has displayed relatively strong resilience to the announcement of Fed tapering growing by almost 5% compared with 2013.

However, some positive side effects from the expected monetary stimulus from the European Central Bank cannot be ruled out.

Standard & Poor's has published its updated criteria for Sukuk rating

Standard & Poor's has updated its methodology for assigning issue credit ratings to Sukuk. These criteria explain how we rate Sukuk with contractual commitments from their respective sponsor. The main changes in the criteria provide further transparency on the conditions under which we rate Sukuk at the same level as the sponsor's rating, as well as identify more clearly cases where additional risks can affect Sukuk ratings.

Key issues addressed in the criteria include:

1. Our five conditions in order to rate Sukuk with an issue credit rating at the same level as the sponsor's senior unsecured rating.
2. How we rate Sukuk when the sponsor's contractual payment obligations do not rank pari passu with its senior unsecured financial obligations. We equalize the issue credit rating of the Sukuk with the ratings that we apply to the sponsor's financial obligations with the same level of seniority, subject to meeting relevant conditions.
3. If we assess certain risks as non-remote, we may assign an issue credit rating on the Sukuk that is different from the sponsor's rating.
4. We assign a 'D' or 'SD' issuer credit rating on a sponsor if the issuer fails to pay on the Sukuk's periodic distributions and principal, and the sponsor has failed to fulfill, in amount or timeliness, one of its payment obligations towards the issuer under the Sukuk's terms and conditions.

In our updated criteria, we have identified cases where a Sukuk rating could be lower than the sponsor's rating because the Sukuk may entail risks that do not exist in conventional bonds. Due to their Islamic nature and specifically to the principles of asset-backing and profit-and-loss-sharing, a total loss event of the Sukuk's underlying assets may result in an unpredictable resolution of the transaction. In most cases, the sponsor offers mechanisms to ensure that the ultimate risk investors take remains the sponsor's counterparty credit risk. Nevertheless, in a few instances, Shariah scholars request higher loss-sharing features, which imply residual asset risk. To rate such transactions, Standard & Poor's looks at the remoteness of the total loss event and the extent to which it affects the overall performance of the transaction. If the total loss event is not remote, we may cap our rating. Our view is underpinned by the lack of standardization in the Sukuk market and the lack of predictability regarding resolution, which could make Sukuk ratings considerations different from those of conventional bonds ratings. ☺

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Accounting and tax developments

Accounting and tax are often thought of together, and commonly involve the same profession since tax practice in many parts of the world is dominated by accountants. However, they are very different and will be covered separately. MOHAMMED AMIN dissects the two fields to look at the differences particularly those that involve Islamic financial transactions.

Accounting

Accounting lends itself to global harmonization, since investors want to compare the accounts of companies from different countries. Today companies in most countries, especially those with publicly traded shares or securities, account using International Financial Reporting Standards (IFRS) promulgated by the International Accounting Standards Board (IASB). The only significant exception is the US, using standards from the Financial Accounting Standards Board (FASB). However, the IASB and FASB have agreed to converge over time.

AAOIFI was established in 1990 to standardize accounting for Islamic financial institutions (IFIs). However, the author's article 'AAOIFI's proper accounting standards role' in *Islamic Finance news* on the 9th February 2011 explained that almost all IFIs, apart from those based in a few countries, account under IFRS.

Accordingly, Islamic finance (IF) practitioners were frustrated by the IASB ignoring Islamic finance when publishing IFRS or issuing guidance on how IFRS should be applied. This resulted in inconsistency between IFIs when applying IFRS to account for similar transactions. The most important recent IF accounting development was in early 2013 when the IASB set up a 'Working group on Shariah compliant instruments and transactions'. It held its first meeting on the 2nd July 2013 in Kuala Lumpur and identified four areas for initial focus:

1. The application of IFRS 9's classification and measurement principles.
2. The application of the IASB's proposed lease standard to Ijarah.
3. Whether restricted and unrestricted investment accounts are to be presented on or off balance sheet.
4. Profit equalisation reserves due to significant differences in practice.

The working group discussed the first subject in some detail at its second meeting held on the 5th September 2014 in Kuala Lumpur.

The key issue is that under IFRS 9 a financial instrument must be measured at fair value with value changes taken to the profit and loss account or other comprehensive income (as appropriate) unless the financial instrument qualifies for amortized cost accounting. There are two tests for amortized cost accounting and both must be passed: firstly, a business model test and secondly, a characteristics-of-the-instrument test. In the second test, the cash flows from the financial instrument must be 'solely payments of principal and interest from the principal amount outstanding'. How should these tests be applied in IF when interest is not charged explicitly or when IFIs use partnership-type contracts such as diminishing Musharakah? The meeting

on the 5th September also had a preliminary discussion on the appropriate IFRS accounting for Murabahah contracts.

It is not feasible to cover the detailed discussion here, but the minutes of the meeting in audio and written forms are available on the IASB website at <http://www.ifrs.org/Meetings/Pages/Sharia-compliant-financial-instruments-and-transactions-meeting-September-2014.aspx>. At that time, AAOIFI was not involved in the IASB discussions. However, AAOIFI issued a news release on the 20th December 2014 reporting on a meeting with the IASB held on the 16th December, which stated:

"During the meeting, AAOIFI formally accepted the invitation from IASB, the body that develops International Financial Reporting Standards (IFRS), to participate in its newly formed Consultative Group on Shariah Compliant Instruments and Transactions. AAOIFI has also offered to arrange the next meeting of the Consultative Group in the first quarter of 2015 in the Arabian Gulf region. The IASB welcomed and accepted this offer."

This is a welcome development as the 2011 article mentioned above suggested that, in accounting, AAOIFI's key role should be to partner with the IASB.

Tax

Unlike accounting, tax law is inherently local, since countries jealously guard their sovereign power to make and change tax law. It is not practical in a short article to enumerate specific tax law changes around the world. The overall trend, however, is for countries to enact legislation with the aim of ensuring that IF transactions do not suffer greater taxation than conventional financial transactions. Even countries with negligible Muslim populations are making such changes as they recognize the growing commercial importance of IF. For example in December 2014 it was reported that South Korea is looking to amend its tax law to facilitate the issuance of Sukuk.

Conclusions

Accounting: The expertise that the IASB has brought together, and the collaboration of AAOIFI, should result in much greater consistency between IFIs when accounting under IFRS. It is quite possible that AAOIFI may eventually withdraw altogether from issuing accounting standards.

Tax: The continued growth of IF should result in more countries adapting their tax systems to enable IF transactions to be carried out within their jurisdiction without adverse tax costs. (2)

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Alternative investments burgeoning

Despite the economic tumult of the Russian rouble crisis and sharp fall in the price of oil which ushered in the new year, 2014 was a profitable year for many. With balance sheets restored and liquidity returning, mainstream investment markets are, in many cases, returning to pre-global financial crisis levels. This is certainly true for the UK property market, where yields are approaching levels not seen since 2007. Investors in the UK real estate particularly, and in 'real assets' more generally, are therefore increasingly looking further and wider for better risk-adjusted returns. STUART JARVIS looks at the continued growth of the 'alternative investments' sector.

Review of 2014

2014 was a year that saw alternative sectors, for example student accommodation, start to enter the mainstream. Already firmly on the radar of many Shariah compliant investors, the final acceptance of student accommodation as a mainstream investment class came when international institutional investors bought into the 'direct-let' student accommodation market. Previously focusing on student residences with a lease or 'nominations agreement' in place to guarantee the income, their move into direct-let assets, where rooms are let on an annual basis directly to students,

demonstrated a clear shift to the mainstream. As a result, yields across the sector have compressed.

Large-scale portfolio transactions reported in 2014 are not hard to find: the Liberty Living student accommodation platform was said to have been put under offer to the Canadian Public Pension Investment Board for GBP1.15 billion (US\$2.29 billion), a joint venture between Middle Eastern family offices and Australian infrastructure fund-backed CLV paid GBP245 million (US\$373.27 million) for a portfolio of Opal student residences,

and Knightsbridge Student Accommodation commenced the sale of a GBP500 million (US\$761.77 million) portfolio to institutional investors. The UK student accommodation sector has become entrenched as a small but significant mainstream investment sector.

Preview of 2015

The UK renewable energy investment market has witnessed billions of investment but, despite interest internationally in a green Sukuk, the UK renewables sector has remained non-core to most Islamic investors.

The investment rationale is relatively straightforward, however. The UK government has passed into law a long-term commitment to reduce carbon emissions: particularly in the domestic electricity generation market.

In order to catalyze the growth of the renewable energy sector, long-term UK government incentives are available for renewable energy producers. Awarded before installation of the renewable energy plant commences, the incentive contract pays a set rate for the renewable energy output of the plant for up to 20 years with no breaks and annual RPI-linked uplifts. This can account for 50% or more of the plant's income.

The balance of the income is from a Power Purchase Agreement (PPA) with a UK utility company which is, again, signed pre-installation of the plant and can run for as short or as long as commercially agreed; typically, two to five years. Should, for any reason, the utility company fail to honour the PPA, the National Grid is obliged to acquire any renewable energy produced.

Assuming good operational efficiency, the income – from two highly creditworthy institutions – can amortize down the cost of the renewable energy plant in full over its useful life, as well as pay a high single-digit yield to investors over a short or long-term

hold: an alternative asset class which exemplifies the higher risk-adjusted returns philosophy.

Another is the private rented sector ('PRS'). While still in nascent stages of development in the UK, it provides an alternative to traditional approaches to residential investment. With stricter lending criteria from mortgage providers, the recent financial crisis having depleted many first time buyers' ability to fund a deposit, a limited supply of new homes and, in London at least, significant annual price increases, the barriers to buying a home in the UK remain high.

For many years, international institutional investment opportunities in the UK residential sector have been limited to a restricted universe of high-end central London properties, which have provided good capital appreciation though very limited net rental income.

The PRS model is to develop and lease on mass at a level more affordable for more tenants. Given the supply/demand imbalance and the introduction of a new, professionally managed, rental offering, continued high occupancy is anticipated. The large scale allows for institutional level investment, with the economies of scale hoped to deliver better risk adjusted returns: both meaningful dividends and capital appreciation to investors.

Conclusion

In conclusion therefore, 2015 promises to follow the trend of 2014: as liquidity increases, alternative asset classes will steadily migrate from the lesser understood fringes towards the mainstream core. For the UK, student accommodation has 'arrived' with renewable energy and the private rented sector two of the most likely alternative asset classes to follow suit. (2)

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Does Kuala Lumpur have what it takes to be an IFC?

With increasing global interest in the Islamic financial industry, there is a new urgency in Kuala Lumpur to maintain its lead and become the international Shariah compliant financial hub.

Global appetite for Shariah compliant goods and services is growing. Some of this is fueled by rising Muslim insistence on Shariah compliancy and the adjustments global companies are making to tap into this rich source of alternative funding.

As industries boom in the Middle East and Southeast Asia, so does the need for Islamic finance services. The Islamic debt market is also becoming more sophisticated with the Shariah compliant banking assets valued at US\$1.7 trillion that will reach US\$3.4 trillion by 2018, according to Ernst and Young estimates.

Islamic finance is also viewed favorably by the mainstream. In recent years, interest in Islamic finance has spiked in traditionally non-Muslim areas. South Africa, the UK and Hong Kong are some of the countries that have woken up to the potential of Islamic finance as an alternative source of funding, each having issued their own Sukuk to tap into the wealth of Muslim investors.

Even the American investment bank, Goldman Sachs, saw the value of Islamic financing when it raised US\$500 million from its first Sukuk issue.

The recent banking crisis resulting from high levels of leveraging has opened the eyes of western bankers to Islamic finance's inherent quality of being based closer to the real economy. Being far less leveraged than conventional finance, it is seen as insulated from vulnerabilities that were exposed during the banking crisis.

Malaysia is now pushing strongly to make Islamic finance its unique selling point in its quest to become a major finance hub, and is part of the present government's strategy to achieve the nation's goal of becoming a high income nation by 2020.

Malaysia already has a leg up in Halal goods and services. According to a recent Thomson Reuters survey, Malaysia leads the world in its global Islamic Economic Indicator, ahead of the UAE, Bahrain, Oman, Saudi Arabia, Qatar, Kuwait, Jordan, Pakistan and Indonesia.

In the more important category for global Islamic finance markets, the top three countries for the survey are Malaysia, Bahrain and the UAE.

Malaysia is the world's largest Shariah compliant bond market where corporate issuance jumped 26.6% to RM61.9 billion (US\$17.33 billion), from RM48.9 billion (US\$13.69 billion) in 2013 according to numbers from Bloomberg.

According to Bank Negara, Malaysia leads globally in integrating Islamic finance with 20 fully-fledged Islamic banks including 10 that are foreign-owned. It is also home to five international financial institutions from Europe, the GCC and Asia Pacific. Malaysia's total Islamic banking assets totaled RM527.2 billion (US\$147.56 billion), which is 24.1% of its banking system. Compare this to just 12.1% at the end of 2006. Malaysia's stock market, Bursa Malaysia remains the

top exchange for Sukuk listings amounting to RM102 billion (US\$28.55 billion) as of August 2013.

Malaysia also leads the way in Islamic capital market development, with more than 60% of the global Sukuk market amounting to US\$164 billion as of the first half of 2014.

Much of this lead in market share came from Malaysia's long history of innovation in Islamic financing to meet its own needs. Malaysia has been building up the infrastructure for Islamic finance for over 30 years and is now head and shoulders above rivals in regulating Islamic finance.

In 2013 it passed the Islamic Financial Services Act 2013, a more comprehensive iteration of its Islamic Banking Act of 1983 to oversee operations within the country. In comparison, other Islamic finance centers like Dubai and London rely on common banking laws with Islamic finance add-ons to govern its Shariah finance operations.

Bank Negara also envisions that Islamic finance will continue to play a bigger role in the Malaysian financial sector that would internationalize its Islamic finance marketplace by creating an environment to mobilize higher volumes of international Islamic financial flows that will be channeled through innovative Islamic financial instruments.

Even though Kuala Lumpur is already a regional hub for Sukuk in Southeast Asia, it has so far focused on tapping into its large and deep base of institutional investors.

Much of this new gambit to become an international financial center is focused on the new financial district being quietly built in the capital city.

Called the Tun Razak Exchange, or TRX for short, the site covers nearly 29 hectares of prime location in Kuala Lumpur.

The multi-billion ringgit TRX development represents the physical nucleus to focus all the good soft groundwork that Malaysia has done and provide a hub to Islamic finance players and investors.

But Malaysia's ambitions will have to take into account other financial centers which not only include neighbors Singapore, Jakarta and Hong Kong, but also Dubai, the UAE and an aggressive London who are all vying to take the lead.

"London is already the biggest center for Islamic finance outside the Islamic world. I want London to stand alongside Dubai and Kuala Lumpur as one of the greatest capitals of Islamic finance anywhere in the world," said the UK's prime minister, David Cameron, when his country hosted the first World Islamic Economic Forum in 2013.

To stave off the competition Malaysia will count on its still many advantages. Malaysia still shines as an example of a stable political and economic environment, something that investors will look with keen interest in these recently troubled times.

And while London, or other financial centers that are not located within Muslim-majority states, can adapt their experience in conventional banking to the Shariah sector, they are still playing catch-up.

For this reason too, Malaysia will attract issuers because, due to more advanced innovation and a liberalised approach, it accepts

a larger variety of Shariah principles and products compared to Islamic finance practised in the Middle East.

Some examples include exchangeable and hybrid Sukuk, and more recently, Sukuk denominated in Chinese renminbi and Japanese yen – all of which appeared for the first time in Malaysia.

Shan Saeed, chief economist and global investment strategist at IQI Group holdings which serves clients in Kuala Lumpur, Singapore, Hong Kong, London, Melbourne and Dubai, says Malaysia can work on its advantages to achieve this ambition.

He said, among the international Islamic finance community, the TRX project is highly anticipated as a good thing and an investment opportunity, especially for investors and financiers who see Kuala Lumpur as the Islamic finance bridge between the Middle East and the Asia Pacific economic area.

"Malaysia needs to have a positioning strategy in the minds of the financial investors," Shan said in an interview.

"It will maintain the lead for sometime before other financial centers catch up."

Shan said one concern that also needed to be addressed is whether Malaysia has enough Islamic finance talent to serve the needs of an international Islamic financial district.

He said in this regard, Malaysia must find the solution quickly and ensure it is sustainable.

"Continuous investment in education will give dividend in the long run," he said.

Shan also noted that while Malaysia is working hard to produce the talent needed in country, the 'option of hiring qualified foreign talent should be considered'.

Bank Negara governor Zeti Akhtar Aziz has pointed out that Malaysia is working on providing a continuous stream of talent to work in its new Islamic financial district.

She said recently that Malaysian institutions like the International Center for Education in Islamic Finance (INCEIF) and the Islamic Banking and Finance Institute of Malaysia (IBFIM) are creating a body of knowledge workers.

INCEIF, with 2,000 students at any one time, is the world's leading university to study Islamic finance while its International Shariah Research Academy is responsible for producing internationally acceptable rules for Islamic finance.

IBFIM in turn provides hands-on vocational training for students and consults with banks that want to become Shariah compliant.

"All these [institutions] give Malaysia greater status within the Ummah and the global Islamic community, and will provide the pipeline of talent for banks," Zeti said recently in an interview with The Economist.

With planning done and groundwork put in place, all Malaysia has to do now is to execute its strategy to become an Islamic finance hub to rival the rest of the world. ☺

This article was contributed by TRX in collaboration with The Malaysian Reserve.

Islamic financing takes to the air in the aviation industry

If the world's commercial airline industry was a country, it would make the top 20 in terms of economic output bracketed by Turkey and Saudi Arabia. In 2014, the global spend on air travel was estimated by IATA at US\$789 billion which represents a full 1% of global GDP. In addition, the sector has a long track record of traffic growth at more than double the annual rate of world GDP. CHARLES F YETERIAN shares his view.

By any measure, the airline industry is world-class in scale if not yet in profitability, although in the case of aircraft investor and commercial lending returns, it has proven attractive and lucrative over many years. The latest financial forecast from IATA suggests that the world's airlines will make a net aggregate profit of US\$25 billion during 2015 equating to an encouraging return on invested capital of 7% (up from 4.3% in 2012).

For the financing community, the airline industry is becoming a fundamentally stable borrower of significant amounts of cash. Airliners are expensive commodities and the economic reality is that the industry is highly capital intensive by nature and will remain so. New aircraft deliveries to cover replacement and growth total around 1,700 per year, at present, with production rates increasing. Boeing Capital estimates the cost of these new deliveries at close to US\$115 billion in 2014 and the major manufacturers have extensive backlogs representing almost ten years of production. With the majority of aircraft investment having to be externally financed, it is highly likely that the two economic sectors, financial services and commercial aviation, will be transacting a lot of business together for some time to come.

Review of 2014

In spite of the geopolitical and economic uncertainties still facing many regions of the world, the airline sector began 2014 with some optimism and ended it on a relative high thanks to the fourth quarter's gift of rapidly declining fuel prices. Investor and lender confidence in recent years have seen a more diversified and competitively-priced range of financing products made available to the world's airlines.

This includes a greater presence of relatively new or niche products like Islamic financing or greater accessibility to long-standing sources like the US capital markets. Access to a wide range of financing options is particularly important for airlines with the uncertainty caused by the 'funding gap' during the global financial crisis still reasonably fresh in the memory.

In 2014, Boeing estimated that almost 40% of new aircraft were delivered to airlines via the financing conduit of aircraft operating lessors who were particularly active in the capital markets for the majority of their own financing requirements. However, the next biggest financing providers to the airlines were the commercial banks (31% of the overall total) with many new entrants to the commercial debt market from the Middle East and Asia Pacific

regions prompted by the positive industry characteristics and proven value retention of the aircraft asset class.

The Middle East region is the world's fastest growing for air travel and this expansion is being propelled primarily by the 'Big 3' Arabian Gulf airlines and neighbouring low-cost carriers. Emirates Airline is already the world's largest international air carrier, in terms of international ASKs (a measure of output), and Dubai International has just overtaken London Heathrow as the world's busiest international airport. This expansion is particularly important from the perspective of Islamic financing as Boeing is forecasting around two-thirds of commercial aircraft deliveries to the Middle East region will be supported by debt sourced from locally-based banks with a natural inclination to promote Islamic lease and financing structures.

Preview of 2015

Forecasts provided by the International Air Transport Association and Boeing Capital infer more of the same in 2015. The global industry will grow by approximately 7.3% overall in terms of capacity added but 15.6% in the Middle East region. Traffic is also expected to increase by 7% and contribute to the industry wide net profit of US\$25 billion mentioned earlier, although this could easily be revised upwards if oil maintains a pricing level of around US\$50 per barrel (the forecast is based on US\$85). New aircraft deliveries in 2015 will require around US\$125 billion in financing, according to Boeing Capital, of which 60% (US\$75 billion) is expected to be sourced from commercial banks and the capital markets.

Conclusion

Islamic financing is present and active in both the banking sector and capital markets and the prospects for increasing market share are highly positive. The launch of a sizeable fund backed by the IDB in mid-2014 and the prospect for an export credit agency-backed Sukuk for Emirates Airline in early 2015 are developments that will further highlight the role of Islamic finance in the commercial aviation space going forward. More transactions are in the pipeline. With the financing parameters and asset value characteristics of commercial aircraft so well suited to Shariah principles, the growth of Islamic financing in the aircraft sector appears cleared to take off. ☺

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Corporate governance in global Islamic financial institutions

The issue of good corporate governance (GCG) has been increasingly important especially after the financial debacle affecting the US and many European countries around 2008-2009. Actually, corporate governance had always been important before, but the issues were seen as more relevant to the developing and/or emerging economies than those in Western developed economies. FAROUK ABDULLAH ALWYNI reviews the state of GCG in Islamic institutions.

The World Bank, in its financing development program for the developing and/or emerging countries, has always raised the issues related to GCG, especially in its fight against corruption. The financial crisis affecting the US and Europe mentioned above has to some extent exposed weaknesses in the implementation of corporate governance. Hence, governance has been an important issue not only for developing and/or emerging economies, but also in developed economies. In fact, according to the study of Edelman Trust Barometer (Askari; Iqbal; Krichene; Mirakhor, 2010), which tracks the level of trust in different countries, it observed that people began to lose trust in business leaders and became critical of their irresponsible actions, especially in the US, where according to the above study, trust in business leaders dropped by 20 percentage points in 2009 as a result of the crisis.

Furthermore, the above-mentioned study also shows that in many other major industrial countries such as Canada, Italy, the UK, France, Germany and Spain, there was a sharp decline in the trustworthiness and credibility of CEOs. Within the above context, more than ever, Islamic finance has a unique opportunity to present itself as a viable alternative to a conventional finance. Here, corporate governance within the context of Islamic finance will carry a new dimension beyond a formality, or beyond just a set of rules; it will also carry with it a heavy ethical and spiritual

dimension. However, to position itself to be a viable alternative, Islamic finance should first address its own issue of governance.

Review of 2014

Corporate governance basically is a qualitative issue not easily measured. However, it still has quantitative implications as seen in many cases of banking and financial crisis affecting many countries in the world. A recent initiative to assess the state of corporate governance in Islamic finance has been undertaken jointly by the ICD, the private sector development arm of the IDB, and Thomson Reuters. The report is called the Islamic Finance Development Indicator (IFDI) and started its first publication with IFDI 2013. Eighty-two (82) countries were included in the report consisting of all OIC countries and non-OIC countries with the presence of Islamic financial institutions (IFIs).

Corporate governance is one sub-indicator within the governance indicator discussed in the report. Other indicators are quantitative development, knowledge, corporate social responsibility, and awareness. The indicator value of corporate governance as shown in Table 1 is based on five metrics. These are: (i) installment of an independent chairperson of the board (ii) number of independent directors on the board, where more is better (iii) requirement of an independent chairperson of the risk management committee (iv)

establishment of independently-chaired audit and governance committees and (v) disclosure index.

The objective of the requirement of the first three points is basically to meet the principal requirements enunciated by both AAOIFI and IFSB that want to avoid conflicts of interest; the objective of the fourth point is to maintain financial reporting and governance oversight; and the objective of the last point (disclosure) is to evaluate if the disclosures are in line with corporate governance-leading practices. Those affecting the disclosure index include financial statements, management discussions and analysis, Shariah reporting, other details of annual reporting, segmental reporting, and risk management reporting.

On the basis of the indicator above, seven countries (Malaysia, Singapore, Sri Lanka, the UK, Bahrain, Qatar, and Indonesia) stay consistently among the top 10 countries having the highest corporate governance sub-indicator value (Table 1). Kuwait and Oman are two GCC countries that have made notable efforts in improving its state of GCG. They topped the list of IFDR 2014, beating even more developed Islamic finance markets such as Malaysia and Bahrain.

It is reported that the Central Bank of Kuwait has brought governance rules in line with international best practices. Oman, on the other hand, has been credited on the strength of its regulations on financial reporting and disclosure requirements. Oman's Islamic banking regulatory framework (IBRF) is said to closely follow AAOIFI standards for financial institutions, particularly for Islamic banking.

Despite a slight fall in its indicator value ranking in IFDR 2014, the UAE actually scored a higher indicator value of 44.8 compared to 34 in 2013. Dubai in November 2013 has stated that it would establish a center to develop standards for corporate governance based on Islamic values, guiding both financial and non-financial activities.

There are three Muslim minority countries (Sri Lanka, the UK, and Singapore) included in the top 10 list of IFDR 2014 and two other Muslim minority countries (South Africa and Australia) within the top 15 countries (top 10 in previous years). Muslim minority countries such as the UK, Singapore, and Australia basically benefit from their already strong corporate governance structure regulating conventional finance.

Pakistan is among the newcomers in the top 10. It revised disclosure requirements for Islamic banks in 2013. It was reported that it aimed to standardize and streamline disclosure of annual and quarterly financial statements.

Indonesia stays in the top 10 list in two consecutive reports. The recent action taken around the end of 2014 by Indonesia's Financial Services Authority (OJK) and Shariah National Council (DSN) to strengthen oversight of the Islamic finance industry will most probably serve the purpose of having effective GCG. In addition, two revised Islamic banking rules issued by the OJK to cover asset quality and capital adequacy are also expected to be able to shape the quality of the Islamic banking industry further.

Preview of 2015

Corporate governance is an important element for the development of the Islamic finance industry. There is no other option for the Islamic finance industry but to continue developing and improving its state of corporate governance in 2015. As mentioned above, although corporate governance is a qualitative

Table 1: Corporate governance sub-indicator – top 10 countries

Islamic Finance Development Report 2013			Islamic Finance Development Report 2014		
Rank	Country	Indicator value	Rank	Country	Indicator value
1	Malaysia	78	1	Kuwait	80
2	Singapore	68	2	Oman	74
3	Sri Lanka	58	3	Malaysia	60
4	Australia	56	4	Sri Lanka	58
5	The UK	56	5	Bahrain	54
6	Bahrain	51	6	Qatar	52
7	South Africa	51	7	Pakistan	50
8	Qatar	38	8	The UK	49
9	The UAE	34	9	Singapore	48.5
10	Indonesia	30	10	Indonesia	47.6

Sources: Islamic Finance Development Report 2014 and 2013

issue, but as shown in many cases in the last few years it has serious quantitative implications.

Beyond the simplified numerical measures discussed in the previous section, corporate governance principles have key elements that actually embody the spirit of Shariah itself. These key elements as highlighted by London-based Chartered Institute of Management Accountant (CIMA, 2011) include honesty, trust, integrity, openness, performance orientation, responsibility, accountability, mutual respect and commitment to organization.

Moreover, Islamic financial institutions are based on the foundations of Islamic religious ethics. Hence, their sound governance from an ethical and religious (Shariah) perspective is crucial to their proper functioning (CISI & ESA, 2010). Shariah rules that Allah's rights, if breached by mankind, may be forgiven by Him. However, people's rights, financially or otherwise, if infringed, cannot be forgiven save by the people themselves, and Allah will not interfere at all (CISI & ESA, 2010). Therefore, in Islamic finance, corporate governance is very important since it essentially functions as a means to establish fairness for all stakeholders and to realize the benefits to the people (Maqasid Shariah).

In view of the above, and to make Islamic finance distinctive and give added value to the betterment of the current global financial system, there is a need also to institutionalize Islamic ethical principles into corporate governance of an IFI. Here, an IFI should be made as a principle and/or value-based entity whose core purpose and vision should be bigger than just making profits. So, there is still room to come up with the measurement that will take into consideration those ethical-related governance issues. In any case, the measurement effort has just begun, and it will facilitate the development and improvement of corporate governance in IFIs in the years ahead, and the year 2015 is expected to build further on the work that has been done previously. ☺

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An opportunity for Islamic finance

Crowdfunding is the practice of funding a project or venture by raising monetary contributions from a large number of people, typically via the internet. This became popular as an alternative source of funding during the height of the global financial crisis as banks cut back on their balance sheet exposures and investors sought higher yields. While this concept may appear new, the principles behind it are based on core Islamic values. MIYAN MANSUR MANNAN explores the new but popular financing platform.

The crowdfunding platforms bypass the banking system by providing investors with direct and quicker access to individuals and businesses needing funds. In most cases, the investors take direct risk in the venture to which they provide funding. This model of financing is therefore simple and can easily be adopted to be in compliance with Shariah principles.

The main countries in which the alternative finance market has gathered momentum are the US and the UK. With support from local government and regulators, the market has developed to cater to funding requirements of a range of different sectors, with most of the growth in consumer finance and business peer-to-peer (P2P) financing. In both these countries the market has been evolving at an accelerating pace, although dominated by a few large players. At the end of 2014, the lending volumes in the US stood at over US\$7 billion and in the UK at just under GBP2 billion (US\$3.05 billion) (a growth of 161% over 2013). The US market is expected to grow to some US\$50 billion by 2025 with the UK market targeted to reach some GBP40 billion (US\$60.94 billion) by that date. The greatest opportunity for Islamic finance is expected to come from crowdfunding financing transactions, in particular the funding of small and mid-sized businesses.

Review of 2014

2014 marked a turning point for crowdfunding as it has entered into mainstream acceptance. One of the largest platforms in the US, Lending Club formed a partnership with Union Bank and became the first peer-to-peer lender to file for an initial public offering (IPO) in December 2014. In the UK, Funding Circle, another major player, entered the US market and announced a similar tie-up with Santander Bank where the bank will refer small business customers looking for a loan. In addition, Santander and Blackrock announced that they are working to create the first rated securitizations of P2P loans from Lending Club and Prosper, a market that could reach billions.

Along with growth, regulations have also been introduced especially in the UK, with all crowdfunding platforms needing a license from the Financial Conduct Authority since April 2014. These regulations are still light-touch and further measures are likely to be introduced in the near future.

Crowdfunding in the Islamic market is still relatively new. Many small players entered the market in 2012-13 particularly in Lebanon and Egypt. These early players follow either a reward or

an investment-based model where investors either fund creative projects by independent artists or students and in return receive tangible non-monetary rewards; or provide funds for start-ups and participate in the equity of the venture. These players continued to progress in 2014 although widespread acceptance still requires significant marketing efforts and regulatory changes.

Preview of 2015

With the continued prospect of a low interest environment, improvements in technology and continually higher capital requirements for the banking sector, the alternative finance market has an opportunity to innovate and accelerate its growth in 2015. In the UK, new regulations for both the pension industry and personal saving schemes are set to be real game changers as significantly, more funds will become available for investing through crowdfunding platforms. The UK regulators have also made it a requirement for banks to refer smaller business clients to such platforms. This has led to major high street banks announcing referral agreements with P2P players. In the US, securitisation and partnership with banks will continue to mark the headlines.

Major Islamic players are also expected to enter the western and traditional Islamic markets either as stand-alone platforms or in joint ventures with established players. Particularly in the western financial markets, the lack of suitable investment products for Islamic investors provides a unique opportunity for such platforms to succeed. Although marketing efforts will be required to educate the investors, the funding model is simple to explain and will easily gain approval from the Shariah scholars. It is also expected that regulators in the Middle East and Asia will catch up with developments of the alternative finance markets and consider the necessary regulatory changes in their home countries. Such changes would allow the Islamic crowdfunding platforms to gain market acceptance in those economies.

Conclusion

Crowdfunding in general seems to have overcome its growing pains and, although many small players will find it uneconomical to continue, the industry is now well established and accelerating its growth with support from both the traditional finance market and the regulators. ☺

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Interview with INOKS Capital

In an exclusive interview with IFN, Nabil Abdul-Massih, CEO of INOKS Capital, shares their achievements in 2014 and plans for 2015 and beyond.

How was your year in 2014 and what were your biggest achievements?

2014 has been quite a challenging year marked by a lot of volatility in world markets, many disturbances in world affairs and a sliding commodities price environment, amid as usual, some noticeable exceptions. Nevertheless, 2014 has been a very important year for us with (a) the confirmation of our Activist Funding Strategies' robustness and resilience in such difficult investment environments and (b) the materialization of founding corporate milestones for our firm. Our strategies, whether on the short-term with CSTF or the mid-term with DECO, have all yielded substantial net returns for our investors, exceeding targets by ranging between 8.7% to 10.4% for CSTF and 24.5% to 26.8% for DECO. On the corporate front, 2014 marked for us the completion of a regulatory and institutionalization drive that started in 2009.

After five years of arduous and dedicated efforts, we have sustainably provided investors with a robust corporate structure, top of the class time-tested processes, policies, and an unrivaled 'in-house' team of unique all-round talents in our fields of core competences, emerging markets and commodities value chains. The year culminated for us with the filing with the Swiss regulator for a fully-fledged asset manager license and last but not the least, the onboarding of top institutional and sovereign investors' names who gratified us with their entrusted fiduciary duty.

What are the major challenges facing asset managers in the Gulf today and where do you see your biggest opportunities?

Today's major challenges appear not to differ very much in the Gulf than from the rest of the world. On the Gulf investors' side,

liquidity is available but it has tended to shy away from the risk or illiquidity, much as it did anywhere else. Scars of 2008/2009 being well in the mindset, Gulf investors have also experienced frustration with the lack of returns that markets globally produced. Irrespective of the asset classes considered, all were either objects of lingering growth or strong unexpected corrections when well performing. Asset managers in the Gulf appear to suffer from the dichotomy of a short supply in Shariah compliant investment products, in quality or number, amid a substantial liquidity availability for investment. Hence, it appears that the Gulf investment community's demand side remains today unsatisfactorily serviced. This represents for us a strong pillar of opportunities as strong investment talent and acumen exist in the Gulf. We thus see great prospect in their development to meet the Gulf investment communities' needs and aspirations rather than seeking to adapt or translate 'non-Gulf' investment products.

How has the volatility in oil prices affected your business?

Our forte and investment expertise primarily lies in understanding the associated risks of emerging markets economies or commodities value chains to proficiently mitigate them and extract, through the implementation of our Activist Funding Strategies, uncorrelated returns from our investments. In 2014, we were again proven grounded in our approach but also positively stress-tested. The energies' volatility had absolutely no impact, be it on the downside or upside, on our returns for both the CSTF and DECO strategies.

You focus on commodities and emerging markets – what impact have trends such as the volatile commodity prices and recent departure of leading US investment banks from the market had on your strategy and performance?

As previously eluded, volatility is neither our friend nor our enemy, our strategies are purposely devised to weather it. That is, of course, provided we do perform our duties, same as for any other asset manager, be it in the alternative world or in traditional asset classes. However and as you rightly point out, excessive volatilities or rather 'black swan' events in certain economies have tended to render our highly specialized investment universe to become very demanding in terms of know-how, market savviness and need for nimbleness. Traditional financial institutions, EU and US-based alike, initially retrieved our universe based on much increased regulatory pressures (Basel II/III), lack of liquidity availability and balance sheet strong deleveraging to cauterize scars of the 2008/2009 crisis. As the 'retrenchment' was coupled with a sensible level of volatility on the value side, the vacuum created was for us, organically and structurally, a very strong and supportive environment for our strategies. On the performance side, we'd rather see these evolutions and landscape changes as the confirmation of the sustainability of the investment opportunity or thesis driving our Activist Funding Strategies. We see strong potential and much sustained demand on the investment side while barriers to entry in the universe are high, be it for asset managers or traditional financial institutions. It will remain as such for most of the next five years.

What is your view on Shariah compliant solutions for your clients and are you seeing an increase in interest? What advantages do you feel Shariah compliant solutions can offer your clients?

Here, a fundamental and an integral part of our Activist Funding Strategies is touched. The Shariah compliant solutions deployed in our investments are as if bespoke by essence for the real tangible and concrete business activities we invest in. It provides the capital for their growth but also does it in the best format and structure possible, thus it is highly appreciated. The investment offers the investee the best allocation and availability of financial resources as and when rightfully needed. It offers the investee with a level of embedment with the investee's business organization that creates the comfort of a financial party that understands the business activity as if it is its own. It also appropriately authorizes us, the investor, full transparency, control and risk management of the investment and the assets. The Islamic financing structures used for the investment could not be more adapted to the concreteness of the commodity value chains and the real non-speculative business activities invested. A corner point of our Shariah compliant solutions is that we very much pride ourselves to do more than just generating substantial returns for the investors. Similarly and aside from producing economic growth for the investee, the Shariah compliant solutions used, above all, generate concrete and tangible positive externalities. These are yielding direct impacts in terms of poverty alleviation, food security, environmental and social respect or corporate governance for the societies invested in. This sustainable and ethical output is not an overlay; it forms an integral part of the Shariah compliant solution we offer.

Will 2015 be the year Islamic finance reaches the mainstream and what levels of interest are you seeing?

We feel that Islamic finance acceptance in the world investment economy is growing pace. We believe that endorsement shall be primarily based on the soundness of Islamic finance's fundamental strengths as a practice. As such, it is a fact that the 2008/2009 crisis supported such a demonstration as many financial abuses suffered by the global investment community were proven not to have been possible if in an Islamic finance environment. Without divulging too much in particular, the soundness and adequacy

of our Shariah compliant solutions is second to none in terms of security, control and risk management. It was proven superior in its application, in many aspects, to non-Islamic finance structures. Further proof is that amid our Activist Funding Strategies all being 100% Shariah compliant, non-Shariah prone investors represent 75% or more of our firm's assets under management, demonstrating more than acceptance but also endorsement of our Shariah compliant solutions for their sheer technical qualities.

What are the key trends in asset management for your sectors of interest in 2015?

Three simple words: regulation and institutional grade. The 'one man show' or 'garage shop' has no future in our industry as a whole, let alone in our highly specialized sectors of interest. One needs to have the teams in place, the robust infrastructure and the proper checks and balances with the process and policies well-entrenched in its set-up. Compliance is no more an option but a standard. Unless asset managers understand and comply with this view, the prospect of survival is slim and only for the short-term. Interestingly enough, many players believed that they would be able to avoid the pain by either migrating to laxer domicile, subcontracting, merging for size effect or aggregating on managers' platforms. We do not think these are sustainable solutions; on the contrary, we opine that they are quick fixes that can rarely answer to the industry's landmark evolutions. As '1+1' does not always add up to '2' in our art and practice, synergies are much more complex to generate than they appear. 2015 is likely to be pivotal for many players, more than ever once again, in our niche-trading environment.

“ The challenges are quite exciting for us as we very much look forward to test the probity of views we previously expressed ”

What are you most excited about for the coming year in terms of your pipeline?

The challenges are quite exciting for us as we very much look forward to test the probity of views we previously expressed. Now on the pipeline side, we have a strong growth pattern on our CSTF strategy and look to marry our ever-growing investment opportunities with the sizeable and sustained institutional investors' interest in the strategy. Our footprint in the space retains its prime importance to us. CSTF is our historical turf, the essence and roots of our firm's DNA but also a potential seed for our other Activist Funding Strategies. On the DECO strategy, we will likely bring onboard quarterly new investments into the portfolio. Together with our partners at SIDRA Capital, we have opened the strategy to the qualified investors' community through a newly incepted Luxembourg open-ended collective investment fund. Finally and importantly, we are readying a substantial and initial ESPE investment in the first quarter already. This long-term (5+2 years) approach to our Activist Funding Strategies is likely to score vivid interest. Such interest is not only due to the intrinsic quality of the investment opportunities in our deal pipeline but also because of the fondness birthed by the region for the tangible strategic business activities to be invested. ☺

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Interview with Sidra Capital

In an exclusive interview with IFN, Hani Baothman, CEO and the managing director of Sidra Capital, discusses their achievements, challenges and plans.

How was your year in 2014 and what were your biggest achievements?

2014 has been great for Sidra and by winning the IFN Most Innovative Deal of the Year Award, Sidra proved itself a pioneer in alternative asset management. Early during the year we completed our Debt Equity Conversion (DECO) transactions for OPES Holdings and RMG which introduced a new product in the alternative asset space. We also managed to enter Africa as an investment destination, advised several London real estate developments and in November launched a Jersey-regulated Expert Fund approved by the Capital Market Authority of Saudi Arabia for offering there. On the corporate finance side, we continued growing our debt raising and advising business and successfully managed to raise funds for local companies from Saudi banks.

What are the major challenges facing asset managers in the Gulf today?

Yield compression occurred in certain asset classes due to too much liquidity chasing so few assets. Asset prices in our traditional markets increased resulting in expected returns dropping. Lower crude oil prices and unstable political situation in the region are worrying and we need to be prepared for any eventuality.

Where do you see your biggest opportunities? What do you think will be the key trends in asset management for 2015?

We will still focus on our core UK and Gulf markets while looking out for other opportunities. The US will be crucial although the entry valuation is going to be high. Europe is in the midst of a crisis and the euro is expected to continue depreciating against the US dollar. Africa's commodity prices have been falling lately while China's growth is also slowing so the next 12 to 24 months are going to be interesting.

You recently invested in the London property market – will this remain a core focus area for you, and what is your outlook for the coming year?

London has been key for us with several ongoing projects. While the London property market has experienced robust price appreciation lately and could be impacted by regulatory changes, we are still committed to investing in London as it should be resilient in the long run and continue to attract investments.

How have the recent DIFC regulations assisted asset managers in the region? Are there any other areas you feel should be addressed?

Regulators globally have moved towards disclosure-based rules to regulate their markets. The introduction of QIF by the DIFC is a right step forward as they are savvy and would need less protection from the regulators. Similarly, changes to the Professional Clients definitions are overdue. With these changes, portfolio managers would be able to dedicate greater

resources towards maximizing returns.

You focus on commodities and emerging markets – what impact have trends such as the volatile commodity prices and recent departure of leading US investment banks from the market had on your strategy and performance?

Interesting question. With our Sidra Ancile fund, we are not taking any price risk on the underlying commodity that we financed. In 2014, the net return should be in excess of 8.5%, demonstrating that with the right approach a good return from investment in the commodity sector is possible. The exit of US investment banks was mainly from the trading aspect of commodities and we are not a player there.

Why do you think Islamic wealth management has been slow to take off, and how do you feel it could be encouraged?

Islamic wealth management may have been slow to take off as a mass product but the large private banks are all providing such services to their ultra high-net-worth clients.

Will 2015 be the year Islamic finance reaches the mainstream?

With the UK, Hong Kong, South Africa and Luxembourg all issuing Sukuks in 2014, it has reached the mainstream.

What advantages do you feel Shariah compliant solutions can offer your clients?

Being Shariah compliant has its own advantages: a larger pool of investors, greater scrutiny and structuring skills, and ethical investments. Our DECO and Structured Trade Finance products serve SMEs and indirectly benefit the vertical value chain as well as communities in which these businesses operate.

What recent transaction (eg. The OPES deal) are you most proud of and why?

The OPES deal has been one of the most fulfilling transactions thus far because its hybrid equity and debt structure provides investors with an upside to their investment returns unlike typical debt-type transactions. We are also proud to have bridged the gap between the source of capital in the Gulf region to Cote d'Ivoire as this transaction has a humanizing impact on the Abidjan community.

What are you most excited about for the coming year in terms of your pipeline?

Sidra has been fairly successful in our private placement funds offering to our HNWI investors. We intend to expand into the retail market in Saudi Arabia and Insha Allah we will launch our maiden retail fund this year. ☺

Hani Baothman is CEO and the managing director of Sidra Capital. He can be contacted at hani@sidracap.com.

Development of Sukuk in Islamic debt capital markets

2014 was a record-breaking year for Sukuk issuances with US\$116.4 billion versus US\$111.3 billion in 2013, and by some measures surpassing even 2012. Total dollar-denominated Sukuk (US\$27 billion) and long-dated deals (US\$20.7 billion) both exceeded issuances in any previous year. Yet 2015 is set to be much more challenging, so what can the markets expect? FARMIDA BI finds out.

Review of 2014

Unquestionably the key development in Islamic debt capital markets in 2014 was the issuance of Sukuk by non-traditional parties. These were mostly sovereigns – the UK, Luxembourg, Hong Kong and South Africa – and also Goldman Sachs, the first American conventional bank to issue a Sukuk and the first conventional bank to issue a Sukuk at all since HSBC in 2011.

Even more encouragingly, the US\$500 million Sukuk issuance by the World Bank for the International Financial Facility for Immunisation gives a striking example of how Islamic finance could be harnessed for projects in the developing world which meet the criteria for Shariah compliant finance to be in the public interest (Maslahah) in a completely positive way, rather than only honoring prohibitions.

Last year also saw continuing diversification of Sukuk structures from Ijarah into hybrid structures (most notably the hybrid Wakalah/Murabahah for Goldman Sachs), showing the ability of Islamic capital markets to respond to the needs of potential issuers who do not always have the assets available for a pure Ijarah structure.

Preview of 2015

One of the biggest stories in all markets, but which may particularly impact Islamic finance, is the incredible fall in oil prices at the end of 2014. How will this affect Sukuk issuance in 2015? There are a number of contradictory factors at play. Gulf economies suffering from low oil prices may need to turn to the capital markets to find funding. However, the steep fall in oil prices may impact the liquidity of Islamic investors who may not have the funds to invest in Sukuk issuances in 2015 to the same extent as in 2014. Basel III liquidity requirements should spur Sukuk sales, with Tier 1 and Tier 2 sales in Sukuk format expected this year. DIB issued a Tier 1 Sukuk on the 15th January which may encourage other banks to follow suit.

Higher regulatory capital requirements mean that Islamic banks (which cannot invest in traditional interest-bearing securities) need to invest in high-grade Shariah compliant debt. The success of the sovereign Sukuk issued in 2014 proves the need for this paper. More sovereigns are expected to issue Sukuk in 2015, particularly in Africa. This follows a significant number of conventional sovereign issuances in 2014 by African countries such as Ethiopia. Senegal's domestic Sukuk in 2014 pointed the way, and Kenya may follow in 2015. Egypt has been the next big thing in Islamic finance for some time but has not managed to gain traction yet, and Nigeria should be a prime candidate to access the Islamic capital markets.

There are renewed efforts in Morocco to strengthen Islamic finance, and although Tunisia has postponed its proposed sovereign Sukuk until the end of 2015 while legislative changes are discussed, it has confirmed its commitment to the issuance. The UK and Luxembourg are still vying for supremacy as the main Western Islamic finance center, and both will need to follow up on their landmark Sukuk issuances in 2014 to consolidate their positions. Luxembourg might find it difficult to issue another Sukuk since the size of the Duchy limits the amount of funding it needs.

The UK is focused on the upcoming election in May and so no major government initiative such as another Sukuk will be forthcoming until later in the year, if at all. However, there is a great desire in quasi-governmental organisations to promote Islamic investment in the UK for infrastructure projects, and this activity may bear fruit in 2015. Using Sukuk for infrastructure finance deserves to be more common. Dubai is hosting the World Expo in 2020 and Qatar has the World Cup in 2022, both of which will be a natural vehicle for Sukuk issuance. It will also be very interesting to see how Hong Kong capitalises on its Sukuk issuance, and there may be interest in a Sukuk issuance in China's Muslim autonomous region. Russian institutions looking for alternative sources of finance in light of the sanctions imposed on them may also consider Islamic financing options.

Central banks also have the potential to push up the supply of Sukuk issuances. Several years ago Bank Negara Malaysia began providing a large volume of short-dated Sukuk for liquidity management, and sold US\$46.2 billion last year, according to S&P. According to the Islamic Finance Information Service, total Sukuk issuances from central banks reached US\$50.2 billion – 43.1% of all issuances – with Malaysia alone accounting for 92.1% of that at year-end 2014, followed by the Central Bank of Bahrain at 3.7%. Bangladesh's central bank also started regular Sukuk auctions in 2014. However, the US Federal Reserve is widely expected to increase interest rates in 2015, which could reduce liquidity currently being invested in Sukuk issuances.

Conclusion

2015 may be a more challenging year for Islamic capital markets than 2014 with continuing uncertainty in the Eurozone and very low oil prices creating a dampening effect. The burst of new entrants in 2014, however, has energised further potential issuers to consider this small but growing part of the capital markets which is now established as an alternative source of funding. ⁽²⁾

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Developments and opportunities for Shariah compliant family offices

Family offices have been around in one shape or form for many years. While a ‘family office’ can be organized across a broad range of legal entities or relationships, at its simplest, the term ‘family office’ is one that refers to a corporate entity that manages the wealth of a family or group of families through a series of trust or other investment structures. JOHN L OPAR and BARRY COSGRAVE believe Islamic finance has a bright future in family offices.

Reflecting the growing prosperity of those regions, family offices are today particularly common in the GCC and South East Asia which means Islamic finance and Shariah compliant investment structures can be of significant interest. As the economies of Muslim countries throughout the world continue to grow, family groups have increasingly sought bespoke solutions to protecting the wealth of future generations through portfolios that include property, equities and other structured investment products. Family offices also typically involve some form of philanthropy which also lends itself well to the moral obligation of all Muslims to pay Zakat each year.

Review of 2014

2014 witnessed continuing demand from family offices for investment solutions. Much of the capital to be deployed has come from family offices seeking investment opportunities that

offer attractive returns but which also accord with the principles of Shariah. For many, the opportunities to invest in line with their religious beliefs have often been too scarce thus leading them to maintain cash deposits. However, throughout 2014 a growing number of Shariah compliant asset classes have attracted investment from family offices including in the form of Shariah compliant feeder funds that offer investments in assets such as real estate, commodities and agriculture and that provide returns comparable to their conventional counterparts. The key to such investments is that the underlying assets do not violate the core principles of Shariah. Residential (multi-family) property is an obvious asset that serves this purpose but additional opportunities in agriculture, commodities and shipping have also proved attractive.

However, 2014 also witnessed family offices come back into the limelight for less positive reasons with the announcement of

the European Union (EU)'s proposed Fourth Money Laundering Directive. This directive seeks to broaden the scope of disclosure requirements of family offices in what has been claimed to be an effort to combat money-laundering and terrorist financing. The directive seeks to increase the obligation on family offices to make disclosure around the fairly nebulous term 'beneficial owner' and proposes a public register of such beneficial owners. The unintended consequence of this regulation may be that it encourages family offices to relocate from the likes of Luxembourg and the Channel Islands to less regulated centers. Family offices generally regard privacy and confidentiality as one of the main, if not the key, factors in choosing a jurisdiction of domicile for investment vehicles and as such this may give pause for thought to family offices establishing new structures.

The Alternate Investment Fund Management Directive that took effect in the EU in 2014 is another example of a regulatory regime that may be applicable to advisors of multiple families. In the US, the renewal by the United States Commerce Department of reporting requirements for foreign investors in US real estate similarly highlights increased scrutiny on foreign investment into the US.

“ The opportunities for Shariah compliant family offices continue to grow but the industry still faces the task of creating a broader range of investment products as a destination for available capital ”

Preview of 2015

Succession planning in the traditional Islamic finance regions of the GCC and South East Asia is set to become ever more important in the coming years as high-net-worth individuals and families seek to protect wealth and insulate future generations from the vagaries of market swings including in oil prices and other asset classes. One way to protect against such shifts is to invest in a broad range of asset classes. However, Shariah compliant family offices have often been restricted to investments in purely Shariah compliant funds or a restricted range of equities. The challenge for wealth managers is to provide innovative investment solutions to these family offices that include greater access to conventional funds through feeder fund structures and Shariah compliant structured investment products.

Wealth and asset management advisors in the Islamic finance sphere may also benefit from aligning themselves with conventional 'ethical investment' funds which may offer a strong development opportunity for Shariah compliant investment products. The investment spheres of ethical funds and Shariah compliant funds overlap to such a degree that perhaps the only Haram asset class that would not also be forbidden by an ethical investment fund is that which relates to investments in pork-related products. Just like Islamic investment funds, conventional ethical investment funds eschew investments in alcohol, gambling, arms manufacture and tobacco (among other



things). Ethical investment funds also avoid high leverage and investments in highly speculative derivative products. If Islamic wealth managers and ethical investment funds can combine their expertise we may see rapid growth in investment products that are Shariah compliant but that are not considered to be exclusive to Muslim investors. This should create a virtuous circle of innovation that may lead to a growth in investment products available to Shariah compliant family offices. The recent announcement by Abu Dhabi Islamic Bank that it is considering changing its name to 'Abu Dhabi International Bank' and Noor Islamic Bank's decision to re-brand as 'Noor Bank' is evidence of the growing alignment of Islamic finance with the conventional ethical investment sphere and it will be interesting to watch its development over the coming years.

Conclusion

The opportunities for Shariah compliant family offices continue to grow but the industry still faces the task of creating a broader range of investment products as a destination for available capital. There are a growing number of Shariah compliant assets coming to market and this is providing family offices with greater choice and competition in product offerings. As the industry continues to evolve family offices should be presented with a broader range of asset classes in which to invest allowing an asset allocation with a better spread of exposure and increased certainty for the future. ☺

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Sukuk on the rise

2014 has been a promising year for the growth of the global Sukuk market. In 2015 we anticipate continuation of the trend. Apart from government-linked entities, the private sector is also anticipated to issue more Sukuks, in particular the financial services sector. SAUD AL NAFISI believes Sukuk issuance from financial institutions is on an upward trajectory.

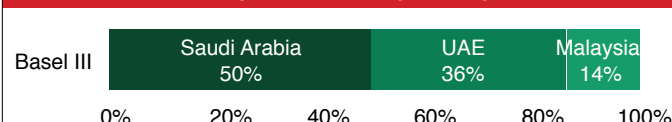
Islamic financial institutions (IFIs) globally are working towards full-compliance with Basel III; in this regard, recent Sukuk issuances by IFIs in the GCC and Malaysia suggest that Basel III-compliant Sukuks are a viable mechanism to meet the enhanced capital adequacy and liquidity standards. In line with recent trends, the Sukuk market will continue to attract cross-border and foreign currency transactions, reflecting in part the attractiveness of leading Sukuk domiciles such as Malaysia. In addition, the demand for US dollar-denominated Sukuk looks set to stay, given the demand for US dollar-instruments globally and ample liquidity of the currency.

Review of 2014

Due to the gradual implementation of Basel III, many Islamic banks are turning towards issuing Basel III-compliant Sukuk instruments in order to satisfy the revised capital standards. Since the issuance of the world's first Basel III-compliant Sukuk in November 2012, Islamic banks in countries including the UAE, Saudi Arabia and Malaysia have issued such innovative Sukuk instruments. To date, a total of nine Basel III-compliant Sukuks have been issued to date raising US\$5.09 billion in proceeds for eight different issuing banks. By domicile, Saudi Arabia accounts for 50% of the total Basel III-compliant Sukuk outstanding; UAE 36% and most recently, Malaysian Islamic banks have begun to issue Basel-III compliant Sukuks and account for 14% outstanding (see Chart 1).

Overall, the global Sukuk market recorded a solid performance in 2014, supported by a recovering global economy, as well as benchmark-sized issuances from sovereign entities and Basel III Sukuks by IFIs. By country, in 2014, Malaysia continued to dominate the Sukuk market, accounting for a 64.6% share of total issuances; with Saudi Arabia (10.3%), Indonesia (5.4%), the UAE (5%) and Turkey (3.6%) rounding up the top five markets. Notably, the Sukuk market is more geographically dispersed this year, which is a healthy sign of expansion into new markets. In

Chart 1: Basel III-compliant Sukuks by country



Source: IFIS, Zawya, Bloomberg, KFHR

2014, the top five countries accounted for around 89% of total issuances, down from 95% last year.

Many IFIs view Sukuk as an essential tool to mobilize funds for establishing a new project or finance a business activity, to raise capital and to satisfy BASEL III capital requirements. Corporate issuances remained steady at US\$21.8 billion in 11M14 (January-November 2014), compared to US\$22.2 billion in 11M13 (January-November 2013) (2013: US\$31.5 billion). The financial sector and infrastructure-related sectors such as power and utilities and transport dominated corporate issuances. Notably, corporate issuances had increased sharply in the second quarter of 2014, including the issuance of several Basel III-compliant Sukuks in June by IFIs in Malaysia, Saudi Arabia and the UAE. In addition, the world's first Sukuk by a Takaful company was launched in May 2014. Another milestone in the Sukuk market was the issuance of a US\$500 million Sukuk Wakalah by a US-based investment bank in September 2014. Moreover, The National Commercial Bank (NCB) has successfully placed its SAR5 billion (US\$1.33 billion) 10 non-call five-year subordinated Tier II capital Sukuk offering, marking 'the largest issuance by a financial institution in the Kingdom of Saudi Arabia' and the 'largest ever subordinated debt instrument' issued by an IFI in the MENA region. Overwhelming interest from the investor community generated a 2.1 times oversubscribed orderbook exceeding the initial target issuance size of SAR4 billion (US\$1.07 billion). Overall, the top 10 list of corporate Sukuk issuers (see Table 1) comprises mainly financial institutions from Saudi Arabia, the UAE and Turkey. Among these

Table 1: Top 10 corporate Sukuk by issuance size (2014)

Issuer	Domicile	Structure	Currency	Issue Size (US\$ million)	Tenure (Years)
National Commercial Bank (NCB)	Saudi Arabia	Mudarabah	SAR	1,300.00	10
EMG Sukuk	The UAE	Wakalah	US\$	750.00	10
Damac Holding	The UAE	Ijarah	US\$	650.00	5
Saudi Investment Bank	Saudi Arabia	Combination	SAR	533.23	10
Saudi Telecom	Saudi Arabia	Combination	SAR	533.20	10
Banque Saudi Fransi	Saudi Arabia	Combination	SAR	533.17	10
TF Varlik Kiralama	Turkey	Murabahah	US\$	500.00	5
Kuyvet Turk	Turkey	Ijarah	US\$	500.00	5
Al Hilal Bank	The UAE	Mudarabah	US\$	500.00	Perpetual
Flydubai	The UAE	Wakalah	US\$	500.00	5

include a US\$500 million perpetual Sukuk by Al Hilal Bank from the UAE, which is also a Basel III-compliant Sukuk.

Preview of 2015

In 2015 we anticipate that IFIs will continue to issue more Sukuk. Islamic financial institutions (IFIs) globally are working towards full-compliance with Basel III; in this regard, recent Sukuk issuances by IFIs in the GCC and Malaysia suggest that Basel III-compliant Sukuks are a viable mechanism to meet the enhanced capital adequacy and liquidity standards. Overall, Basel III Sukuk represent a milestone development in Shariah compliant financial engineering which enables IFIs to progress alongside their conventional counterparts. On a macro basis, Sukuk issuances will be supported by the ongoing recovery in the global economy, with firmer global growth forecasted at 3.8% on 2015, an uptrend compared to 3.3% growth in 2013 and 2014 estimates (see Charts 2 and 3).

Conclusion

Although the Sukuk market will be driven mainly by sovereign issuers and infrastructure spending, many IFIs are turning towards issuing Basel III-compliant Sukuk instruments in order to satisfy the revised capital standards. The struggling economies of Europe and Russia may drive banks/FIs to tap into the Sukuk market as an alternative method to increase capital and widen its investor base. (2)

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Chart 2: Global Islamic finance assets by sector

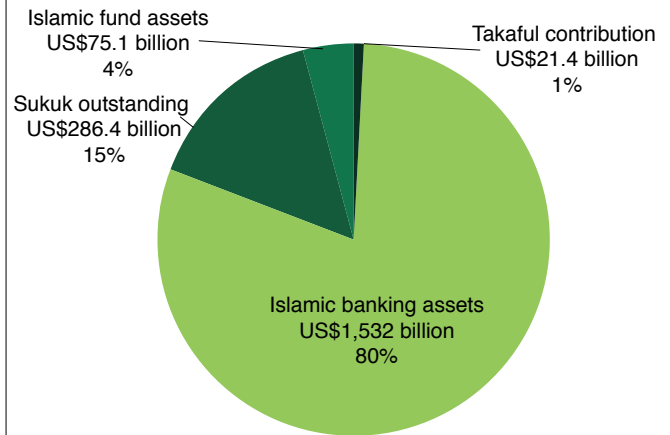
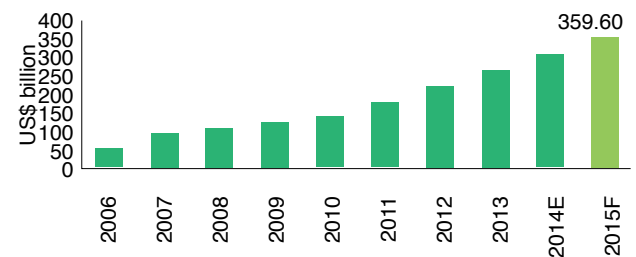


Chart 3: Global Sukuk outstanding (2006-2015F)



Source: IFIS, Zawya, Bloomberg, KFHR





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A review of the global Sukuk market

Of all the financial structures born of the principles of the Holy Shariah and now grouped together as Islamic finance, none can challenge historically the Sukuk in terms of developed and sustained global transaction volume. One commentary indeed has described global Sukuk, in terms remotely redolent of the Christian festive season, as ‘the golden child of the Islamic finance industry’. ANTHONY COLEBY reviews the global Sukuk market to see what is in store for the future.

2014 has seen Sukuk consolidate its position prodigiously, through high level investor demand, innovative structures, robust supply and wide global reach.

Figures for global Sukuk issuance in 2014 vary considerably but a consensus is closer at hand with estimates of current and prospective outstanding Sukuk assets: these being US\$240 billion as at the 1st January 2015 and in the region of US\$900 billion by 2020 respectively. Malaysia leads the way (itself up some 48% in 2014), with a 65% share currently, followed by the GCC (principally the Kingdom of Saudi Arabia and the UAE) with 21%.

Three factors may likely significantly affect the current spectrum from 2015 onwards: the continuation of substantial sovereign asset supply, a prospective increase at some point in global interest rates and a most volatile oil price.

Review of 2014

In global Sukuk, 2014 can be seen as the strongest year so far for the issuance by sovereign issuers, with the participants being of varied size and credit stature: the UK had debuted in 2013 and mulled further issues; then came not just Dubai (through the Dubai International Financial Center (DIFC)) and, as newcomers, Luxembourg, South Africa, Hong Kong and Indonesia but also the Maldives, Pakistan and Senegal. Oman is to go live in the first quarter of 2015 and Sharjah will not be far behind. Egypt, Jordan, Morocco and Tunisia are among other debutants in the coming year.

While the commercial motivation of these new issuers to enter the market is driven by a myriad of factors (diversity of investor base or budget debt profile, restructuring of existing conventional finance facilities and funding of planned infrastructure projects, for example), the fiscal attraction is commonly value for money over the medium term driven by an asset demand unmatched by supply, with investors keen to lock into safe (sovereign backed) investment in ring-fenced cash generative assets, offering a rate of return that current interest rates cannot currently match.

As noted, by no means all of the new sovereigns are stellar credits (Pakistan is currently rated ‘Caal’ by Moody’s) and the recent downward revision of Oman’s credit outlook has not derailed its prospective debut. Shariah compliance of the subject asset and investment structure are both, however, of the greatest importance for the likely investor who would otherwise look strategically for returns from other parts of the Asian emerging market sector.

Preview of 2015

The key factors that drove the issuance of Sukuk in 2013 and for most of 2014 remain in play (issuer’s need for funds and value for money, investor demand, low global interest rates, investment in an identified asset with the right status and so forth) and the projected issuance volume figure up to 2020 (see previous) is upheld by a wide body of global market opinion. The supply of future sovereign issuers also remains strong.

That is not to say that the sovereign ‘pot’ is unlimited in capacity and those participating now and in the future will continue to participate only as long as they need to and while the fundamentals (including levels of debt to GDP) for them are right.

It is also legitimate to point out that the burgeoning pace of 2013 and the first three quarters of 2014 took place in the presence of an oil price at or above US\$100.00 per barrel and that a major proportion of the current and prospective issuers of sovereign Sukuk are countries the GDPs of which remain heavily oil-weighted.

Halfway through the fourth quarter of 2014, 1MDB, the Malaysian sovereign wealth fund, pulled a US\$2.4 billion (Murabahah-based) Sukuk and this was in large part ascribed to the fall in oil prices (although 1MDB was also seen as looking to incur a ceiling of debt that was too high). This is perhaps a straw in the wind.

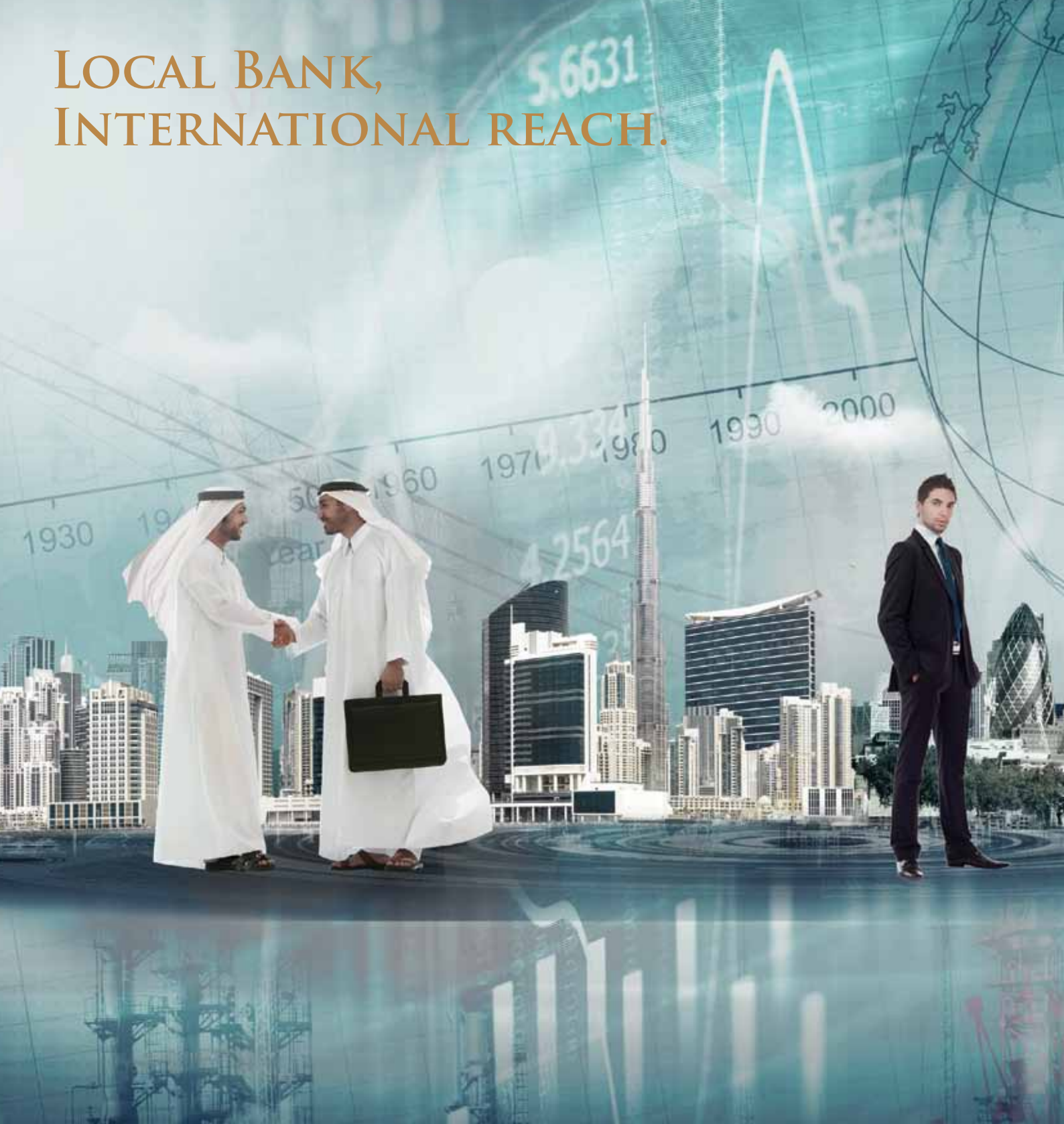
Separately, it is widely seen that, in order to underpin continued investor demand, the global Sukuk market needs to pursue the program of Shariah product standardization and compliance launched successfully last year by Manama-based International Islamic Financial Market in collaboration with the DIFC. This is an ambitious initiative with the backing of most of the major players and is needed to protect the market structurally when the current favorable fundamentals begin to weaken or change, as they inevitably will.

Conclusion

These are boom times in the global Sukuk market. But this success rests upon the co-existence of easily identifiable fundamentals, meaning that the market must, so far as is possible, take early steps to protect itself against the times when those fundamentals begin to change. ☹

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Looking for a miracle

Russia is among the world's largest newsmakers in the political and economic arena. Yet in the world of Islamic finance it is still lacking behind the rapidly developing industry. MADINA KALIMULLINA analyzes the situation to find out why.

Review of 2014

The year 2014 have brought serious changes for the Russian economy. The sanctions of the European countries and the US and historically low oil prices have led to a doubling of prices of many goods in the internal market, and this concerns not only imported items. Businesses have lost the access to traditional finance, and most banks supported by the government can suggest limited financing at a very high cost.

At the same time the Russian economy is relatively stable but the market is troubled about the future. Dmitry Medvedev, prime minister of Russia have called for the development of the import substitution sectors of the economy, during his speech at the annual Gaidar Economic Forum which took place on the 14th-16th January 2015. And the same forum had put in its agenda for the session on Islamic finance development prospects in Russia, thus confirming that the market has shown greater interest towards Islamic finance.

Among the speakers were: Andrei Simonov, professor at Michigan State University (USA); Birol Bashkan, assistant professor of political science at Georgetown University in Qatar; Linar Yakupov, director of the Islamic Business and Finance Development Fund; Bulat Mulyukov, chairman of the Islamic Law of Islamic Economics and Finance Development Center; Murad Aliskerov, Director General, CEO and founder of the Islamic financial company LaRiba Finance; and Victor Chetverikov, General Director of the National Rating Agency.

It should be noted that in 2014, for the first time in Russia's history, the expert commission of the National Rating Agency, the second largest Russian rating agency, have awarded diplomas to those who have made a personal significant contribution to the development of Islamic finance in Russia. Among those awarded were: Aliskerov again of Lariba-Finance (Makhachkala), for the creation of an efficient Islamic financial company; Rashid Nizameev, CEO of Amal Financial House (Kazan), for the efficient management of the Islamic financial company; and Bulat Mulyukov, for enlightenment in the sphere of Islamic finance.

Indeed the year 2014, especially its second half, had been filled with economic and finance forums and seminars which embraced among others the issue of Islamic finance. The industry which can bring new investments into the market seemed to be taken more seriously at last. And not being bounded by the level and market players, Islamic finance have been studied at various government bodies and institutions, both at the federal and regional levels.

At the same time the Islamic finance expert community and Islamic financial companies continued their gradual work. Moscow Halal Expo, the annual meeting platform for Islamic financial companies and experts from all the main Russian regions, held a seminar devoted to the bases of Islamic finance for the business audience. The LaRiba-Finance company based in Dagestan has been awarded a prize as the Halal company of

the year, an annual contest held by Moscow Halal Expo together with the National Rating agency.

At the roundtable titled 'The practice of Islamic business and finance in Russia. Success stories. New horizons of development', deputy chairman of the International Islamic Fiqh Academy, Shaikh Abdulkaher Qamar revealed subtleties of the review and adoption of Shariah-issued Fatwas, including for Islamic finance.

Behnam Gurbanzade from the International Bank of Azerbaijan, announced the intention to offer services in Islamic finance in the Russian market. Mulyukov presented the newly created organization designed to solve infrastructure problems of development of Islamic finance in Russia — the Center for Islamic Economics and Finance Development, which he chairs.

Aliskerov complained that Muslims can easily call Halal as Haram and vice versa when it comes to the cost of services. Nizameev in detail revealed the process of pricing of Islamic financial services, starting with the phrase: "Let's say we want to provide our investors with a 15% yield."

Isa Barhaev head of the Educational Center Fikra shared his experience on the evaluation of contracts for Shariah compliance stressing that the company's management is not always aware of how serious this job is in the process. Eldar Yachin, head of Yumart Finance proposed a model of closed mutual funds as an opportunity to implement Islamic mortgages in Russia.

Also in 2014, three AAOIFI Shariah standards have been translated and published in the Russian language. In November 2014 a Russian delegation visited Bahrain to meet the new secretary-general of the main Shariah standard-setting organization.

Preview of 2015

In 2015 it is expected that the discussions over the best legal framework for Islamic financial companies will be continued on various levels. And the process is likely to be time-consuming. It goes without saying that the Islamic financial companies existing in the market are likely to continue their gradual work and probably will make attempts to unite efforts for the creation of an investment fund that would act as an important part of the Islamic financial market of the country by attracting investments and disseminating them among the Islamic financial companies.

Conclusion

It can be said that when it comes to entering the Russian market by international Islamic investors, the first limiting factor is the absence of a law on Islamic banking in Russia which is a major reason why it lags behind in the industry.⁽²⁾

Madina Kalimullina is the director of Economic department, Russia Muftis Council. She can be contacted at econodep@gmail.com.



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Hedging Sukuk: Alternatives for issuers

Sukuk is one of the most significant financial market success stories of the last decade. While annual issuance of Sukuk (which, according to S&P, was US\$116.4 billion in 2014 and likely to exceed US\$100 billion again in 2015), remains small relative to the conventional bond market, Sukuk has become a viable funding option for many issuers, including sovereigns, sub-sovereigns and supra-nationals. **MICHAEL BENNETT and AKINCHAN JAIN** share their thoughts.

Surge in Sukuk issuance

During the second half of 2014, the UK, Hong Kong, Luxembourg, the Emirate of Sharjah and the International Finance Facility for Immunisation (a supra-national backed by nine sovereigns) all accessed the Sukuk market for the first time. For these issuers, the benefits of issuing Sukuk (such as investor diversification and significant available liquidity) outweigh the complexities involved in structuring and executing a Sukuk.

Hedging of Sukuk issuance

Many issuers of conventional debt regularly enter into hedging transactions to convert the liability incurred into a different currency or interest rate basis. For example, an issuer may be presented with an attractive market opportunity to issue a five-year, fixed rate bond but in fact desire a floating rate liability. In that case, the issuer may decide to issue the fixed rate bond and simultaneously enter into a five-year interest rate swap under which it receives from the swap counter-party the fixed rate amounts it needs to repay the bond and in exchange pays to the counter-party a floating rate of interest, thereby effectively converting its liability from a fixed to a floating rate.

Issuers considering the Sukuk market as a potential source of funding frequently face the question of whether similar hedging transactions are available in respect of Sukuk as they are accustomed to in the conventional market. In general, the answer to this question is "yes." Provided the relevant Shariah board views the Sukuk and the hedge to be entirely separate transactions, the issuer is free to enter into a conventional hedging transaction to hedge its Sukuk liability. In other words, since the hedge is viewed as independent of the Sukuk, there are no specific requirements imposed on the hedge by Shariah. However, Shariah compliant hedging options also exist in the market, and these can be employed by a Sukuk issuer either if required by the relevant Shariah board or if the issuer otherwise desires to enter into a transaction that is fully Shariah compliant (in respect of both the Sukuk itself and the related hedge).

Islamic derivatives

Various types of Islamic derivatives have been developed over the past decade, subject in all cases to the fundamental requirement that any instrument involve neither (i) speculation or excessive uncertainty nor (ii) the payment or receipt of interest. The types of Islamic derivatives that may be relevant for issuers considering hedging Sukuk include Salam contracts, profit rate swaps, and Ijarah rental rate swaps. These instruments generally involve the exchange of variable cash flows from one asset for fixed cash flows from another. The currency of denomination of the two assets also can be different, enabling issuers to issue in a currency that is most advantageous in terms of cost of funding and then hedge it back to their desired currency.

Hedging with Islamic derivatives is not, however, free of any difficulties, particularly for non-Islamic issuers that do not have experience with such instruments. One difficulty is using these derivatives require the issuer to identify and designate specific assets that are then linked to the instrument. Issuers can purchase commodities or other assets and use them as a reference on the hedge, but this can create risk management, operational and accounting issues. Moreover, even if the issuer can identify existing assets that can be used for the purpose of the hedge transaction, there may be issues around ring-fencing these assets on the issuer's balance sheet.

Once the assets are identified, another difficulty issuers may face is around documentation. Islamic derivatives are negotiated on a bilateral basis between the two parties, and in general there is not as much standardization of the terms of Islamic derivatives as issuers may be accustomed to in the conventional derivatives market. However, in recent years, the problem of documentation has begun to be addressed by the development of standard forms for many types of Islamic derivatives.

In 2010, for example, the International Swap Dealers Association (ISDA), in collaboration with the International Islamic Financial Market (IIFM), developed a Tahawwut (hedging) Master Agreement (TMA). This initiative was followed by the launch of the ISDA/IIFM Mubadalatul Arbaah (profit rate swap) product standard in 2012. As these standard forms become more widely used, the documentation hurdle for issuers looking to hedge with Islamic derivatives will be reduced significantly.

Conclusion

The Sukuk market has proven that it is capable of providing ample liquidity for issuers, even those with significant funding needs. That liquidity, combined with the publicity generated by the successful debut Sukuk issues executed in 2014, are likely to attract more conventional issuers to consider this market. These issuers will at some point face the question of how and whether to hedge a Sukuk transaction. While in many cases, issuers may be able to use a conventional hedge, as Islamic derivatives become more standardized and widely available, Shariah compliant hedging options should become increasingly available.⁽²⁾

The findings, interpretations and conclusions expressed herein are those of the authors and do not necessarily reflect the views of the World Bank or its affiliated organizations.

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Legal framework for Islamic finance transactions

Islamic finance poses unique legal issues, which have become more apparent as the industry has developed and become more cross border in nature. An overriding legal concern is how Shariah law operates alongside the governing law of the contract. In order for a contract to be certain and effective, the set of laws and rules which govern the contract must be clear. FERZANA HAQ puts the legal framework for Islamic finance transactions under the microscope.

Complexity arises in Islamic finance contracts because although such contracts are expressed to comply with Shariah principles, they are not, or are rarely expressed to be governed by Shariah law as a matter of contract. The landmark English Court of Appeal judgment of *Shamil Bank v Beximco* (2004), made it clear that where a contract is expressed to be governed by English law, the courts would interpret the contract in accordance with English law only despite any arguments that elements of the contract may be contrary to Shariah principles.

Many industry participants therefore regard the conflict between

the governing law of a contract and Shariah law as theoretical, since Shariah law (as applied to commercial contracts) has co-existed peacefully with national laws (or some sceptics would say, largely ignored) in the interpretation of Islamic finance contracts. However, we should not assume that this conflict will not arise. The fact is that since the *Shamil Bank* case, very few disputes on the alleged invalidity of a contract under Shariah law have been adjudicated publicly in a court of law.

Secondly, the fact that Islamic finance contracts are becoming increasingly cross border in nature means that the parties may

choose to have the laws of other jurisdictions govern their contracts where the judgment of the English courts is not binding or even persuasive. For example, in Malaysia, the commercial courts are bound by the opinions of the central bank's Shariah advisory council (SAC) in respect of the Shariah aspects of a commercial dispute. This raises the broader issue as to whether Shariah law, as it relates to commercial matters, will hover in a vague area alongside the national laws governing a contract or there will be a push for it to be incorporated into the national legal framework or even become a governing law in its own right.

The second and related issue is whether Shariah compliance will become increasingly regulated and centralized at a national level, or whether it will be largely self-regulated and left to be determined by the Fatwa (opinions) of the Shariah scholars appointed on the transaction.

“There is nothing inherently wrong with Islamic finance contracts being governed by the national law of a country – it is a part of Islamic tradition one must respect and abide by the laws of the nation where one resides while avoiding those activities which are contrary to Islam”

Review of 2014

Looking back over the past year, certain trends have emerged. Firstly, there seems to be a dichotomy between those jurisdictions which actively seek to incorporate Islamic finance in their national legal frameworks (for example by establishing national Shariah councils to set Shariah standards) and those which simply allow Islamic finance to be governed by existing national laws.

Not surprisingly, the former are Muslim countries, while the latter tend to be secular countries. Malaysia is a stalwart of the first category as the laws applicable to Islamic finance are monitored at a national level by the SAC. The SAC monitors Shariah compliance of Islamic finance contracts, the appointment of scholars and the governance of Islamic financial institutions. Other countries have attempted to follow this example – the most recent being Oman which set up its own National Shariah Council in 2014 to have direct oversight over Islamic financial institutions. Curiously, despite being the latest entrant to the Islamic finance market, Oman is the only GCC country which has centralized the regulation of Islamic finance.

Secular countries on the other hand have allowed Shariah contracts to be determined as a matter of contract. Rather than create a legal framework, they have amended their banking and tax laws to ensure that Islamic finance contracts are not disadvantaged in comparison to conventional contracts. Significantly, Hong Kong amended its taxation and stamp duty laws in 2013 in order to permit certain tax deductions and concessions for Sukuk issuances. Following these amendments, the Hong Kong Monetary Authority issued its first sovereign

Sukuk in 2014. Hong Kong has now created the necessary infrastructure to be a center of Islamic finance in the region although time will tell whether these new laws will have a real impact on the market. In a surprising contrast, Singapore, which had implemented certain concessionary tax rates for Islamic finance transactions, allowed such concessions to lapse in 2014 thereby potentially increasing the costs of undertaking Islamic finance contracts in Singapore.

Preview of 2015

My view is that in 2015, more countries will attempt to regulate and centralize Islamic finance. The industry will be closely watching whether Indonesia will introduce more regulations to centralize and monitor its domestic Islamic finance market, following announcements in 2014 that its regulators are proposing a five-year roadmap for the industry including the implementation of a clearer legal framework. Following the change in government, it will be interesting to see the extent and the impact of such changes.

In terms of dispute resolution, the establishment of the Singapore International Commercial Court (SICC) in 2015 may provide a suitable venue for hearing disputes in Islamic finance contracts under various governing laws. The SICC, which is comprised of an international panel of judges, is empowered to adjudicate on commercial matters governed by foreign law. Unlike arbitration, which is confidential between the parties, the judgments will be public and we may well see the interpretation of Shariah contracts being argued and adjudicated in court.

Conclusion

There is nothing inherently wrong with Islamic finance contracts being governed by the national law of a country – it is a part of Islamic tradition one must respect and abide by the laws of the nation where one resides while avoiding those activities which are contrary to Islam. Moreover, Shariah principles, as applied to commerce and finance, are often consistent with national laws. For example, the requirement of certainty of contractual terms is a key element of the common law and many jurisdictions already have laws that prohibit gambling or excessive speculation. Although Shariah law and national laws are viewed as parallel legal systems, let us not forget that there are more similarities than differences. ⁽³⁾

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Liquidity management in the Islamic finance industry

Liquidity is a financial institution's capacity to readily meet its cash and collateral obligations at a reasonable cost. When it comes to managing their liquidity, conventional credit institutions have at their disposal well-developed interbank markets that can be tapped for short-term funding, as well as a plethora of instruments. But this is not the case for Islamic financial institutions. MUJTABA KHALID looks at the developments and challenges of liquidity management for Islamic financial institutions.

Islamic financial institutions (IFIs) face great difficulties in managing their liquidity. The dearth of financial instruments at the disposal of IFIs makes for less efficient liquidity management (LM), as more than necessary cash is held, thereby reducing their profitability.

Some of the avenues of effective LM at the disposal of Islamic financial institutions include:

- Sukuk
- Inter-bank Musharakah/Mudarabah-based pools
- Islamic placement accounts
- Commodity Murabahah transactions
- Trading/hedging currencies

- Shariah compliant equities and mutual funds.

This report will assess the developments in LM over the past year in the Islamic finance industry with an emphasis on the Sukuk market. This report will also look at the expected developments and challenges the industry might face vis-a-vis LM in 2015 and beyond including the effect of Basel III and LM of Islamic financial institutions.

Preview of 2014

Sukuk

Compared to 2013 which saw a slowdown in Sukuk issuances, the Sukuk market in 2014 was very active. Governments and

sovereign issuances were especially lively with 19 jurisdictions tapping the Sukuk market. The Sukuk market saw the entry of Hong Kong, Luxembourg, Senegal, South Africa and the UK — giving a boost to the Islamic finance industry. 2014's other prominent issuers included Jordan, Maldives, the Emirate of Sharjah, Goldman Sachs and Japan's Bank of Tokyo-Mitsubishi UF. Total Sukuk issuance in 2014 surpassed the US\$100 billion mark, which was a significant improvement of almost 25% compared to 2013.

The previous year also saw Islamic finance actually make a move towards the actual spirit of Islam. In 2014, innovative ethical Sukuk structures such as the World Bank's Immunization Sukuk based on a Murabahah model backed by pledges made by leading global economies were initiated. The Securities Commission Malaysia launched the sustainable and responsible investment (SRI) Sukuk framework to facilitate the financing of sustainable and responsible investment initiatives.

“Momentum is being built towards realizing connectivity of Islamic funds with the global US\$3.7 trillion socially responsible investment funds”

Despite their growing circulation, a reliance on medium and long-term Sukuk for liquidity management purposes has several drawbacks. They bear a higher market risk, and this problem is exacerbated by the insufficient development of secondary markets. Moreover, only a minority of countries has developed a regular Sukuk issuance program.

LM tools

One of the most-used instruments in LM operations was the commodity Murabahah. However, the high fixed costs make shorter-term maturities particularly expensive. Similarly, another widely used instrument was the Mudarabah interbank deposit (MID). Under the MID, a deficit Islamic bank can obtain liquid funds from a surplus bank for a predetermined period of up to one year. It is often difficult to calculate overnight pricing of this instrument — in practice, however, it is often predetermined and the principal is paid back at maturity.

Preview of 2015

Basel III

Basel III introduces two new ratios (liquidity coverage ratio and net stable funding ratio) that banks must maintain as a minimum at virtually all times to help ensure they maintain sufficient liquidity to withstand cash obligations even under stress. As Basel III requirements start to roll in from 2015, the deficiency of alternative Shariah compliant liquidity management tools and the absence of a developed Islamic money market, could adversely affect the operations of Islamic banks. The idea that Islamic financial institutions are immune to liquidity risk has proven to be wrong with the default of many Sukuk-oriented Islamic funds.

Organizations such as IFSB are already revising their regulatory and supervisory rules in line with the Basel III framework. The magnitude of the impact will basically depend on other factors,



such as the jurisdiction where the IFI operates and the nature of banking activities within each institution.

Socially responsible investments (SRI) funds

Momentum is being built towards realizing connectivity of Islamic funds with the global US\$3.7 trillion socially responsible investment funds. Given that Islamic funds are relatively miniscule even within the Islamic finance space, they can benefit from broadening the current primary focus on 'negative' screenings to a wider socially-conscious investment consideration (i.e. positive screening). This will appeal and attract both Islamic capital as well as a wider global interest.

The way forward

To promote liquidity management, regulators and other Islamic finance market stakeholders need to work on:

- Building a global robust, integrated cross-border liquidity infrastructure which includes a money market and secondary market — the International Islamic Liquidity Management Corporation and the Bahrain Liquidity Management Center are a step in the right direction
- A globally accepted legal and Shariah regulatory framework.

Conclusion

The 2015 year is projected by many experts and analysts to send Islamic finance soaring into the mainstream. On the backdrop of this growth, LM especially in the short run continues to be a challenge for Islamic banks and financial institutions. Although these have shown some improvement, the following hurdles continue to hinder effective LM for Islamic banks:

- Absence of an effective global Islamic inter-bank market
- Lack of a range of Shariah compliant alternatives, both at a micro and macro level. (⇒)

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Beyond microcredit: The future of microfinance

In several African countries the microfinance market has been solely relying on providing microcredit – small microloans to the poor and low-income microfinance segments via commercial banks and non-governmental organizations (NGOs). PROF SHAHINAZ RASHAD ABDELLATIF believes that in some countries there should be a new microfinance law that allows for more financial inclusion and go beyond microcredit.

Needless to say, the participation of low-income groups who have little experience with formal finance and low levels of financial literacy and capability in the formal financial sector posed several challenges. Those segments require microfinance programs that include streamlined, efficient, simple borrower procedures, alternative approaches to collateral, as well as reliable, and convenient financial services tailored to their needs.

Policymakers in several countries in Africa, Asia and the Middle East and Africa (MENA) region have long realized that the potential for economic growth and poverty alleviation is contingent on the development of a more inclusive financial services sector. Yet, the International Finance Corporation (IFC)'s recent study shows that microfinance still reaches less than 20% of its potential market among the world's nearly 3 billion people in developing countries

that have little or no access to formal financial services. Most statistics have shown that most countries in the MENA region still suffers from a low penetration rate; especially in rural areas, in addition to a sizable financing gap as witnessed in the demand from microcredit borrowers which far exceeds the supply.

Review of 2014

Globally, multilateral organizations played a major role in supporting the microfinance sector. IDB and IFC (a member of the World Bank group) were major players in this arena supporting several microfinance initiatives in Kenya, Sudan and Yemen. For example, IFC supported an initiative related to AlKuraimi Islamic Microfinance Bank and the moveable asset registry in Yemen; whereas IDB continued to support initiatives in Sudan.

Asia continued to be an active global player in supporting microfinance initiatives which started off altogether in Bangladesh by Grameen Bank's experience but was extended to Pakistan and other countries in the region. Grameen-Jameel had several initiatives in Arab countries especially Egypt and Morocco and supported crowdfunding initiatives with KIVA.

In Egypt, the non-banking financial regulator – Egyptian Financial Supervisory Authority (EFSA) has increasingly revived its position in the region and embraced financial inclusion as one of their policy objectives permitting the entry of new players; mainly microfinance institutions (MFIs) with legal status as non-deposit-taking financial institutions. The law was passed in November 2014 and EFSA has issued several decrees to regulate the market including the maximum credit exposure cap of EGP100,000 (US\$13,070) per client and the types of microfinance products MFIs shall provide. In addition, EFSA is currently establishing a regulatory framework that allows an array of financial products and services and yet still provides effective consumer protection mechanisms for the overall sustainability of the financial market system. Under the new microfinance law, microfinance shall be provided by either newly established MFIs or transformed NGOs.

“ MFIs are expected in the future to provide a complete microfinance solution to expand the range of financial products offered to the poor beyond simple lending or microcredit to include other non-banking products ”

Preview of 2015

However, the immediate challenge in 2015 is the transition of some NGOs into a formal financial intermediary. Yet, more MFIs are expected to emerge in response to the entrepreneurial poor's unmet demand for financial services. Best practices in 2014 have shown that the poor are bankable, less delinquent and that banking with the poor can be profitable and sustainable. Microfinance can be a profitable and appropriate niche for new entrants — banks — especially those that are active in retail banking or consumer lending. This could encourage them to establish their own subsidiaries to capitalize on the advantages that the new microfinance law provides in addition to achieving sustainability and outreach — in terms of number of borrowers - through expanding its microfinance programs nationwide across all branches. This could bring about economies of scale to cover operational and financial costs. Moreover, microentrepreneurs are willing to pay high interest rates for convenient and quick access to well-designed financial services.

In addition to microcredit, more MFIs are shifting from conventional to Islamic microfinance, using Islamic finance principles such as Ijarah, Mudarabah, Murabahah, or Musharakah to meet the needs of Shariah compliant microfinance poor segments, which may be constrained by social, cultural, or religious barriers that usually prevented them from dealing with the banking system.



In addition, MFIs are expected in the future to provide a complete microfinance solution to expand the range of financial products offered to the poor beyond simple lending or microcredit to include other non-banking products — such services would include microhousing, microleasing, microfactoring and microinsurance without separate licenses such as in Latin America. To illustrate, microleasing is often a viable alternative for MFIs directly or in collaboration with leasing companies indirectly (lessors) in emerging countries to expand into micro and small enterprises (MSEs) longer-term asset financing (fixed assets or capital expenditures (CAPEX)) and for borrowers (lessees) who did not previously have access to asset financing.

In addition, in countries where MFIs and microleasing companies are not allowed to accept deposits and microfinance segments with no savings, it is expected that there should be an alternative means to encourage savings. Alternatively, a new microinsurance law may play a crucial role in the future to alleviate poverty and create sustainability among the poor, low-income microfinance segments. This could be done by encouraging savings through low-premium contributions collected on a periodic basis among microentrepreneurs in the poor segments. Meanwhile, this could also help MFIs to reduce their credit risk through collaborations with microinsurance companies.

Conclusion

The emergence of new MFIs in the region reflects the growing trend of fragmentation of banking conglomerates into various subsidiaries of the same group that presents a wide array of non-banking financial services such as investment funds, asset management, leasing, mortgage, insurance, and microfinance. (2)

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An assessment of the need for Islamic pensions

One of the main economic challenges faced by most governments is the ageing population, which is accompanied by the longevity risk. The Muslim world is not immune from the longevity risk because the ageing population will start affecting them by 2030 and the pension industry is poorly developed to meet the challenges of sustaining the aged population. SHAIKH FAIZAL AHMAD MANJOO opines the need to seek Islamic pension solutions is warranted

The cost of the longevity risk is heavy to be met by governments, financial institutions and individuals. There are various factors that led to this new phenomenon in the financial industry such as a drop in fertility rate and improved health services. The United Nations and other institutions have advised that pension is one of the most viable solutions to attend to this problem although existing pension plans have elements of Riba, Gharar and Maysir.

Usually three streams of income are required to maintain a consumption smoothing process after retirement: State pension, occupational pension and private pension. The state pension is known as the unfunded pension, whereby people contribute towards their pension but the state does not contribute as such. When a person retires he/she receives state pension. Governments provide this form for the next working generation

who pays tax and pension. This is known as the dependency ratio, i.e. how many people who do not work (i.e. children and elderly people) are maintained by the working force. But with an ageing population, the ratio of dependency drops because fewer people are paying tax to look after a growing elderly population.

Consequently, more emphasis has been laid on the funded pension by the authorities. The funded pension is offered by the employees who contribute towards the pension contribution of employees. It is also known as the occupational pension. Two main types of occupational pension exist: the defined benefit and the defined contribution. In the first case, one knows how much he/she will receive as annuity after retirement. Usually this is a fraction of the final year's pay. In this case the employer is shouldering the risk of the pension pot as he has to ensure that

enough money exists in the pot to meet the pension liability. But as the cost of maintaining this scheme is skyrocketing, the shift is now towards defined contribution whereby the employee bears the risk as the employee knows how much he contributes and decides where the pension provider should invest the money. So the risk is now shifted on the employees to meet this liability.

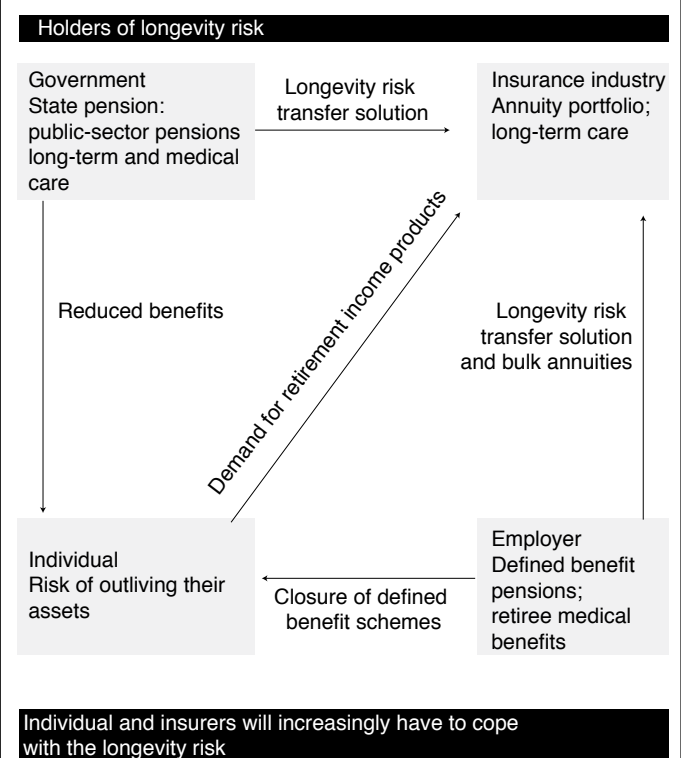
This scenario is reflected in Figure 1. It shows how various stakeholders are shifting the risk; and ultimately the insurance industry, which tends to have enough data to price the longevity risk, is shouldering this risk. However, they are developing longevity bonds by securitizing these liabilities and this risk is further spread in the capital market.

To bring a balance regarding the longevity risk, defined ambition is being developed in a few European countries. This relatively new pension plan is a compromise between the defined contribution and defined benefit, whereby the employer promises to pay a minimum amount to the employee upon retirement and the remaining risk is shouldered by the retiree.

The third source of income, i.e. private pension, is hardly accessible because the average person cannot have enough disposable income to make investment for retirement in a private pension. This creates a further gap in the consumption smoothing process.

The problem in the Muslim world is that the pension has mainly

Figure 1: Shifting balance in meeting costs of retirement



Source: Alison Martin (from Swiss Re), 2011



been focused on state pension. This can be considered as a demographic and financial time bomb. The reality is that people do not see the need to provide for their old age because they want to maximize their income utility in the present rather than to enjoy it in the future. This is problematic from a Shariah point of view because the higher objectives of Shariah (Maqasid Shariah) warrant that life, wealth, human dignity and descendants be protected. Old age is a stage in life where one can lose that dignity. Therefore, one of the ways of monitoring the longevity risk is by appropriate investment and savings.

As the present Muslim population is relatively young and few countries are becoming emerging markets, this creates a space for discussing pension provisions. The young working class can save their disposable income for their private pension and employers should also play an important role in creating more occupational pensions. The main problem, however, is the lack of data to price the longevity risk. The Takaful industry can play a very important role in realizing this objective as they can extrapolate for the data bank or even seek help from the conventional insurance industry. However, the uncertainty in longevity risk is well pronounced. Hence, there is a tendency in the developed world such as the UK where the state shares the risk by issuing a longevity bond.

The challenge for the Muslim world therefore is to develop Shariah compliant occupational and private pension plans. However, the state also should share the longevity risk by issuing long-term Sukuk. ☺

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The next frontier

The prospects for global wealth management have improved tremendously over the years. Malaysia can potentially be the global hub for Islamic wealth management due to its available infrastructure and market-friendly incentives for the investors. With the introduction of new regulations in the financial market, the ever-changing client behavior, the competitiveness of emerging markets and the highly liquid Malaysian market, there is a demand for foreign investors as well as domestic institutional investors to invest in Malaysia. **HAJI MOHD RASHEED KHAN MOHD IDRIS and GIFFIN LEE WEON LI** examine the Malaysian private banking and wealth management industry.

IFD report 2014

According to the Islamic Finance Development (IFD) Report 2014, Malaysia performed relatively above average as the top player against 91 other countries. Malaysia ranked top for knowledge and quantitative development, and second for governance and awareness.

For example, the establishment of the Labuan International Business and Financial Center (Labuan IBFC), is complementary to the objective of the Securities Commission Malaysia to be the global hub for Islamic wealth management.

The private wealth landscape continues to diverge according to the market behavior. For organizations with rapid growth, certain measures and considerations need to be taken into account especially organizations that grew out of a family business. To ensure perpetuity and longevity of the family business, proper

business succession planning is essential. Wealth managers and private bankers also play an important role in ensuring that the business is run with proper management and funding.

Asia-Pacific Wealth Report 2014

The Asia-Pacific Wealth Report 2014 by Capgemini and RBC Wealth Management showed that the high-net-worth individuals (HNWI) in Malaysia prefer to seek advice on family wealth (34.0%) than on personal wealth (21.7%). Contrary to the global trend, the HNWI in Asia-Pacific (40.7%) (excluding Japan) were more focused on wealth growth than preservation (31%).

This showed that the HNWI need a more comprehensive succession plan than just having a will or a trust for their legacy. As for those HNWI with a family business and an intention of running the business for generations, the transition controls in the family business, succession planning for the ageing business

founders, the spinout of a family office or the managing of the company assets can be complex.

Succession plan

As individuals now are better informed with digital technology means, it allowed individuals to create their wills (Wasiat) online without going to lawyers or estate planners. Moreover, individuals can even purchase unit trusts or open bank accounts or get limitless access to the market information from the internet. Continuous global wealth creation and wealth distribution have led to the increase in percentage of the HNWIs. More often than not, these HNWIs do not generally have a proper succession plan that can allow the beneficiaries to inherit their legacy without hassle. A good plan puts in place structures that will secure the legacy for them. This can be done by creating a family charter and structuring a long-term plan for the family members. The family charter should adopt a more formal governance structure and implement a more institutional risk management program, provide proper controls and adopt an advance technology platform in all levels of the family charter.

As the saying goes: "Most of the family business cannot sustain more than three generations." The first generation makes the business, the second sustains it and the third expands it. Unfortunately, Asian family businesses are at a critical stage of management succession where next generation training and development is imperative. This involves appointment of trusted non-family management and/or advisors who have the adequate knowledge in facilitating these family business transitions. A study shows that the majority of family business owners would like to see their business transferred to the next generation. However, it is estimated that 70% will not survive into the second generation and 90% will not make it to the third generation.

Family charter

A reason why business founders will only step down from management control at a later stage of their lives is a lack of talent inventory and readiness among the young generation to

lead the business. To achieve effective business succession, the business founder should consult and lay down proper motives for business succession when he or she is still in control to get the optimal guidance in a timely manner. Getting the next generation involved in business earlier allows generic knowledge and business skills to be acquired and to be implemented in the future. That is to say, incorporate the succession plan in writing, together with the existing instrument that can be found in the market. Creating a foundation or a family charter can ensure the right person fits the right position thereby optimizing the management succession control in the family business.

It is, however, worth pointing out that the process of making a succession plan could be more significant than executing the plan itself. Devising a succession plan for a family-owned business allows the business founder to identify and deal with the many emotional issues at hand and provide solutions in managing a family business.

Operationalizing the succession plan during the lifetime of the business founder will become a model to ensure that the business will run through generations and put the family members in harmony as required under the family charter. Even though major Chinese enterprises have successfully implemented business succession plans, the concept of the family charter and succession planning is only slowly picking up with the Malaysian Muslim business community.

With the implementation of the new Islamic Financial Services Act 2013 in Malaysia, private bankers, financial planners and wealth managers must be able to grasp the new regulations to unlock the opportunities derived from the financial markets and to develop the succession planning market for the Malaysian Muslim community. (2)

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Of Sukuk and asset management – a chat with BNP Paribas Investment Partners

From welcoming a host of new players to weathering market volatility, 2014 was indeed an interesting year for the Islamic capital markets and Shariah compliant asset management segment. IFN catches up with BNP Paribas Investment Partners's CEO and country head, Angelia Chin-Sharpe (ACS) and head of global Sukuk investment, Jesse Liew (JL) to review the past year as well as discuss what we should anticipate in the Sukuk and asset management space this year.

IFN: What were some of the key Sukuk/Islamic asset management trends of 2014?

JL: There were a lot more unrated Sukuk papers issued last year, particularly from Dubai such as issuances by the government of Dubai, the Investment Corporation of Dubai and low-cost carrier, flydubai. Another notable trend is the issuances coming out of non-traditional Sukuk markets such as the UK, Hong Kong, Luxembourg, South Africa, the US and Pakistan. These new

markets add to the geographical diversification in the global Sukuk market; also, the highly rated sovereign issuances from the UK, Hong Kong and Luxembourg enhance the overall profile of the universe.

ACS: [The entrance of these new jurisdictions] is good for the market as it offers more diversification and more players. Other than this, fund growth and assets under management growth were not strong due to market uncertainty.

IFN: Touching on this diverse range of new issuers – which were some of the most interesting Sukuk markets and why?

JL: New issuances out of Hong Kong, Luxembourg, the UK and the US provide an interesting diversification because these are well-developed financial markets. The UK and Luxembourg Sukuk issuances, which are denominated in GBP and EUR respectively, introduce a currency play for global Sukuk investors. With Pakistan also joining the primary issuance fray, the global Sukuk reach has also expanded to investors in the high yield spectrum.

IFN: It is obvious that the UK is assertively positioning itself as an Islamic finance center and Dubai is also anchored firmly in doing the same, how then will Malaysia compete?

JL: While a good number of countries are in the race to position themselves as a key global Islamic finance hub (i.e. the UK, Dubai, Hong Kong and Luxembourg) we believe that Malaysia will continue to maintain its forefront position given the maturity of the domestic Sukuk market which is exemplified by the vast number of local as well as international issuers and the solid track record of regulatory support from our government, which we have seen for the past 20 years.

“ We will continue to engage directly with our client, committed to delivering long-term success and achieving investment excellence ”

IFN: Jesse, Sukuk has always been the poster child for Islamic finance – do you think we are over-relying on this instrument? If so, what other alternatives should we look out for?

JL: Not really; Islamic banking has always been around, while Takaful and Shariah compliant equities have been gaining prominence over the years along with Sukuk. Part of the recent rise in Sukuk demand could be attributable to the decreasing cost of borrowing, which makes perfect sense for issuers to tap considering that yields are still near historical lows.

IFN: What about innovation? Over the past year, has the implementation of Basel III resulted in any structural innovation?

JL: In the global Sukuk space, there has only been one Basel III Sukuk issuance so far, which is the Tier 1 Perpetual Sukuk by Al Hilal Bank. We haven't noted any structural innovation so far, as this particular issue uses a basic Mudarabah agreement to facilitate the transaction; the same structure was used for previous Basel II Tier 1 Sukuk issuances by other UAE-based banks. In the Malaysian ringgit domestic Sukuk market, the Basel III Sukuk issuances that we have seen so far have also used generally straightforward Murabahah or Ijarah structures.

IFN: The Sukuk market is dominated by Malaysian ringgit and US dollars but we are also seeing growing interest in non-traditional currencies in terms of Sukuk issuance (euro for example), can we expect to see a shift in currency preference?

JL: Issuances in the near term will naturally be demanded by Islamic banks, Takaful companies and pension funds in key Islamic countries (i.e. based out of the GCC region and Malaysia). Given that most GCC countries have their local currencies pegged to the US dollar, we expect the ringgit and US dollar to continue dominating the Sukuk space.

IFN: Angelia, there has been a lot of market chatter about the rising demand for SRI funds. Has this had any effects on Islamic funds, considering their overlapping ethical proposition?

ACS: No, not really. Shariah compliant funds may not necessarily be environmental, social and governance (ESG)-compliant.

However, an ESG filter can be added on top of the Shariah screening methodology. I think it is good that investors are being more aware of ESG requirements and these forces can push companies towards better standards. BNP Paribas Investment Partners is already managing our clients' monies in line with ESG.

IFN: Which were the best-performing asset classes of 2014? Which asset classes should investors keep an eye on moving forward?

ACS: Our key macroeconomic convictions based on the fact that valuations of developed stock market indices remain close to their post-crisis highs emphasize the pull that equities exert on investors with the appropriate investment horizon in a world where real interest rates are exceptionally low as far as the eye can see.

We believe global equities have the potential to once again generate attractive absolute returns as better economic growth and attractive valuations provide the basis of a virtuous cycle.

IFN: As we wrap up; Jesse could you share with us what is your market outlook for the Sukuk industry for 2015? And Angelia, will you share with us BNP Paribas Investment Partners's strategy for this year?

JL: We believe that the fundamentals of the global Sukuk market continues to be strong despite the oil price decline largely due to the last three years of high oil prices, as well as the low fiscal breakeven from the three major issuing GCC nations (ie. Qatar, the UAE and Saudi Arabia need oil prices to maintain between US\$40/bbl and US\$80/bbl to fund its fiscal expenditure).

ACS: There will be no changes in BNP Paribas Investment Partners's strategy. We will continue to engage directly with our client, committed to delivering long-term success and achieving investment excellence. 'Engage, Commit and Achieve' is our tagline.

In our opinion, valuations in emerging markets are approaching levels at which their numerous strengths (eg: strong growth, low debt, structural reform, favorable demographics) will become apparent to investors seeking attractive returns over the appropriate investment horizon.

BNP Paribas Investment Partners Malaysia is going to keep promoting our global Sukuk and ASEAN equities capabilities. (2)

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Improving global market for Islamic private equity and venture capital

Islamic private equity (PE) remains a very small component of the global PE market but showed signs of strength last year with an increase of mergers and acquisitions (M&A) activity in the Middle East hitting a four-year high. Islamic venture capital (VC) continues to face an uphill battle in the region but demonstrated signs of improved market perception and attention. SUHAIL AHMAD writes.

Global alternative investment assets reached US\$7 trillion in 2014 according to Preqin's 2015 Global Alternatives Report. PE including VC was the largest component of alternative assets with US\$3.8 trillion under management, an increase of 12% over the previous year.

Review of 2014

Aggregate capital raised by PE and VC firms worldwide in 2014 was a strong US\$495 billion, with 85% of the activity in North America and Europe. PE returns as measured by public pension fund holdings reviewed by Preqin Performance Analyst remained strong at just under 20% for the year and clearly beating other alternative asset classes such as real estate and hedge funds with the latter closing out 2014 with a measly 2.9% average investment return as measured by the Barclay hedge fund index.

“ Aggregate capital raised by PE and VC firms worldwide in 2014 was a strong US\$495 billion, with 85% of the activity in North America and Europe ”

The Middle East witnessed some strong deal-making with publicly announced M&A across the Middle East increasing 23% to reach US\$50.3 billion last year, the highest amount since 2010. Despite the strong M&A activity in the region, international private equity firms were not as aggressive as expected and inbound M&A activity declined 30% last year to US\$4.2 billion, according to Thomson Reuter's data.

One of the region's largest PE firms, Dubai-based Abraaj Capital had an active year teaming up with the US-based TPG Capital to bid for Saudi fast-food chain Kudu, although it lost out to multinational cereal giant Kellogg in a bidding war for Egyptian biscuit maker BiscoMisr.

The sector in 2014 also saw the successful fundraising of the largest PE fund since 2011 with Gulf Capital of Abu Dhabi closing its largest and third private equity fund; GE Equity Partners Fund III with a US\$750 million raise. Although Gulf Capital is not a dedicated Islamic PE firm, the closing is a positive development for the region and should spur more activity in PE in the coming years.

In the VC space we expect 2014 investment levels to improve over the US\$29 million in funds raised in 2013 according to

the MENA Private Equity Associations 4th Venture Capital in Middle East and North Africa Report. Similar to the regional PE data, it is unclear how much of the VC deal flow was Islamic but nevertheless the VC sector in the region continues to remain embarrassingly low compared to the rest of the world which had total VC investments of US\$86 billion last year including the closing of 273 new VC funds!

Preview of 2015

PE firms will be increasingly interested in the Middle East region as investors look at diversifying geographically, better valuations than in the US, and capitalizing on the growth opportunities of the young demographics of the region.

Interestingly, a series of interviews of 75 corporate executives across the Gulf Cooperation Council (GCC) in the GCC Investment Outlook report late last year revealed only 45% of respondents think that the opening up of GCC stock markets to foreign direct investments will be one of the main drivers for investment in the region. However, 51% of respondents do believe PE transactions will increase significantly in 2015.

Small mid-sized enterprises (SMEs) and start-ups that do not have access to traditional Islamic banking credit options for a lack of collateral or operating history are desperate for an increase in venture capital options in the region. The 10th World Islamic Economic Forum (WIEF) held in Dubai last year had a lively panel discussion on the role and future of crowdfunding to fill the VC void in Islamic finance. The discussion and increased interest in crowdfunding is a positive step and will help increase awareness of VC as an important tool for positive socio-economic development in the region.

Conclusion

Islamic PE and VC have an opportunity to substantially contribute to the economic growth in the region by supporting businesses of all sizes reach the next level. However, it will continue to be a challenge for the industry to differentiate itself from conventional PE.

However, there are encouraging signs for VC with the growth of crowd equity funding which is inherently compatible and mutually reinforcing with Islamic values of building and supporting local communities, encouraging risk and wealth sharing, promoting real economic activity, and equity ownership over debt. These goals should be near and dear to all investors and participants in Islamic PE and VC. ☺

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The world needs an Islamic quantitative easing

Seven years have passed since the 2008 financial turmoil, and we are still experiencing waves of new crises. The reason why we have not really moved on yet is because the policy response to the monetary and economic challenges has been contradictory and ultimately inadequate. The two main policy responses to the 2008 crisis in advanced economies were quantitative easing (QE) on the monetary front, and austerity measures (AM) on the fiscal front, referred to here as the QEAM (quantitative easing and austerity measures) policy combo. DR ARMEN PAPAZIAN takes a look at QE in Islamic finance.

2015 started off with a landscape defined by currency wars, declining oil prices, geopolitical conflicts, deflation risks, stagnating economies, large debt burdens, post austerity pains, and an overall sense that whatever recovery we went through did not really feel like a recovery at all.

The simultaneous implementation of QEAM reveals an incomprehensible absurdity in the economic wisdom behind these policies: one of them, austerity measures, is being implemented because "there is no money" and the other because we can "invent money as we please". There is no money for the government to spend, but the central bank can invent as much money as it sees fit. The difference of course, is the source and the destination of new money. Besides the questions and doubts that this raises about the wisdom behind such a monetary architecture, the fact is, the QEAM policy combo has been ineffective and has added on to the difficulties and inequalities that the world economy needs to address.

Through QE the US, the UK, Japan, and now Europe have injected or are planning to inject trillions of US dollars worth of new money into their banking systems. QE is a money creation mechanism through which a central bank invents new money by purchasing existing government bonds from banks, thus increasing their reserves. In the case of the US Federal Reserve, QE3 also involved the purchase of mortgage-backed securities from banks.

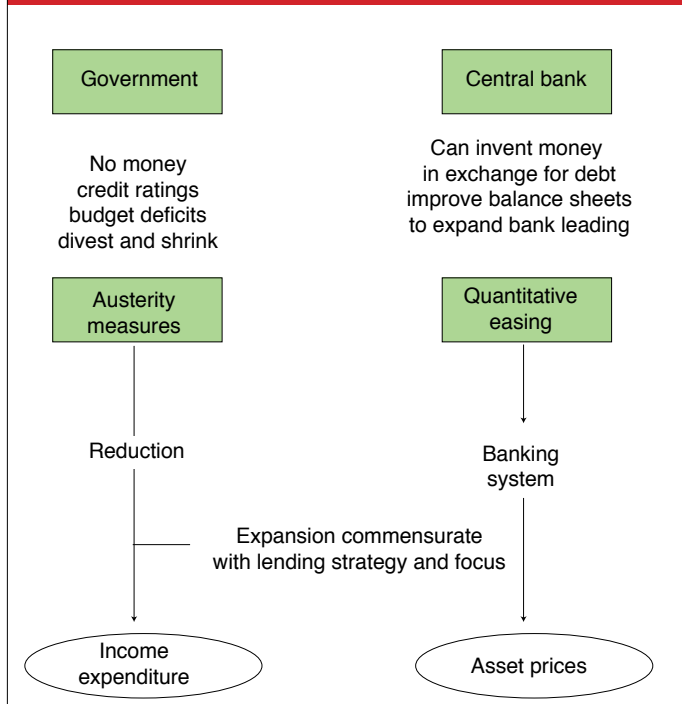
A QE bond-based injection of new money eases the system, as it is suggested in the very name of the program, by increasing bank reserves and allowing more room for new debts and lending by banks. However, and this is crucial, when, if, and where this new lending actually occurs and what type of activity it ends up supporting are totally dependent on the discretionary policies of the banks. Given already existing levels of debt, private and public, and the availability of eligible borrowers, a credit-dependent policy is bound to be slow, and also ineffective.

Furthermore, given the recent involvement of banks in a series of scandals, from rate rigging to price manipulation, and unethical conduct, and taking into account the large fines they have had to pay, the decision to entrust such a critical injection of new liquidity at such a critical moment to the same banks is absurd, and again raises doubts about the wisdom of the policy as a whole.



While QE is ultimately conditioned by banks and their lending policies, AM had an immediate impact on government budgets, and hence also on government expenditures across a variety of sectors and realms of economic activity. Indeed, across the advanced economies, AM have had a negative impact on education, healthcare, science, welfare, and a host of other sectors and local communities. Government budget cuts due to austerity have affected income levels as well as the level of public investments and local infrastructure. The structural damage that AM have inflicted cannot be underestimated, and despite recent headlines across the US and the UK, the pain and destruction they have caused is still very much a reality, although without much coverage.

Chart 1: The QEAM combo-Quantitative Easing and Austerity Measures



Indeed, in many instances, and for millions of people, AM have led to humanitarian crises that have been brushed off as side effects. Greece's recent anti-austerity wave, and the results of the elections are a testimony to the fact that these side effects are very serious, and austerity cannot possibly be the path towards prosperity. In fact, it is absurd to think that it actually can.

Given the current state of affairs in the global economy, the QEAM combo has already proven itself to be an inappropriate approach to tackling the real challenges we face. Indeed, QEAM has been the wrong remedy, and has only had short term effects on asset prices, with almost no real recovery in sight.

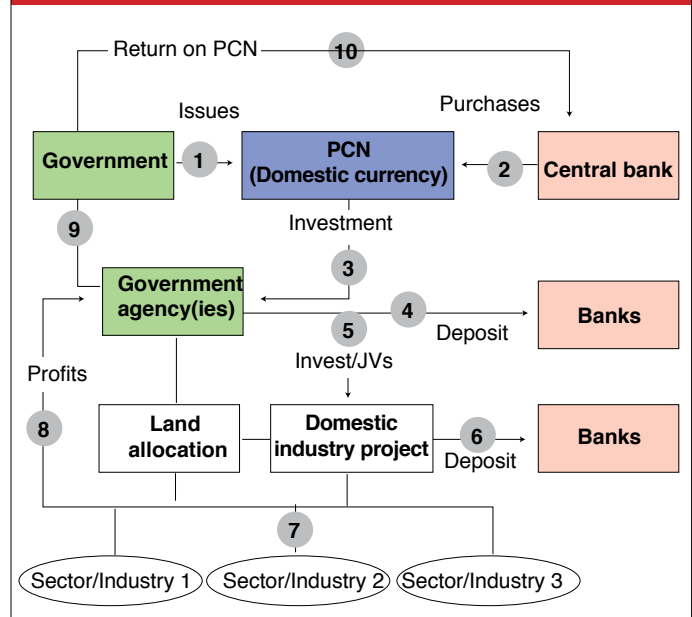
What we need now, is new and more direct monetary injection tools that do not depend on debt and credit expansion to reach and impact real economic activity. The necessity to diversify the tools of money creation and injection beyond debt is key to the global economy. My assessment is that we will not truly turn the page on this protracted crisis, until we adopt a more balanced and more diversified logic of money creation.

This is why the time has come for the introduction of an Islamic QE, i.e. the injection of new money through instruments that are in line with the principles of Islamic finance. An Islamic QE would use profit-sharing and risk-sharing instruments directed at and involving real activity creation from the get-go. By entrenching the real economy component into the instruments through which the new money is being injected, an Islamic QE ensures that the flow of money is directed at value-added real activity-creating projects and investments.

Indeed, an Islamic QE does not necessarily need to be called as such, and can be adopted anywhere. The point being made here is that the invention of new money into the economy should not start with the banks and be dependent on further credit expansion; instead, it should start with real investment projects creating new income and new expenditure from the very first round.

In 2011, in a paper I presented at Sorbonne University, titled 'A

Chart 2: QE through Public Capitalization Notes (PCN)



product that can save a system: Public capitalization notes,' I argued for such a monetization tool, and also identified public capitalization notes (PCNs) to be in line with Islamic finance principles.

How such a product would be issued and used is described in detail in Chart 2. The numbering describes the issuance of a PCN as a first step, its purchase by the central bank as the next, and then on follows the flow of funds.

A QE, or monetary injection based on a PCN would ensure that the new money injected into the economy is not conditioned by further bank lending. Banks get the money eventually, but as new deposits. The injection starts off as real expenditure that turns into income in round one. PCNs allow the reduction in existing debt levels, and do not condition future debt reduction by present debt expansion, which is the inherent absurdity of a solely debt-based monetary architecture.

How many more years of economic failure is it going to take to finally turn the page on the obsolete wisdom that has brought the world to the brink of socioeconomic, environmental, and political disaster?

The world needs an Islamic QE program, and although any country with a sovereign monetary system could initiate an Islamic QE, without having to call it as such if they did not want to, at this moment in time, the Islamic world is an ideal candidate to take the lead. With declining oil prices and adjusted more modest expectations for the short and long-term, a number of economies in the Islamic world are now facing significantly reduced export revenues. Given these countries' reliance on oil, their state budgets and domestic expenditures are at risk. Furthermore, given their domestic monetary architecture, a number of these economies will experience this impact on a money supply level as well.

I think it is high time for an Islamic QE, and PCN can do the job perfectly. ☺

Dr Armen Papazian is a financial economist, innovator, and consultant with a track record of global industry experience and achievements as a former stock exchange executive, investment banker, and advisor.

What's beyond Islamic finance?

With the financial crisis hitting the world's economy, heads started turning towards Islamic finance and sustainable investment, mostly referred to as socially responsible investments (SRI) or environmental, social and governance (ESG), despite their old origins. Islamic finance was suggested as an alternative for conventional finance, while SRI provided modifications for conventional finance. AHMED SIAM brings an overview of Islamic finance as an alternative to conventional finance.

Several studies proved the resilience of Islamic finance against the financial crisis compared to its conventional counterpart due to the structure of its asset-based business model and risk-sharing model. As for the ESG, which involves a set of standards upon which socially conscious investors do their fundamental investment analysis, studies have found that companies with high corporate social responsibility (CSR) and ESG ratings showed a lower cost of capital. Around 90% of these companies outperformed other companies in terms of market-based aspects.

Based on the latest 2014 reports, ESG's assets under management (AUM) are almost seven times that of Islamic finance assets; with the former surpassing the US\$13.6 trillion bracket, and Islamic finance approaching the US\$2 trillion level. Both markets are growing significantly but in different regions. ESG shows a great focus mainly in Europe (US\$8.76 trillion), the US (US\$3.74 trillion) and Canada (US\$590 billion), whereas Islamic finance's focus is in the GCC (US\$716 billion) and South East Asia regions (US\$459 billion). Also, the number of Islamic funds increased throughout 2014 to reach 791 Shariah compliant funds with more than US\$51 billion in AUM. On the other hand, Sukuk witnessed a tremendous growth with 1,814 of outstanding Sukuk and 44 listed Sukuk around the globe, representing more than 17% of total Islamic finance assets.

“Islamic finance has the potential to adapt the ESG investment criteria, to form a new viable alternative that relies on real economic activity going back to its basics and objectives (Maqasid Al Shariah)”

Despite this regional variation, researchers believe that both segments are considered compatible and even complementary to each other. Since most of the Muslim investors are reluctant to invest their money in a way that does not align with their beliefs, it was noted that a considerable amount of Muslims keep their money in real estate assets or liquid cash. Interestingly, in the last couple of years a number of our clients have approached us to extend our coverage from Islamic finance to ethical investments and to ESG issues. Doing this, a number of synergies between the two areas were discovered, and we believe that such a

trend will continue and grow tremendously in the coming years targeting more ethically-minded clients irrespective of their religious affiliations.

Islamic finance has the potential to adapt the ESG investment criteria, to form a new viable alternative that relies on real economic activity going back to its basics and objectives (Maqasid Al Shariah). Both sectors have common grounds in terms of taking care of the social aspects which is specifically reflected in Zakat, in Islamic finance, and community development programs in ESG. There is also a negative screening process present in both ESG and Islamic finance to exclude sectors that are deemed harmful to society and its individuals. There is even more overlap when checking Maqasid Al Shariah and how it helps create better individuals and a better society that can easily be reflected in the ESG aspects. At the same time, with the positive screening methodology, which helps in deciding the best sectors and best companies in a sector for better investment decisions, ESG is providing a second layer of screening after Islamic finance. So eventually it is not only forbidding what is wrong, but also welcoming all that is good.

Practitioners should start focusing more on this overlap and combine the best of both to reach maximum economic growth. By this, the Islamic world could benefit from such a combination to move towards welfare problems and start directing investments in underdeveloped sectors, such as; microfinance, alternative energy, health, education and other relevant sectors that would benefit the community.

It should be noted that few relevant initiatives took place in 2014, where last year one of the leading financial services firms signed the United Nations' Principles for Responsible Investment (UNPRI) to become the first GCC Islamic asset manager to do so. Another London-based Islamic asset manager launched three consecutive SRI and Shariah compliant equity funds. Moreover, Malaysia's Securities Commission (SC) announced the long-awaited guidelines for SRI Sukuk. The SC listed an extra set of rules for SRI Sukuk, in addition to the existing guidelines on all Sukuk.

It is believed that these steps will allow more funds to be raised for renewable energy, hospitals, and other infrastructure long-term projects. With more similar initiatives, 2015 is expected to be a turning point towards more global sustainable financing and development. Islamic finance could increase its annual growth rate with such a combination as it will enable it to explore more underdeveloped countries in addition to being more appealing to investors from Europe and the US. (F)

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Islamic real estate on the upswing

Real estate has been a staple investment class for institutions and individuals alike since the dawn of time. However, it was the innovations within the Islamic finance industry when the wealth generated from the Gulf region was looking to break into the international real estate market that really shaped the industry as we know it today. PHILIP CHURCHILL provides a brief account of developments in the Islamic real estate space.

From its tentative beginnings when lawyers and advisors were learning on the job how to structure deals and get the required approvals, the Islamic real estate industry can now rely on a number of fairly standardized legal structures to enable levered investments to be undertaken in a Shariah compliant manner. However, it is the constantly evolving tax and regulatory environment that is now driving innovation.

What investors continue to value is local knowledge and expertise, for the real estate industry remains the archetypal 'local business' where significant advantage can be gained and traps avoided through working with local advisors or partners.

Review of 2014

2014 built on the renewed confidence that both investors and banks had re-established the year before. Global appetite to investment both locally and internationally continued to build, with CBRE predicting mid-year that the Middle East alone would generate US\$180 billion of international real estate investment over the next 10 years.

Investors sought a seemingly ever-increasing volume of transactions and were able and willing to look at new countries and regions. With memories of the euro crisis of summer 2012 now fainter, investors looked again at mainland Europe, albeit focused on the stronger economies. The US provided many opportunities, and not just in the gateway cities of New York and San Francisco. Meanwhile, the familiarity and economic recovery within the UK proved hard to resist both for investments and a material increase in appetite for development transactions.

While publicity was focused (for good reason) more on the Sukuk issue itself rather than the underlying real estate assets, the UK government's sovereign Sukuk issue provided the key transaction of the year. This provided a useful reminder that real estate and Shariah compliance is largely a natural fit, not requiring a square peg to be shoehorned into a round hole. All of this activity was helped by the eagerness of banks to provide Shariah compliant finance, with a significant fall in pricing over the year.

Preview of 2015

Real estate investors whether Islamic or not are getting used to a new world of low oil prices and low inflation. With the underlying source of wealth for many Islamic investors reduced and low inflation driving low returns on many assets, property finds itself looking very attractive, with higher yields than can be achieved elsewhere and economic recovery to sustain values.

With competitiveness among banks to provide finance continuing to increase, I expect margins to fall further, as they still remain

“ **The Islamic finance industry has shown great flexibility in responding to changes in tax and regulatory requirements, and I suspect that this will again be required in 2015** ”

comfortably above the lows seen in previous cycles. Teamed with historically low reference interest rate swaps, this should provide low overall costs of finance, further improving the levered yields that can be achieved. Currency exchange rates will have a significant impact, with the US starting the year looking relatively expensive from a Malaysian perspective, while the euro area is increasingly attractive with the quantitative easing of the European Central Bank driving interest rate expectations even lower.

Appetite for development transactions should continue to grow as pricing on existing investment stock continues to rise. Ranging from the significant regeneration projects being undertaken by the Malaysians, to more modest but no less important individual apartment developments funded from the Middle East, London has been the focus to date, but I expect this to move beyond London to the southeast of England and perhaps further afield, as well as to the US and Germany. The Islamic finance industry has shown great flexibility in responding to changes in tax and regulatory requirements, and I suspect that this will again be required in 2015, as governments continue to respond to the post-recession environment and are themselves potentially changing, with a national election in the UK and the US preparing itself for a presidential election in 2016.

Conclusion

So, while it seems that everything is changing, some things remain the same. For Islamic investors real estate remains a core part of their investment strategy and as both investors and advisors get used to the very different political and economic environment that 2015 provides, the desire to invest both for shorter-term gains and longer-term diversification remains. Islamic real estate pounced on the opportunity to invest on the upswing in the markets and is continuing to recognize the opportunities that this asset class provides. (P)

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Good times ahead for Islamic retail banking

It's an exciting time for Islamic retail banking. Established markets are pioneering ways to achieve market growth and emerging markets are looking at ways to fuel rapid expansion. This is reflected in the opinion offered by industry experts. TIM SINCLAIR writes.

The trend so far for impressive growth is set to continue, according to estimates by Ernst and Young, the global professional services firm. The firm estimates that global Islamic banking assets grew at an annual rate of 17.6% between 2009 and 2013, and will grow by an average of 19.7% each year until 2018.

Overall, growth has been driven by a variety of factors, with Sukuk issuances in non-Muslim markets including the UK, South Africa, Hong Kong and Luxembourg dominating the headlines in 2014. However, a closer look shows that the impressive achievements of the retail Islamic banking sector has also played a significant role in helping the industry.

Review of 2014

While Malaysia, Indonesia and the Gulf region are the main centers of the global Islamic finance industry, significant developments have been taking place elsewhere.

In the UK, for example, the government launched the Help to Buy:

Home Purchase Plan Guarantee scheme, aimed at widening consumers' accessibility to Shariah compliant retail financial products.

This was an extension of the existing state-backed Help to Buy mortgage guarantee scheme for home buyers, to include Shariah compliant home finance. Launched in February 2014, the scheme was developed by the Treasury with support from the UK's Al Rayan Bank, formerly known as Islamic Bank of Britain (IBB).

This was an important milestone for the Islamic finance industry and, in particular, Muslim consumers. It allowed them to benefit from the same government support offered to customers of interest-based mortgages, giving access to low-deposit home finance based on Shariah principles.

Al Rayan Bank launched the UK's first, and currently only, Home Purchase Plan to be backed by the government's scheme in September 2014.

Important gains were also made in markets further afield including Pakistan, Turkey, Africa and Australia.

In Turkey, where Islamic banking is also called 'participation banking', the government stated its intention to establish three Islamic banks, as subsidiaries of state-run conventional banks, by the end of 2015. Given that, until now, state lenders have stayed away from the Islamic finance arena, the move was a bold one, designed to grow the market share held by the Islamic finance sector from 5% to 15% by 2023.

In Pakistan where Islamic banking is more established, Islamic banks enjoyed a boost in profitability underpinned by an ambitious five-year plan that regulators hope will double the industry's share of the banking sector to 20% by 2020. A growing client base and improving asset quality helped Islamic banks post profits before tax of PKR12 billion (US\$116.7 million) in the third quarter of last year, almost double the amount posted 12 months earlier, according to data from the central bank.

Preview of 2015

The developments of 2014 signal a clear trend. It shows that there is a conscious effort being made by local regulators to facilitate the development of Islamic finance, setting the scene for what is to come in 2015 and beyond.

In the UK for example, product development is key to maintaining the industry's growth. This is an area in which Al Rayan Bank, the UK's only wholly Shariah compliant retail bank, has excelled by offering the country's largest range of Shariah compliant retail financial products.

However, in order for the Islamic sector to flourish even more, liquidity, and the ability for Islamic banks to increase the number of tools they can access to improve this, is one of the key areas that needs improvement.

The GBP200 million (US\$308.9 million) sovereign Sukuk issued by the UK government in June 2014 gave the industry a major boost. Similarly, a government policy statement known as PS4/14,

announced in May 2014, is expected to deliver a huge advantage to British Islamic banks. By allowing them to widen the range of assets they hold in their liquidity buffers, it will enable them to grow their financing business and offer even more competitive rates to their customers.

Another trend is for the increasing utilization of digital media to improve the market penetration of Islamic banking. This has been identified as a key issue for established markets in the GCC region by Ernst & Young in its report, 'World Islamic Banking Competitiveness Report 2014-15 - Participation Banking 2.0'. According to this report, the overall market penetration of Islamic banking ranges from nearly 50% in Saudi Arabia to over 20% in the UAE. However, the concern is that customer satisfaction remains low due to ineffective online and offline interaction. The firm suggests that this needs to be tackled by employing customer-centric engagement strategies, which focus on their lifestyle and priorities.

Conclusion

The retail Islamic finance sector is the 'public face' of the overall industry, and despite its strong performance, it is regularly subject to comparisons to the conventional finance sector. For this reason, those within the industry need to focus on both growth and supporting the industry to help it position itself more convincingly against its interest-based counterparts.

Critical factors include focusing on the ethical nature of Islamic finance, securing government support in order to strengthen the infrastructure on which it is built, and investing in product development and customer experience.

These factors are the basis for the initiatives that have been discussed in this article. It will be interesting, therefore, to see how these developments unfold over the coming year and how they help the industry to achieve the ambitious growth targets it is aiming for. ☺

Tim Sinclair is the senior head of marketing and retail sales at Al Rayan Bank (formerly known as Islamic Bank of Britain).



Islamic finance regulation – key trends and challenges

Since its inception, regulatory reforms have been key in supporting the growth of Islamic finance. Indeed, regulatory clarity, even only at a level playing stage by tax alignment with conventional products, is crucial to implementing a promising Islamic finance industry. VALENTINE BAUDOUIN gives an overview of the developments in Islamic finance regulation.

It should be noted that there is in fact a wide set of approaches to the formal introduction and regulation of Islamic finance. In short and as explained by the 2014 IMF working paper, 'Islamic banking regulation and supervision': "these range from a custom-made decree for a particular entity wishing to conduct Islamic banking to stand-alone and focused Islamic banking legislation." However, some notable trends that can have a positive impact on the development of the Islamic finance industry have to be highlighted.

Review of 2014

One of the most notable trends in 2014 in the development of Islamic finance is the expansion of a centralized Shariah board at the level of the central bank. As an example, in October 2014, the Central Bank of Oman set up a five-member Shariah board which will have a direct supervision role on Islamic banking institutions. The same approach was followed in December 2014 by the Central Bank of Bahrain that introduced a central Shariah body in charge of approving Islamic products. Similarly, Morocco took also the approach of a centralized Shariah board adding to the list of countries where the legal framework requires setting up a Shariah board for the central bank including Afghanistan, Malaysia, Pakistan, Palestine, Sudan, and Syria. This development of a centralized Shariah board is a strong signal that the industry is focused to address the challenge of the consistency between Shariah opinions and the need to innovate and develop new products based on Islamic foundations.

“One of the most notable trends in 2014 in the development of Islamic finance is the expansion of a centralized Shariah board at the level of the central bank”

Indeed, another challenge of the development of the Islamic finance industry is to answer the growing demand of millions of consumers who feel ill-served by conventional finance. In that respect, it should be noted that even if the formative stage of the Islamic finance industry reach a consensus on the need for further legal, accounting, governance, regulatory and supervisory enhancements, its role to address the growing demand of bringing back ethics into finance and to promote a

fairer financial industry linked to the real economy is crucial for its sustainability and that increased regulations should not lead to a 'conventionalized Islamic finance' model. The proliferation of centralized Shariah boards can be in that respect a key element to re-orientate Islamic finance to its 'macro-concept' rather than to 'micro-realities' of assessing the formally compliant replication of conventional products. Indeed, the recent growing disappointment summarized by the 'form over the substance' trend in Islamic finance highlights that the biggest challenge of the Islamic finance industry's integration into the global financial new regulatory system is to maintain its explicit ethical and participating approach. Accordingly, in a post-crisis regulatory environment, Islamic finance players should consider if the changing regulatory environment allow to bring ethics back into finance, and if Islamic finance can make a difference within the regulatory perimeter.

Preview of 2015

Banking institutions entering into the Islamic finance market encompass several profiles like conventional banks eager to capture a piece of a promising market by structuring functional equivalents of conventional products, far from the macro-concept of an ideal Islamic bank defined as a 'vehicle for equitable distribution of wealth'.

This is particularly true in countries where the implementation of Islamic finance consisted only of assessing the gaps between conventional finance and Islamic finance. Combined with the post-crisis regulations that lead to the moderation of risks taken by banks, Islamic banking is challenged on its ability to propose a different model.

In that respect, it should be highlighted that innovative forms of participatory finance are being explored and are anticipated to grow during 2015. A report produced in November 2013 by Fajr Capital Advisors and Crowdfund Capital Advisors outlines steps governments can and should take in implementing crowdfunding frameworks in Muslim markets, with one of the concrete actions being: "draw on the experience of crowdfunding legislation in other markets to introduce 'light touch' regulation that protects market participants without deterring investment and design the regulations to meet the needs of Shariah-sensitive investors and entrepreneurs."

Regulation in this area can have a positive impact to develop a new market directly linked to the real economy and demonstrate that innovation is at the heart of Islamic finance. (2)

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Shariah governance and compliance risk

Shariah compliance is the cornerstone of Islamic finance. Observing the tenets of Shariah represents the foundation of the industry and its prime source of confidence and credibility. It has been a recurring theme in all discussions concerning Islamic finance and is part and parcel of the process of corporate governance and standardization. DR MUHAMMAD AL-BASHIR MUHAMMAD AL-AMINE shares his insight.

Various standards governing the industry functions issued by the IFSB or the AAOIFI with regards to risk management, capital adequacy, accounting, audit, corporate governance, ethics and others all have Shariah elements. Similarly, almost all risks affecting Islamic financial institutions whether it is credit risk, liquidity risk, or others have Shariah dimensions. Good Shariah corporate governance will not only depend on the existence of a competent Shariah board and capable Shariah department but also upon a reliable mechanism in resolving any possible conflict between a Shariah board ruling and the judiciary or national legislation.

“ Considering this central role of Shariah in Islamic finance, some important legislation and policies have been promulgated recently with the aim of strengthening the industry governance ”

Considering this central role of Shariah in Islamic finance, some important legislation and policies have been promulgated recently with the aim of strengthening the industry governance. These include, among others, the Islamic Financial Services Act (IFSA) 2013 and Central Bank of Malaysia Act 2009 in Malaysia or the different policies of module rules from the Central Bank of Bahrain (CBB). It is also towards these objectives that we have seen in 2014 the CBB planning to strengthen its Shariah board with a broader role of monitoring Shariah issues across the Islamic finance industry in the Kingdom and the move by countries such as Oman or the UAE to establish their national Shariah board for Islamic financial services (IFSs). However, despite the coming into effect of these moves and their positive impacts, further reforms are still needed.

Minimum regulatory common approach to Shariah governance

One of the prerequisites for any effective Shariah corporate governance is the need for a minimum common approach by the

various regulatory and supervisory authorities towards Shariah governance. Unfortunately, currently there is no such minimum approach. In some jurisdictions, Islamic financial institutions are allowed to decide for themselves what kind of Shariah governance system to adopt in order to determine the credibility of products and services they are offering. Other supervisory authorities that are more concerned with market deficiencies and the need for client protection, require that each IFS should have a properly functioning Shariah governance system in place and will seek reassurance that this is the case. This is generally implemented through circulars and directives by the central bank.

In some other jurisdictions, the supervisory authorities go further by having their own Shariah board that works together with them, issuing standardized national Shariah pronouncements and aligning relevant policies and regulatory frameworks with Shariah. In this approach, besides circulars and directives by the central bank, the legislative body is directly involved and sometimes national laws are promulgated. Moreover, the judiciary is required by law to refer to the national Shariah board resolutions to avoid any conflict of interpretation. Although this approach is currently the exception in Shariah governance approaches, however, it is gaining momentum as it seems to be more in line with effective corporate governance and best practices. Yet this does not rule out the fact that genuine improvements are still needed.

It is a serious corporate governance deficiency if the judiciary cannot uphold the Shariah compliant nature of a specific transaction already approved by a Shariah board on Shariah grounds or if a product used by the Islamic finance industry in a particular jurisdiction is not in harmony with state legislations. The issue was addressed by the Central Bank of Malaysia Act 2009 which makes it mandatory for the court to refer and follow the opinion of the Shariah advisory council in their decision and the ruling and any ruling made by the council should be binding on the court and any arbitration tribunal. This is definitely a welcome development that needs to be followed by other jurisdictions.

Moreover, in the process of ensuring best practice of Shariah governance the role of governments should not be limited to the requirement of making reference to the national Shariah board resolutions in delivering judgments, but should also involve specific punishments to be inflicted against those who contravene Shariah principles. The IFSA in Malaysia addressed the issue noting that any person who contravenes Shariah principles commits an offence and shall, on conviction, be liable to imprisonment for a term not exceeding eight years or to a fine not exceeding RM25 million (US\$6.95 million) or to both. This

is another precedent in Shariah governance that needs to be followed by other jurisdictions.

Central role of the Shariah board in Shariah governance

Primarily, Shariah governance relates to Shariah board members, their conduct, independence, competence and capabilities. Although the IFSB and AAOIFI standards are clear that the appointment and dismissal of the board is the prerogative of the general assembly so that the independence of the board and its integrity are preserved, in some jurisdictions the CEO might perform this role in violation of best practices of corporate governance. Moreover, sometimes the appointment and dismissal of Shariah board members is politically influenced and therefore, casting doubt on the credibility of the board. Similarly although the IFSB and AAOIFI standards make it mandatory that a Shariah board should be composed of at least three scholars, in some jurisdictions transactions are sometimes approved by a single scholar and therefore, opening the doors for Shariah compliant risk, governance issues and supervision failure.

“ Effective Shariah governance will help in stimulating public confidence, reducing financial loss in income, reducing the effect on asset values and averting possible regulatory damage ”

Improving the regulatory framework of internal Shariah officers

The central role of internal Shariah reviewers and auditors in the Shariah governance of IFSs needs adequate scrutiny. The scope of this important control function is not always defined, although it is expected to perform several distinct roles that include review, audit, research and serving as the Shariah board secretary. These functions are not clearly demarcated and their regulatory foundations are shaky in most jurisdictions except in the case of Malaysia and Bahrain to some extent. Similarly, as it is the case with the Shariah board members the need for an adequate and appropriate qualification for internal Shariah officers is a must. Unfortunately, sometimes a person without Shariah qualification is appointed to assume the Shariah reviewer function. This is a governance issue that needs proper regulations that define the academic credentials, language proficiency particularly Arabic and English, and research ability of a Shariah officer.

More importantly, the presence of a Shariah control function should be considered a must in all financial institutions whether fully-fledged IFSs or windows. Equally important is the fact that the functions of the internal Shariah officer should not be delegated to another department such as the legal or audit department as “no one gives what he doesn’t have”. Therefore, it is believed that provisions in the IFSB standard on Shariah governance with regard to these issues need to be revised. Independence of an internal Shariah officer requires that his appointment and dismissal is not influenced by external factors. The CBB adopted recently important rules in this area which



are worth being adopted by other jurisdictions and reflected in existing standards. It has been maintained that the appointment of all persons wishing to undertake a control function, including internal Shariah officers, in an IFS must be approved by the CBB prior to their appointment. Moreover, if the IFS wishes to dismiss or suspend such an employee, the IFS must seek the CBB’s prior written approval before the proposed dismissal or suspension takes place and communicated to the person involved.

Another issue of governance that needs to be highlighted is the relation between the Shariah board and internal Shariah officers and what can be delegated by the former to the latter. Although the IFSB standard points out “the Shariah board shall be able to mandate and delegate some of its functions to the ISCU [internal Shariah compliance unit]”, the standard is short in giving some concrete demarcations despite the huge practical ramification of the issue in terms of governance and risk.

Finally, the role of the external Shariah bureau and consultancies is a contentious issue. A number of governance concerns regarding competence, independence, possibility of conflict of interest and scope of work of such a bureau need to be regulated.

Conclusion

Strengthening Shariah governance at the organizational and structural level of IFSs or at the level of product structuring, documentation and implementation is about minimizing and mitigating various risks including Shariah compliance risks. Robust Shariah governance requires harmonization and consistency in pronouncement issuance within the same Shariah board, among different Shariah boards and among various international Shariah bodies. Needless to say, greater involvement of regulators and supervisory bodies is a must towards the legislation and implementation of best practices of Shariah governance. Effective Shariah governance will help in stimulating public confidence, reducing financial loss in income, reducing the effect on asset values and averting possible regulatory damage. Despite the welcome efforts undertaken by different jurisdictions to strengthen their Shariah governance, many issues still need to be addressed and it is hoped 2015 will be the year of Shariah governance reforms. ☺

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Sovereign Sukuk landscape continues to expand

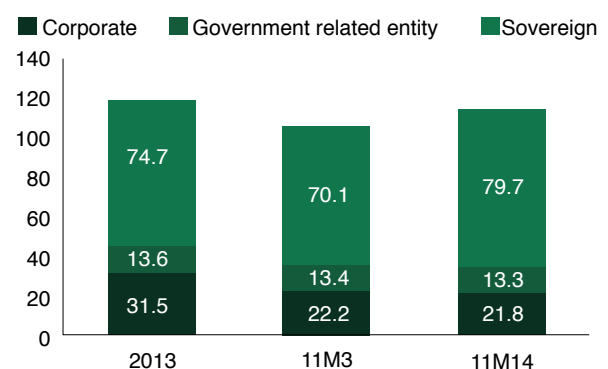
2014 has been a promising year for the growth of the global Sukuk market. The year saw the entry of new sovereign players. SAUD AL NAFISI notes that Sukuk issuances have expanded to new markets while cross-border issuance activity has accelerated with many sovereign issuers viewing Sukuk as an essential tool to accelerate infrastructure funding.

Debut issuances from non-traditional markets such as the UK, Luxembourg, Hong Kong, South Africa and Senegal bodes well for the growth of the Sukuk industry. The government of Sharjah also issued their debut 10-year US\$750 million Sukuk setting two milestones: The first debut issuance with a tenor in excess of five years and the first debut issuance in excess of US\$500 million. Among the other notable issuances were Pakistan who returned to the market with a US\$1 billion five-year paper after a lapse of nine years.

Review of 2014

Total sovereign Sukuk issuance in 2014 accounted for 69% of the total US\$114.7 billion Sukuk issuances, a 13.7% gain from the US\$70.1 billion sovereign Sukuk volume recorded during 2013 (see Chart 1). The growth in Sukuk issuances was accompanied by a deepening of the Sukuk market, with a number of first-time sovereign issuers from 19 different countries tapping the market this year; including landmark issuances from the UK, Hong Kong, Senegal, South Africa, the Emirate of Sharjah and Luxembourg (see Chart 2; see also Chart 3 for individual deal sizes). Sovereign issuers were encouraged to tap into alternative sources of liquidity, amid the increasing acceptance and understanding of Islamic finance globally. The global Sukuk outstanding reached

Chart 1: Sukuk issuers by type (11M13-11M14)



Source: Bloomberg, Zawya, IFIS

US\$300 billion as of 11M14 (January-November 2014), an 11.4% rise from US\$269.4 billion for the financial year ending 2013. Malaysia's secondary Sukuk market is fairly sizeable at approximately US\$173.4 billion, a 9.6% increase year-on-year. Meanwhile, the total GCC Sukuk outstanding portfolio grew by 6.4% to US\$90.8 billion, as compared to US\$85.3 billion outstanding for the financial year ending 2013.

Chart 2: Top 15 sovereign Sukuk by issuance size (2014)

Issuer	Domicile	Structure	Currency	Issue Size	Tenure (Years)
Qatar Central Bank	Qatar	Murabahah	QAR	1,921.00	3
Perusahaan Penerbit SBSN Indonesia	Indonesia	Ijarah	IDR	1,663.74	3
Government of Indonesia	Indonesia	Ijarah	US\$	1,500.00	10
IDB Trust Services	Saudi Arabia	Wakalah	US\$	1,500.00	5
Saudi Electric Company	Saudi Arabia	Ijarah	US\$	1,500.00	10
IDB Trust Services	Saudi Arabia	Wakalah	US\$	1,500.00	5
Government of Malaysia	Malaysia	Murabahah	RM	1,244.77	3.5
Saudi Electric Company	Saudi Arabia	Istithmar	SAR	1,199.87	10
Qatar Central Bank	Qatar	Murabahah	QAR	1,097.00	5
Government of Hong Kong	Hong Kong	Ijarah	US\$	1,000.00	5
Government of Pakistan	Pakistan	Ijarah	US\$	1,000.00	5
Saudi Electric Company	Saudi Arabia	Ijarah	US\$	1,000.00	30
IDB Trust Services	Saudi Arabia	Wakalah	US\$	1,000.00	5
Government of Turkey	Turkey	Ijarah	US\$	1,000.00	10
Government of Malaysia	Malaysia	Murabahah	RM	915.90	7

Source: IFIS, Zawya, Bloomberg, KFHR

Chart 3: Sukuk issuances by individual size (11M14)

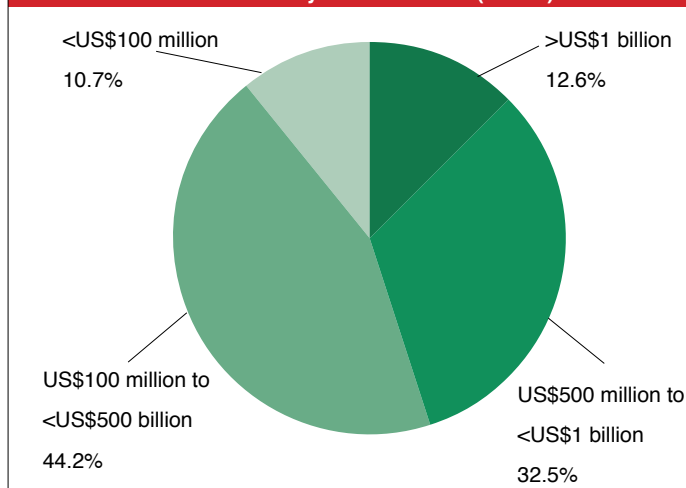
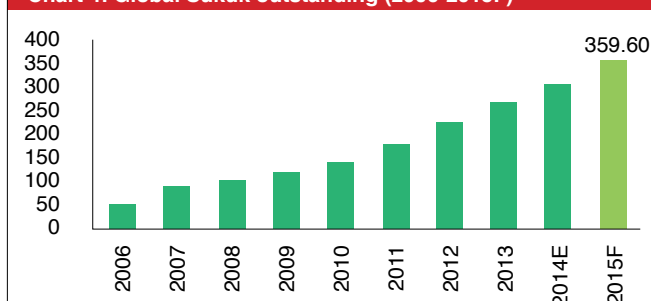


Chart 4: Global Sukuk outstanding (2006-2015F)



Source: IFIS, Zawya, Bloomberg, KFHR

Preview of 2015

In 2015, the Sukuk market is expected to continue to record issuances of more than US\$100 billion (2011-2013 average: US\$112 billion), and to expand to various countries and sectors. Meanwhile, Sukuk outstanding is expected to grow at the average pace of the past five years (around 16% per annum), to US\$348-360 billion in 2015 (see Chart 4). While issuances of longer-term Sukuk with more than 10-year maturities are on a declining trend, the market has seen an increase in the share of three-year to 10-year Sukuks, which would support Sukuk outstanding for several more years.

On a macro basis, Sukuk issuances will be supported by the on-going recovery in the global economy, with firmer global growth forecasted at 3.8% on 2015, an uptrend compared to 3.3% growth in 2013 and 2014 estimates. Underpinning this growth is robust domestic demand in emerging economies, including in Asia Pacific and the Middle East, amid stronger global trade activity (2014E: 3.7%; 2015F: 5%).

Nevertheless, financial market sentiment remains vulnerable to external events such as geopolitical crises, especially in the Middle East and Russia; as well as shocks to oil prices. Russia's economic struggle may cause the country to tap into the Sukuk market as an alternative solution to increase capital and increase its investor base.

An important supporting factor for Sukuk issuances is the major infrastructure needs in the GCC, South Asia, Southeast Asia and Africa. Notably, the timing for infrastructure investments is optimal at the moment, due to relatively low borrowing costs globally, amid significant infrastructure bottlenecks in emerging economies. Looking ahead, the continued strong growth of the Sukuk market is expected sustain in 2015. The Sukuk pipeline suggests a healthy mix of sovereign and corporate Sukuks in the first half of 2015 (see Chart 5).

Conclusion

Sukuk outstanding is also expected to increase to almost US\$350 billion. While Malaysia is expected to retain its lead, Sukuk outstanding in the GCC will amount to almost US\$100 billion. The Sukuk market will be driven by sovereign issuers and infrastructure spending, reflecting mainly the large financing needs of these issuers/projects. Nevertheless, stronger domestic demand in both Asia and the GCC will spur more issuances from services-related sectors (such as F&B and retail), healthcare and education, as seen in 2014. The key challenges for the market include the decline in oil prices, which is an important source of income for the GCC economies; as well as the potential for disorderly exit from easy monetary policies in the advanced economies. Despite these risks, the Sukuk market remains supported by structural factors which will continue to bolster its growth and depth in the medium term. (3)

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Chart 5: Sukuk pipeline in first half of 2015

Issuer	Country	Region	Currency	Amount, US\$ equivalent
Central Bank of Nigeria	Nigeria	Africa	TBC	TBC
Central Bank of Mauritania	Mauritania	Africa	TBC	300
Government of Sudan	Sudan	Africa	US\$	758
Government of Tunisia	Tunisia	Africa	US\$	500
Islamic Bank of Thailand	Thailand	Asia	US\$	150
Ministry of Finance	Ireland	Europe	TBC	TBC
Islamic Development Bank	Saudi Arabia	GCC	US\$	Up to US\$10bln per year
Oman Sovereign	Oman	GCC	OMR	300-400
Morocco Sovereign	Morocco	Africa	TBC	TBC
Central Bank of Yemen	Yemen	Middle East	LCY	233
Asian Development Bank	The Philippines	Multilateral	TBC	TBC
Republic of Tatarstan	Russia	Europe	US\$	100-200
Ras Al Khaimah	The UAE	GCC	US\$	TBC
Kazakhstan Sovereign	Kazakhstan	Central Asia	TBA	TBA (1Q15)



Environmentally- conscious and socially responsible investment: A growth opportunity for Islamic finance

Ethical, environmental and socially responsible values within finance and business are considerations that are deeply entrenched within Islamic theology and jurisprudence. As the Islamic finance industry develops further, it will only be a matter of time before socially responsible investment (SRI) and ethical and 'green' financial products draw upon guidance from the rich heritage of Islamic teachings pertaining to the environment and social development. SAMIR SAFAR-ALY examines these new investment structures.

As of July 2014, climate-themed bonds were estimated to total approximately US\$502.6 billion globally (an exponential jump from US\$174 billion in 2012). In its report, 'Sizing the climate economy', HSBC estimates that nearly US\$10 trillion in cumulative capital investments will be moved towards low-

carbon energy alone between 2010 and 2020. Furthermore, over 1,300 signatories to the UN Principles for Responsible Investment (UN PRI) represent over US\$45 trillion in managed assets (from US\$4 trillion in 2006). Since the product inception in 2008, the World Bank has issued approximately US\$7 billion in

green bonds across 17 currencies. These trends, taken together with the needs and opportunities for infrastructure and renewable energy projects across the Middle East and North Africa regions, as well as global interest in Islamic financial products, may present opportunities for product development within the ethical, environmental and SRI investment space.

Review of 2014

The past year has seen a great amount of development within the Islamic finance industry towards an ethical, SRI and 'green' trend. The Securities Commission Malaysia, the Malaysian financial regulator (SC), launched an SRI Sukuk framework in August to facilitate the financing of certain defined SRI initiatives. The SRI framework places disclosure and reporting obligations on SRI Sukuk issuers, as well as the appointment of an independent party to assess underlying projects. Since the launch of the SRI Sukuk framework, Khazanah (Malaysia's state-owned sovereign wealth fund) announced in November that it is considering issuing a benchmark-sized ringgit-denominated Sukuk to finance development in its renewable energy or education businesses.

“ 2015 will potentially bear witness to an inaugural SRI Sukuk under the SC framework, should Khazanah move ahead with plans for such a Sukuk ”

Similarly, the International Finance Facility for Immunisation Company (IFFIm – whose Treasury manager is the World Bank) launched its inaugural Sukuk in November, raising over US\$500 million for the Gavi Alliance (a global organization dedicated to improving access to vaccines for children in the world's poorest countries). The three-year Sukuk Murabahah was oversubscribed by US\$200 million and attracted a widely diverse investor base (21% in Asia, 11% in Europe and 68% in the Middle East and Africa, with central banks/official institutions taking up 26%).

The past year has also seen increasing discussions on the topic of a 'green' Sukuk. One of the more recent models being advanced (by the Green Sukuk Working Group) includes a Sukuk complying with the Climate Bond Standards (a framework designed by the Climate Bonds Initiative (CBI)). Although the CBI model incorporates disclosure, certification and independent third-party evaluation obligations, there are many other existing credible environmental financial frameworks that exist for conventional green bonds that a 'green' Sukuk can draw upon.

In January 2014, 13 major banks came together to launch the Green Bond Principles, which represent a voluntary set of guidelines for 'green' projects, including standards for the use of proceeds, evaluation, management, and reporting performance indicators.

One of the more established 'green' financing models includes the voluntary Equator Principles (the EP), applicable to project finance. Currently, more than 80 financial institutions have signed up to the EP framework (which includes considerations for human rights in its latest version). Although the CBI has issued

guidance for certain industries, the EP incorporates the World Bank's Environmental, Health, and Safety (EHS) Guidelines and applicable IFC Performance Standards (which includes detailed technical guidance for over 62 different industries). Islamic financial institutions therefore currently have a wealth of existing frameworks to choose from in the development of a 'green' Sukuk.

Finally, with the rise in asset managers offering Shariah compliant investments becoming signatories to the UN PRI (such as SEDCO Capital, Arabesque, Saturna Capital, Kagiso and Mulkia), it is evident that SRI investments are becoming a rising theme within the industry.

Preview of 2015

2015 will potentially bear witness to an inaugural SRI Sukuk under the SC framework, should Khazanah move ahead with plans for such a Sukuk. It is likely that the global Islamic finance industry will see more and more Shariah compliant asset managers becoming UN PRI signatories as SRI becomes a growing theme in conventional finance.

We envisage that 2015 might be the year where we witness a 'green' Sukuk issuance from the Middle East. Abu Dhabi announced a target of generating 7% of its energy capacity from renewable sources by 2020. In January 2015, the Masdar Institute of Science and Technology released a UAE Wind Atlas, similar to its previous Solar Atlas, to support investment in renewable projects. The King Abdullah City for Atomic and Renewable Energy in Saudi previously announced plans to procure 54,000 megawatts from renewable energy projects by 2032. Similarly, the Dubai Integrated Energy 2030 Strategy plans for solar energy to account for 5% of Dubai's total energy mix by 2030. The inaugural Sustainability Report 2013 issued by the Dubai Electricity and Water Authority, notes that the 1,000-megawatt H.H. Sheikh Mohammed bin Rashid Al Maktoum Solar Park will provide 'global financial investment opportunities in green finance'. With the establishment of the Dubai Islamic Economic Development Center in 2013, perhaps governmental support will be what paves the road for a 'green' Sukuk issuance for renewable energy projects.

Finally, it is yet to be seen whether the AAOIFI and/or the IFSB will play an active role in helping to promote the SRI, ethical and 'green' trend, through the development of guidelines and standards, in coordination with Shariah scholars and third parties, to help to introduce further classical Shariah considerations on environment and social welfare into contemporary Islamic finance.

Conclusion

We envisage a bridge being built between Islamic finance and the conventional SRI industry. By expanding the pie beyond the Islamic economy through SRI, ethical and environmentally-friendly certifications, Islamic products may potentially find new markets further afield. Ethics and stewardship are at the core of Shariah. By rekindling some of Islam's deep ethical traditions, there appears to be a great potential for the industry to grow its investor base among conventional SRI investors. (3)

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Global Islamic syndications: Expanding horizons

Islamic syndications are a comparatively inconsiderable part of global debt capital market localized mostly within the GCC region and Malaysia. In the meantime, other Muslim-populated countries — specifically Indonesia and Turkey — are experiencing growth in Islamic syndications within the last two years. The global Islamic-term syndications market increased significantly in 2014 following a slight decrease in new loans in 2013 when global capital was focused on the west resulting in a slight outflow from emerging and alternative finance markets. **ELINA KHAYRULLINA** and **DAMIR GALIEV** feel Islamic syndications are fast gaining a foothold globally.

Review of 2014

The numbers in the article are based on Bloomberg data including the top 20 countries represented by new deals in the global syndications market (hereinafter — global syndications) and the top 20 countries by the amount of newly issued Islamic syndications (hereinafter — Islamic-term syndications). In our sample we included both structure types (loans and syndicated loans) to provide full coverage of the Islamic term loans market.

2014 was marked by a 30% growth of Islamic-term syndications amounting to US\$25.5 billion. Saudi Arabia, the UAE and Qatar made up three-quarters of the market. Real estate and industrial (37%), airlines (14%), transportation and logistics (8%) were framing 59% of newly issued Islamic-term syndications in 2014 with the banking sector also represented in the top five.

At the same time, there is still space for the growth of the facility. In 2014, the value of Islamic-term syndications was less than 1% of those issued globally with the latter increasing by 44% year-on-year.

Among the top 20 global syndications only Japan and Russia suffered a decrease in the facilities amount by 44% and 51% respectively. In 2014, Japan experienced the first signs of recession. Real gross domestic product decreased by 1.6% on an annualized basis in July-September, following a 7.3% contraction in the previous quarter meaning Japan fell into recession defined by a contraction of two consecutive quarters. This was a direct consequence of Abenomics.

The Russian market faced more severe barriers to access the conventional markets within the final months due to the US and

European sanctions. There is expected to be a sharp reduction of new issuances along with a significant amount of maturing deals in 2015. There is obvious demand for foreign borrowings which usually are of particular importance in emerging economies.

Preview of 2015

We find it reasonable to expect the growth of the Islamic syndications market. It is still underpenetrated and there is decent demand in emerging markets. We expect the Islamic syndications to continue developing at a moderate rate.

In particular, in Russia the alternative finance business may occupy its niche in view of the contemporary landscape. Due to present geopolitical conditions, Russian banking authorities are considering the legislative matters for the development of Islamic finance in the country. At this stage, there are no provisions within the Russian legal environment allowing for the development of Shariah compliant banking. Therefore, in regard to the Islamic market, companies are moving from a particular to general strategy to find non-controversial solutions from the regulatory perspective.

It is fair to assume that in the near future Russian banks in their pursuit of diversification of liabilities, will be able to satisfy their funding needs if they looking more attentively to the east. In the meantime, when it comes to the alternative financial market, it is always a decent time to build relations with its participants, although there are already significant precedents.

In 2011 and 2013, AK BARS Bank – the leading bank in the Republic of Tatarstan with a major Muslim population – successfully completed two Murabahah syndication projects raising US\$160 million in total. Both projects attracted substantial interest among investors in the Middle East and raised awareness in the Islamic investment community of Russia and specifically Tatarstan. The AK BARS Bank's Islamic finance deal was the first of its kind in the CIS taking a special approach when combining Russian legislation and English law with Shariah principles. There are also a few companies providing Shariah compliant

services in Tatarstan where the government fully supports the initiative of Islamic finance.

The bottom line is that the idea of alternative finance development is most effective when coming from the bottom upwards and conversely.

Referring to the top 20 countries list by Islamic-term syndications loans, it is clear that there are only four countries represented in the sector among G-20 members. Those are Indonesia, Saudi Arabia, Turkey and the UK. G-20 economies account for around 85% of the gross world product (GWP), 80% of world trade and two-thirds of the world population with 472 million practicing Islam. The other 16 countries' Muslim populations make a significant 38% of overall Muslims in the G-20.

Traditionally, religiosity is among the strongest determinants motivating large firms to choose an Islamic loan over a conventional loan (the conclusion made by L Weill and C Godlewski in their practical research, 'Why do large firms go for Islamic loans?', 2012). So, the expansion of Islamic-term syndications in the aforementioned countries may create the potential for the market growth.

Conclusion

The Islamic syndication market is quite a dynamic market which is entrenched in the GCC and developing in other Muslim-populated countries where it is likely to continue to grow in the coming years. There is space for its penetration in emerging markets requiring, together with other arrangements, relevant initiatives for the development of regulative infrastructure. Perhaps, it is the right time to think of development in an alternative direction to be in the moment and enter the market at an early stage in anticipation of building a decent track record. ☺

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An overview of the development of Takaful globally

If we look at the prospects for Takaful in different parts of the world for 2015, we may have to look even further in the future to get a better idea where the highest growth and largest markets in Takaful are to be expected. Will the largest Takaful markets of today continue to hold their position in the future or are there other natural larger markets gearing up to catch up and take the lead? MUKTISJAH RAMLI discusses the outlook of Takaful.

Generally insurance and also Takaful is being sold, not bought, and it is often not easy to sell insurance or Takaful plans to the market, as clients do not come to insurance or Takaful companies, but have to be approached. It is different in the case where the insurance or Takaful scheme has been made mandatory by the regulatory authorities, such as the motor and health insurance in Saudi Arabia, which accounts for 76% of total insurance premiums (2013), or where in countries insurance has been fiscal facilitated (tax deductible or tax deferred) by the tax authorities, such as the advanced pension schemes in the Netherlands and Switzerland according to the three pillars of provision: 1. state pension, 2. corporate pension, 3. individual pension. Even in most West European countries, 67% of all insurance premiums is generated, because of the two major factors: The insurance

line of business is either mandatory or fiscal facilitated or a combination of both.

Although we are aware that Takaful is and will also work perfectly in Muslim minority countries, and also appeals to customers with different religious backgrounds, the focus of this article is on the natural markets of Muslim majority countries. The emergence of Takaful in most developing Muslim majority countries is following a similar pattern as in the more established (conventional) insurance markets; Takaful will sell best when made mandatory or fiscal facilitated. To get a better idea where the Takaful markets are expected to grow exponentially, we should also take into account the size of the existing conventional insurance industry including Takaful in a country for future projections (2015 and

beyond). This article will look at three major Takaful markets of 2014, Malaysia, Saudi Arabia and the UAE and include in the projections other large Muslim majority countries such as Indonesia, Turkey, Nigeria, Egypt and Pakistan.

Analyzing the tables, based on selected sample countries, we can see in terms of Takaful contributions that currently the largest Takaful markets (2013) can be found in Saudi Arabia, Malaysia and the UAE. However, in terms of overall insurance, the largest markets are Indonesia, Malaysia and Turkey. Now to look at the potential of Takaful in a country, if we can assume that all can reach the Organization for Economic Co-operation and Development (OECD) insurance penetration level of 8.4% and Takaful achieves 50% of total insurance, the top three are Indonesia, Turkey and Saudi Arabia. If we use the same parameters and can boldly project into the year 2050, the top three will then be Indonesia, Turkey and Nigeria. These countries are currently below the radar screens, but form the highest potential to become the largest Takaful markets globally, as they have a favorable ingredient mix in terms of (Muslim majority) population and size, and economy, provided they can reach insurance penetration of 8.4% of GDP and at least 50% of all insurance is Takaful-based. The other two large countries, Egypt and Pakistan are missing out on having a large economy like Turkey and Indonesia, to reach the top three in the long term in the Takaful world.

In short, for a market to become a large natural Takaful market in the long term, key ingredients are:

- A large Muslim majority population, relatively above 50% and also in absolute numbers above 50 million
- A large economy with GDP (nominal) above US\$500 billion with strong economic growth to join the above US\$1 trillion club
- A medium to high GDP (purchasing power parity) per capita above US\$5,000
- Mandatory lines of insurance business and fiscal facilitation for pension schemes
- A large number of Islamic banks, leasing companies, mutual funds, Sukuk listings and a developed capital market as a supporting industry
- A domestic Takaful industry which can compete with the

Takaful scheme has been made mandatory by the regulatory authorities, such as the motor and health insurance in Saudi Arabia, which accounts for 76% of total insurance premiums (2013)

- conventional market to reach at least 50% of total market
- A domestic insurance market which can reach the OECD average of at least 8.4% in terms of insurance penetration
- State-owned companies having mandatory coverage with Takaful companies.

In order to achieve the previously mentioned scenario in 2015, there are some issues, challenges and opportunities to be overcome.

Indonesia: The new insurance regulation became effective on the 23rd of October 2014 and 2015 will be the first implementation year for the regulator OJK. It will be interesting to see if all the 43 Takaful windows are going to wait for 10 years for the mandatory spin-off or will spin-off earlier to be able to compete better in the Takaful and insurance industry. From the 1st July 2015, a mandatory pension scheme will be in place for practically all employed staff, which will help boost awareness of supplementary pension schemes.

Malaysia: Mandatory split-off of the life and non-life business forms issues for all players, for composite operators to either split-off both lines or sell one of the units. Many Takaful operators are expected to grow, but growth levels are not expected to be as fast as previous years and a large demography to grow exponentially further is missing.

Table 1: GDP (nominal), GDP (PPP) per capita and population projections

GDP (nominal) in US\$ billion	2015	2019	2030	2050	GDP (PPP) per capita in US\$ (2015)	Population (in millions)	2015	2020	2030	2050
Egypt	324	528	N.A.	N.A.	11,444	Egypt	88	96	113	149
Indonesia	914	1,230	2,135	5,077	10,759	Indonesia	253	266	291	328
Malaysia	375	535	N.A.	N.A.	25,833	Malaysia	30	33	38	49
Nigeria	657	830	1,379	3,686	6,467	Nigeria	180	207	274	504
Pakistan	249	342	N.A.	N.A.	4,943	Pakistan	192	213	261	379
Saudi Arabia	805	962	1,321	2,600	56,253	Saudi Arabia	30	34	42	58
Turkey	861	1,081	1,833	3,762	20,299	Turkey	77	81	89	101
The UAE	440	562	N.A.	N.A.	67,202	The UAE	8	9	10	13

Source: IMF, PWC, UN

Table 2: Takaful premiums compared to total insurance industry (2013) and projected scenarios (all monetary values in US\$ billion)

A. Insurance and Takaful assets and premiums (2013)	B. GDP nominal (2013)	C. Insurance penetration of GDP 2013 (nominal) OECD	D. Takaful as % of total insurance 2013	E. Total insurance Premiums (in US\$ billion) 2013	F. Takaful contributions (in US\$ billion) 2013	G. Projected Takaful contributions based on 8.4% of GDP (2013) and percentage (2013) of total insurance	H. Projected Takaful contributions based on insurance penetration (2013) of GDP (2013) and 50% of total insurance	I. Projected Takaful contributions based on 8.4% of GDP (2013) and 50% of total insurance	J. Projected Takaful contributions based on 8.4% of GDP (2030) and 50% of total insurance	K. Projected Takaful contributions based on 8.4% of GDP (2050) and 50% of total insurance
Egypt	271	0.66%	9.1%	1.8	0.2	2.1	0.9	11.4	NA	NA
Indonesia	870	1.80%	5.1%	15.2	0.7	3.7	7.8	36.5	89.7	213.2
Malaysia	313	5%	15.9%	15.1	2.4	4.2	7.8	13.1	NA	NA
Nigeria	521	0.35%	0.3%	1.8	0.005	0.1	0.9	21.9	57.9	154.8
Pakistan	232	0.73%	3%	1.7	0.05	0.6	0.9	9.7	NA	NA
Saudi Arabia*	748	0.9%	43.3%	6.7	2.9	27.2	3.4	31.4	55.5	109.2
Turkey	819	1.4%	1.1%	9.9	0.1	0.8	5.7	34.4	77	158
The UAE	402	2%	12.5%	8	1.2	4.2	4	16.9	NA	NA

Source: www.ojk.go.id, www.bnm.gov.my, www.naicom.gov.ng, www.sama.gov.sa, www.ia.gov.ae, www.tsb.org, www.iap.net.pk, www.ifegypt.org, www.iii.org, www.oecd.org

*Saudi Arabia uses a unique cooperative model, different from the traditional Wakalah or Mudarabah Takaful models, and not all insurance companies have a Shariah advisory board. The insurance companies are filtered by Al Rajhi Capital to ensure they are Sharia compliant.

Nigeria: The licensing of the first fully-fledged Takaful operators by the regulator National Insurance Commission (NAICOM) are expected to take place this year, while there are only two Takaful window operators active. With a large population of 180 million and GDP (nominal) of US\$D657 billion, Takaful and insurance is still in its infancy, and only at the very beginning of the expected steep growth curve in this promising country.

“The UAE: Caught in between the larger neighboring country the Kingdom of Saudi Arabia and smaller fellow GCC members Kuwait, Qatar, Bahrain and Oman, with a relatively large expat population, it would be better to focus on becoming a regional hub, as the home market is relatively small.”

Saudi Arabia: Expected consolidation still needs to happen, as it remains to be seen which shareholder groups are willing to or can cooperate with each other to merge and many capital increases are expected as many cooperative companies are facing losses in a market with fierce competition in the mandatory medical and motor plans. No income tax means it is difficult to build up a traditional pension market with the three pillars of provision, as the General Organization for Social Insurance (GOSI) scheme already takes care of pensions for local citizens. If GOSI would

retreat and leave room to build up pensions through private insurance/Shariah compliant insurance companies, this will help in reaching higher levels of insurance penetration from the current low 0.9% of GDP.

Turkey: Only two dedicated Takaful operators are active, one life and one non-life, while there will be seven participation (Shariah compliant) banks in the country from the current four. This means at least three to five new Takaful companies are expected to be established by the banking groups or other financial institutions. Turkey is helping pension plan holders by adding 25 Turkish lira for each 100 Turkish lira contribution, which helps to build up long-term pension assets.

The UAE: Caught in between the larger neighboring country the Kingdom of Saudi Arabia and smaller fellow GCC members Kuwait, Qatar, Bahrain and Oman, with a relatively large expat population, it would be better to focus on becoming a regional hub, as the home market is relatively small. New insurance regulations have become effective recently, which is aimed at strengthening the domestic insurance industry. No income tax means it is difficult to provide fiscal facilitation and to build up a traditional pension market with the three pillars of provision.

Pakistan: Since the country is trying to increase the Takaful market share by allowing conventional insurers to open up windows, more conventional insurers are expected to enter the Takaful market through a window operation. Pakistan with a population of 192 million still offers wide opportunities for new players, although GDP (PPP) per capita is US\$4,932 and GDP (nominal) is US\$249 billion, which need the right policies to reach US\$500 million or the even better US\$1 trillion mark. ⁽⁹⁾

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The modernization imperative

Today, Islamic finance is officially recognized within the global financial framework as an independent and entirely viable financial system. Thus, the market and demand for Islamic financial products and services exist; it is also significant and poised for further growth and expansion. However, in a time of remarkable technological change, ROSIE KMEID is of the opinion that the industry ought to accelerate its efforts to meet the multitude of challenges it is facing, if it is to benefit fully from the next period of growth.

Even though Shariah compliance is key for Islamic finance, competitive technological advancements have been identified as priority areas for ensuring convenience, speed, time saving, cheaper methods of performing banking transactions and increasing market share.

Looking back on 2014 which was a disruptive yet interesting year in technological advancements, there have been various information technology (IT) trends that have impacted the global financial services industry, and there are more to look out for in 2015, for they present huge opportunities for financial institutions to improve business performance, innovate, modernise and gain a competitive advantage.

Four key proponents that helped define 2014

2014 was a game-changing year for cloud computing and new

innovations in cloud technology, software as a service, and a big year for mobility, social media and big data. During this year, we have witnessed the rise of multiple cloud-based services, like private clouds, public clouds and hybrid clouds, increasingly becoming the default IT platforms prevalent among financial institutions.

While a few years ago, mobile banking seemed futuristic, it has emerged in 2014 as a key basis of competition and a must-have tool of financial inclusion. The enormous progress and penetration of mobile banking seem very exciting and revolutionary, while it continues to gather momentum in fast-developing markets.

In addition, 2014 was important for social media in the financial services industry. This non-traditional method of interaction is increasingly becoming an important marketing tool, and one of the fastest-growing channels, and therefore holds an opportunity

for financial institutions to streamline their operations and improve business opportunities across key markets worldwide. This field, once mature enough, has the potential to transform the whole finance industry.

Big data was also all the buzz for financial institutions last year. The pivotal role played by big data analytics in facilitating better decision-making, bringing to light trends and providing greater insights that can be used to shape an institution's strategic direction had a special focus in 2014. The steady march towards big data continues, hence the need for a new class of technologies to help financial institutions cope with the velocity, variety and volume of big data, and to extract business value.

Such disruptive technologies are carving a new path of innovation in banking operations and strategy. It has thus become very critical for financial institutions to have appropriate technologies in place that increase their revenues and expand their footprint.

Islamic finance in a new gilded age

The demand for Shariah compliant banking products and services is expected to grow rapidly, especially in large unbanked markets, as a consequence of the growth of Islamic populations in some countries.

A report released by Ernst & Young projected that by 2015 the MENA Islamic finance industry will be worth US\$990 billion as the uptake of Islamic finance surges, more than double the 2010 figure of US\$416 billion.

Islamic financial institutions tend to view technology in the same light as their conventional counterparts. As the industry continues to grow and evolve, technology is becoming a value lever to traverse this fast-paced growth trajectory. By utilizing cutting-edge technologies, Islamic financial institutions will be able to achieve both innovation and speed in new product development. Plus, they will be able to meet the most stringent regulatory compliance requirements, scale up their operations, grow market share and above all enhance their profitability.

Ground-breaking technologies to help develop banking products, processes and services is the new mantra. According to CII-PwC's latest report entitled 'Connecting the dots: Wiring business, technology and operations', technology is considered as a critical pillar to meet the strategic objectives of an institution, and measures like data aggregation, customer relationship management and financial inclusion initiatives are essential to take banking to the next level of growth.

For IT experts, the strategic technology trends that will shape 2015 are nothing new to the financial services industry, but represent further enhancements to the tendencies in vogue.

Cloud computing will remain at the fore. Cloud adoption continues an upward trend as a mainstream IT deployment model. The cloud will firmly evolve as an enabler of business agility, scalability and transformation. The ability to plug-and-play with cloud-based applications, the low upfront costs, the rapid return on investment and the enhanced experience it provides are some reasons why it is growing in popularity.

Mobile banking, identified as the preferred transaction medium globally, is having significant impact on financial institutions' performance and profitability. As user experience is of critical importance, mobile banking will witness a breathtaking growth in 2015. In a crowded field of digital disruptors, mobile banking will



shift into high gear with increased use of mobile specific features and by redefining the way applications will be delivered in the future.

In the not-too-distant past, information security awareness seemed irrelevant and odd. Nowadays, security largely dominates the concern of financial institutions around the globe, since data security is an operational and, at the same time, regulatory imperative. In 2015, effective information security practices will be the core focus in the industry's evolution towards the digital future. The world is moving rapidly towards ubiquitous connectivity and the protection of private data, its confidentiality and its transmission will all be necessary.

2015 will be the year of strict compliance obligations. The new banking landscape taking shape now is more likely to bring positive effects by strengthening the resilience of financial institutions. Basel III requirements figure at the top of their list of to-dos. This is a trend which IT experts anticipate will not abate and which will dominate the financial sector for the foreseeable future.

The popularity of Islamic finance is attributable to multiple factors, but one thing is certain: The growth would not be possible without the deployment of modern technologies that underpin the industry. While it may have been quite conceivable two decades ago to ignore the role of IT in Islamic finance, going forward it will not only negatively affect its future development but will also lead to the convergence of the industry with the dominant, conventional financial system. (F)

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An Australian growth story

By Yema Akbar

Australia's political stability, close proximity to the Asia Pacific and resilience during the global financial crisis make it a crucial regional player in the global financial services market — including Islamic investment. The broader Australian corporate sector has now fully grasped the fact that Shariah compliant standards produce a far larger footprint across many parts of the 'real' economy in Australia than at first thought. Islamic finance is already often the key element to many existing investments, transactions and trade agreements that Australia has with global partners, both domestically and abroad, considering that 972.5 million (or 62%) of the world's Muslim population resides at Australia's doorstep.

Unlike many other emerging Islamic economies, the foundations of the Australian Islamic finance industry were born from an existing government policy introduced in 1992. The superannuation system was launched as a pension system in order to boost national savings and combat the effects of an ageing population as part of a major reform package.

To ensure Australians have adequate funds at retirement, employers are required to contribute 9.5% of employee salary into a retirement fund chosen by the employee. Nationwide the Australian pension system now has a total pension savings of US\$1.9 trillion, with the industry contributing more than 2% to annual GDP from fees revenue alone and now ranks as the fourth-largest pension fund industry in the world.

This has been a major reason for the growth in Australian Islamic wealth managers now targeting the potential market of US\$20 billion in Islamic pension assets, based on the fact that there are over 500,000 Muslims in Australia. A relatively small number, which however grows in significance when total retirement saving assets are considered.

“To ensure Australians have adequate funds at retirement, employers are required to contribute 9.5% of employee salary into a retirement fund chosen by the employee”

Even more important is the fact that the development of Islamic wealth managers in the superannuation (pension) space has created a solid springboard for international expansion. Now, growing momentum in Islamic property investment is key to the development of Islamic finance in Australia — with the objective of establishing Australia as a financial services leader in the highly competitive Asia Pacific region.

Review of 2014

Mixed view

Economic analysts have mixed feelings. The economic growth story for 2014 has been surprising. While first quarter growth exceeded expectations, the release of Australia's annual budget (a document which communicates fiscal policy) did not help investment confidence. Question marks over China's growth have further weakened the mining sector, hurting Islamic Australian equity funds heavily invested in resources. Falls in iron ore and oil prices have not helped.

The Thomson Reuters Crescent Wealth Islamic Australia Index reported a 1.5% growth for the year with underperformance primarily due to an overweighting towards resources.

However, retirement funds have gone up by about 12%, with a depreciation in the Australian dollar supporting a recovery towards the tail end of the year and raising confidence for 2015.

“ Domestically the Islamic finance industry will benefit from increased competition in the superannuation (pension) space. With investors increasingly disposed to Islamic financial products, it will be key for service providers to match growth with excellent performance and quality service ”

Islamic property investment - growing awareness

Foreign investors have flocked to Australian commercial property. Offshore investments surged by 12% in 2014 with foreign buyers accounting for US\$6.2 billion in deals, around 23% of commercial property transactions last year.

Around two-thirds of foreign investments now come from the Asia Pacific and the Middle East, with plenty of so-called maiden buyers from Islamic economies lining up in search of Islamic compliant property investment opportunities.

The falling Australian dollar can make Australian office towers, shopping centers and industrial facilities cheaper for offshore buyers.

Islamic property funds invested in Shariah compliant Australian real estate investment trusts (A-REITS) were key winners in 2014, with data from Morningstar showing the Crescent Diversified Property Fund as a top performer, returning 25.75% over the calendar year. This reflected growing demand for high-yielding, income-generating and conservatively-managed stocks.

Preview of 2015

Domestically the Islamic finance industry will benefit from increased competition in the superannuation (pension) space.



With investors increasingly disposed to Islamic financial products, it will be key for service providers to match growth with excellent performance and quality service. The real test will be reaching the US\$100 million mark in assets under management.

Increased collaboration on a number of fronts between Australian and OIC-based economies is expected, following the entrance of Dubai Islamic Bank's Shariah consultancy and advisory firm, Dar Al Sharia Legal & Financial Consultancy, into the Australian Islamic finance space. Key will be efforts to effectively bridge Shariah compliant investment between Australia, and the Middle East and Asia Pacific.

Many of the same factors that attracted those players into the Australian property market remain as drivers in 2015, most importantly the stronger yields here compared to other world markets. It will be interesting to see if Islamic property investment, operating in one of the world's largest commercial property markets, can propel the Shariah compliant investment space forward.

Conclusion

Australia has always been eager to attract institutional investment flows from regional neighbors in order to develop and capitalize on strengths in commercial banking, infrastructure, property, resources and agricultural financing. In 2015 the country is well-positioned to use the established scale, structures and expertise to take the Islamic finance industry to new heights and cement Australia's position as the opportunistic destination for Shariah compliant investment. (2)

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Fresh evidence of growth and optimistic outlook despite market challenges

By Dr Hatim El Tahir

The Kingdom of Bahrain continues to strive for growth to achieving financial stability and sustainable growth in all sectors of the economy. Despite difficult global economic conditions and increased volatility in global oil prices, the economy has had a fairly good year in terms of commerce and industry. Fresh evidence emerged of the country's economic growth which remained strong and positive throughout the year. The real GDP growth for Bahrain has continued to increase from 3.4% in 2012 to reach 5.1% in the third quarter of 2014, while this marked a slight deceleration from the 5.7% pace recorded in the second quarter (See Chart 1). Overall growth for 2014 has so far exceeded 4% according to the December 2014 Bahrain Economic Quarterly Report of the Economic Development Board (see Table 1).

Regulatory level

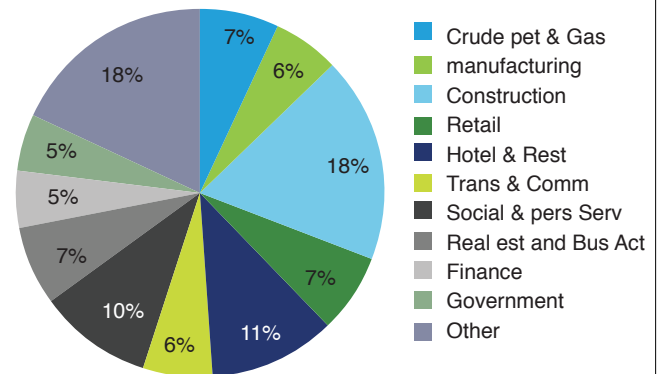
On the regulatory landscape and as a part of its continued efforts, the Central Bank of Bahrain (CBB) has unveiled a series of new regulatory initiatives in an effort to enhance the regulatory environment in the Kingdom. Early in the year, the CBB announced new measures to strengthen Shariah governance in Islamic financial services in Bahrain. The new measures revealed an emphasis on the effectiveness of a centralized Shariah advisory board to approve and oversee the product development process and innovation within the industry. It was also asserted that the Shariah Supervisory Board will help further standardize the Islamic financial services and products offered. In addition, the new regulatory measures will include new Shariah governance guidelines to enhance the internal Shariah review and audit functions with a mandatory external Shariah assurance report for all operating institutions offering Islamic financial services (IIFS).

In line with the development of the product offerings and diversity in the sector, the Bahrain Bourse plans to launch a range of Islamic investment products including an equity-based Murabahah financing tool and Islamic real estate investment trusts (REITs). The bourse is also working on creating a Bahrain Islamic prices index, expected to be introduced in 2015.

Other developments in the sector include Takaful insurance which has continued to grow in scale and scope and has received significant emphasis from the regulator and business community. In general, the Kingdom had taken the lead to achieve the highest insurance penetration in the Gulf region at 2.3% and gross contribution in Takaful insurance rose from US\$5 million in 2001 to more than US\$110 million in 2013.

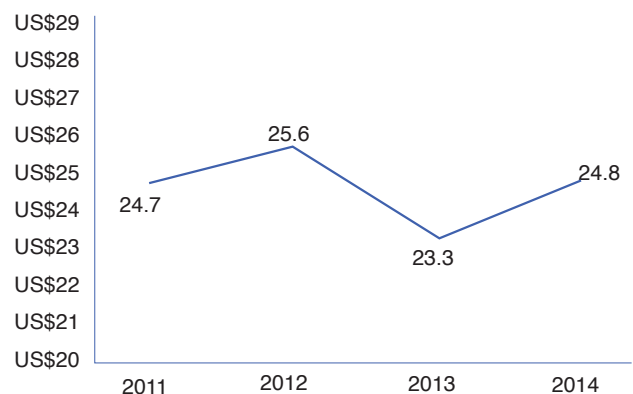
This noticeable growth in the sector was further boosted by continued support from the government and the CBB. More

Chart 1: The real GDP of key sectors in Bahrain as of October 2014



Source: Economic Development Board, Bahrain Economic Quarterly, December 2014

Chart 2: Bahrain Islamic banks consolidated balance sheet (US\$ billions) as of October 2014



Source: Central Bank of Bahrain, Economic Indicator – September 2014

recently, the CBB introduced new solvency requirements for the Takaful industry with the aim to promote best practices and facilitate growth and sustainability in this industry in Bahrain.

Another important market that continued to grow and provide liquidity in the country is the regular Treasury bills and Sukuk issuances. The government continued to rely on its Sukuk market program as a tool of monetary and liquidity management strategies where both long-term and short-term Sukuk issued attracted

Table 1: Year-on-year real growth for 2012-2014

2012					2013				2014			
Annual	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
3.4%	4.9%	2.9%	2.9%	2.8%	5.3%	4.4%	5.8%	5.7%	5.4%	3.1%	5.6%	5.1%

local, regional and international investors. It is also worth noting that the CBB had recently developed and issued the 'Module on issuing and offering of securities and Shariah compliant Sukuk'. It provided new guidance for the treatment of capital-boosting instruments under Basel III rules and drafted separate rule books for conventional and Islamic banks, proposing they both come into effect in January 2015.

Practice level

The Islamic banking industry in Bahrain has recorded constant growth for four decades but this trend was slightly interrupted in the last few years due to global and regional financial geopolitical challenges. As shown in Chart 2, total assets showed a pronounced decrease from the preceding year, amounting to US\$25 billion in October 2014, which represents 13% of the total banking assets of US\$189 billion. The financial and banking sector remains buoyant and represents around 17% of Bahraini GDP in the first quarter of 2014.

In particular, there were a number of interesting corporate and transactional activities in the sector. For instance, Kuwait Finance House-Bahrain launched a new financing product for individuals. The new product is structured on a Tawarruq facility and based on palm oil commodity Murabahah whereby the transaction and transfer of product ownership occur in real time. The new offering - expectedly - will help retail customer access new means of Shariah compliant personal financing to manage their liquidity shortages and capital needs.

The small and medium enterprises (SMEs) sector plays an important role in the economy of Bahrain as the Bahrain Economic Development Board (EDB) provides significant technical and financial support to this sector under the umbrella of Tamkeen. As part of this program, the EDB joined forces with the Islamic Corporation for the Development of the Private Sector (ICD), the private sector arm of the IDB, and signed a memorandum of understanding (MoU) to offer Shariah compliant products and training. It was also reported that under the terms of the joint partnership, the ICD will establish the Islamic Ijarah Company in Bahrain to help SMEs grow and offer Shariah compliant financing products.

Moreover, it was also reported that the ICD plans to set up a software development center in Bahrain to develop software solutions for Ijarah, Takaful (Islamic insurance), mortgage and Islamic banking, for export to the international market. Other terms of the MOU included a possibility of establishing an SME fund, in partnership with the EDB, with the aim of supporting and investing in SMEs based in Bahrain.

A landmark transaction in the aviation landscape was completed successfully by Ibdar Bank. The US\$100 million lease agreement was structured to finance the purchase of four aircrafts by Ethiopian Airlines. This was the first ever Shariah compliant transaction in the African aviation sector.

In 2014, Bahrain also witnessed the establishment of a professional association of asset managers. The association will be regulated and supervised by the CBB and will include Islamic and conventional financial institutions specialized in asset management.

Business support services level

Likewise, on the business support level, the Kingdom witnessed year-long activities by professional training and research organizations. In this regard, the Waqf Fund, a Bahrain-based special fund to support Islamic finance training, education and

Table 2: Bahrain economic outlook

	2013	2014F	2015F	2016F
Real GDP growth	5.3%	4.2%	3.6%	3.3%
Non-hydrocarbon sector	3.0%	4.6%	4.5%	3.9%
Hydrocarbon sector	15.3%	2.9%	0%	0.5%
Nominal GDP growth %	8.3%	3.1%	2.1%	5.8%
Inflation (CPI%)	3.3%	3%	3%	3%
Current account (% of GDP)	7.8%	5.7%	2.9%	2%
Fiscal balance (% of GDP)	-3.3%	-3.9%	-4%	-1.5%
Crude oil Arabian Medium (US\$)				

Source: Bahrain Economic Development Board, Bahrain Economic Quarterly – December 2014

research, worked with the University of Bahrain to provide financial support to its four-year Bachelor's degree in Shariah for banking and finance program.

Another new initiative approved by the Waqf Fund's board relates to cooperation with the AAOIFI and financial support to help AAOIFI in further developing the Certified Islamic Professional Accountant qualification.

The Bahrain Institute of Banking and Finance (BIBF) signed an MoU with the UK's University of Bolton to develop an MBA in Islamic banking. Under the agreement, BIBF will act as lead content provider for Islamic finance subjects and will supervise all dissertations.

BIBF also announced the launch of two new levels of qualifications around the already existing CISI Islamic Finance Qualification (IFQ) Level 3. The first qualification offers a foundation level (Level 2) qualification, the Fundamentals of Islamic Finance Certificate, as an entry point for those wishing to develop the essential knowledge related to Islamic finance before progressing to the (IFQ) Level 3.

Outlook

Overall, the Kingdom of Bahrain represented by its key government agents, the CBB and EDB, continued to support the well-being of the Islamic financial services industry and provided several regulatory and business support initiatives to facilitate the country's competitive edge and soundness for foreign and regional investors. However, a number of factors may not necessarily be in favor or help Bahrain achieve its growth targets. More precisely, tumbling oil prices and regional geopolitical risks coupled with slow world economic recovery, all pose fresh challenges to Islamic banks and the financial sector in general to meet capital adequacy and solvency requirements set by local and international regulators.

Nevertheless, the forecasts and economic outlook in the year 2015 (see Table 2) remain positive with inflation curbed at an average low level of 3% and a drop in real GDP growth to 3.6%. It is also hoped that the impact of the drop in oil prices is minimized by the country's investment in other non-oil sectors.⁽²⁾

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Islamic banking: The first choice of Bangladesh business people

By Md Shamsuzzaman

Islamic banking commenced operation in Bangladesh in 1983 and now alongside eight fully-fledged Islamic banks and 825 branches or windows of 17 conventional banks are offering Islamic banking products. Foreign banks like Standard Chartered containing the name Saddiq and HSBC containing the name Amanah have been included in the group. The full operations of non-bank financial institutions, namely Islamic Finance & Investment and Hajj Finance, are compliant with Shariah principles. Therefore, Islamic banking and its network is widening its base consistently and it is a competitive component of the banking industry.

Review of 2014

The impact of political difficulties and a vulnerable business environment throughout the year 2013 was still persistently felt in 2014, with the banking sector showing a modest growth. In December 2014, the statistics showed that exposure to Islamic banking has remarkably grown. Out of total banking deposits of US\$84.47 billion, Islamic banking deposits was US\$17.73 billion which was 21%.

The total loan portfolio of the country was US\$67.63 billion where US\$12.85 billion belonged to Shariah-based banks. The growth in deposits and loans of Islamic banks were 20.77% and 13.78% respectively compared to the national growth of 13.46% and 15.47%.

As per the data of the central bank, the value of import letters of credit opened from July-November 2014 was US\$17.74 billion where Islamic banks contributed US\$1.87 billion. The national export receipts during the period of January-June 2014 was US\$11.81 billion of which Islamic banks contributed US\$1.72 billion. Islamic banks' figure from January-December 2014 was US\$4.58 billion for wage earners' remittance where country receipts were US\$14.94 billion.

Financial inclusion

Central Bank Governor Dr Atiar Rahman has urged the banking industry to make banking services available to everyone including the disabled. More and more school-going children and farmers are opening bank accounts. As of September 2014 as many as 790,000 accounts were opened with deposits of US\$78 million for schoolchildren whereas farmers opened eight million accounts of BDT10 each.

Islami Bank Bangladesh was awarded the first prize for opening 160,000 school banking accounts alone while First Security Islami Bank organized a camp in urban renowned schools to facilitate the service. Bangladesh Bank, meanwhile, set a target of disbursing BDT2 billion (US\$25.19 million) to farmers through their accounts in different banks under an agreement to meet their financial needs during the harvesting season.

Non-formal banking

Mobile banking provides financial services to the un-banked community efficiently and affordably. Services like cash in cash out, fund transfer, utility payment, telco charges, salary disbursement, remittance payment and ATM withdrawal have become very popular in the remote areas. These services are being provided through POS and agents under the local branches of the banks. bKash of BRAC Bank leads mCash of Islami Bank Bangladesh with services in 18 conventional banks and one Islamic bank. Up to the third quarter of 2014 an average cash transaction of US\$42.70 million had been made daily through mobile phones. Access to formal banking activities is limited to only 17% of the population where 115 million mobile users are fuelling the expansion of mobile financial services.

Rural development

Islami Bank Bangladesh has been working with an innovative Islamic microfinance scheme to meet the demand from the rural poor since 1995 and has now become the second largest

organization with 780,000 members; it provides financial assistance for education, sanitation, health programs and entrepreneurship. Most of the members (92%) are females divided into groups of 10 members who collectively stand as guarantors for refunding the loan. Clients are being graduated from the rural scheme to mainstream investment as their capacity and assets grow.

Non-performing loans

The gross non-performing loans in the banking sector increased to 9.92% amounting to US\$6.71 billion and that of private sector 7.67% and Islamic banks 4.87%. Fitch, an international rating agency pinpointed mainly two reasons for the increase: political uncertainty and financial sector risks. But to some economists it is also due to the effective legal protection to the lenders against the credits, absence of corporate governance, negligence to due diligence, unethical practices or fund diversion and influenced loan sanction. In mid-December, the central bank governor asked all scheduled banks to reduce the non-performing loans volume by any means under existing regulations.

Regulatory changes

The most important regulatory changes in 2014 came from the central bank to form a refinance scheme for Shariah-based banks and other financial institutions to provide loans to agro processors, small enterprises, and renewable energy and environment-friendly initiatives, since Islamic banks are sound in liquidity. They will deposit their surplus funds to an Islamic refinance fund account and the Shariah lender can obtain the funds under the average Mudarabah rate or 5%, whichever is lower. The central bank will not partake of the income. It will be distributed among participatory banks according to their investment ratio. Another declaration which came from the central bank is to declare Sukuk guidelines which will give support to extend the Islamic capital market.

The Bangladesh Bank issued on the 24th December 2014 guidelines on bidding for the Bangladesh government Islami Investment Bond, which is known as the Islami Bond. According to the guidelines, only Shariah-based banks and financial institutions will be allowed to participate in the bidding for the bonds which are usually issued with maturity periods of three and six months. Any individual or institution wishing to purchase the Islami Bond should participate in the bidding through any financial institution. Islamic banks with surplus funds will hope to invest in this lucrative scheme of the central bank in the year 2015.

Preview of 2015

Bangladesh's economy is growing and even the US ambassador to Bangladesh, Den Mazina remarked at the end of his tenure that Bangladesh is a strong contender to be the next Asian economic tiger. He added: "Yours is [a] rich nation with fertile soil, ample natural water, perfect growing climate and world [']s most hard working, creative and entrepreneurship [sic] people."

This is the reality in Bangladesh where there is a need to restructure the banking industry to make it more socially responsible and welfare-oriented and based on Shariah principles. Banks awaiting for Islamic license from the central bank may push further in the coming year using government positive attitude. Changes in Islamic banking regulations, Islamic bond issues, Shariah banks' refinancing schemes, declaration of Sukuk induction and other changes will definitely encourage the rapid proliferation of Shariah products and services in the banking and finance industry.

Bangladesh is a country with the fourth-largest Muslim population in the world so Islamic banking has a bright future. According to the World Islamic Banking Competitive Report 2013-2014, Bangladesh stands equal with Qatar and Malaysia in capturing 20% of market share and 45% banking penetration

Without a doubt, Bangladesh will be missing an opportunity to build a global footprint in Islamic banking in the absence of regulatory reforms and strong sovereign support. Recent refinancing changes and funding agreements, as well as the Sukuk declaration of the central bank, will move the industry closer to the global standard.

Conclusion

Mamunur Rashid, ex-CEO of Citibank in Bangladesh made a comment in his recent write-up in a newspaper that it would be foolish to think of Islamic banking as an economic business of religion based on political parties rather than the reality that 18% of deposits, 20% of loans, 21% of imports, 24% of exports and 30% of remittances of the total national portfolio are being controlled by the eight Islamic banks. He added that any ready made garments (RMG) exporter will surely pick an Islamic bank as his chosen bank. In addition, Islamic banking is popular because it has the capacity to absorb any sudden shock or risk, with a soft balancing approach for SME clients, including a program for mass banking that is also socially responsible.

Bangladesh is a country with the fourth-largest Muslim population in the world so Islamic banking has a bright future. According to the World Islamic Banking Competitive Report 2013-2014, Bangladesh stands equal with Qatar and Malaysia in capturing 20% of market share and 45% banking penetration. A customer base of about 12 million has been achieved out of 38 million customers globally. In respect of asset growth, Bangladesh has attained 24% in 2012 and 17% in 2013 which is higher than Bahrain, Kuwait, Egypt and Pakistan. Mohammad Abdul Mannan, CEO and MD of Islamic Bank Bangladesh, in his paper presented recently at a bankers' seminar at the Bangladesh Institute of Bank Management stated that Bangladesh can be a strong hub of Islamic banking in Asia due to the following:

- i) regulatory support and a huge demand from the unbanked population
- ii) Islamic systems have been growing successfully, and
- iii) from 1983 until 2013 the bank achieved a 20% market share which is much higher than contemporary start-ups in Malaysia and Bahrain. (2)

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Bosnia: Potential Islamic finance center for South Eastern Europe

By Velid Efendic

Bosnia and Herzegovina (B-H) is a country in the South Eastern Europe (SEE) region with a population of close to four million of which about 40% are Muslims. It is common knowledge that Bosnia endured a horrible war that ended 20 years ago, and now Bosnia is a stable country with great potential for economic development.

In recent years, tourism grew rapidly, and Bosnia is recognized as one of the most desirable tourist destinations in many countries in the east and west. Its financial system is mostly banco-centric, with 29 banks majority foreign-owned with assets close to EUR12 billion (US\$13.58 billion) (Central Bank of B-H, 2014).

Following the European model of banking, Bosnian banks are very often co-owners of leasing companies, brokerage houses, investment houses and even insurance companies. Its capital market is not so well developed (it is small in size), with market capitalization at the Sarajevo Stock Exchange close to EUR2.44 billion (US\$2.82 billion) (SASE, 2014: <http://195.222.43.81/sase-final>) while the insurance industry is in a developing phase, with assets close to EUR670 million (US\$758.03 million) (Central Bank of B-H, 2014).

Microfinancing plays a significant role in Bosnia where the microfinance sector supports SMEs and low-income households, with 19 microfinance institutions having an asset size close to EUR375 million (US\$433.09 million) (Central Bank of B-H, 2014), and 10 leasing companies with assets of EUR391 million (US\$451.57 million) (Central Bank of B-H, 2014). The investments in the Bosnian financial sector mostly come from Western Europe, Austria, Germany, and Italy.

In 2000, Bosna Bank International (BBI) was established by the capital provided by IDB, Dubai Islamic Bank and Abu Dhabi Islamic Bank and it was the first bank in Europe to operate on the principles of Islamic banking. BBI's market share is 3.2% of the total banking assets (FBA, 2014). There is one Islamic microfinance institution that is active in Bosnia, but there are no investments registered in Takaful yet.

Review of 2014

The banking sector of Bosnia is still affected by the recent global financial crisis. New regulatory changes from Basel III and the introduction of international accounting standards required a lot of regulatory adjustments in the last few years. Slight credit growth was recorded in 2014, and total credits are now on the level of EUR8.6 billion (US\$9.64 billion) in the first six months of 2014 (Central Bank of B-H, 2014). Most of the loans go to the private sector, with close to EUR3.9 billion (US\$4.37 billion) while households received around EUR3.7 billion (US\$4.15 billion) (Central Bank of B-H, 2014). There was also a slight growth of deposits recorded, reaching EUR7.4 billion (US\$8.29 billion).

Finally, assets growth followed the trends in loans and deposits, growing from EUR11.8 billion (US\$13.22 billion) in 2013 to close to EUR12 billion (US\$13.45 billion) in mid-2014.

In terms of promoting education in Islamic finance, 2014 was very successful where the School of Economics and Business of the biggest and oldest public university, University of Sarajevo, launched their Center for Islamic Economics, Banking and Finance, as a result of 10 years of doing research and education in this field (<http://www.efsa.unsa.ba/ciebf>). As the result of their work, more than 500 students passed through different programs and courses in Islamic finance. Master's studies were developed from 2008, while a new international joint MA degree program started last year in collaboration with the University of Bolton from the UK (<http://www.efsa.unsa.ba/ciebf/ba/about-the-program>). Also in November 2014, the European Association for Islamic Economics, Banking and Finance organized the International Sarajevo Islamic Finance and Economics Conference SIFEC 2014 (<http://www.islamicfinanceeurope.com>) in collaboration with IDB and Islamic Research and Training Institute and other partners. With all these activities and events, Bosnia (and Sarajevo) aims to promote itself as an Islamic finance center for South Eastern Europe.

Preview of 2015

In 2015, some new investments in Islamic banking are expected and new banks with capital from the east could be established. New investment opportunities in the renewable energy sector, tourism and infrastructure will attract more investors from Islamic countries like Kuwait, Kingdom of Saudi Arabia, Qatar and others.

The new government will be announced in early 2015, and new strategies and plans of the central government should be supportive of investors in Islamic banking. Strategic plans of the new government are expected to include Euro-integration (aspiration for Europe Union membership), joining NATO and increasing investments for new jobs. Bosnia needs foreign investments to overcome the effects of the financial crisis and to open up new investments and businesses. The coming years will be a great opportunity for Islamic finance to grow rapidly. Those who take the initiative to enter the market first will benefit most and although opportunities are present, but they are not unlimited.

Conclusion

The Bosnian financial market is a potential investment opportunity for Islamic financial institutions as the country is experiencing new development trends in its aspiration to join the European Union and NATO. New governments and strategies should very soon open the market to new investments in infrastructure, energy production and tourism. Western countries like Germany, Austria and Italy already recognized the opportunity and they are now the most significant investors in Bosnia. Accordingly, with more attention and efforts from Islamic countries and financial institutions, new investment opportunities could be reached in the Islamic finance sector as well, including in Takaful, investment funds and especially Sukuk which are perfectly suitable for many infrastructural projects that will be implemented in Bosnia in upcoming years. (2)

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Brazil: an alternative for investors

By Fábio Figueira

In the last decades, the world has naturally turned its eyes to China, which has become, undoubtedly, one of the major locomotives of the world economy. Investors looking for opportunities in China is something that no longer brings surprises. This fact poses a question whether investors should also be looking at other economies, which might not, somehow, be in the spotlight, but which can turn out to be very promising.

Brazil is the only South American country in the globally known acronym BRICS (Brazil, Russia, China and India). It is one of the largest economies in the world and plays a very important role in the economic scenario whenever an investor thinks of Latin America as a region for possible investments.

The Brazilian economy, formerly framed into its borders until the 1990s, has been integrated into the global economy. It is practically mandatory for major international companies and groups to be in Brazil, as they want to participate in the country's recent economic growth. On the other hand, some Brazilian companies (Ambev, Embraer, Itaú and Vale, among others) have become international as well, with an ineluctable footprint in the US, Europe, Africa, Middle East and other relevant regions of the world.

One cannot disregard the importance of Brazilian cities like São

Paulo (the South American economic and financial hub) and Rio de Janeiro (with an economy tightly connected with the oil and gas industry). Not to mention other geographic areas of Brazil in the northern and southern regions which, although may not be well-known by some foreign investors, offer very good opportunities for investments in sectors like the manufacturing, services, mining and agricultural ones.

Brazil is today a country that not only produces goods and services for its internal market (approximately 200 million inhabitants) but has been exporting its products to different parts of the world, like the US, Europe, China and the other South American countries. Historically, the US and Europe have been the greatest commercial partners of the Brazilian economy. Recently, China has also assumed such a position, but the links to the US and Europe have not been weakened. These links with China, the US, Europe and its leadership in economic terms in South America reveals that the Brazilian economy is very well positioned.

Further, the government has strongly assumed the promotion of social programs which, as a whole, aim at reducing the poverty levels in the country and has thus successfully increased the consumer basis, bringing to the market many individuals that in the past were not the focus of the Brazilian and international companies.

Of course, the Brazilian challenges are also great: how to

incorporate the new rising middle class, decrease the level of poverty and develop the country, if the economy presents historical low rates of savings and investments?

One part of the answer is the following: the Brazilian economy needs foreign investment to foster its economy. This is why since 1990 the country has been, on a constant pace, opening its market to foreign investments by taking measures like the implementation of regulations that give transparency for a foreign investor about the inflow and outflow of foreign monies (direct investments and loans, dividends and repatriation of the invested capital, tax benefits for investments in securities), the privatization of companies and activities in certain economic sectors (aviation, telecommunications and mining), the possibility of foreign investors holding the totality of the capital stock in insurance and reinsurance companies, etc. These measures helped unleash very promising years, between 2002 and 2008 (with relevant annual average growing rates), until the world crisis came up.

“ By suffering the effects of the world crisis, the performance of the Brazilian economy in 2014 did not differ from other developing countries. The growth of the Brazilian GDP (Produto Interno Bruto) in 2014 is expected to be around 0.2% ”

By suffering the effects of the world crisis, the performance of the Brazilian economy in 2014 did not differ from other developing countries. The growth of the Brazilian GDP (Produto Interno Bruto) in 2014 is expected to be around 0.2%. The economy was relevantly impacted by the reduction of exports, due to the strong decrease in the price of commodities. Brazil is very active in agribusiness and, consequently, agricultural products have an important weight in the Brazilian economy. Therefore, it has been affected by the world crisis. Notwithstanding, it seems to be coming back to its promising track. The government has taken recent measures to adjust the public deficit, increase the exports and restore investors' confidence in the economy.

Brazil has a presidential system and at the end of last year the president was re-elected. It is clear for the president that it is very important to make the economy grow and to continue attracting foreign investment which, as mentioned above, is a key element for such growth. The appointment of the new finance minister who is a well-known professional in the financial market and who was the national secretary of Treasury during the first presidential term of former president Luiz Inácio Lula da Silva (in which the economy grew considerably) is a very positive signal that the president is willing to give to both Brazilian investors and entrepreneurs and foreign investors. The government is aware that Brazil must be seen as a country for investment opportunities and with a stable economic and political scenario.

In this context, investments in infrastructure in Brazil are essential for its growth. The economy shows good opportunities in sectors



like ports, airports, roads and energy. Brazil needs good roads aiming at the circulation within the country of agricultural and manufactured products. Good ports and airports are also of the essence for the export of its products and, of course, for the import of products which are relevant for the activities of several sectors of the economy.

Further, Brazil definitely needs energy to foster, among others, the manufacturing plants established in the country, to bring electricity of high standard levels to its big cities and regions that are not yet in the spotlight for foreign investors. Investments in both energy production and transmission are crucial to meet the country's growing demand. At least three auctions for the sale of energy are promoted by the government each year, allowing participation of new generation projects of different sources, such as hydro, thermo, biomass, wind and solar. In addition, several auctions to grant concessions for energy transmission are held each year, and concessions for energy generation, transmission and distribution which are about to terminate and will not be renewed are also subject to auctioning to new investors. Opportunities in the areas of self-production of energy for large consumers and in energy trading are also promising areas for investments.

Despite the current low prices of oil, foreign investors should continue to look with interest at the Brazilian oil and gas industry since it will continue to play a key role in the national economy. Brazil currently produces 2.86 million barrels per day and, as it is well known, the oil and gas industry is an economic sector that attracts not only those companies that are directly exploiting oil and gas but also for those companies that may be deemed as part of the industry – i.e. service and manufacturing companies that are the suppliers of the oil companies.

As mentioned previously, despite any effects that the country may still be suffering from the global crisis, Brazil is a country with many opportunities for investments in several economic sectors. It is a country whose political stability gives assurance to a foreign investor that it is making the investment in the 'right place', i.e. the rules governing foreign investments tend to be clear and stable. Finally, the Brazilian legal system (which is the Civil Code one) gives the possibility of investments either through direct investments (i.e. the incorporation of a company in Brazil or a joint venture with a Brazilian partner, in which case dividends can be remitted completely tax-free abroad) but also through international financing transactions, including project finance structures with complex security packages, such as mortgages and pledges of assets, rights and receivables. (P)

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Brunei: Islamic finance as an economic diversification beyond oil and gas

By Dr Aimi Zulhazmi

Brunei Darussalam (Brunei) is located northwest of the island of Borneo and has a total land area of 5,765 sq km with a coastline of 161 km along the South China Sea. The tiny size has not impeded Brunei's social and economic progress, as illustrated by its per capita GDP (PPP) which is among the highest in Asia at US\$54,800 (2013).

The key event for Brunei in 2014 was the implementation of Shariah criminal codes as the prominent laws of the country. This deepens the role of Islam in the country's judiciary, which was previously limited to marital issues.

The central bank, Autoriti Monetari Brunei Darussalam (AMBD), projected the Brunei economy to grow by 1.1% in 2014 as lower production is expected from the oil and gas industry. Non-oil and gas, conversely, grew 2.5% in the second quarter and was expected to reach 3.4% by 2014, which is in line with the government's policy to diversify its reliance on oil and gas that make up 60% of Brunei's GDP of US\$22.25 billion (2013).

Review of 2014

Brunei continues to grow the Islamic finance industry with Sukuk issuances to shore up its oil and gas industry as well as infrastructure development. Seven Sukuk had been issued over the years, with a significant one in Sukuk Ijarah (IDB and Brunei LNG) raising US\$1.6 billion in July 2014. The total holdings of the Brunei government Sukuk outstanding stood at BND700 million (US\$514.29 million) to date.

The Islamic finance industry experienced double digit growth in Islamic banking and Takaful. As of the second quarter of 2014, their market shares stood at 47% and 32% respectively. An industry study has estimated that by the year 2020, the market share of Islamic banking and finance in the sultanate will grow to at least 50% of the total financial sector. This growth is on track to achieve the targeted 8% contribution of the GDP by 2035 from 2.8% in 2008.

In order to develop the industry further, AMBD planned to establish the Brunei Capital Market, via the Securities Market Order 2013, which took effect on the 22nd August 2014; the new order replaces the Securities Order of 2001 and Mutual Funds Order 2001; a significant milestone as the government intended to streamline the legal and regulatory framework and regulations as laid out by the International Organisation of Securities Commissions. AMBD also signed a memorandum of understanding with the Securities Commission Malaysia to enhance cooperation in the capital market.

AMBD had been very market proactive in 2014. It deregulated the capping set on interest/profit rates on residential property loans hence allowing the market forces to determine the competitive rates. It also established the Credit Bureau that provides

comprehensive credit reports to the public. AMBD is also now undertaking the central clearing system of cheques, which was previously conducted by the Brunei Association of Banks. Moreover, AMBD introduced three new guidelines in July 2014 that required all insurance and Takaful agents to register with AMBD to ensure professionalism and enhance public confidence.

Preview of 2015

A lot is expected from Brunei in 2015 as it possesses a conducive environment for a strong Islamic finance industry hence the potential to be an Islamic finance hub for the global market. With a relatively small population, Brunei would not be able to speed up growth in the industry and the sultanate should look at offshore markets as a catalyst. The Brunei offshore industry with over 13,000 companies registered in 2014 can play a significant role in attracting development to the Islamic finance industry. This strategy should be integrated with the anticipated introduction of the Brunei Capital Market in 2015 as outlined by the Securities Market Order 2013.

The establishment of a stock exchange in the country is to realise the country's vision of becoming one of the strongest financial hubs in Southeast Asia by 2035 and ASEAN's vision of an integrated regional economy by 2015. The industry players hope the capital market will provide the right platform to strengthen Brunei's indigenous market as it allows for Bruneian entities and even foreign entities to tap the equity market. It will also benefit medium to large-scale businesses as they would have an alternative avenue to access funds. Furthermore, it will lead to developments of secondary markets, where banks can play a greater role in driving investment.

Conclusion

The significant drop of 40% in crude oil prices towards the end of 2014 and Brunei's declining production cast a pessimistic outlook on the economy in 2015. From a positive perspective, many believe this is an immediate pressure on the sultanate to accelerate its economic diversification beyond oil and gas. In Islamic finance, Brunei has the right industry to thrive in.

The Sultan of Brunei envisions his country to become a premier Islamic financial center in the near future. There is a niche for Brunei in the growing global Islamic finance of which assets have doubled to US\$1.8 trillion from 20 years ago. A concerted effort by all stakeholders through a strategic development plan by combining Shariah laws with the established oil and gas industry and the growing offshore jurisdiction and coupled with the introduction of the capital market in 2015 should be able to position Brunei in the right direction to be a significant player in the global Islamic finance industry. ☺

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Canada: A promising emerging market for Islamic finance

By Jeffrey Graham

Canada is widely considered to have the most effective and safest banking system in the world, according to the World Economic Forum. The Global Financial Magazine reports that six of the world's top 10 safest banks are Canadian. The World Bank ranks Canada in the top five countries in terms of investor protection.

One of the most rapidly growing segments of the international financial services sector is Islamic finance. Recognizing this trend, and in competition with a number of other western financial centers, including London in England, Toronto is leading Canadian efforts to explore the prospects of attracting additional international financial activity, including Islamic finance.

Review of 2014

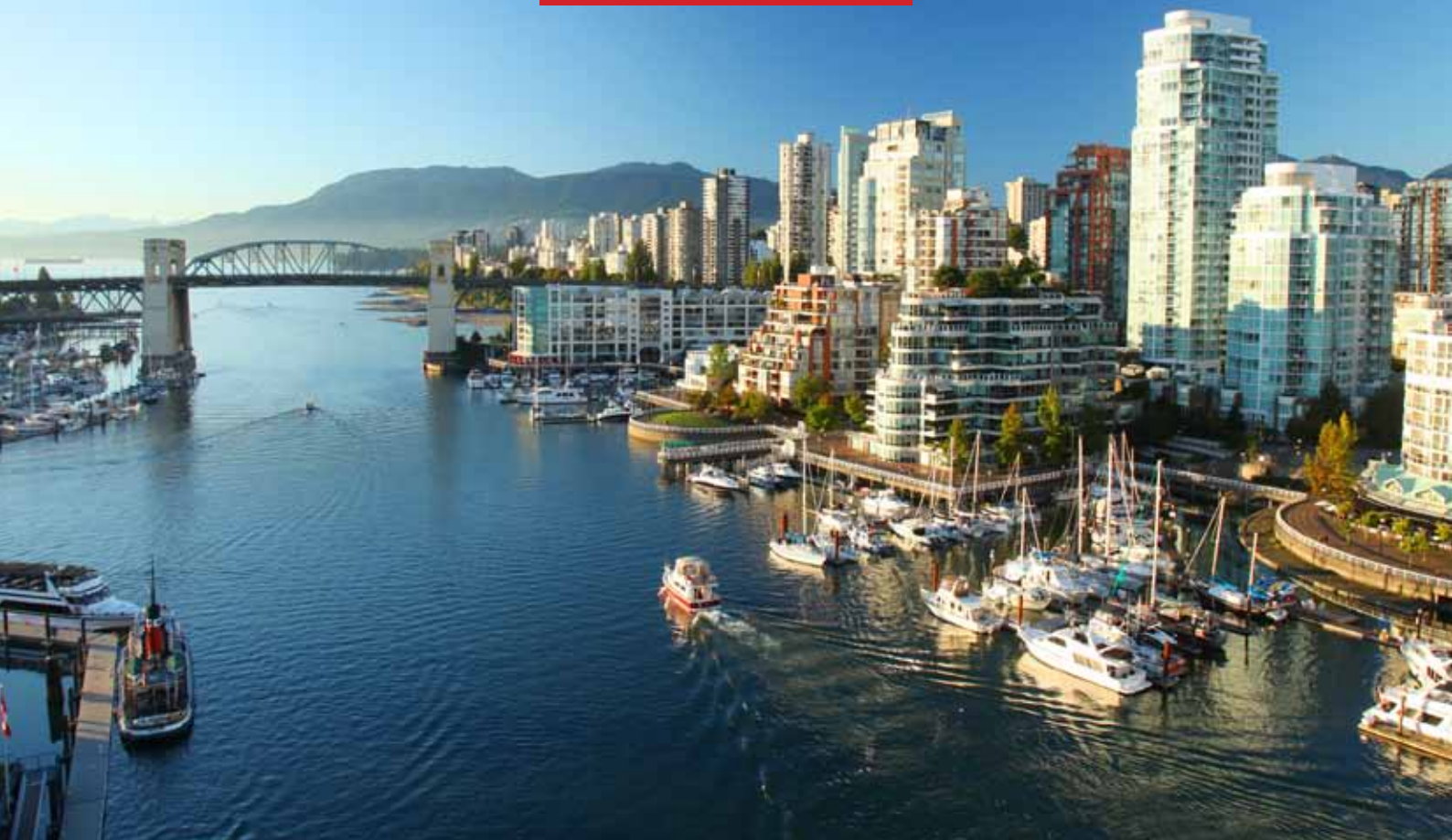
In March of this year, the Canadian Minister of Foreign Affairs, the Honourable John Baird, spoke at the annual dinner of the Canada Arab Business Council. He said at that time: "Islamic finance is welcome in Canada. I would set the goal of establishing Toronto as the next global hub for Islamic finance — in order to help bring new investment into Canada and also to help give Canadian business new tools and opportunities to succeed in the Islamic world."

Subsequently, Etihad Etisalat Company (Mobily) agreed to a SAR750 million (US\$196.33 million) 10.5-year Shariah compliant financing facility with Export Development Canada, which will

be used to acquire telecommunication equipment from Alcatel-Lucent.

In addition, AGInvest Properties, an Ontario-based firm dedicated to helping investors diversify their portfolios with class 1 and 2 prime farmlands in Canada, announced that it had entered into a Shariah advisory agreement with the Shariyah Review Bureau. AGInvest currently owns and manages farmland across Ontario. With the assistance of the Shariyah Review Bureau, AGInvest is offering Shariah compliant investment partnership opportunities involving the Canadian agriculture sector.

A number of major Canadian financial institutions continue to make progress in developing Shariah compliant investments for their international clients. For example, Bank of Montreal owns an asset management firm, Pyrford International, that offers clients Shariah-based investment strategies from its London, England location. In Malaysia, Manulife Financial offers a number of private retirement schemes consisting of the Manulife PRS Growth Fund, the Manulife PRS Moderate Fund, the Manulife PRS Conservative Fund, and corresponding Shariah-compliant funds. In addition, Sun Life has Shariah compliant products which include Brilliance Hasanah Protection Plus, a single premium unit-linked, and Brilliance Hasanah Sejahtera, a regular premium unit-linked with six riders. These are sold in Sun Life's more than 48 marketing offices in 32 cities across Indonesia, with more than 6,000 Shariah certified agents. Sun Life Financial Indonesia (Sun Life)'s Shariah business unit received two awards at the 10th Karim Consulting Islamic Finance Awards. These include



being ranked first as The Best Risk Management Islamic Life Insurance with assets below IDR150 billion (US\$11.99 million) and ranking third as The Profitable Insurance with assets below IDR150 billion.

“ There is no doubt that Canada has been slow to become a full participant in the exciting global Islamic financial movement ”

Locally, a number of Canadian-based financial entities continue to focus on a growing demand for Shariah compliant residential mortgages and investment products, including mutual funds.

There are several educational ventures that are helping to develop the Islamic finance knowledge base in Canada. For example, the Rotman School of Management within the University of Toronto continues to provide a leadership role in Islamic finance education. It introduced Canada's first Masters of Business Administration (MBA) course in Islamic finance, which is now entering its fourth year. A second major Canadian university, McMaster University in Hamilton, Ontario, in its DeGroote Business School, is also offering an MBA level course in Islamic finance. In addition, a prominent Ontario college, Centennial College, is offering a program on Islamic finance and investment based on a similar program offered by the UK Securities and Investment Institute.

Preview of 2015

2015 could be the year when visible progress on making Toronto the North American center for Islamic finance is achieved. In

November of 2014, Minister Baird and his counterpart in the UAE, Sheikh Abdullah Zayed Al Nahyan met with representatives of the private sector to review progress on the development of a Canada-UAE business council. One of the objectives proposed for the council in 2015 is Islamic finance. Among other things a bilateral Islamic finance committee has been proposed.

There are also various Islamic finance projects in Canada that are making progress. First, there are renewed efforts under way to create a regulated Islamic banking institution in Canada. The most promising initiative involves a number of international Islamic institutions working together to provide a substantial share of the initial capital of the institution and contributing their global experience in product development and risk management.

This initiative is expected to make the application for the first regulated Canadian Islamic banking institution sometime in 2015. In addition, there are various Islamic organizations, both domestic and international, in discussions with Canadian sovereign and corporate issuers regarding the opportunities to tap into the global Sukuk market. It is reasonable to expect that a number of Canadian issuers will find a way to participate in the Sukuk market in 2015.

Conclusion

There is no doubt that Canada has been slow to become a full participant in the exciting global Islamic financial movement. There are many reasons to believe that 2015 will be a year of growth. It may be that the growth is slow and steady or it may be a year in which one or more major developments announce the arrival of Canada's growing interest in Islamic finance on the global stage. ☺

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Islamic finance in the Czech Republic

By Dr Ivana Hrdlickova

The practice of Islamic finance is still a very new phenomenon in the Czech Republic. However, professional awareness has been increasing. For example, a prestigious law firm, PRK Partners, not long ago became a member of the ISFIN network (for Islamic finance lawyers), an association of leading law firms focusing on Islamic finance services.

While public awareness about Islamic finance services remains weak, compared to the past, when there was absolutely no knowledge of such services, there has been gradual change in the direction of better understanding. A significant number of students from legal, economic and social studies perspectives have submitted theses related to Islamic finance. More and more academic institutions are including Islamic finance topics in their educational programs. Further, there is growing interest among businessmen in Islamic finance operations and investment. Yet, on the other hand, “Islamophobia” does appear to be a real issue in the Czech Republic that may, if not effectively combatted, negatively influence the development of Islamic finance education and the practice of Islamic finance. In summary, though there is still no substantial practice of Islamic finance, and there may be cultural barriers, the increasing interest, awareness and knowledge among professionals representing various financial institutions, as well as among the public, are encouraging signs that there will be further development.

“There is growing interest among businessmen in Islamic finance operations and investment. Yet, on the other hand, “Islamophobia” does appear to be a real issue in the Czech Republic

Review of 2014

The past year witnessed a significant increase in public awareness about Islamic finance. Prague College, a Prague-based university accredited by the British Teesside University offering internationally recognized professional education, hosted an international conference in June 2014 titled “Shared values – strategy finance and business ethics. One part of this conference was dedicated to Islamic finance, the practice of which was considered from several angles. Further, students from the Anglo-American University, the Economic University and the law faculty of Charles University, all in Prague, have continued to research Islamic finance and Islamic banking issues from different perspectives.

There were also many presentations, public lectures and



professional discussions relating to Islamic finance, which represent a major step further towards increased knowledge. Notably, Czech state authorities have expressed an interest in this field and have received several lectures explaining Islamic finance principles.

Moreover, enormous changes in Czech legislation, which have had, and will continue to have, a huge impact on the whole of civil law and on business practices in the country, including cross border transactions, came into force on the 1st January 2014. These changes — new civil and commercial codes along with many implementing regulations — are better harmonized with European legislation, strengthen the rule of law underlying business and investment, guarantee a higher level of investment protection and ensure better enforcement of rights under contracts, and should thus also create improved conditions for the practice of Islamic finance and Islamic banking services. The old legislation, which slowed business and did not adequately encourage execution of contracts, had been considered an impediment to increasing business in the Czech Republic generally and may have negatively influenced potential Islamic finance business as well.

Preview of 2015

It is realistic to expect a considerable further increase in public awareness and knowledge of Islamic finance issues in the Czech Republic, particularly in light of anticipated lectures, presentations and academic training. The Prague branch of the International Chamber of Commerce (ICC Czech Republic) is paying attention to the practice and focusing on Islamic finance news. Export and import is a major industry in the Czech Republic and Islamic finance is no doubt an important tool for facilitating export and import with Islamic countries around the world. As has been stated in previous reports, the first step has been taken — the introduction of Islamic finance in the Czech Republic. Going forward, the need is for even greater explanation and dissemination of knowledge, through training, seminars and public debates, and for growth in the actual practice of Islamic finance in the country. (3)

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Development of Islamic finance in France

By Kader Merbouh and Valentine Baudouin

Six years after former French finance minister Christine Lagarde declared her intention to make Paris “the capital of Islamic finance”, the promise of her announcement remains far from being fulfilled. Nevertheless, constant progression by French actors (banks, insurance companies, universities, intermediaries) that have emerged since, combined with the fact that innovative initiatives to develop Islamic finance in France are well underway, could be a strong signal that France is on the right track to take the next step.



Review of 2014

The financial crisis sparked a search for viable alternatives which were both more directly-linked to the real economy and ethical. These concerns led to a wider interest in “participatory finance”, which has recently successfully addressed various challenges, such as reforming the regulatory environment and approving new product initiatives. Both of these advances could also favor the development of Islamic finance in France.

Indeed, 2014 has seen the development in France of a regulatory framework specifically intended to encourage participatory finance (finance participative) by allowing web-based platforms to provide investment services, such as direct investment into French companies, through an internet website complying with specifications set forth by the French Market Supervisory Authority (AMF) General Regulations. A particular status has also been defined for platforms offering investment opportunities in loans (bearing interest or not) and streamlining donations. Principles of “crowdfunding” result from post-crisis shared values: the need for SMEs and associations to have access to non-conventional banking sources of funding and the conviction of consumers and investors that they are willing to support projects directly linked to the real economy rather than to invest into non-transparent financial products.

Islamic finance, based on ethical principles, participatory methods and use of defined contracts as the basis for financial intermediation, fits well with many of participatory finance’s essential characteristics. The combination of both has resulted in the expansion of a variety of disruptive business-models, such as the first Islamic crowdfunding platform offering French Muslims the ability to help students who have turned to crowdfunding to finance their higher education, all in compliance with Islamic principles. Attracting nearly 3,000 investors registered in the first few months, this platform has completed 14 projects so far, ranging from donations, reward-based and loans without interest, all towards non-profit educational projects or Masters-level students in prestigious universities and business schools in France (source: easiup.fr).

If innovation can benefit the development of Islamic finance in France, it should also be noted that Islamic finance has itself led to innovative initiatives in France. This can be demonstrated by Paris-Dauphine University’s participation in the ISMED (Investment Security in the Mediterranean) Support Program implemented by the MENA-OECD Investment Program, which promoted Islamic finance as an innovative tool for improving the

legal environment and financial arrangements, thereby facilitating the successful completion of infrastructure projects. Moreover, in the retail and private wealth management sectors, both Swiss Life, through its Salam Epargne & Placement contract, and Vitis Life, through its Amâne Exclusive Life contract, reported strong appetite for such products, positioning both insurance companies as major players in product innovation.

Preview of 2015

The digital revolution allows each consumer to become an immediate and permanent witness to world-changing events while enabling a deeper respect of different cultural values. This could definitely ease the creation in France of a demand-oriented set of Islamic-compliant products. Furthermore, the entry of market-oriented companies as French Islamic finance players, with cutting-edge technologies that endeavor to better understand clients’ needs and wants, from product development through to product sales, will likely fill the gap left by French banks, which have developed Islamic finance products for overseas markets but hesitate to do so in France. The year ahead might also see these new market participants facilitate the analysis and dialogue needed to build bridges between banking and insurance actors, on the one hand, and the increased demand by French retail clients, in particular for Takaful solutions and longer-term Murabahah contracts (although more than 200 mortgages have been executed as of the 31st December 2014 by the platform, 570easi.fr, this amounts to a relatively low intake compared to the number of projects registered by 570easi’s clients, which represent more than 6,500 potential buyers for about EUR700 million), on the other.

Conclusion

If one of the challenges of the development of a sustainable Islamic finance industry is to avoid simply replicating conventional financial products, the French market is well-suited to meet such a challenge, reflecting an undeniably strong link between ethics, values and financial innovation and putting the customer at the heart of a new, demand-oriented area where trust, transparency, solidarity and entrepreneurship are modifying financial intermediation. ☺

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Islamic finance in Hong Kong

By Amirali Bakirali Nasir

Seven is a significant number in Islam in many ways. The Hong Kong government announced the development of an Islamic bond market as a key government initiative in its 2007 policy address and indeed it has taken years for implementation of the initiative. Legislative amendments, mutual agreements, roadshows and education have all helped to pave the way to the issuance of the inaugural Sukuk in September 2014. Trade between Hong Kong and the Middle East and other Asian countries have risen, as has travel between those regions for business and trade purposes. Hong Kong's population of seven million people includes a minority Muslim population of about 200,000 and Hong Kong must therefore rely on its strengths as an international financial center to attract international institutional investors seeking Islamic investments.

Review of 2014

Following the legislative amendments in 2013, allowing for the introduction of Sukuk (alternative bonds) to be treated for tax purposes like other bonds, the government made necessary amendments to the Loans ordinance in April 2014 allowing the government to borrow, by broadening the definition of "borrow" to include "alternative bonds" and to place such sums in the Bond Fund. Just a month before the issuance of the first Sukuk, the Inland Revenue issued guidance in the form of Stamp Duty Interpretation and Practice Note # 6 on alternative bonds.

Under the memorandum of understanding signed between The Hong Kong Monetary Authority and Bank Negara Malaysia, for knowledge exchange in different areas of Islamic finance, a joint Islamic finance conference was held in April 2014.

Following continuing investor demand, RHB Asset Management (RHBAM), a wholly-owned subsidiary of RHB Investment Bank in Malaysia, unveiled Hong Kong's first Shariah compliant, actively managed Islamic balanced fund, the RHB-OSK Islamic Regional Balanced Fund, in July 2014. It is the 17th Shariah compliant fund and is expected to reach US\$50 to US\$70 million with a return forecast between 10% to 15% and dividend distribution of up to 5%. The fund tracks the global Sukuk market. Around 60% of the assets are from Malaysia, 20% from the Gulf Cooperation Council region, and the remaining 20% spread to other countries. This cross issuance was possible under the mutual recognition agreement signed between Hong Kong Securities and Futures Commission (SFC), and the Securities Commission of Malaysia.

Hong Kong's Sukuk with a tenor of five years, was issued in September 2014. This was the world's first US dollar-denominated US\$1 billion Sukuk issuance, assigned credit ratings of 'AAA' by Standard and Poor's and 'Aa1' by Moody's. The Sukuk was developed on an Ijarah contract structured on two commercial properties in Hong Kong, held by the special purpose vehicle, Hong Kong Sukuk 2014, which is wholly owned by the HKSAR government.

The international institutional investors are 6% from Europe, 11% from the US, 36% from the Middle East and 47% from Asia. The Sukuk is listed on the Hong Kong Stock Exchange, Bursa Malaysia (Exempt Regime) and NASDAQ Dubai. The issuance was oversubscribed 4.7 times allowing a final price at



2.005%, being 23 basis points over the corresponding yield of US treasuries. National Bank of Abu Dhabi and CIMB acted as joint lead managers and joint book runners. HSBC and Standard Chartered Bank acted as joint global coordinators, joint lead managers and joint book runners.

A range of other seminars were arranged by the SFC in July, by the Treasury Markets Association through Nova Training and Education Institute in November and by the Hong Kong Law Society through the Academy of Law.

Preview of 2015

The government continues to provide support and training opportunities for issuers and is committed to the development of a wholesale Islamic capital market to leverage on its existing strengths in the conventional financial services industry and Hong Kong's unique role as a gateway to mainland China. RHBAM is expected to unveil further investment funds in Hong Kong and more Sukuk issuances, such as yuan renminbi-denominated Sukuk could be expected, given the growing importance of the yuan renminbi and Hong Kong's position as the premier offshore center for yuan renminbi business. It would not be surprising if China were to issue its own yuan renminbi-denominated Sukuk in the near future and it could well use the Hong Kong-Shanghai link to enhance its position in the Islamic finance market. The Asian Financial Forum held in Hong Kong on the 19th January 2015 made reference to the development of Islamic finance for investors and issuers.

Conclusion

The development of a truly integrated and sustainable Islamic financial market includes Islamic banking, Takaful and other specialized financial services. Development of each of these products and services is necessary for the sustained development of an Islamic finance market, suited to the needs of international investors. Islamic funds will also allow conventional investors to diversify their investment portfolios and manage various risks. As for local issuers, Islamic financial products will provide diversification of the investors' base. The potential for use of Hong Kong's other exchanges, such as the metal exchange, in Islamic contracts has not even been considered and is worthy of research and development. (2)

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Regulation of the Islamic finance sector in India

By H Jayesh

Islamic finance has immense potential and scope in India and there is a latent demand for products and services. According to the Islamic law, “interest” on periodic financial borrowings is not acceptable. Therefore, Islamic finance has come into existence to provide an alternative method to optimize the returns on investments.

The National Stock Exchange of India and the Bombay Stock Exchange have introduced two exclusive Shariah indices, namely S&P CNX Nifty Shariah Index and TASIS Shariah index, respectively to enable Shariah compliant investment opportunities including for institutional investors and sovereign wealth funds. As per market survey and press reports, India has one of the highest numbers of Shariah compliant listed companies. Taking into account the existence of several Shariah compliant listed companies, the regulation of the Islamic finance sector in India merits immediate attention.

Review of 2014

Today, Islamic finance has a small presence in India in the form of Non-banking financial companies (NBFCs) and Baitul Mal (Islamic treasury) catering to a niche segment at a regional level. The positive aspect is that many Indian institutions, including some government-owned ones, have shown interest in this growing niche opportunity. Apart from being a practicable alternative to conventional banking, the interest-free (which does not mean no returns) solutions of Islamic banking could restore equilibrium in Indian society by providing support to debt-ridden farmers, rural artisans, and other marginalized groups.

Another development in the past year was when the Ministry of Minority Affairs launched the National Waqf Development Corporation (NAWADCO). The objective of NAWADCO is to facilitate and mobilize financial resources for the development of Waqf properties for community development purposes in a joint venture with the State/Union Territory Waqf Boards and the Mutawallis. It is expected that with the recent enactment of the Waqf (Amendment) Act, 2013, administration of Waqf properties would now be more transparent. These initiatives from the government should put the spotlight back on Islamic finance and increase its awareness in India.

Additionally, a very positive update was the permission granted by the Reserve Bank of India (RBI) to an NBFC called Cheraman Financial Services, floated by Kerala State Industrial Development Corporation with an authorized capital of INR10 billion (US\$162.78 million), to work as an Islamic financial institution. It clearly appears that the RBI may be softening its views on Shariah compliant NBFCs in India. This will also help in creating awareness in the country, besides setting a precedent for more “mainstream” Shariah-based products and structures to be launched.

Preview of 2015

One of India's largest bank, State Bank of India (SBI), has set up an Islamic equity fund and is planning to launch a Shariah compliant mutual fund in the coming year. Although it received the necessary



approvals to launch the fund, it was deferred for further analysis and for review of the structure of the SBI's Shariah fund.

In India, Sukuk are now beginning to be seen as a feasible and viable Shariah compliant financing instrument. Sukuk are a fundamental unit of Islamic finance transactions. Sukuk represent a beneficial ownership interest in an underlying asset or portfolio, in conformity with Islamic law and Shariah principles.

The Ministry of Finance has taken an initiative to review what impediments Sukuk can face in India. They have set up a committee to review the legal, regulatory and taxation issues impacting the market for Islamic finance bonds and other issues relevant to the development of the market for Sukuk and functioning of the leasing industry.

Another potential development in the context of Sukuk is the proposal of the Securities and Exchange Board of India (SEBI) to permit trading in four new categories of debt including Sukuk. If implemented, the ramifications are positive.

Firstly, Sukuk would be “explicitly recognized” in the context of the Indian legal and regulatory framework. Secondly, its recognition by SEBI should pave the way for the RBI and the Insurance and Regulatory Development Authority of India (IRDA) to also recognize Sukuk as “investible securities” for entities regulated by them.

If RBI recognizes Sukuk as an added category of “non-SLR” (non-statutory liquidity ratio) instrument, then banks in India can finance Shariah compliant projects by funding them through Sukuk. Similarly, if Sukuk are notified by IRDA as permissible investment products for insurance companies, then long-tenor Sukuk would find a ready pool of investors. In addition to insurance companies, mutual funds and alternative investment funds shall have more comfort investing in Sukuk.

Conclusion

Dr Raghuram Rajan, the current governor of the RBI, was previously also part of a committee which studied the feasibility of introducing interest-free banking in India. The RBI appears to be opening up to the idea of a Shariah-based NBFC operating in India. The notion of a pan-India and vibrant Islamic finance market that renders quasi banking services to Shariah compliant consumers is closer to becoming a reality. ☺

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Indonesian Islamic finance industry in 2014: The government Sukuk-led growth

By Farouk Abdullah Alwyni

As was the case in the previous year, two major players dominating the share of the Indonesian Islamic finance industry are the Islamic banking sector (fully-fledged Islamic commercial banks and windows) and the government Sukuk issuance. However, in 2014, the government Sukuk issuance is the only factor that significantly continues driving the growth of the Islamic finance industry. There is, of course, still growth in the Islamic banking sector, but the 2014 growth is the slowest ever growth in the last five years (see Table 1).

There is actually also growth in other segments of the Islamic finance industry such as corporate Sukuk, mutual funds, insurance, and rural banks, but their size is relatively small compared to those two dominant players in the industry mentioned above. Although 2014 did not paint a very bright picture of the Islamic finance industry quantitatively, there are some initiatives taken that may well contribute to the enhancement of the industry for the years to come.

Apart from the above, the macro factors such as election year, the increase of electricity and gasoline prices — creating many questions in the country amid the global slump of oil prices — and the depreciation of the currency in 2014 could also contribute to a large extent to the growth of the industry. How these macro factors continue affecting the growth of the industry in 2015, especially with the latest increase of non-subsidized cylinder gas prices, remains to be seen.

Review of 2014

In terms of quantitative growth, the only dominant player left in 2014 was the government Sukuk issuance. This is due to the fact that the Islamic banking industry in Indonesia faced its major test in 2014. Up to the end of October 2014, the growth of the industry as a whole was only at around 7.5%, a major drop from the 23.6% growth in 2014 already considered low compared to the Islamic banking industry's previous records.

The growth until the end of 2014 was not expected to exceed 10% at most since major Islamic banks in the country like Bank Syariah Mandiri (BSM) and Bank Muamalat Indonesia (BMI) struggled with issues of quality assets after the departure of their respective executive management. It is most likely that these issues of quality assets will continue in 2015 since it normally takes time to deal with re-structured assets.

As mentioned above, the only driver of growth in 2014 was the issuance of government Sukuk. The growth of Sukuk in the last three years (2012, 2013, and 2014) has been relatively constant at above 30%. It is predicted that it will not be long before the amount of cumulative issuance of government Sukuk will exceed the Islamic banking asset. Unlike its sovereign counterpart, the corporate Sukuk has been relatively stagnant. Some issues hampering the growth of corporate Sukuk such as tax issues, "grey areas" on SPV-related matters, and a lack of fiscal incentives like those applied in Malaysia have largely not been addressed throughout 2014.

Table 1: Selected figures of the Indonesian Islamic finance industry (in IDR trillion)

	2010	2011	2012	2013	2014
Islamic Commercial Bank and Islamic window assets	97.62	146.47	196.02	242.28	260.37*
Islamic rural bank assets	2.74	3.52	4.70	5.83	6.27*
Sovereign Sukuk Issuance (cumulative)	48.22	81.53	138.62	186.22	248.95**
Corporate Sukuk Issuance (cumulative)	7.82	7.92	9.79	11.99	12.73**
Islamic mutual funds (net asset value)	5.23	5.56	8.05	9.43	10.20**
Islamic life insurance (premium)	2.12	4.08	4.82	N/A	5.74***
Islamic general insurance and re-insurance (premium)	0.67	1.00	1.64	N/A	0.87***

Sources: Ministry of Finance, Financial Services Authority (OJK), Thohuri (2013), and re-calculated further.

Notes: *As of October 2014; **As of November 2014; *** As of September 2014 (gross contribution); US\$1 equivalent to IDR12,000 (December 2014).

In connection to the corporate Sukuk issue above, there is a plan by the Indonesian Financial Service Authority, known as OJK, to study the possibility of developing rules, regulations and procedures for the issuance of retail corporate Sukuk. However, this will not be sufficient without addressing properly the constraints and lack of incentives faced by the companies to issue Sukuk in the first place.

As with corporate Sukuk, other Islamic finance instruments such as mutual funds, life insurance, general insurance, and Islamic rural bank assets did not really record significant growth in 2014. Yet, it is important to note that 2014 also witnessed new actions taken related to the development and promotion of the Islamic finance industry.

“ The year 2015 may be another challenging year for the growth of the Islamic financial industry ”

Among others, the actions include: (i) the first IPO in the Islamic banking industry carried out by Panin Bank Syariah; (ii) the plan of the OJK to lobby the Tax Directorate General to give fiscal incentives for the issuance of corporate Sukuk; (iii) the first issuance of the US dollar-based term deposit by Bank Indonesia (BI) intended to support liquidity management of Islamic banks; (iv) the establishment of the first Islamic financing guarantee company by a state-owned Indonesian credit guarantee company; (v) the signing of the agreement between the OJK and the republic's national Shariah board, known in Indonesia as Dewan Syariah Nasional (DSN) to strengthen oversight of the Islamic finance industry; and (vi) the issuance by the OJK of two revised Islamic banking rules covering asset quality and capital adequacy as part of 20 rules issued in the banking, capital market and non-banking financial industry in an effort to strengthen the country's financial industry.

Preview of 2015

The year 2015 may be another challenging year for the growth of the Islamic financial industry. Some policies undertaken by the newly formed government such as the rise of the price of

subsidized fuel around the end of 2014 which were considered not to be in line with the reality of declining oil prices have somehow caused an inflationary impact. Although oil prices have been decreasing at the beginning of 2015, it still did not immediately bring down the general prices that had already risen. In addition, the increase in electricity and non-subsidized cylinder gas prices would also contribute to the inflationary impact.

In response to the above, the central bank may again increase its benchmark rate. The latest increase of the central bank rate was on the 18th November 2015 when it increased its rate to 7.75% from 7.5%.

Nevertheless, from a more positive note, 2015 is expected to be the year of quality improvement for the Islamic finance industry especially when the two major Islamic banks in the country have now been working more to improve their quality assets after the major change in the composition of their management. Here, a proper implementation of good corporate governance (GCG) and risk management will be more critical than ever.

More actions taken and policies applied in between the middle and the end of 2014 as mentioned in the second part of this article above are also expected to have more impact in 2015. The joint effort between the OJK and DSN to strengthen oversight of the Islamic finance industry is basically aimed at realizing a more stable and sustainable Islamic financial sector with a strong “Shariah principles” foundation. This will basically serve the purpose of having effective GCG and risk management. In addition, two revised Islamic banking rules issued by the OJK to cover asset quality and capital adequacy are also expected to be able to further shape the quality of the Islamic banking industry.

Conclusion

Having a better governed Islamic banking industry and a more risk-based approach in running it will also ultimately lead to a more robust quantitative result, and more importantly, will be a critical foundation to apply the same in other sectors of the Islamic financial industry in the country. (f)

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Towards financial sector development in Iran

By Farhad Nili and Asad Jafree

Following the Islamic Revolution, the Islamic Republic of Iran with one of the largest Muslim populations of any country (exceeding 99% of the country's population) established the Usury Free Banking Law in 1983. The Law outlined the objectives and duties of the banking system in addition to the products that will be used to mobilize monetary resources and the corresponding asset facilities they can be used to finance. By doing so, Iran became the first country to transform the complete banking system to being fully Shariah compliant.

Iran's economy with the fourth largest proven oil reserves in the world (and the second highest in the Middle East) and also the highest proven gas reserves in the world, suffered recently from stagflation with high levels of inflation coupled with a contraction in the economy. However, since the new administration took office, the inflation has been reduced from over 40% to 17.2% according to the most recent data from the Central Bank of the Islamic Republic of Iran (CBI). In addition, the CBI reported that Iran's GDP grew by 4% compared to the same period in the previous year. These figures may be adjusted to 17.5% and 3.2% for annual inflation and economic growth respectively, should the severe reduction in oil prices persists for the whole of 2015. These recent positive signs have been noted by the IMF who in April commented that Iran had achieved considerable progress in raising per capita income and living standards as compared to previous decades.

Iran has over 30 banks which are regulated by the CBI and also over 6,000 Gharz-al-Hassan institutions which cater mostly to needy consumers, SMEs and microfinance sectors of the economy. The regulated banks include four specialised banks which focus on housing; agriculture; industry and mining; and the export sectors of the economy.

Review of 2014

Iran's banks have accumulated large amounts of non-performing loans (NPLs) as the economy was in recession for the last few years and as a result some banks have recapitalised. The NPL problem has led to a drag on the amount of new facilities offered by the banking sector and certain sectors that contribute to economic growth and employment generation have had limited access to credit due to the crowding out of funds by the public sector. This is corroborated by data from the World Bank that shows credit to the private sector fell from approximately 37% of GDP in 2007 to approximately 11.5%.

Presently, Iran has good rates of financial inclusion for deposits (at over 74% of the population over 15 years old) but this is quite low for loans compared to regional peers (at approximately 31%).

President Rouhani has prioritised the banking sector as one of the key sectors that requires reforms and accordingly, the CBI has commenced a project to develop a vision for the financial services industry and an associated financial sector development plan.



Preview of 2015

The CBI is identifying the initiatives needed to promote monetary stability, economic development and financial stability. The initiatives which will be outlined in a comprehensive financial sector development plan will be accompanied by greater adherence to Shariah compliance by all market participants in the financial sector industry. Key players of the financial market expect this to commence with recapitalisation of weak banks with low quality assets and perhaps consolidation within the market along with a strengthening of the regulatory, reporting and disclosure standards of the CBI.

Iran's banks currently report their capital adequacy under Basel I while the rest of the world is implementing or has implemented Basel III. In addition, Iran's accounting and associated reporting standards are not fully in line with the International Financial Reporting Standards. One can expect these elements to form part of the financial sector development plan which will strengthen the international financial community's confidence in Iran's banking sector as the industry prepares for the lifting of international constraints and the opening up of the economy.

Conclusion

The banking sector is expected to transform over the coming year(s) as President Rouhani's government have identified that a healthy banking sector is vital to Iran's economic growth, stability and success as access to credit is a significant driver of private sector growth which in turn will lead to job creation and fiscal sustainability.

For Iran to achieve a healthy banking sector, its main priority is to urgently and effectively implement a banking sector reform program to tackle its high NPL levels, as currently, scarce financial resources are locked into unprofitable sectors which are reducing productivity and leading to a drag on economic growth and employment levels. ☹️

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Bright outlook in Ireland

By Simon O'Neill

Ireland has a very conducive legal and financial services regulatory regime for Islamic finance. The International Financial Services Center (IFSC) established in the center of Dublin's Docklands is home to practically all of the international financial services institutions, corporate services providers, and leading legal and accountancy firms. Ireland has a clear and developed legal system which recognizes trust and beneficial ownership structures (which are often utilized in Islamic finance structures) and established legal and taxation regimes for incorporation of special purpose companies (SPCs or otherwise known as SPVs). Ireland has amended its tax code to provide equivalent tax treatment for Shariah compliant structures and the Irish Revenue has issued guidance on the measures introduced for such structures.

Ireland provides a stable legal jurisdiction with a supportive and transparent taxation policy which is supportive of business and the international funds and investment industry. The Irish government have made firm commitments to maintaining its corporation tax rate at 12.5%. Ireland's membership in the European Union provides beneficial access to the wider EU market through mechanisms such as mutual recognition of banking authorizations (the passporting regime). In addition Ireland is a member of the Organization for Economic Co-operation and Development (OECD) and has extensive international double taxation treaty arrangements.

Review of 2014

2014 was the year that Ireland successfully exited its IMF 'Bailout Program' and significant progress has been made on the road to economic recovery since its exit, the business cycle and property markets have returned to growth and there was significant investment activity in the corporate markets, commercial and residential property markets. In fact the year was marked with the sale of significant loan portfolios and asset portfolios by banks, many of which were acquired by international investors. The Irish Stock Exchange also experienced a strong year and has been very successful in attracting a significant number of Sukuk listings.

After a long period of review and consideration the consolidation of Ireland's various company law statutes since 1963 was completed and the Companies Act 2014 was signed into law

by the President of Ireland in December 2014 with an intended commencement date of July 2015. This will further aid Ireland's reputation as an efficient jurisdiction for establishing and conducting business.

2014 also saw the Department of Finance launch a review of its strategy for the IFSC. The IFSC has been an outstanding success since its initial establishment in 1987 and the government is committed to building on this to strengthen and develop its contribution to Ireland's international reputation. Islamic finance should form part of this strategy as the government continues to build on the steps it has already taken in the tax code to ensure that Islamic finance structures are treated equivalently for tax purposes as conventional finance.

Preview of 2015

2015 represents an opportunity for Ireland to take its place on the international stage as a jurisdiction for advancing Islamic finance through the IFSC strategy and an international Islamic finance conference due to be hosted in Ireland in the summer of 2015. The international momentum from 2014 which saw groundbreaking sovereign Sukuk issuances from a number of non-Muslim jurisdictions has created an opportunity and interest in Islamic finance. Corporate Sukuk may emerge as an area to watch in 2015 as the appeal of Islamic finance grows. This is likely to be the case as the trend for standardization grows in Islamic finance, supported by international standard-setting bodies and other stakeholders leading to lower costs to market and shorter transaction timelines as counter parties become more comfortable with documentation and structures.

Conclusion

The outlook for Islamic finance in Ireland remains bright. With an ever-growing Muslim population (a new mosque and religious center and associated facilities commencing construction in Dublin alone in a EUR40 million (US\$45.37 million) project), a vibrant property market recovering from the financial crisis, an evolving legislative framework supportive of Islamic finance, a revised consolidated company law framework and corporate governance regimes designed to simplify and streamline corporate life, and a reinvigorated, focused and fit-for-purpose strategy for the IFSC, 2015 could be Ireland's year for Islamic finance. ☺

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Opportunities abound in the Japanese Islamic finance industry

By Kaoru Haraguchi

The Islamic finance industry in Japan is in the dawn of development. By 2009 and 2011 legislations, the Japanese government officially recognized Islamic finance.

There have been aggressive movements among Japanese mega-banks to participate in Islamic finance, especially in Southeast Asia. However, this movement is occurring mainly in outbound business transactions, which means that Japanese financial institutions are the big players. The Japanese Islamic financial market is not yet widespread, and many enterprises are not yet aware of the outstanding merits of Islamic finance. Recently, however, creative parties in the private and public sectors in Japan have been introducing Islamic finance under the new legislations by importing Islamic finance techniques from the well-established markets, such as Malaysia.

Review of 2014

The outbound Japanese Islamic finance business

As previously mentioned, 2014 was the year of Japanese mega-banks which played an aggressive role in outbound Islamic finance transactions. This movement is supported by the 2009 amendment of the Japanese Banking Act, which stipulated that subsidiaries of Japanese banks can participate in Islamic finance business.

On the 28th March 2014, Mizuho Bank announced that Malaysia Mizuho, the Malaysian subsidiary of Mizuho, executed lending to Century Tokyo Capital, the Malaysian subsidiary of Tokyo Century Lease in Malaysia. This lending was based on commodity Murabahah. Mizuho started Islamic lending since October 2013, and the latest case above is said to be the first time a Japanese bank is lending to a Malaysian subsidiary of a Japanese enterprise.

On the 25th September 2014, Malaysia Bank of Tokyo Mitsubishi UFJ, the Malaysian subsidiary of BTMU, issued a US\$25 million Sukuk in Malaysia, which was the first case among Japanese commercial banks. This event surprisingly coincided with that of Goldman Sachs, which also issued Sukuk for the first time that year.

On the 4th December 2014, Malaysia Sumitomo Mitsui Banking Corporation, the 100%-owned subsidiary of SMBC, announced the setting up of a Shariah board in its premises, in order to judge the compliance of its Islamic financial transactions. The members of the Shariah board consists of former Islamic bankers, individuals with corporate board experience, Islamic scholars, and other similarly qualified individuals.

The inbound Japanese Islamic finance business

Not only Japanese mega-banks, but domestic players are also working towards introducing Islamic finance to the Japanese market.

At the World Islamic Economic Forum, which was held in Dubai, Mr. Nishida, Toshiba's special counselor suggested that: "It would

be necessary to import Muslims' abundant money to Japan for further growth."

On the 12th November 2014, Rating and Investment Information (R&I), the renowned Japanese rating institution held an Islamic finance seminar with RAM Ratings (RAM), the highly esteemed rating institution in Malaysia. In this event, R&I and RAM signed a mutual partnership agreement, in order to discuss the system and possibility of developing Islamic finance.

The important point is that the Japanese government is also pushing to introduce Islamic finance in Japan. The Financial Service Agency, the government administration in charge of Japanese Islamic finance, is suggesting legislation which would eternalize the series of special tax treatments with respect to J-sukuk, the Japanese version of Sukuk Ijarah. This scheme was introduced under the 2011 legislation of special tax treatments.

This way, the Japanese financial business players, both private and public, are working positively to develop the Japanese financial market.

Preview of 2015

The 2014 outbound business of Japanese mega-banks may seem like big progress has been made, but it is only the first step for the Japanese banking business. In general, Japanese banking institutions are eager to find new markets to lend money, since the Japanese market is shrinking due to the decreasing birthrate and the aging population.

This also applies to the financial market, which means domestic financial transactions would not satisfy further growth. In contrast, Southeast Asian countries are in the middle of growth, from the perspectives of population, personal wealth, technology, etc. It is common knowledge in the Japanese banking industry that, instead of seeking the shrinking domestic market, they should attempt to enter foreign markets. Therefore, other banks, even small or medium-sized rural banks would prepare to participate in Islamic finance.

With respect to the inbound business, J-sukuk would be the most important measure to introduce Islamic money to Japan. The advantage of issuing J-sukuk in Japan would be to enhance the business's reputation as being Islam-friendly. J-sukuk was established with the support of Malaysian Islamic scholars, so it is very applicable to the Southeast Asian Islamic financial market and hopefully, many Islamic investors will agree.

Conclusion

Islamic finance is a great, new opportunity to stimulate and develop both the international and domestic financial markets of Japan and it is hoped that many investors and business players will be aware of the opportunities in Japanese Islamic finance. (2)

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Islamic finance growing in Kenya

By Mona Doshi

Since the inception of Islamic financing in Kenya in 2008 or thereabouts, markets for Islamic financing have grown considerably in a relatively short space of time. Kenya has a large Islamic community and therefore there is a high demand for Islamic financing.

There are two fully fledged banks, namely First Community Bank and Gulf African Bank that exclusively provide Shariah compliant products and control approximately 1% of the banking sector. There are currently eight commercial banks that operate windows offering Shariah compliant products. In addition, there are a number of more conventional banks that are in the process of launching Shariah compliant products. Banks have recognized that there is a potential and growing market and are therefore positioning themselves to take advantage of this opportunity. Takaful Insurance is a fully compliant insurance company and Crescent Takaful Sacco Society is the first compliant sacco (savings and credit co-operative).

The Capital Markets Authority (CMA) is keen to develop Islamic finance in Kenya. For example, provision has been made for the creation of Islamic compliant REITs in the REIT regulations introduced in 2013.

Review of 2014

In 2014, more conventional banks created autonomous departments and launched Shariah compliant products; these included Standard Chartered Bank Kenya and Kenya Commercial Bank. Kurwitu, a Shariah compliant investment firm, was listed on the Growth Enterprise Market Segment of the Nairobi Securities Exchange. Kurwitu should attract Muslims looking for compliant investment opportunities as the majority of listed companies in Kenya are not Shariah compliant and therefore not appealing investment options for Muslims.

Kenya has an Islamic Finance Country Index score of 2.2 which is relatively low globally and even in relation to its neighbor, Sudan, whose score is 14, the highest in Africa.

The key drawback facing the growth of Islamic finance is the lack of a proper legal and regulatory framework and this has prevented banks from offering certain Islamic financing products. There is also ambiguity on the tax treatment of Shariah compliant financial instruments which needs to be addressed. The various regulators are working towards harmonizing current legislation so that Islamic financing products do not fall foul of the laws. The regulatory bodies have identified the challenges and the National Treasury is setting up a steering committee whose mandate is to supervise the establishment of a platform within the capital markets for Islamic compliant financial products.

In December 2014, a roundtable workshop was organized by the CMA, together with Awal Consulting, the Islamic Research and Training Institute (a member of IDB) and the Malaysia International Islamic Financial Center to discuss the development of a competitive legal, policy and regulatory environment to support the growth of Shariah compliant finance as a key source of infrastructure financing in Kenya. At the workshop, Paul Muthaura, the acting CEO of the CMA, said: "In order to achieve better rankings, all industry stakeholders should work in



concert towards achieving the specific criteria such as: number of institutions involved in Islamic finance, number of Shariah banks, central Shariah supervisory regime, size of Islamic financial assets, size of Sukuk, education and culture as well as regulatory and policy regime."

As the regulators have recognized what needs to be done, the year ahead and coming years should see more growth in Islamic finance in Kenya.

Preview of 2015

The CMA has been working on a strategy to boost Islamic finance in Kenya. It plans to create a regulatory framework for Islamic capital markets. The CMA says the strategy will be launched soon, which is likely to be in early 2015.

Henry Rotich, the cabinet secretary for the Treasury, has indicated that Kenya may also issue its first Sukuk in the financial year 2015/2016. Kenya's Central Bank chief, Njuguna Ndung'u, has also said that the Central Bank of Kenya has received requests for projects that would require financing through Sukuk. If the regulators act swiftly to equalize the tax treatment of conventional and Shariah compliant debt and put an appropriate legal framework in place, there is a possibility for Sukuk to be introduced in 2015.

The planned introduction of Islamic treasury bills and bonds will improve the liquidity of the capital markets in Kenya, provide new investment opportunities as well as attract funds from global Islamic investors, particularly from the Middle East and Southeast Asia.

Conclusion

Kenya has the potential of being a financial hub serving the region with a vast array of financial products. It is Kenya's goal under Vision 2030 to be an international financial center. Efforts are underway to ensure that the proper regulatory and legal framework is in place so that local and overseas-based investors can confidently invest in Kenya. The opportunities are huge and with the development of funds structuring, private equity funds, REIT and other appealing investment products, Kenya will have the ability to attract more foreign investment and be the financial center it strives to be. ☺

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Game-changing new regulations in the Kuwaiti Islamic finance landscape

By Alex Saleh

In Kuwait, parliament approved a number of new laws in 2014 that will benefit Kuwait's business environment. Among the wide variety of new laws and regulations passed in Kuwait, the most notable ones are Law No. 116 of 2014 (the New PPP Law), and the issuance of the Executive Regulations for Law No. 116 of 2013 regarding the Promotion of Direct Investment in the State of Kuwait (the Executive Regulations). We first briefly discuss the key changes introduced in the New PPP Law in relation to Islamic financing in Kuwait.

On the 17th August 2014, the Kuwait Parliament passed the New PPP Law. We note that Law No. 7 of 2008 (the Old PPP Law), together with its executive regulations, continues as the main legislative framework governing public-private sector partnerships (PPP) projects and their implementation in Kuwait, except for Articles 11 and 12 of the Old PPP Law which relate to the Higher Committee and the Partnerships Technical Bureau that have now been superseded by Articles 2 through 6 of the New PPP Law, which relate to the Supreme Committee and the Public Authority for the PPP Projects.

Other portions of the New PPP Law will come into effect when its executive regulations are published within six months of the date the New PPP Law was published in the Kuwait Official Gazette. The executive regulations have yet to be published; however, we anticipate the same will be issued in the next month or so.

Nonetheless, under the Old PPP Law, private sectors were allowed to take a greater role in project financing in Kuwait; however, one major drawback of the Old PPP Law was that it was overly restrictive in the type of security lenders could take. For example, Article 13 of the Old PPP Law prohibited (i) the disposal or grant of any lien, mortgage or other real rights to the subject land and the constructions and buildings upon it; (ii) any asset reverting to the state of Kuwait following the end of the Build-Operate-Transfer (BOT) term; and (iii) attachment of any real rights over the same. From a lenders' perspective (both conventional and Shariah compliant), Article 13 of the Old PPP Law restricted lenders from being able to take any ownership interest in any of the project assets, effectively prohibiting certain modes of Islamic financing, such as Ijarah, Istisnah or Wakalah.

Unlike Article 13 of the Old PPP Law, Article 23 of the New PPP Law relaxes the restrictions and prohibitions in Article 13. Article 23 now allows private financiers, for the purpose of financing a project, to mortgage and establish guarantees in kind on any assets that the financiers hold among the assets that are included in the project.

Furthermore, Article 23 codifies principles, such as assignment of contractual proceeds and pledging against shares prior to the two-year lock-out period, applied in the Az-Azour project which our office acted on behalf of a consortium of international and local lenders and closed the debt financing of US\$1.4 billion in completion of the country's first PPP project.

With the introduction of the New PPP Law, specifically with

respect to Article 23, Shariah compliant banks and financiers are now able to take beneficial rights in assets being built on a project site. However, as with the Old PPP Law, Shariah compliant banks and financiers will not be able to sell or mortgage the land upon which the project is being built. Nevertheless, the easing of restrictions under the New PPP Law on financiers' ability to take beneficial interest in project assets will allow Shariah compliant banks to take a greater role in project financing in Kuwait and will open a wider array of Islamic financing options available to them.

The second most notable law and regulation introduced in Kuwait is the Executive Regulations of Law No. 116 of 2013 regarding the Promotion of Direct Investment in the State of Kuwait (the Executive Regulations) issued on the 14th December 2014. The Executive Regulations clarified many issues for the effective implementation of Law No. 116 of 2013 (the Direct Investment Law), which aims to diversify the economy, reduce Kuwait's dependence upon the oil sector, and enact initiatives through inviting the private sector to drive the economic sector.

The Direct Investment Law and its Executive Regulations expands on the type of investment entities eligible for the investment license allowing ownership of 100% of the capital of a company, the rules and procedures for the submission and registration of the applications to obtain an investment license, the incentives and exemptions including, but not limited to, tax exemptions, customs exemption and allotment of land and real estate, and many more.

In 2014, many foreign investors were eager to apply for the investment license; however, we were waiting for the issuance of the list of sectors excluded from direct investment within the scope of the Direct Investment Law (the Negatives List); the Direct Investment Law did not specify that the Negative List would be set forth in its Executive Regulations. However, on the 26th January 2015, Kuwait issued Ministerial Resolution No. 75 of 2015 (Specifying a List of the Direct Investments which are not subject to the Provisions of Law 116 of 2013) and published the same in the Official Gazette on the 1st February 2015. The Negative List sets out 10 different sectors which are not eligible for an investment license. Upon the recent issuance of the Negative List, we have been assisting numerous more foreign and local investors eligible for the investment license with the submission of applications and the registration process.

In light of the above, with the recent modernization of legislation in Kuwait, the New PPP Law and the Direct Investment Law have already proven its success in attracting investments in the Kuwaiti market.

Since the launch of the aforementioned laws and regulations we anticipate many more requests from clients to advise on PPP and Islamic financing issues arising under the New PPP Law, as well as our legal assistance with the submission and registration of applications to obtain an investment license as permitted by the Direct Investment Law. ☺

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Islamic finance industry in Lebanon

By Johnny El Hachem

Lebanon is a potentially lucrative market for Islamic banking in view of its diversified community, according to many Lebanese bankers. The idea behind the establishment of the Islamic financial institutions is to mobilize the resources to finance productive activities and consumption needs. The essential rationale behind this resources mobilization is profit and loss sharing, rather than interest payment or time value of money. However, the country still notes a shortage of Islamic financial operations vis-à-vis growing conventional transactions.

Eight years after the introduction of Islamic banks to Lebanon, and despite efforts by the central bank to regulate the industry, Shariah compliant lenders have yet to make significant inroads into the country's thriving and competitive banking sector.

Review of 2014

Statistics provided by the central bank showed that Islamic banks in Lebanon had US\$674 million in total assets in December 2012 and that by November 2013 the amount had only grown to US\$712 million, with the four Shariah compliant banks operating in the country failing to increase their market share beyond even 1%.

As a result, the central bank initiated the Islamic finance qualification (IFQ) program in order to streamline the competencies of employees in the Islamic finance industry. The IFQ is a ground-breaking qualification that covers Islamic finance from both a technical and Shariah perspective, providing the first international benchmark in the area of Islamic finance.

The IFQ provides candidates with an understanding of the influence of Shariah in a business context, and prepares candidates to hold key positions in the Islamic finance and Takaful (Islamic insurance) industries. The qualification is appropriate for existing employees, new employees and those seeking a career in Islamic finance.

Key Features of the IFQ program

- 1) Staff gains a basic knowledge of the general principles of Shariah and its application to Islamic banking and finance.
- 2) Staff acquires knowledge of the different types of Islamic finance contracts and products from both a technical and Shariah perspective.
- 3) Staff expands their understanding of the practices used in the Islamic financial markets and the principles behind investment selections.
- 4) Equipping staff with the IFQ indicates that a company is willing to contribute to the development and promotion of high ethical standards of employees working in the Islamic financial services industry.
- 5) The syllabus, workbook, other teaching materials and examinations have been developed with the support and collaboration of a panel of internationally-recognized experts in Islamic finance.
- 6) The qualification is reviewed annually to reflect developments in the fast-changing world of Islamic financial services.

- 7) The qualification was initiated and is supported by the Central Bank of Lebanon (Banque du Liban).
- 8) Staff gains a prestigious qualification awarded jointly by the Securities & Investment Institute recognized by l'Ecole Supérieure des Affaires (ESA).
- 9) The qualification is available internationally.

Moreover, and with further development of specialized capabilities in the sector, Islamic banks in Lebanon have already led several development initiatives in producing new Shariah compliant products that found their way into other regional markets. Banks said they could use Lebanon as a basis for new cross-border expansion, despite the size limitations of the local market. These initiatives have been encouraging investment in productive sectors and supporting consumption.

Lebanon's central bank governor, Riad Salameh, said that the Islamic finance industry "is not restricted to Muslim countries and could benefit from Western and Middle Eastern experience as well."

Preview of 2015

Lebanon, where Muslims make up more than half the population, is considering legislation to boost Islamic finance after the industry failed to garner 1% of total banking assets. The central bank is working with a group of local lenders to amend a 2004 law that allowed the establishment of Shariah compliant banks with amendments such as:

- (i) to amend the regulation on unrestricted deposits account,
- (ii) receiving short-term deposits of less than six (6) months, and
- (iii) eliminating the double stamp taxation.

If Islamic finance is to move deeper into mainstream global finance, the Lebanese Islamic finance industry needs to promote not only innovation, with gaps across asset classes (sector specific, fixed income, hedge funds), but also reliability by harmonizing standards and practices.

Conclusion

Nevertheless, the key issue which has been heavily impacted and which really concerns banks is investment. The central bank stressed that the key to the success of any Islamic bank is product innovation, as well as the creativity necessary in setting up new Shariah compliant deals and structures within the Lebanese financial system, and this can only be achieved in a secure, stable and peaceful environment, which is currently lacking in Lebanon.

Consequently, Islamic products will need to become more cultured to fulfill those needs. But while continuing growth seems likely, and a wider range of products is now available to investors, legitimate challenges and concerns over the mechanics and regulation of Islamic finance remain. ⁽²⁾

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A mountain to climb for Islamic finance development in Libya

By Adil Hussain and Albudery Shariha

Libya remains a very difficult market to carry out business. The continuing political uncertainty, lack of dialogue between the main factions and unstable security situation make Libya an unattractive place to do business. According to data provided by the World Bank, Libya ranks 188 out of 189 in respect of ease of doing business in 2014. The only country where business is more difficult to conduct is Eritrea. Despite the challenges and difficulties of doing business in Libya, there are opportunities available in certain industry sectors such as oil, energy and infrastructure and there is expected to be some appetite from international companies to carry out business in Libya.

In respect of Islamic finance, Libya has recently undergone a major change in Law No 1 of 2013 (Law No 1) which has come into effect on the 1st January 2015 which makes it a criminal offence to provide for interest in Libya. This affects loans provided by banks, shareholder/inter-company loans as well as provision in commercial contracts which make references to interest-based calculations. Law No 1 was introduced as part of a move for Libya to introduce a fully Shariah compliant legal system.

Review of 2014

2014 was a crucial year in post-revolution Libya. In the first two quarters of 2014, businesses were still relatively optimistic about the Libyan market. During this time, Libya saw an increase in oil production which many commentators and business leaders saw as encouraging signs of paving the way to rebuild Libya and to re-start projects to make much needed improvements to the Libyan social and physical infrastructure. In July 2014, the Wall Street Journal reported that Libyan oil productions hit a five-month high, although it was noted that production levels remained significantly lower than in pre-revolution Libya.

The second half of 2014 was overshadowed by fighting between various militias in Libya and the resulting travel warnings, withdrawal of embassies and evacuation of non-Libyan citizens were major turning points for national and international companies operating in Libya, with many either exiting the Libyan market entirely, putting their operations on hold or significantly reducing their local footprint.

The end of 2014 also saw a decision by the Libyan Supreme Court declaring the House of Representatives in Tobruk as unconstitutional therefore deepening the political uncertainty and thus worsening the ability to do business in Libya.

Preview of 2015

2015 has started in much the same way as 2014 ended. The political instability remains and peace talks brokered by the United Nations have not progressed as expected. It is expected that oil production levels will be heavily affected by the continuing unstable political and security situation. This, coupled with falling oil prices, will make it more difficult for Libya to attract international expertise which it requires to provide essential infrastructure to its population.



Despite this, it is also expected that some of the economic drivers that attracted international companies to Libya following the revolution will remain in 2015 and that Libya will be attractive to those who operate in specific industries.

It is further expected that legal developments will remain overshadowed by the political and security environment. It is unclear, for example, how Law No 1 will be applied in practice given that the Libyan institutions, banks and businesses are not as equipped to implement a fully compliant Islamic finance regime as expected at the time when Law No 1 was passed. From a legal perspective, however, Law No 1 remains in force and, at present, there is no government in place that can withdraw/amend Law No 1. The practical/legal application of Law No 1 has not been tested, but it is only a matter of time before this matter goes before the Libyan courts. It will also be interesting how Law No 1 affects the enforcement of foreign court judgments/arbitration awards which may refer to 'interest' in Libya. From an Islamic finance perspective, this is a key development to monitor in 2015.

Conclusion

Libya remains a very difficult place to conduct business and the problems that Libya experienced in the second half of 2014 are very likely to remain in 2015. Despite this, Libya will remain attractive to specific industries.

The move towards a fully compliant Islamic finance regime and the lack of banking/operational infrastructure to support Islamic finance provides an opportunity for Islamic finance practitioners and institutions to assist the Libyan authorities, banks and businesses to adapt to these changes and the development of Shariah compliant insurance and finance products. (3)

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Lively outlook for Islamic finance in Luxembourg

By Said Qaceme

2014 has been a dynamic year in the field of Islamic finance in Luxembourg. Indeed, while the country became the third largest Shariah compliant investment funds center in the world, the Luxembourg Stock Exchange listed various 'Islamic bonds' including the sovereign Sukuk of Luxembourg, Pakistan and South Africa.

In addition, the main government agencies representing the financial sector, as well as several service providers have once again been quite supportive of Islamic finance and participated in various events in and outside of Luxembourg. For instance, during the 10th World Islamic Economic Forum held in Dubai last October, Xavier Bettel, Luxembourg's prime minister, met with UAE vice-president, prime minister and ruler of Dubai, Sheikh Mohammed bin Rashid Al Maktoum, in order to discuss the importance of the Islamic economy and the role of Islamic banking in achieving global economic growth.

Review of 2014

Sukuk

The Luxembourg government issued the first euro-denominated sovereign Sukuk in the second half of 2014. This is only the fourth Sukuk issued by a non-Muslim country after Hong Kong, the UK and South Africa. The Islamic bond amounts to EUR200 million (US\$226.94 million) and uses an Ijarah structure linked to three buildings belonging to the Luxembourg state.

In addition, the Luxembourg Stock Exchange (LuxSE) listed and admitted to trading a US\$1 billion, five-year sovereign Sukuk from the Islamic Republic of Pakistan; an Ijarah Sukuk with underlying assets comprising the Islamabad-Lahore motorway. The debut Islamic bond issue from the Republic of South Africa has also been listed in Luxembourg since 2014 and amounts to US\$500 million with a maturity in June 2020. It has also been structured under the Ijarah structure.

Finally, the LuxSE listed and admitted to trading the debut Sukuk from the investment bank Goldman Sachs. The US\$500 million Sukuk was issued by an SPV entitled 'JANY Sukuk Company' and was structured as a Wakalah Sukuk with a five-year maturity.

Investment funds

In 2014, Luxembourg was identified by Thomson Reuters as the third largest domicile for Islamic investment funds behind Malaysia and Saudi Arabia. This ranking takes into account both the assets under management and the number of investment funds.

The Association of the Luxembourg Fund Industry (ALFI) published an interesting document aggregating 'best practices for setting-up and servicing Islamic funds in Luxembourg'. Over the last months, Islamic finance practitioners outside of Luxembourg very much valued the work performed especially potential investors who were not aware of the level of knowledge of local services providers.

Finally, in Luxembourg, Islamic investment funds have been



included in the category of sustainable and responsible investment (SRI) funds. In addition to putting forward the 'ethical' side of Shariah compliant investment funds, it may help reach a wider audience in the investment world.

Banking

Islamic finance was not a top priority among the local conventional banks. This may be explained by the fact that these institutions have mainly been focusing on adapting to and anticipating the new European regulatory requirements as well as consolidating their client base mainly in Europe.

However, several interesting initiatives took place last year, including the development of Shariah compliant real estate investment structures for high-net-worth individuals.

Moreover, various new products were announced or launched at the end of 2013, including Vitis Life's Luxembourg Takaful product for distribution in France.

Preview of 2015

The fact that the country is one of the few to hold an 'AAA' rating in Europe may encourage its situation as a European hub for Islamic finance and 2015 may again be a dynamic year in the field of Islamic finance. Indeed, the net assets under management in Luxembourg investment funds (mainly conventional of course) reached EUR3.03 trillion (US\$3.47 trillion) at the end of October 2014. This represents an increase of 16% since the 1st January 2014. One may expect an increase in the number of Islamic funds setting up or relocating to Luxembourg. Moreover, as the parliament adopted the law transposing the Alternative Investment Fund Manager Directive (AIFMD) into Luxembourg law mid-July 2013, one may also expect a 100% Shariah compliant investment manager to be set up in Luxembourg.

While it is difficult to assess whether new Sukuk issuances will occur in the coming months, the fact that governments and well-known investment banks have chosen Luxembourg as a listing place is promising.

Conclusion

Finally, in 2014, a lot has been written about the creation of the first Islamic bank in the Eurozone. Therefore, expect further developments in 2015 and hopefully the launch of such a banking institution, which should consequently trigger the development of additional Shariah compliant initiatives and businesses. (◡)

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Malaysia – The Asian tiger that roars

By Hussain Kureshi

It may not be anytime soon that Katy Perry may be seen performing her hit 'Roar' in Malaysia, but the spirit of the song typifies the strength of Malaysian resolve and business acumen. The rest of the world has certainly heard the sound of her roar. 2014 was a very difficult year for Malaysia; just as the first quarter came to an end, Malaysian Airlines Flight MH370 went missing while en route from Kuala Lumpur to Beijing. The fall in the stock price of Malaysian Airlines further aggravated the balance sheet of the troubled airline.

However, a closer look at the numbers reveals a story of recovery and strength. Malaysia's economy has grown on a quarter to quarter basis since 2007, despite the global financial crisis (GFC). In a recent report published by the ADB, Malaysia is referred to as the world's workshop. Well, it seems to be quite a successful workshop. Not only has the country earned a name for itself in the global supply chain as a destination for cheap labor with political stability and developed infrastructure with regards to transportation, electricity, port facilities and ease of doing business, the country has demonstrated that it no longer depends on external demand for running the machines of the economy. In the past five years, domestic consumption has bankrolled the economy. The agricultural sector, led by the sale of crude palm oil, has had an increased role to play in the country's growth along with the finance sector and construction sector, complementing the oil and gas sector and the manufacturing sector in the country.

This surreal growth trajectory remains all the more difficult to understand as the major trading partners of Malaysia, such as the US, the European area and Japan experienced nearly negative growth in the post-GFC world, and 1% growth from 2011 to 2014. Without an improved global economy, Malaysia seemed to have bucked the trend, with companies being innovative enough to find new trading partners. Figure 3 illustrates this point that at this time of global economic downturn, Malaysia still managed to keep exports in a growth trajectory along with household consumption. Household consumption represented 50% of the total GDP by 2014. The only worrying factor here is however, that close to 80% of this household consumption has been financed by the banks. Household debt to GDP has grown by 12% since 2003 to 2013, and is hovering around 88% of GDP. In a country where entry-level job salaries are RM2,000 (US\$548.74) and a salary of RM5,000 (US\$1,371.85) is considered to be high, this is an alarming statistic and may prove to be the Achilles' heel in the fabric of the Malaysian economy. Whether this debt has been secured through Shariah compliant products or conventional debt is irrelevant, after all debt is still debt. Money has to be paid to a lender in as much as it has to be paid to a counterparty that sold a good on credit.

Thus, the secret of the success of the Malaysian economy has been to replace international orders with domestic orders, not by sharing the wealth that was accumulated during the good days, but by simply making the middle income population even poorer by injecting them with a steroid of buying power vis-a-vis debt vehicles, be they credit cards, home mortgages, car loans, etc. But then again, the powerful neighbor of China did the same thing by converting their population from cheap factory workers into consumers by handing them credit cards and making credit easily available. China switched its dependency from international

Figure 1: Malaysia GDP 2007-2010

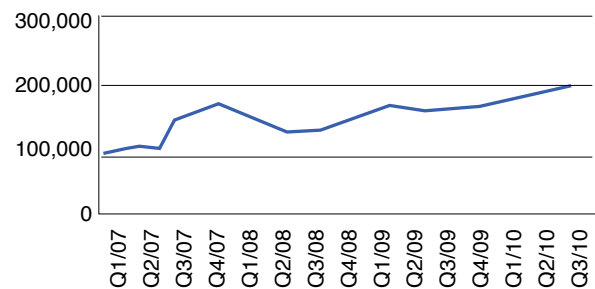


Figure 2: Malaysia GDP 2011-2014

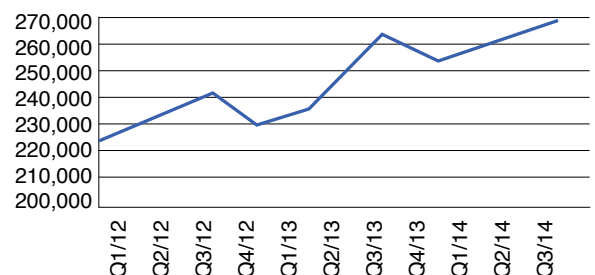
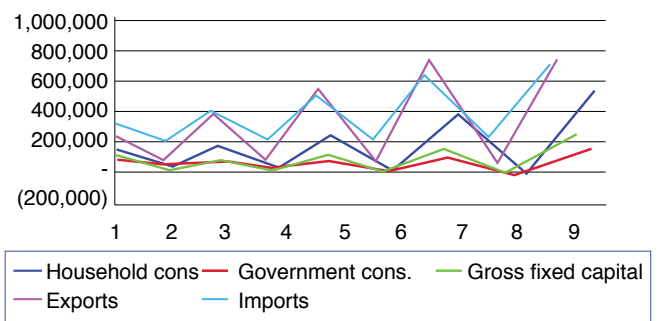


Figure 3: GDP by component



orders to domestic purchasing by making an about-turn on its economic policies and turned its mammoth economy so quickly that it is possible that the ship may keel over. With reports of a US\$6 trillion parallel economy, analysts fear that loans are being secured from informal markets to pay off the banks. The roaring success of Bank Rakyat may also demonstrate that pawning of household assets to pay off loans sought to purchase those very same assets has become a bit of a trend in Malaysia as well. Government-borrowing levels have also been increasing over the past five years but do not seem to be at alarming levels, certainly not as alarming as those of Japan. Government debt to GDP ratios stand at 54.80%, higher than other ASEAN partners, but far lower than the 105% of Singapore and the 220% of Japan. Of the more developed economies of Asia, only South Korea has a lower debt to GDP ratio.

Other fears have been triggered off due to the state of the Malaysian economy given its dependency on oil revenues. Let's have a look at some numbers again. Government revenues total RM235 billion (US\$64.48 billion). Of this total, RM135 billion (US\$37.04 billion) comes from direct taxes, of which a mere RM25 billion (US\$6.86 billion) comes from the petroleum sector.

Figure 4: Government debt until 2014

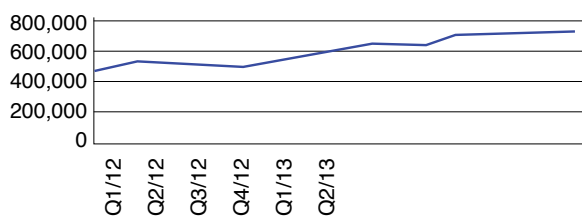
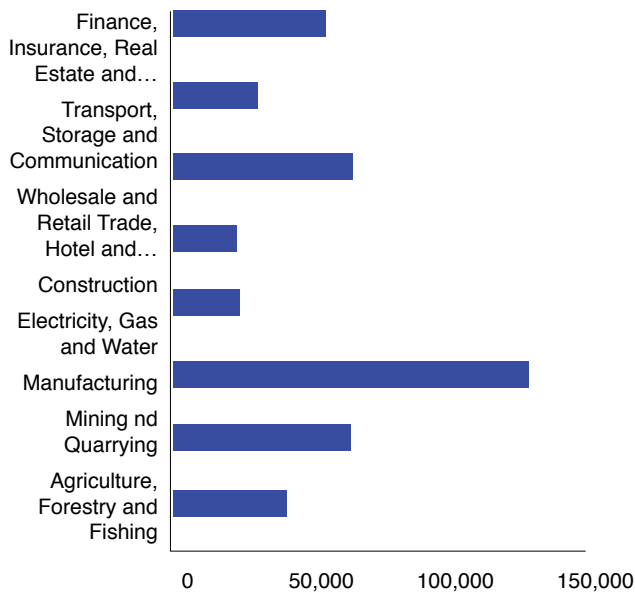


Figure 5: GDP make-up 2007



This number has been forecasted by the Ministry of Finance for 2015, given oil prices are at US\$105. How this number may look if oil is at US\$50 a barrel is another matter, but close to RM100 billion (US\$27.44 billion) of income comes from taxing individuals. However, Petronas on its balance sheet alone seems to have paid RM31.8 billion (US\$8.72 billion) in taxes alone, and reported a profit after tax of RM66 billion (US\$18.11 billion) of which the Malaysian government is entitled to RM54 billion (US\$14.82 billion). There seems to be a slight disconnect here in the numbers.

What would be of interest to note is, how much of the tax revenue earned by the government from individuals and companies is linked indirectly or directly to the oil and gas industry, in terms of vendors, and the like, and how much of the financial system is geared around oil and gas and how much of the overall employment is linked to the oil and gas industry. Let us not forget that the oil and gas industry, of which Petronas alone spent RM200 billion (US\$54.87 billion) in cost of goods sold, is a major client of steel, pipes, aluminium and other metals, cement for its wells, of logistics, of IT infrastructure and so on. How much of the other sectors are dependent on the oil and gas sector to keep things moving is a systemic test the Malaysian economy will undergo in 2015.

Islamic finance made headlines in Malaysia within the corporate sector and with sovereign issues in international financial markets. 2014 saw the first yen-denominated Sukuk which was structured by BTMU out of Kuala Lumpur, a GBP Sukuk and a perpetual Sukuk issued by Malaysia Airports Holdings. Corporates in the budget airline business like AirAsia, in the property sector like SP Setia and Boustead Holdings have also begun eyeing the Sukuk market. Sovereign issues were seen in London, Hong Kong and Luxembourg which were welcomed by the markets. Malaysia leads in global Sukuk issuances with 90 papers issued in 2014 with a volume of RM1.88 billion (US\$515.82 million); however, Saudi Arabia and Turkey seem to be offering Malaysia a run for their money.

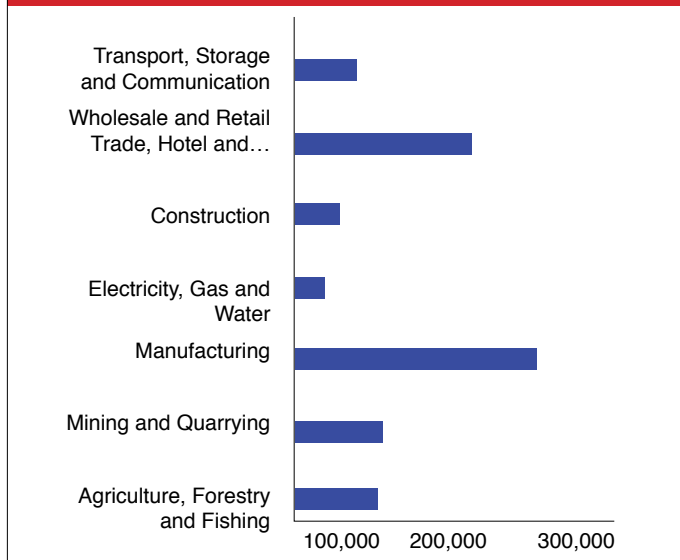
Total assets within the banking system have risen in the past five years from RM1.30 trillion (US\$371.43 billion) to RM2.17 trillion (US\$620 billion). Assets within the Islamic banking system have increased from RM219 billion (US\$60.09 billion) to RM455 billion (US\$124.84 billion), and where Islamic banks occupied hardly 8% of the financial space in 2007, it now occupies 20.72%, eating away at the dominance of commercial banks whose presence has been eroded from 86% to 76% since 2007. ☹

Assets within the Islamic banking system in Malaysia have grown at a faster pace than the industry as a whole, but these numbers need to be read with some care as the starting base number is small. 2013-14 possibly saw the slowest growth in Islamic banking assets since 2007 with less than 7%. However, the total of RM455 billion worth of assets is too small to lay any career bets on the industry. With most activity being in the capital markets arena, where typically the debt capital markets division of a parent conventional bank does much of the work, the growth in the industry is not contributing to job growth as much as opening up brick and mortar branches would.

Table 1: Total assets within the banking system (US\$ million and percentage)

	2007		2008		2009		2010		2011		2012		2013		2014
Commercial bank	1,020,006	85.95%	1,063,447	81.67%	1,111,386	79.87%	1,197,710	79.13%	1,356,861	77.78%	1,453,332	77.21%	1,576,166	76.58%	1,665,547
Islamic bank	92,337	7.78%	181,359	13.99%	219,848	15.8%	253,516	16.75%	320,578	18.38%	367,685	19.53%	426,430	20.72%	455,410
Investment bank	74,364	6.27%	57,306	4.4%	60,275	4.33%	62,297	4.12%	67,017	3.84%	61,373	3.26%	55,668	2.7%	56,383
Total	1,186,707	100%	1,302,112	100%	1,391,509	100%	1,515,523	100%	1,744,456	100%	1,882,390	100%	2,058,264	100%	2,171,340

Figure 6: GDP make-up 2014



Conclusion

The Malaysian economy is an interesting case study. The country presents some interesting features and contradictions. Since the 1970s it has been part of the global value chain, or destination for cheap labor. 1974 saw the emergence of Petronas and oil wealth. The country at the time with the benefit of political stability and continuity of policies developed itself into a smart little economy with a population of 26 million. The country has a well-organized financial system which is integrated into the systems of the US and Europe and its powerful neighbors of Singapore and Hong Kong. An investor sitting in Kuala Lumpur can purchase financial assets on NASDAQ as easily as on KLCI.

There are few restrictions on movement of capital which makes the country a destination for foreign direct investments, although such investors are just fair-weather friends and should not be counted upon. The economy did well to steer itself through the GFC on the back of consumer expenditure finance by cheap

and easily available credit. Households should be rewarded by a marginal increase in incomes so that they can pay off their debts with ease and possibly start shopping again.

The Islamic finance front has been moving on steadily; however, I believe that government-linked companies should transfer as much of their financing needs to Islamic financial institutions as possible. Petronas's Islamic financings are less than 15% of total borrowings. Yet, shipments of oil and gas are not covered by Takaful, but by using conventional insurance. Within the context of Malaysia it is hard to determine if the growth in Islamic finance has been due to a natural demand for Shariah compliant products or due to government incentives and pressure.

Would the government consider making it mandatory for Malaysian Muslims to convert their banking from conventional banks to Islamic banks (in a manner like Iran)? I personally see no issue with this as especially within Malaysia, Islamic subsidiaries of conventional banks offer similar products in retail and corporate, have similar standards of service, and leverage of the same infrastructure in the shape of branches and call centers. Stand-alone Islamic banks like Bank Muamalat and Bank Islam employ the same technology, service standards, offer the same products and have the same ratings as subsidiaries of larger conventional banks. With this uniformity, Malaysian consumers would not be disadvantaged in any way if they switched to Islamic banks either by choice or by regulatory edict.

The GDP make-up for Malaysia has remained a diversified source of income from 2007 onwards. Contrary to popular belief that the Malaysian economy is overly dependent on oil revenues, one can see that the manufacturing sector makes a far greater contribution to the overall GDP than the sale of oil.

The same story continues to 2014, where in fact Malaysia enjoyed a far more diversified economy, with wholesale and retail trade making a fair contribution to the overall number.

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Table 2: Growth rates within the banking system (US\$ million and percentage)

	2007		2008		2009		2010		2011		2012		2013		2014
Commercial bank	1,020,006	4.26%	1,063,447	4.51%	1,111,386	7.77%	1,197,710	13.29%	1,356,861	7.11%	1,453,332	8.45%	1,576,166	5.67%	1,665,547
Islamic bank	92,337	96.41%	181,359	21.22%	219,848	15.31%	253,516	26.45%	320,578	14.69%	367,685	15.96%	426,430	6.8%	455,410
Investment bank	74,364	-22.94%	57,306	5.18%	60,275	3.35%	62,297	7.58%	67,017	-8.42%	61,373	-9.3%	56,668	1.28%	56,383
Total	1,186,707	9.72%	1,302,112	6.87%	1,391,509	8.77%	1,513,523	15.26%	1,744,456	7.91%	1,882,390	9.34%	2,058,264	5.79%	2,177,340

A spindle for Islamic finance institutions

By Aishath Muneeza

Maldives is a 100% Muslim country situated in the Indian Ocean. The country is a famous tourist destination. The economy of the country heavily depends on tourism. The growth of Islamic finance in the country is fast though the initial development was slow. 2014 is a remarkable year for the growth of Islamic finance in the country as numerous initiatives to develop and sustain Islamic finance took place. New players considered coming into the market and existing players played hard to dominate the market. The main focus of the year was to develop a talent pool required for the sustainability of Islamic finance in the country and also to develop a comprehensive legal and regulatory framework for Islamic banking and Takaful by the central bank, Maldives Monetary Authority, in affiliation with IDB and Islamic Shariah and Research Academy (ISRA), Malaysia. The introduction of the Halal logo of Maldives marked the tapping into the Halal industry as well. The revival of Waqf via Islamic finance mechanisms was initiated too. All these developments made 2014 a very fruitful year for Islamic finance in the Maldives and creates new hope for 2015.

Review of 2014

The year 2014 brought new innovations to the Islamic finance industry of Maldives. During this year, the Islamic finance industry was further enhanced by the introduction of the Halal logo and the revival of the Waqf sector. For the first time, a Shariah advisory firm was established in the country by Amana Global. A regulation on the issuance of Halal certificates was gazetted and under the same regulation the Halal logo was issued to local fishery products. Majlis Ugama Islam Singapura (MUIS) recognizes the Maldivian Halal logo. The Darul Eman project, which was the investment made in real estate to sustain the mosque cash Waqf fund, was initiated by the Ministry of Islamic Affairs. Maldives Islamic Bank, the only fully-fledged Islamic bank in the country, opened its first branch outside the capital Male' in Addu City. A private sovereign Sukuk was issued to purchase generators to guarantee 24-hour electricity to all inhabited islands of Maldives. Maldives Hajj Corporation, the only fully-fledged Islamic fund in the country began investing in Islamic products to give returns to Hajj savings account holders.

During the year, Bank of Maldives (BML), the national bank of the country, also announced that it was making headway to introduce Islamic banking. Housing Development Corporation (HDC) also expressed its intention to Islamize its conventional portfolio to a Shariah compliant one and appointed a Shariah committee to initiate the work. This work will formally commence early next year. Allied Ayady, the Takaful window of the biggest state-owned insurance company Allied Insurance, was inaugurated and General Takaful products were offered to the public. In the area of Islamic capital market, the Capital Market Development Authority maintained its position as co-chair to the Islamic finance task force of the Standing Committee for Economic and Commercial Cooperation of the Organization of the Islamic Cooperation (COMCEC). Monthly awareness workshops on Islamic finance was conducted with the help of the Ministry of Islamic Affairs, Maldives Islamic Bank and Amana Takaful Maldives. The Capital Market Development Authority with assistance from the College

of Islamic Studies began to offer a Masters in Islamic Finance Practice program of the International Center for Education in Islamic Finance (INCEIF) in Maldives. These initiatives were taken to create the required talent pool for Islamic finance in Maldives. The Shariah compliant portfolio of the national pension fund also grew, but it will still take time to become a significant part of the whole pension fund.

The first Maldives Islamic Banking and Finance Industry Conference was held, bringing all Islamic finance players in the country together to discuss common issues. A seminar on Islamic tourism and the Halal industry was also held with assistance from UTO Edu Consult of Sri Lanka. IDB by affiliating with the Capital Market Development Authority also held the annual training course on Islamic capital markets which is a five-day program which was held at a regional level where participants from countries like Turkey, Indonesia and Malaysia participated. National strategies aimed to align the Islamic Finance Center as part of the general Offshore Finance Center were made. The Capital Market Development Authority shared its plan to develop an Islamic Finance Center with the Ministry of Finance & Treasury. Murabahah Treasury bills were also issued. The central bank, Maldives Monetary Authority, also continued its efforts to create a comprehensive legal and regulatory framework for Islamic banking and Takaful with assistance from IDB and the Islamic Shariah and Research Academy of Malaysia. As for publications, the Housing Development Finance Corporation during the ceremony held to mark its tenth anniversary, introduced the first Sukuk Investment Guide in the local language Dhivehi. The guide consists of the Sukuk structures that can be issued in Maldives with the legal limitations and is freely available to the public.

Preview of 2015

The year 2015 will see new opportunities for the wide usage of Islamic banking in the country as it is anticipated that in the month of January Bank of Maldives Islamic will open its doors for business and 26 branches of BML spread across the nation will increase the practice of Islamic banking in the country. It is also hoped that the Housing Development Corporation (HDC) will introduce Islamic finance products. A competitive Islamic banking industry will come into force and more focus and emphasis will be given to the development of a pool of local talent. Islamic microfinance projects which are being assisted by IDB and managed by the Ministry of Economic Development will also take off with assistance from BML. This will introduce Islamic finance to micro, small and medium enterprises.

Conclusion

Indeed, 2015 will be a good opportunity to show Maldivians the social and ethical aspect of Islamic finance. In short, 2015 will be a year that facilitates Maldivians to experience and relish the benefits of Islamic finance. With all these new achievements in the Islamic finance arena, 2014 can be described as the year where Maldives has become a spindle for Islamic finance products and services. (2)

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Moroccan Islamic finance still in its infancy

By Dr Ahmed Tahiri Jouti

Morocco is one of the rare Muslim countries which still do not host Islamic financial institutions. However, in 2007, there was a first experience that allowed conventional banks to commercialize 'Alternative products' and the results were disappointing in the absence of a comprehensive regulatory framework and a global awareness of the issue.

Review of 2014

2014 was a decisive year for Islamic finance in Morocco that is aiming to position Casablanca as the financial hub for the northern and western regions of Africa. This strategy relies on diversifying the financial instruments' offer in a way that meets the expectations of all the stakeholders. In that context, Islamic finance can contribute actively in the development of the local financial system and enhance the reputation of the Casablanca Finance City. Indeed, this year was marked by many events that are favorable for launching a sound Islamic finance industry. Those events include the following.

The regulatory framework

After the approval of the new banking draft law recognizing Islamic banks (called participative banks) by the government council on the 16th of January, it was voted in the parliament (by both Houses) on the 25th of November.

Meanwhile, the draft was submitted to the Economic, Social and Environmental Council (the Council) by the House of counselors in order to assess it and issue adequate recommendations to improve the bill before the final vote.

The Council's opinion issued on the 28th of August was favorable and recognized the positive impact of Islamic banks on the economy. Moreover, in order to ensure a supportive environment for the Islamic finance industry, the Council recommended:

- The promotion of a comprehensive Islamic financial system through the implementation of a legal framework for the insurance (Takaful) and the capital market sectors.
- The establishment of a tax system that meets the basic principle of tax neutrality between the two industries (conventional and Islamic) and a financial reporting framework adapted to Islamic banks in line with the standards of the central bank.
- The provision of mechanisms for the guarantee fund for the two types of banks.
- A responsible communication campaign in order to explain the functioning principles of Islamic products and banks.

Furthermore, on the 23rd of April, the Moroccan government published the Draft Law No 059-13 completing and modifying the Law No 17-99 on the Insurance Code. The aim of the amendments is the establishment of a regulatory framework for the Takaful industry.

The Shariah governance system

According to the constitution, the only institution in Morocco authorized to issue Fatwas is the higher council of ulemas (CSO). Thus, the regulatory framework for Islamic banking identified the CSO as the central Shariah board for the banking sector.

Furthermore, each Islamic financial institution is required to

establish a compliance entity whose mission consists of overseeing the proper application of Shariah standards.

The Islamic banking sector players

According to the current context and the declarations made in the annual conferences, there are three types of potential players in the Moroccan Islamic banking sector:

- Moroccan banking groups: are looking forward to launching fully-fledged Islamic banks in partnership with international Islamic financial groups. (BMCE Group and GBP already have partners)
- Moroccan subsidiaries of international conventional banking groups: would rely on the experience of their parent companies to develop a Shariah compliant offer such as BMCI (subsidiary of BNP PARIBAS), Crédit du Maroc (subsidiary of Crédit Agricole) and Société Générale. Nevertheless, the choices (Islamic windows/fully-fledged) are still not clear.
- Islamic banking groups: many international groups expressed their will and interest in launching subsidiaries in Morocco (such as Faysal Bank, Al Baraka Bank, etc).

The awareness

Recent surveys made in 2012 showed that there are misunderstandings regarding the Islamic financial products. Indeed, a segment of the population thinks that Islamic banking is based on charity or on interest-free loans while another segment considers the Islamic financial solutions as tricky and aim to imitate the conventional products which reinforces the idea that it is not Shariah compliant.

Those misunderstandings would limit the long-term development of the industry in Morocco and justify the need for market education to reinforce the awareness and the comprehension of the techniques used in Islamic banks. In the academic field, many universities and business schools launched Master's programs on Islamic finance and organized international conferences to promote the industry and raise awareness of researchers on the issues of the industry. In the professional field, many executive trainings and roundtables were organized to discuss the impact of the introduction of Islamic finance on the economy (financing and investment opportunities, etc.)

Preview of 2015

In 2015, financial institutions willing to launch an Islamic banking activity would need to apply to the central bank. According to different analysts, the Moroccan banking sector would host three or four fully-fledged Islamic banks and three Islamic windows which would be an encouraging start for the industry. Furthermore, the CSO would issue the local standards for Islamic banks in Morocco and the regulatory framework for Takaful would go through the legislative process.

Conclusion

Finally, Morocco adhered to the Islamic finance industry after the final vote of the regulatory framework related to Islamic banks. The analysts seem to be optimistic concerning the potential of the industry. Nevertheless, it is only the beginning for the industry and a lot of attention is required to ensure its success. ⁽²⁾

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Riding the wave of success

By Auwalu Ado

The quest for Nigeria to become the leading Islamic finance nation in Africa is gaining momentum with improvement year-in and year-out. It is therefore only a matter of time before the country becomes Africa's Islamic finance hub. Nigeria's entry into the league of countries with an Islamic finance system started three years ago when the Central Bank of Nigeria (CBN) released its non-interest banking framework. This development was welcomed by many who see it as an opportunity for the country to provide an alternative financial system to the large unbanked population and those with bias towards the interest-based system of banking. The country started with a single fully-fledged Islamic bank and now has two other players operating on a window basis. Three players also exist in the Takaful industry while there are a couple of other institutions offering Islamic fund management, Shariah services and consultancy as well as educational services.

Review of 2014

The year 2014 was a memorable year for the development of the Islamic finance industry in the country looking at the various achievements recorded by various sectors including regulatory, banking, Takaful, Halal industry, capital market and Islamic finance educational services.

On the regulatory part, the apex bank witnessed the exit of the former governor Malam Sanusi Lamido Sanusi who spearheaded the introduction and development of Islamic banking to its current position in the country against all criticisms after the expiration of his five-year tenure. He was replaced by another banker and former CEO of Zenith Bank, Godwin Emebele. In the same year the new CBN governor also appointed Dr Umar Yakubu as the special advisor to the governor on non-interest banking who brings with him a wealth of knowledge and experience in the banking industry.

For players in the banking subsector, it was a good 2014. Jaiz Bank increased its network of branches from 10 in 2013 to 16 by the end of the year making its services accessible to most locations in the north. The bank also increased its balance sheet size to NGN40 billion (US\$207.07 million) by December 2014. Most importantly for Jaiz Bank was its achievement of profitability during the last quarter of the year increasing confidence of all stakeholders.

Another player is Sterling Bank which rolled out its alternative banking service early in the year. Some of the products under the Sterling Alternative Finance (SAF) included agricultural finance, asset finance, project finance, home finance and trade finance among others. The other player, Stanbic IBTC, has seen tremendous growth in its deposits during the year with its Wadiah savings account taking the lead.

The year 2014 witnessed fewer activities in the Takaful industry despite its potential and the release of Takaful regulatory framework by the insurance regulator, the Nigerian Insurance Commission (NAICOM). With the exception of the three Takaful window operators, not much was recorded in this sector with huge demands. The good news is that some companies have applied for a Takaful license from the regulator, among which

is Jaiz foundation which intends to open a fully-fledged Takaful company and has even gone ahead to source for technical partners with a Sudan-based Takaful operator.

The capital market was one sector that has contributed immensely to the development of Islamic finance in the country during the year. One of its major achievements in 2014 in addition to the NGN10 billion (US\$51.77 million) Osun state Sukuk is the issuance of the NGN620 million (US\$3.21 million) Equity Exchange Traded Fund (ETF) by Lotus Capital in collaboration with the Nigerian Stock Exchange. Equally worth mentioning is the successful hosting of the Halal industry conference in November by LCM consulting which was the first of its kind in Nigeria and added to the collection of Islamic products and services.

Meanwhile, the year 2014 ended with some shock due to declining oil prices in the international market which resulted in the naira declining against the US dollar. This affected most of the financial institutions including the non-interest banks due to competition for deposits and the increase in the interbank rate.

Preview of 2015

Despite the challenge of declining crude oil prices in the international market which is the major source of revenue for the country and the year 2015 being an election year, the Islamic finance industry in the country is likely to record significant growth and expansion. There will be more products to be introduced in the banking sector to enable such banks to capture a significant size of the Nigerian market. Warehouse financing, SME financing and microfinancing that are compliant with Shariah will be brought into the market.

There is an expectation for more players including the likelihood that a Dubai-based bank may set up shop there in view of its recent enquiries and NAICOM may issue licenses to some fully-fledged Takaful operators. The year may also witness the Central Bank playing more prominent roles towards Shariah compliance of all products. More robust policies on Shariah compliance are likely to be issued by the regulator while increasing awareness in this emerging market. 2015 may witness the introduction of the Halal industry in the country including Halal foods, tourism, fashion, etc. Above all, it is expected that the government may initiate the process of issuing a sovereign Sukuk by the second quarter of the year.

Conclusion

Riding with confidence and the success recorded especially by the Islamic banking (non-interest banking) players, the country provides a bright future for the Islamic finance industry. However, more efforts have to be put in place by both the players and their regulators. The Central Bank has to provide a level-playing field for the non-interest banks as well as provide additional licenses to interested parties in order to create healthy competition. The players on their part have to demonstrate the seriousness required by making use of the opportunities available in the Islamic finance industry as well as ensure that all products and services offered are truly compliant with Shariah principles and collectively improve on the awareness campaign front. (2)

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The use of offshore entities in Islamic finance — current trends

By Louise Groom

The traditional offshore jurisdictions of the Cayman Islands and the British Virgin Islands have long been popular in cross-border Islamic financing transactions. The benefits they offer (such as privacy, bankruptcy-remoteness and tax efficiency) are attractive and as their legal systems are based on English common law, with final recourse being to the Privy Council, they are also trusted by stakeholders.

As Islamic finance extends its reach, more and more international finance Centers (or IFCs) are proposing themselves as credible alternatives, offering clients a light regulatory touch coupled with time-zone convenience and efficient incorporation processes. Hong Kong, Singapore, Mauritius, Luxembourg, the Channel Islands and Ireland are now vying for business from investors for whom compliance with Shariah is a priority. Offshore entities are used across all four main aspects of Islamic finance: Islamic banking, Sukuk, funds and Takaful.

In Islamic asset, real estate or project financings, offshore special purpose vehicles (SPVs) are commonly used as financing, project and lessor entities. The SPVs are beneficial because in many

jurisdictions, local companies are subject to restrictions, such as who can own shares, the number and classes of shares that can be issued and the type of activities that can be carried out. In developing countries, there may also be concerns that business law is in its infancy relative to other jurisdictions and that courts are inexperienced in dealing with complicated corporate matters. In a Sukuk structure, the issuing entity is frequently an offshore SPV whose sole shareholder is an offshore-domiciled trust. With this structure, none of the parties have to own the SPV directly or include it as an asset on their balance sheet. The combination also achieves bankruptcy-remoteness and allows the issuer to deal with the obligor at arm's length.

The most popular jurisdictions for incorporation of Shariah compliant funds have always been Malaysia and Saudi Arabia. While these jurisdictions (along with Kuwait, Bahrain and Indonesia) dominate, the global landscape has become much more diverse and IFCs such as Cayman, Luxembourg, Jersey and Ireland now account for more than 20% of incorporations. This geographic diversification is evidence of the evolution of Shariah compliant funds away from simply domestic market demand into the global wealth management space facilitated by IFCs.

In contrast with Islamic banking, funds and Sukuk, the offshore Takaful market is relatively small, with Bermuda as the only IFC with a significant stake. Offshore insurance in the conventional sphere is a fairly niche practice area, so it follows that Takaful is not yet widely established throughout the IFC network.

Review of 2014

The most newsworthy developments in offshore Islamic finance occurred in the Sukuk market, with Hong Kong and Luxembourg both issuing sovereign Sukuk. The issue of a sovereign Sukuk by any new jurisdiction is seen as a significant commitment by that government to the promotion of Islamic finance and the assumption is that corporate sponsors will follow suit. Hong Kong and Luxembourg have effectively announced themselves as credible players in their own right.

Despite these developments, Cayman remained the most popular jurisdiction for incorporation of Sukuk issuers in 2014, just ahead of Saudi Arabia. The majority of the Cayman issuer SPVs were UAE-sponsored, but other sponsors utilizing Cayman SPVs were from Saudi Arabia, Bahrain and the USA. In contrast, the Saudi Arabian Sukuk issues were mostly locally-sponsored, reflecting the liquidity in that market.

In the funds space, Saudi Arabia and Malaysia continued to dominate, holding around 65% of global Islamic assets under management (AuM) between them. Along with Cayman, European-domiciled funds accounted for a significant percentage of global Islamic AuM, with Jersey, Luxembourg and Ireland being the key players.

Preview of 2015

The indicators are that Africa is the next big opportunity for

Islamic investment. We have recently seen sovereign Sukuk launched by the Republic of Senegal, South Africa and Nigeria's Osun State; and Tunisia, Egypt, Morocco and Kenya are tipped to follow suit. There are also signs that a sovereign Sukuk from Mauritius may be back on the agenda, which would place it as an excellent candidate to be the IFC-of-choice for Gulf investment into Africa.

With the increasing appetite of North and South America for Islamic finance (illustrated by the successful Goldman Sachs Sukuk and Banco do Brasil's announcement that it intends to launch an Islamic fund), Cayman is ideally placed to take advantage of these new opportunities in its own time-zone. Asset managers in Hong Kong and Malaysia have aligned themselves to market Islamic funds into mainland China, with a planned launch in the first quarter of 2015.

Conclusion

So what drives the choice of jurisdiction for SPVs used in Islamic financing structures? There is evidence to suggest that tax efficiency and bankruptcy-remoteness are not always the main drivers for Muslim investors; rather familiarity, privacy and convenience are key. IFCs are now competing for business, so the established IFCs must not be complacent if they wish to maintain their position as go-to jurisdictions for Shariah compliant structures.

The foregoing discussion and analysis is for general information purposes only and not intended to be relied upon for legal advice in any specific or individual situation. ☺

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Oman – on the right path

By Bilal Fiaz

Islamic banking in Oman has been well-received. It was eagerly anticipated by the people of the Sultanate – the last of the GCC countries to offer Islamic finance solutions. This delay gave an added advantage to the regulators in Oman over other markets, to learn from the experiences of other countries and implement best practices. In 2012, the Central Bank of Oman (CBO) issued the Islamic Banking Regulatory Framework (IBRF).

Thereafter, came the launch of Islamic financial services in January 2013, with the establishment of the first fully-fledged Islamic bank. Now there are two fully-fledged Islamic banks and six windows and a further two Takaful companies which are operating in the Sultanate. There are a total of 29 branches of Islamic banks and windows in 2013 and 47 in 2014; the figure almost doubling in one year. They hold a combined OMR1.1 billion (US\$2.86 billion) in assets as of June 2014, or a 4.4% share of total banking assets in Oman. There is still a fair amount of ground for Islamic banks to cover in Oman, from the roughly 25% share of the financial services market that Islamic banks enjoy in the Gulf Arab region. Its outreach compares to the 5% share in countries such as Turkey and Egypt.

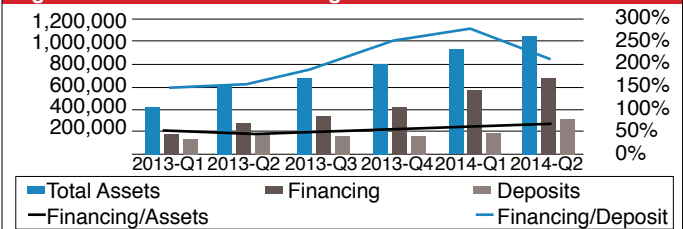
Review of 2014

Oman's outlook for the Islamic banking industry remains positive based on strong economic growth projection. In the first five months of 2014, the economy has posted reasonable growth. Although the oil and gas sector recorded a decline of 0.2%, this has subsequently been offset by an increase of 8.3% in the non-energy sector mainly driven by a 10.9% increase in the service industry. Although there is pressure on oil prices, the estimated public expenditure for the current year is up by 5% over the last year in the current budget proposal.

According to the ICD-Thomson Reuters Islamic Finance Development Indicator (IFDI), Oman's Islamic finance industry is the world's third most developed, behind Malaysia and Bahrain. Given the infancy of Islamic banking in Oman and its low level of penetration compared to other GCC countries, Islamic banks should take advantage of growth opportunities to contribute more to the country's gross domestic product (GDP). The financial inclusion index in Oman shows an overall low level of banking penetration. This is a golden chance for Islamic windows and standalone Islamic banks to contribute more to the GDP by introducing new products in line with customers' needs in order to retain existing customers and attract new ones. Oman's banks should invest in mobilizing new distribution networks to attract more assets to the banking sector.

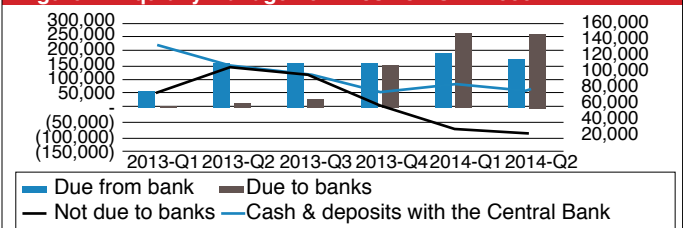
Oman has all the required ingredients to establish a successful Islamic banking sector. It is a Muslim country with a population base of over four million, with an average age of around 25.88 years which comprises 42% of Oman's total population. This segment will be the main driver of Islamic finance in the country as they are very receptive towards Shariah compliant banking solutions. The customers are gauging the Islamic banks' experience by engaging themselves through different channels offered by the banks. According to the survey reported by EY on customer sentiments, 55% of customers are positive while 30% are neutral on Islamic banking services. There is an opportunity

Figure 1: Omani Islamic banking balance sheet trends



Source: Bank financial statement and IFG analysis

Figure 2: Liquidity Management Position OMR '000



Source: Bank financial statement IFG estimates and IFG analysis

to turn the neutral into the positive by further education and awareness.

Preview of 2015

In order to promote the organic growth of Islamic finance in the Sultanate, there is an urgent need to focus on training for staff of Islamic banks and Islamic banking services and also focus on public awareness programs on Shariah compliant products and services. Another important avenue that needs to be considered by the Central Bank is the issuance of Sukuk to further develop the market and to fund deficit and also not forgetting the development of short term Sukuk and how to manage liquidity. Islamic banks should move towards a customer-centric approach and regular development of Shariah compliant banking solutions for the SME segment. In addition to this, Islamic financial institutions should take appropriate measures to meet customer expectations from this infant industry by delivering suitable products, state-of-the-art services and competitive turnaround times. Islamic banking is faith-driven and relies mainly on the public's trust and Shariah authenticity. A recent survey found that 74% of respondents consider adherence to Shariah rules as the most important element that would encourage them to deal with Islamic banks. A study conducted by Thomson Reuters suggests that Islamic banking assets will reach US\$7 billion, or 10% of the total banking assets by 2018 up from 4.4% as of June 2014. The Islamic banking industry in Oman is on the right trajectory and it is expected to accomplish many more milestones in the coming years.

Conclusion

In the long term, there could be scope for mergers and acquisitions in the sector, as some lenders may seek to offload their Islamic window if they do not deem it to be of strategic priority. ☺

Source of figures: Oman Islamic Finance report and Economic Diversification report/article.

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Pakistan: A progressing market of Islamic finance

By Muhammad Shoaib Ibrahim

The year 2014 proved remarkable for the Islamic banking and finance industry across the world. It not only crossed US\$2 trillion in assets size but also gained access to new markets. There was rapid change in the financial landscape of the world market and the growth and evolution of Islamic finance have continued with good pace. The growth has continued to gain scale with its geographical outreach now extending beyond Muslim countries to the more established international financial centers and to other emerging economies.

The Islamic finance market of Pakistan has also made impressive growth within the overall financial market. The growth rate of Islamic banking is higher than the conventional banks and Pakistan has enough room for further expansion of Islamic finance. Pakistan is located in South Asia and is at the junction of Central Asia and the Middle East, which gives its location great economic significance.

In this new era of great transformative change in the world, the growth and evolution of Islamic finance has continued to be very much a part of the changing configuration of the global financial system. The Islamic banking industry of Pakistan from its infancy stage has now grown to a mature level in the rapidly changing global environment of banking and finance. Through sound regulatory policies and the foundation of State Bank of Pakistan (SBP), Islamic banking has been able to achieve impressive growth year on year.

Review of 2014

During 2014, Islamic banking again remains the fastest-growing segment of Pakistan's financial services sector. Presently, Pakistan has five fully-fledged Islamic banking institutions and 17 stand-alone Islamic banking divisions within conventional banks. The total branch network of the 22 Islamic banking institutions is around 1,500 spread across the country and the share of assets size reached around 11% of the conventional size.

SBP has been playing a leading role in the promotion and

development of Islamic banking in the country on sound footings. The central bank has played a key role in facilitating the Islamic banking industry to reach a point of recognition both at the local and international level. SBP is one of the few regulators that have introduced a comprehensive legal, regulatory and Shariah compliance framework for the Islamic banking industry.

During the year 2014, the SBP took several initiatives for further development and strengthening of the Islamic banking industry. Some of the initiatives are as follows.

- a) Issuance of a five-year Strategic Plan for Islamic Banking Industry 2014-2018. The key focus areas of the plan includes:
 - i) Further improvement in the legal and regulatory environment
 - ii) Improving Shariah governance
 - iii) Enhancement of market size, products diversification and awareness
 - v) Capacity building of service providers
- b) Launching of the Knowledge, Attitude and Practices Survey of Islamic banking in Pakistan
- c) Development of a comprehensive Shariah governance framework
- d) Second mass media campaign was launched for the Capacity Building & Awareness creation initiatives.
- e) The initial paid-up capital requirement for an Islamic banking subsidiary has been revised to PKR6.0 billion (US\$58.35 million) from PKR10.0 billion (US\$97.25 million).

“ For a country of over 180 million people who are predominantly Muslims with a significantly large population excluded from the financial system, there is huge opportunity for further expansion of the IFIs ”

The Securities & Exchange Commission of Pakistan (SECP) has also taken various initiatives for the promotion of Islamic finance and the Islamic capital market during the year. The most important steps were the formation of specialized departments to regulate the Islamic finance market under the supervision of Bilal Rasul, director of the SECP. The Islamic Finance Department (IFD) would carry out the functions of Shariah regulations and compliance, product development, market awareness, Shariah securities market development, international liaison and networking. The SECP controls diversified sectors of the economy and is entrusted with regulating a wide spectrum of Shariah-oriented companies and funds ranging from Mudarabahs, Takaful and Islamic mutual funds along with the Islamic capital market.

During the year the SECP has published long-awaited rules for the issuance of Sukuk, as part of efforts to strengthen governance and broaden their approach to investors. The Shariah board under the SECP was also dissolved for reshaping purposes in



line with the new mandate of the IFD.

Within the non-bank Islamic financial institutions under the SECP, the Mudarabah sector again performed well during the year in terms of profitability, assets size and Shariah governance. Excellent growth in Islamic mutual funds was also achieved. Conventional insurance companies have also started establishing a Takaful window within their structure in order to tap the large Takaful business within the Pakistan market.

Preview of 2015

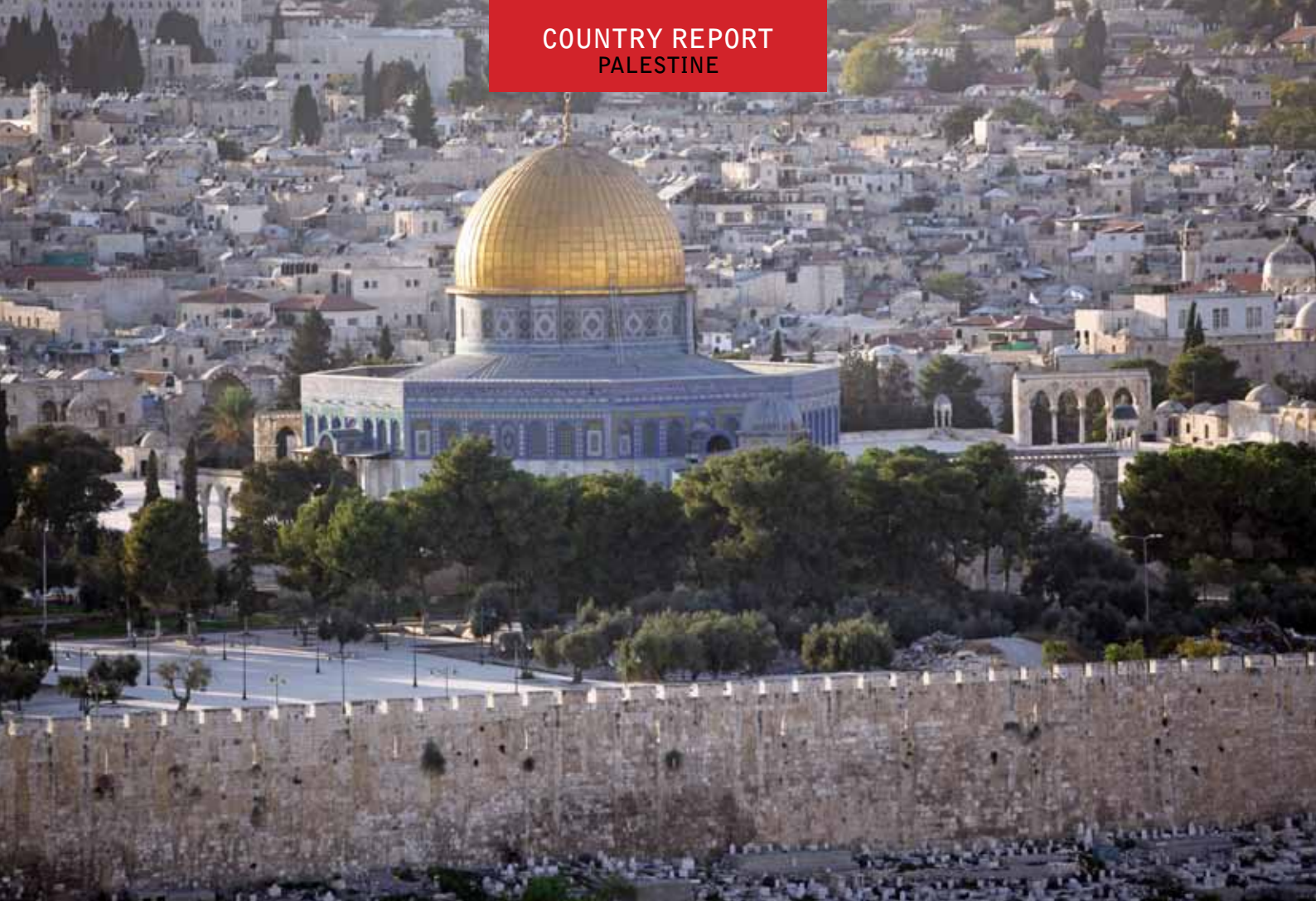
Keeping in view the growth and progress of Islamic financial institutions (IFI) of Pakistan, the future prospects of the Islamic financial industry looks very bright. For a country of over 180 million people who are predominantly Muslims with a significantly large population excluded from the financial system, there is huge opportunity for further expansion of the IFIs.

Both the regulator i.e. SBP and SECP are playing their roles for the overall promotion of Islamic finance within the country. The present government is fully committed towards the development of the Islamic finance industry on a sustainable basis. In this regard a steering committee for the promotion of Islamic finance has already been formed with representation from all key stakeholders to formulate a comprehensive framework to address challenges/hurdles that are adversely affecting the growth momentum of the industry. The extensive second media campaign on Islamic banking would greatly boost the people's knowledge about Islamic finance and ultimately lead to growth of the industry on a large scale. The relaxation on the paid-up capital of Islamic banks as a subsidiary of conventional banks will support the enhancement of market players as Islamic banks.

Conclusion

The Islamic banking and finance industry is set for major growth in 2015 and is expected to reach around US\$2.5 trillion by the end of the current year. Pakistan being a Muslim country with a large Muslim population has great potential for further expansion of Islamic finance within the masses. According to a recent comprehensive survey conducted by the SBP, there is an overwhelming demand for Islamic banking in the country. Given the supply-demand gaps there is huge potential for further development of Islamic finance in Pakistan. Due to a low financial exclusion and weak awareness, a very large segment of the demand for Islamic banking and finance is yet to be met which carries huge potential for growth. ⁽²⁾

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Prospects of Islamic finance in Palestine

By Dr M Hisham Jabr

Islamic finance has moved through several phases throughout the years.

Marketing the Islamic finance idea

Since the 1980s, meetings were held with businessmen on Islamic finance, lectures were given in universities, articles and books about Islamic banking have been published, and Islamic banking courses have been introduced in the universities.

Review of 2014

Establishment of Islamic finance institutions

The result of the above marketing efforts was the establishment of the Palestinian Finance House Corporation in 1994, and many other Islamic banks such as: Cairo Amman Bank Islamic branches, Arab Islamic Bank, Palestine Islamic Bank and Al Aqsa Islamic Bank. Later on in the 2000s, the Palestine Islamic Bank acquired Cairo Amman Bank Islamic branches and Al Aqsa Islamic Bank. So now there are only two Islamic banks currently operating in Palestine: Arab Islamic Bank and Palestine Islamic bank in addition to the Islamic National Bank in Gaza which is still not licensed by the Palestine Monetary Authority. Table 1 shows Islamic banks operating in Palestine as at the end of September 2014 whereas Table 2 shows different indicators of the Islamic banks.

Table 1: Islamic banks operating in Palestine as at the end of September 2014

	Total	Palestine Islamic Bank	Arab Islamic Bank
Number of branches	26	17	9
Number of offices	2	1	1
Date of establishment		1996	1995

Table 2: Islamic banking indicators as of the 30th October 2014 (US\$ million)

Indicator	% of Islamic banks to total banks	All banks operating in Palestine	Islamic banks
Paid-up capital	10.6	946.2	100
Net worth	0.095	1,400	133
Deposits	11.6	8,200	954
Credit facilities	16.6	3,487	578.4
Total assets	0.097	11,597	1,120

Islamic banks market share

Islamic banks represent about 10% of all banking activities i.e. its banking share is still very low in spite of the rapid increase in the past years. Table 3 shows the growth of Islamic banks' activities as a percentage of all banks' activities.

Table 3: Islamic banking indicators in Palestine comparing 2012 and September 2014

Islamic banks indicators	% of total banks as of Sept 2014	% of total banks as of 2012
Deposits	11.6	6.7
Credit facilities	16.6	10
Assets	9.7	8.7

Types of Islamic finance instruments used by Islamic banks

About 95% of all Islamic instruments used by Islamic banks in Palestine are in the form of Murabahah, as shown in Table 4. The table shows that Islamic banks concentrate on Murabahah because of its low risk and periodic cash flows.

Table 4: Distribution of Islamic banks' investment according to instruments as of the 30th October 2014

Financing instrument	% of total Islamic banking facilities	Balance as of the 30th October 2014 (US\$ million)
Murabahah	94.3	530
Istisnah	0.006	3.5
Mudarabah and Musharakah	2	11
Ijarah Muntahiya Be Tamleek	3	16.6
Others including Salam	0.001	1.2
Total	100	562

Islamic insurance

In the area of Takaful, there are two companies currently operating in Palestine as follows:

a. Al Takaful Palestine Company in the West Bank.

Table 5 shows selected financial data of the company and it is evident from the table that there is an annual increase of about 12% in all its activities.

Table 5: Financial data of Al Takaful Palestine Company (US\$ million)

	Percentage increase	2013	2012
Assets	12.5	23.997	19.275
Investments	12.6	11.362	9.051
Equity		10.443	9.140
Number of branches		11	
Number of employees	11.97	91	76

b. Al Multazem Insurance Company in Gaza.

Established in 2008, its assets as of 2012 reached US\$13.15 million, compared with US\$10.3 million in 2011. It distributed profit to shareholders of 9% and 2% as shares in 2012.

Micro Islamic finance

There are about nine microfinance institutions providing Islamic finance besides conventional finance with a total of 71 branches.

Role of UNDP (DEEP) in Islamic finance

The IDB in Jeddah provided the United Nations Development Program (UNDP) called Deprived Families Economic Empowerment Program (DEEP) with US\$15 million to be invested according to Islamic Shariah. DEEP in turn provided this amount to microfinance institutions to use them in financing according



to Shariah. These institutions used the amount on a Murabahah basis only. DEEP also prepared and approved a manual in Arabic and English which contains the following:

- Practical procedures for every Islamic financial instrument.
- Forms for every instrument.
- Practical accounting procedures for every instrument.
- Training workshops for employees of these Islamic institutions.

The training workshops were conducted for about 30 working days during 2014

Preview of 2015

Islamic finance in Palestine has very good prospects. The people are starting to understand the advantages of dealing with Islamic finance institutions and this was apparent from the rapid growth of these institutions. It is expected that Islamic finance will grow in Palestine in the coming year at a rate of not less than 10-12% annually. A new Islamic bank is expected to start business in early 2015. Islamic banks therefore need to increase their marketing and promotional campaigns regarding Islamic finance and they need to concentrate their marketing strategies on the difference between Islamic finance and conventional finance as there is generally a misconception in this regard.

Conclusion

Islamic finance in Palestine started in the early 1990s and has come a long way since then.

The share of Islamic finance institutions' activities in Palestine is about 10% of total financial institutions' activities in Palestine.

It is expected that Islamic finance will grow in Palestine at a rapid rate in the coming five years in the form of new institutions and a diversity of services, such as by introducing new instruments. (f)

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The Philippines: Pushing forward

By Rafael A Morales

The Philippines was one of the earliest in the region to recognize Islamic finance considering that, more than 40 years ago, a legislative franchise was granted to AlAmanah Bank, the country's first Islamic bank formed to cater to the banking requirements of the Muslim population in southern Philippines. The said bank was eventually reorganized in 1990 as the Al-Amanah Islamic Investment Bank of the Philippines. Since that time, however, the Philippine government has lagged behind its neighbors in the area of Islamic banking and finance, despite the fact that existing Philippine laws applicable to conventional banking and finance are not a hindrance to Islamic banking and finance in the country. Article 1306 of the Civil Code of the Philippines allows contracting parties to 'establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order, or public policy'. This freedom in contract-making would certainly allow the adoption of terms and conditions suitable to Islamic banking and finance, with the approval of the Bangko Sentral ng Pilipinas (BSP) and other pertinent regulators.

Review of 2014

The private sector led the way to spur Islamic investments in the country. The Philippine Stock Exchange (PSE), in collaboration with IdealRatings, came up with a list of companies that passed the Shariah standards of the AAOIFI. When finally launched, this sub-index of Shariah compliant stocks would diversify PSE's investor base.

In line with the planned economic integration of the countries comprising the Association of Southeast Asian Nations, the Philippines sought to enhance its bilateral ties with Malaysia and Indonesia in the area of Islamic finance, knowing full well their expertise and experience in that field.

Preview of 2015

2015 promises to usher in positive developments in Islamic banking and finance. It is true that the Congress of the Philippines has yet to pass a law providing for a general framework in that area. However, even without such a framework law, the BSP can actually allow local banks to, at least, open Islamic windows, based on the BSP's mandate in the General Banking Law to classify and license 'Islamic banks as defined in Republic Act No. 6848, otherwise known as the Charter of Al-Amanah Islamic Investment Bank of the Philippines'. One will observe here the reference to Islamic banks (in the plural and not singular), with the existing Al-Amanah Islamic Investment Bank mentioned only as a model entity. Plainly, the mandate is for the country to have more than one Islamic bank. Initially, the BSP can authorize conventional banks to open Islamic windows. If the BSP is inclined to push the frontier further, and there are reports that it might do that, it can license the formation of stand-alone Islamic banks (not merely Islamic windows), based on its aforesaid mandate, coupled with its authority under the same General Banking Law to make 'other classifications of banks' as it may deem appropriate.

Conclusion

With the signing by the Philippine government of a framework agreement on the Bangsamoro in order to end the armed conflict in southern Philippines, and with the anticipated passage of an enabling legislation to implement that agreement, a further impetus for the promotion of Islamic banking and finance in the country has arisen. With the BSP and the PSE assuming a more pro-active role, the prospects for Islamic banking and finance in the Philippines have become more promising than before. ☺

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Qatar — growth despite change

By Amjad Hussain

During 2014 Qatar has continued to prove itself to be a country that has successfully embraced change and provided leadership to many in the region. There were many changes on a macro level in the region. For instance, this was the first fiscal year that the new Emir, Sheikh Tamim Bin Hamad Al Thani, took control of the reigns; it was a year when the geo-political face of the Middle East continued to change yet Qatar has managed to navigate itself successfully through the turbulent waters and a year when the world continued to struggle to make sense of where it was going. Qatar, despite the challenges, has shown itself to be a bastion of stability, growth and prosperity for the Islamic finance industry.

Review of 2014

The year started strongly for the Qatari Islamic banking industry with the completion of the acquisition of a market-leading Islamic bank, Islamic Bank of Britain, by Masraf al Rayan. This transaction was key not just for Qatar but also for the UK, a key European market for Islamic finance. Islamic banks continued to deliver strong financial performance each quarter and were at the forefront of some of the leading transactions in the region and wider afield. Barwa Bank was a lead arranger for the debut Sukuk issued by the government of the UK and Qinvest continued to lend its expertise to a number of foreign issuers.

Qatar saw its first IPO in recent years and the Islamic banks showed full support to it by offering tailored products to assist the listing achieve its aim of encouraging Qatari nationals to save and invest their wealth in stable and long-term opportunities which the likes of Mesaieed Petrochemical Holding Company present. Following the upgrade of the Qatar Stock Exchange from frontier market status to an emerging market, there has been considerable interest and activity in the stock markets.

Qatar's budget has continued to grow, in line with the requirements of the country to deliver on the FIFA 2022 World Cup and the Qatar Vision 2030 commitments. The budget for 2014 went up by 3.5% to US\$62 billion, with particular focus on infrastructure spend. A number of Islamic banks have benefited from the infrastructure rollout by supporting contractors with financings; most notably being the US\$1 billion financing of the Doha Metro Golden Line involving a consortium of Islamic banks and led by Barwa Bank.

Barwa Real Estate, the leading state-backed Shariah compliant development company which is listed on the Qatar Stock Exchange has carried out a major divestment program. This is another example of Qatari companies continuing to revisit their operations to see how best to achieve higher objectives of providing greater value to investors.

Preview of 2015

Moving forward, the price of oil will be a key factor for Qatar (as with all other GCC countries) in determining whether the government will need to scale back some of the infrastructure and related expenditure. However, given Qatar's commitments, and the relative strength of its economy, it is unlikely that the country will scale back its spending any time soon.



Another key area to watch is the increasing global outlook of the Islamic banks in Qatar. Many banks have progressively increased their cross border lending and this is a trend that is likely to continue, especially in favor of government-backed entities in other Muslim countries. Also, recently closer ties have been established between Qatar and China. It is likely that there will be greater opportunities for Islamic banks in the Far East in 2015.

The equity capital markets will continue to grow and their attraction is likely to continue in the coming year. A number of state and family-owned entities are looking at potential listings already and are likely to be ready for a listing in 2015. Also, there is much talk about the launch of the debut exchange traded fund in Qatar. This will clearly help increase the accessibility of the Qatar Stock Exchange to a wider range of potential investors.

Conclusion

In summary, Qatar continues to provide growth and opportunity for investors during turbulent times and where change is the norm. This is a strength that will continue to assist the Islamic finance industry to develop and shine in the coming year. ⁽²⁾

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Russia: new horizons

By Roustam Vakhitov

Despite the economic slowdown, Islamic finance is developing further in Russia and is becoming more interesting as an alternative opportunity to attract foreign financing. New players are coming to this market and the government has finally indicated its willingness to consider necessary changes to tax and banking laws.

Review of 2014

Islamic financing transactions

Following a successful first Islamic finance deal in 2011, Ak Bars Bank continued its success and repeated this financing deal in late 2013, although with almost double the amount of financing (US\$100 million v US\$60 million in 2011). This proved that Islamic financing can be practically implemented and used as an alternative financing model under current tax and legal regulations.

Following political tensions with EU and the US, many businesses and state companies have started to more actively look at the opportunities to attract Islamic financing.

In particular, one of the largest Russian banks, Vnesheconombank, announced its plans to access Gulf countries' financial markets via Islamic finance instruments, more specifically, its intention to issue Sukuk and extend cooperation with Gulf banks, among which Al Baraka Bank was specifically mentioned. Head of Vnesheconombank, Vladimir Dmitriev, announced that the bank will investigate relevant opportunities to become an active player in this market within a year.

As for the domestic Islamic finance market, Azerbaijani International Bank of Azerbaijan declared its intention to offer corporate and retail Islamic finance solutions in the Russian market in the near future. International Bank of Azerbaijan already has a subsidiary in Russia, which is fully operational and a licensed bank under the same name.

Policy developments

What is most important is that after years of public discussions and calls to amend legislation to facilitate Islamic finance transactions in Russia, the Russian Parliament has finally established a working group to investigate the necessary changes in domestic tax and banking laws and regulations to facilitate the growth of Islamic finance in Russia. A series of roundtable discussions were conducted in the last quarter of 2014 and hopefully will bring results in the following year.

Other alternative ethical banking initiatives

Another new development which was not seen before, is the movement towards the creation of ethical financial establishments operating on the basis of Jewish and Orthodox Christian traditions. Although it has been reported to be launched in late 2012, only this year did Menora Bank which is a branch of a conventional bank become visible and better known in the market. This bank operates on the basis of Jewish ethical traditions which is considered to deliver instruments and solutions similar to those used in Islamic finance.

Regarding Christian ethical banking, one of the top officials of the Russian Orthodox Church, Vsevolod Chaplin, who often



makes important public announcements on behalf of the Church, called for the creation of a series of banks operating on the basis of Christian values. It was reported that the working group developing this plan has already been established. The project should result in the creation of several banks and an investment fund. Interestingly enough, Chaplin directly referred to the success of Islamic banking as one of the reasons why he proposed this initiative and why it should also be successful.

Preview of 2015

Most of the developments above took place in late 2014, so it remains to be seen if they will develop and materialize in 2015. Economic sanctions introduced by EU and the US on Russia may have an adverse effect on the Russian economy, although considering the results of the 1998 and 2008 economic crises, their indirect impact was the development of domestic production to replace imported goods which were becoming unavailable or too expensive.

Thus, 2015 may result in an increase of domestic Russian production and there will be a need to finance this. Considering that traditional Russian, US and European financial markets will be less available, Islamic finance channels will be looked upon as an attractive alternative. Domestic Islamic financing projects are also an opportunity to attract financing from investor segments which were less active due to a lack of proper, compliant investment solutions.

It is also important to note that the government appears to be ready to amend legislation to facilitate Islamic finance transactions. Overall, these developments can be regarded as positive and promising for the further growth of the Islamic finance sector in Russia in 2015 and beyond. (P)

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Saudi Arabia: Adapting to change

By Nabil Issa

According to Jadwa Investment, the Saudi Arabian government is believed to be estimating an oil price of US\$56 a barrel, representing a drop of about 50% from earlier this year. The Council of Ministers on the 25th December 2014, however, endorsed another expansionary budget. While a deficit of US\$39 billion is projected for 2015, it is expected to be financed by the substantial assets held abroad.

Almost 45% of the budget is earmarked for education and healthcare indicating the importance of these sectors to the Saudi Arabian government. While education is allocated the largest portion of the government budget, healthcare received the largest percentage increase of any governmental sector. A portion of the education budget will be used to upgrade schools and create new technical and vocational centers. Transportation and infrastructure received the third highest allocation with continued plans for new metro and rail lines, upgraded road networks, etc. The Saudi king also made a number of changes to the heads of various ministries that were announced around the 9th December 2014. Changes were made at the Islamic affairs, information, agriculture, higher education, telecommunications, health, social affairs and transportation ministries. However,

posts in areas such as oil, finance, interior and defense, were left unchanged.

A number of rights offerings is in the pipeline for 2015 for listed insurance companies and there will be continued plans for new IPOs in the Kingdom. Continued focus on investments is expected in the healthcare, education, real estate (including hospitality), district cooling, retail, petrochemicals and food and beverage sectors in the Kingdom. High-profile private equity deals in these sectors were closed in 2014 by Abraaj, Amanat, Jadwa, Rashed Al Rashed and others. A number of high-profile real estate projects have also utilized locally domiciled Saudi Capital Market Authority (CMA) fund structures. One of the most high-profile deals announced was that for a company known as Jeddah Economic Company, which includes Kingdom Holdings among its shareholders. It intends to develop the tallest building in the world in Jeddah and it is believed such a project will be financed completely on a Shariah compliant basis.

Review of 2014

Some of the legal updates include the following:

Healthcare

On the 29th November 2014, the Ministry of Health (MoH)

announced forthcoming amendments to the Private Health Institutions Law in the form of a Ministerial Decree. The MoH appears to be potentially encouraging foreign investment in healthcare, although it is still unclear which healthcare sectors will be opened up to this traditionally closed sector. It is expected that the MoH will encourage foreign investment in the form of joint ventures with Saudi-owned entities.

Earlier this year, the MoH awarded contracts to foreign-owned Diaverum and DaVita to operate dialysis clinics in Saudi Arabia. It is expected the MoH will privatize other areas of healthcare in the near future. The Saudi Food and Drug Authority earlier this year encouraged all drug manufacturers to appoint more than one distributor in Saudi Arabia. It is expected other sectors may also soon be encouraged to have more than one distributor.



“ Almost 45% of the budget is earmarked for education and healthcare indicating the importance of these sectors to the Saudi Arabian government. While education is allocated the largest portion of the government budget, healthcare received the largest percentage increase of any governmental sector ”

The policy of ‘Saudization’ aims to encourage the employment of Saudi nationals, which is implemented by the Nitaqat program. Under the program, companies are placed in the red, yellow, green or platinum category based on their Saudization percentages. Companies that are not deemed to be in the platinum or green categories will face challenges in recruiting new foreign employees.

Wage protection system

Similar to the UAE, Saudi Arabia recently implemented a wage protection system (WPS), in which employers must provide the employment information of their employees to the Ministry of Labor and pay their employees’ salaries directly into a bank account in Saudi Arabia. WPS became mandatory for all companies with 200 or more employees in October.

Finance

There was also continued implementation of registration of pledges under the Uniform Center for Commercial Liens. However, a system to register mortgages over property in Saudi Arabia continues to be unavailable.

Preview of 2015

It is believed that a number of mega real estate projects in Saudi Arabia will continue to be partly financed by CMA funds and leveraged by Shariah compliant financing. It is also believed that quasi-governmental entities such as the IDB and various Saudi governmental funds will continue to invest in funds as limited partners further enhancing the Saudi funds industry.

Conclusion

A number of finance-regulated regulations were passed in 2013 and we expect the system to record mortgages will come to fruition in 2015. Such a development will lead to securitizations and further develop the Islamic finance industry. Hopefully, the financial institutions and borrowers will utilize finance structures other than commodity Murabahah. A continued focus is also expected on healthcare, education and infrastructure projects, with private equity groups focusing on these sectors. The liberalization of Tadawul will lead to a number of foreign parties investing in listed shares in Saudi Arabia and will continue to fuel the number and quality of IPOs and rights offerings in the Kingdom. All parties, however, will continue to watch the drop in oil prices and signs as to how that may impact the overall economy. ☹

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Real estate

A record number of CMA real estate funds were launched in 2014. A number of Shariah compliant sale and leaseback funds were launched by Sedco Capital, Malaz Capital, Riyadh Capital and others. Malaz was the fund manager for one of the largest sale and leasebacks on two mega compounds in Saudi Arabia. Riyadh Capital acquired and leased back a variety of assets including bookstores, warehouses, etc. All such funds obtained leveraging on a Shariah compliant basis.

Venture capital

A number of venture capital and SME funds were launched in 2014 by Riyadh Capital with Taqnia, Malaz Capital, Al Khabeer Capital and Alinma with BlueVine. Almost all of these funds operate on a Shariah compliant basis.

Liberalization of Tadawul

Draft regulations have been announced to potentially permit direct foreign investment in listed securities in Saudi Arabia. Such a change is expected to be the first step in a likely two to three-year process to move Saudi Arabia from a frontier market to an emerging market.

Saudization/minimum wages

Saudi Arabia has now required a minimum wage of SAR3,000 (US\$797.52) per month for an employee who will be counted in the Nitaqat Saudisation quota. It is expected such a minimum wage will increase to SAR5,300 (US\$1,408.96) a month.

The Saudi British Bank (SABB)

Fact Sheet

Who we are:

The Saudi British Bank (SABB) is a Saudi joint stock company, established by Royal Decree No. M/4 dated 12 Safar 1398H (21st January 1978G) and is an associate member of the HSBC Group. SABB is listed on the Saudi stock market (Tadawul) with a capital of SAR10 billion divided into 1 billion (US\$2.66 billion) shares with a nominal value of SAR10 (US\$2.66).

The main objective of the bank is to provide a complete range of banking products and services to both retail and corporate customers through its business segments and branch network across the Kingdom. SABB does not operate outside the Kingdom of Saudi Arabia.

Total Assets	SAR188 billion (US\$50.09 billion) as at the 31 st December 2014	
Net Profit	SAR4.27 billion (US\$1.14 billion) for the 12 months ended the 31 st December 2014	
Capital Shareholding	Paid-up capital of SAR10 billion as at the 31 st December 2014:	
	Saudi shareholders	60%
	HSBC Holding (A wholly-owned subsidiary of HSBC Holding)	40%
Customer deposits	SAR146 billion (US\$38.9 billion) as at the 31 st December 2014	
Loans and advances	SAR115 billion (US\$31 billion) as at the 31 st December 2014	
Market capitalisation	SAR58 billion (US\$16 billion) as at the 31 st December 2014	
Branch network	The bank operates through a network of 99 branches including 18 exclusive ladies' branches: • Central Province 38 • Western Province 34 • Eastern Province 27	
ATMs	854 as at the 31 st December 2014	
Staff	3,314 employees as at the 31 st December 2014	



Singapore finding its second wind

By Suhaimi Zainul-Abidin

The Singapore government has always maintained its recognition of the fact that the country needs to offer a full suite of financial products and services, including Islamic financial products, in order to compete as an international financial center. There is a noticeable difference between such a stance and that adopted by countries like Malaysia, Bahrain and the UAE, among others, which have arguably adopted an Islamic-first strategy in developing their financial markets. The latter approach is one that is probably unsuitable for Singapore given the racial composition of its population, of which only about 15% are Muslims, and would be counterproductive given Singapore has already established a reputation as an international financial center.

Given the existing size and breadth of the financial markets in Singapore, the reality is that Islamic finance is unlikely to contribute to the financial landscape in a significant manner in the near future in terms of absolute numbers. Notwithstanding this reality, there are indications of encouraging growth in the sector.

In July 2014, the Monetary Authority of Singapore (MAS) reported as many as 15 banks in Singapore involved in Islamic banking activity, double the number in 2009, and Islamic assets under

management (amounting to approximately US\$4.37 billion based on other sources) having grown four-fold since 2009. Singapore has made a credible effort since 2005 to facilitate Islamic financial activity in Singapore, including by refining its banking regulations and the removing of additional stamp duties for certain Islamic transactions and launching its landmark Sukuk program in 2009.

A difference of opinion still lingers within Islamic finance circles as to whether Singapore's approach to merely facilitating Islamic finance and 'leveling the playing field' is the correct one in contrast to the more aggressive stance adopted by other countries in the Islamic finance space. Notwithstanding the ongoing debate, Singapore is the only non-Muslim majority country among the top 15 countries for Islamic finance, ahead of any other recognized international financial center.

Review of 2014

There were a few Sukuk issuances in Singapore in 2014, making up the 30 Sukuk issuances in Singapore as at October 2014 with approximately SGD\$2.8 billion (US\$2.07 billion) of corporate Sukuk outstanding. Among them was the issuance of SGD\$100 million (US\$73.81 million) worth of Sukuk in October by Sabana Sukuk, a wholly-owned subsidiary of Shariah compliant Sabana REIT.

Notwithstanding its relatively low number of Sukuk originations, Singapore remains a very important roadshow stop for foreign Sukuk issuers. The Singapore Exchange has also proven to be a popular platform for the listing of foreign Sukuk. This includes the US\$300 million Sukuk Wakalah issued by the Export-Import Bank of Malaysia, Sukuk issued by Khazanah's Rantau Abang under its RM1.5 billion (US\$412.58 million) Sukuk program as well as the US\$500 million exchangeable Sukuk issued by Khazanah's subsidiary Cahaya Capital, and Khazanah's Singapore dollar-denominated exchangeable Sukuk issuance in 2013.

The reverse enquiry Sukuk program established in 2009 by the MAS continues to be regularly tapped by local financial institutions, and has since seen issuances amounting to SGD459 million (US\$338.77 million). However, the highly sought-after Sukuk remains closed to foreign financial institutions.

“ There is also a growing awareness and understanding of Islamic finance among the Muslims in Singapore, leading to a gradually increasing take-up of Islamic retail products, and growing demand for the reintroduction of Takaful products ”

Sabana REIT remains the only certified Shariah compliant company listed on the Singapore Stock Exchange. Since its listing in 2010, the multiple award-winning trust has grown its portfolio of properties under management from 13 to 23, the latest addition being a warehouse in the Changi South Industrial Estate.

Maybank and CIMB both reported robust performance from Singapore in 2014, and both banks remain active in the Islamic retail and corporate banking space. Maybank launched a number of new Islamic retail products including its Islamic business term financing and overdraft facilities and also Islamic foreign currency current account and term deposits, and entered into a number of private Murabahah financing deals.

The Islamic Bank of Asia also continues to build on its focus on private equity and direct investment strategy following its SG\$15 million (US\$11.08 million) convertible debt facility for Singapore-listed Ley Choon Group Holdings. The Islamic private investment in public equity (PIPE) transaction was concluded in the early part of 2014 and should pave the way for further Islamic investments in growing listed companies.

Singapore's fund managers appear to finally be jumping on the Islamic finance bandwagon. In August 2014 boutique asset management firm DCG Capital announced the intention to launch a long-only Islamic Asia ex-Japan equities fund in partnership with Fortune Capital Management. This follows the launch by Franklin Templeton Investments of three Shariah compliant funds the year before.

There are also other new players entering the Islamic finance scene in Singapore. Pergas Investment Holdings, a subsidiary of the Singapore Islamic Scholars and Religious Teachers Association announced its intention to launch ArRahnu, an Islamic pawnbroking business, and has entered into a memorandum of understanding with UAE-based consultancy firm MIT Global with respect to part-funding the venture. Local crowdfunding platform Ethis has also successfully funded a number of local SMEs and foreign property development projects, all structured in a Shariah compliant manner.

Preview of 2015

These varied examples of Islamic finance activity in Singapore make for a vibrant and growing market, comprising a growing mix of traditional Islamic banking products and the advent of innovative private equity deals and other non-bank financing platforms.

There are many reasons for industry players to be optimistic about 2015.

CIMB's proposed merger with RHB for the formation of a mega-Islamic bank was initially seen to have significant implications for CIMB's business in Singapore, particularly given how RHB's seven branches in Singapore would complement CIMB's branches in Singapore's Central Business District and Orchard Road; unfortunately, the merger has since collapsed.

Singapore's fund management sector has consistently grown in the last few years and will expect to attract more capital from foreign investors in 2015, particularly with the inception of the APEC Asia Region Funds Passport and ASEAN CIS Framework. There is already a large amount of money from Malaysian, Indonesian and Middle Eastern high-net-worth individuals and family offices invested in Singapore, and interest in Islamic fund management strategies to capture the market is starting to swell.

Conclusion

There is also a growing awareness and understanding of Islamic finance among the Muslims in Singapore, leading to a gradually increasing take-up of Islamic retail products, and growing demand for the reintroduction of Takaful products. However, the most encouraging aspect yet is the rise of privately-led Islamic financial initiatives such as ArRahnu and Ethis, which follow the global trend of financial start-ups providing new age financing alternatives outside traditional bank financing channels. More such initiatives are expected in 2015, and could very well prove to be the bedrock of real Islamic finance development in Singapore in the future.

In the past few years, industry players may have focused their attention on what more the government can do to promote Islamic financial activity in Singapore. More recently however, there is perhaps a greater realization among industry players in Singapore that the steps taken by the MAS have consistently been in line with the country's long-term 'level playing field' approach to Islamic finance, and that in the absence of artificial government-led stimulus for the industry, Islamic finance players will have to be more innovative in order to capture a greater share of the market. It is possible that this setting could yet bring the best out of what Islamic finance has to offer. ☺

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Investment opportunities in Somalia

By Hassan Yusuf

One may raise eyebrows by reading the title of this topic. But believe it or not I traveled across Europe, Middle East and Africa for the last 18 months. The interest shown by investors towards Somalia was far more than anyone's guess. There were three conferences and seminars of investments in Somalia held in Dubai in March and April 2014; another investment conference was held in Stockholm in June 2014; and I attended all of them as I was part of the speakers and panel sessions. In November last year, there were meetings on investment opportunities held in Amsterdam and Johannesburg, not to mention other investment forums held in London and Paris in the same year. In March 2015, there will be a Diaspora Investment Forum in Nairobi. These conferences are evidence of the high interest of international investors focusing on Somalia alone. No other country has attracted as much interest as Somalia did since late 2012. The question to ask is: why is there such interest placed on Somalia and what do we know about Somalia?

In late 2012, the international community has recognized the Somali federal government since the collapse of the military

government in 1991. This recognition is followed by widespread peace and stability and many governments poured assistance to Somalia in the forms of technical experts and economy rebuilding with a huge influx of Somali Diaspora setting up businesses and small firms. This had affected microeconomic conditions in Somalia. Many countries have resumed their diplomatic relations with Somalia by opening their embassies in the capital, Mogadishu.

Somalia is one of the rare countries in the world that has almost all types of resources. For example, Somalia has oil and natural gas deposits that have not been drilled yet, and with the latest survey completed, the government is expected to award concessions to oil companies. The oil and gas resources are available both onshore and offshore. There are also gold and other mineral deposits in Somalia like feldspar, gypsum, iron ore, kaolin, limestone, quartz, silica sand, tantalum, tin, and uranium. Somalia has the longest coastline in Africa and the Middle East, with a length of more than 3,025 kilometers with abundant fishing resources and according to researchers, fish migration that takes place in the Atlantic and Pacific regions meet at the tip of Somalia and that attracts fishing companies to the region. Somalia also has the largest number of livestock in the world. The land that is available for cultivation and agriculture is measured at 70.18%

Table 1: Sectors in Somalia available for investment using a partnership model

S. No	Investment areas	Model	Guarantee
1	Agriculture/farming	Partnership structure with joint ownership of a 70:30 ratio with the investor owning up to 30% of the company	IBS provides guarantee up to a certain level
2	Fishing industry		
3	Livestock		
4	Minerals		
5	Real estate		
6	Cement		
7	Dairy products		
8	Hotel and tourism		
9	Health sector		
10	Agricultural processing factories		
11	Cotton		
12	Electricity		
13	Water		
14	Sanitation and sewerage systems		
15	Consultancy firms		
16	Airlines		
17	Education/primary schools		
18	Advertising industry		
19	Salt factories		
20	Fast-food/bakeries and coffee outlets		
21	Construction of highways/roads		
22	Real estate construction		
23	Waste management and recycling		
24	Insurance services		
25	Authorized agency services		

of total land in 2009, according to the World Bank. Somalia is sitting on rivers of water of a high quality, pure and clean, that can provide for millions of people for the next 2,000 years and beyond, not to mention Cement Mountains, and other rare sands that are available in the country.

Somalia is well positioned along the trade route of the world and gives access to land-locked countries in Africa. Since emerging countries and countries with a large economy are looking for resources to develop their economies and production sectors, Somalia is the country of choice for long-term investments. Here the question is: what are the sectors to invest in and how to go forward?

Recently a new bank, International Bank of Somalia (IBS), started operations in Somalia. The IBS research team identified 25 sectors that are available and ready for investment with the investment to be structured in a partnership model (see Table 1). The partnership model works by identifying the local partner that is already engaged in the business sector that the foreign partner is interested in. For example, Somalia has the capacity to produce thousands of tons of fruits and vegetables and one of the most famous is the Somali banana. The model works by creating a local company with joint ownership between the foreign/investor partner and the local partner identified through IBS. The investor partner can have up to 30% of the local company. After the completion of the assessment process, background checks and legal due diligence are performed. Capital is provided to both partners and IBS can help if it is required. Once the business

is ready, as in our example, finished goods will be shipped and owned 100% by the foreign investor. Other service industries can use this model with slight changes as to how the business is carried out.

Investors or clients interested in the products of Somalia will have a local partner that takes care of the local business needs such as registration and licensing requirements and the international investor gets a stake or share in the local ownership (a local company is established as a joint ownership vehicle between the local partner and the investor). The local partner absorbs the local risks of the business and the finished products are shipped to the international investor/partner. This suits Somali products and other investments such as services and trade are structured in the same way with little modification of the operational mode. IBS plays many roles here including: ensuring the partnership structure is right, performing due diligence for the right partner, making legal and risk assessments for the project and, depending on the type of project and the investment threshold required, providing guarantees up to a certain level.

If there is any prediction regarding what the future holds for Somalia, it is that it will undergo fast economic progress and stability and the country will dramatically develop for the better in the next five years. Those who can get a head start will be the beneficiaries in the long term. ☺

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A new dawn for South African Islamic finance

By Amman Muhammad

In a country where only 2% of the total population follow the Islamic faith, South Africa's achievements in benefiting the global Islamic community are noteworthy. It is the world's third largest producer of Halal foods, where every large scale commercial abattoir is certified as such and 50% of all fast-moving consumable goods produced within the country also carry Halal certification. These amazing statistics are further ratified by the country's status as a global top five Halal-friendly destination for Muslim tourists. It is no wonder that developments in sectors calling for Shariah compliance would have impacted areas other than just food, consumables and recreation.

South Africa has been a productive and diligent contributor to the area of Islamic finance, albeit flying under the radar. Within the last few years, it has witnessed a competitive Islamic finance landscape develop where the average citizen is afforded easy access to Shariah compliant banking, asset management and Takaful, all of which are offered by some of the country's most reputable financial institutions.

Review of 2014

South Africans, having seen off the last few days of their vacations and the festive cheer now fading into distant memories, one wonders what the New Year's eve social chatter will be about? Probably to proclaim 2014 as a year of achievement and recognition for the South African Islamic finance industry. A testament to that achievement was undoubtedly the government's decision to proceed with the issuance of its debut sovereign Sukuk, which drew significant attention in the global marketplace, a curiosity which invited investors to sub-Saharan Africa. This issuance was of specific significance to the South African Islamic finance industry as it witnessed the successful culmination of years of planning and hard work.

Crucial to paving the path to this issuance was the amendment and inclusion of specific provisions into the legislation to enable Islamic financial transactions in general. These amendments and inclusions into the legislation were instrumental in formally establishing the practice of Islamic banking, nearly 30 years after the first foray into this alternative banking form.

Amendments to the National Taxation Act during 2014 saw the widening of the definition of Sukuk, which allows additional institutions to issue Sukuk. The amendment extends to a variety of state-owned entities, ranging from the country's pre-dominant power supplier through to the country's national broadcaster. This amendment ensures that Sukuk cements its position as a viable alternative in the raising of funding to these core critical institutions within the Republic.

On a more personal note, FNB Islamic Banking recently sponsored a community event where I had the good pleasure of not just sharing a table with two of the past Ministers of Finance but to personally thank them for their commitment and foresight in approving the development and going ahead with the issuance

of Sukuk from a non-Islamic country. Minister Trevor Manuel (served in the Cabinet between 1996 and 2009) and Minister Pravin Gordhan (served in the Cabinet between 2009 and 2014) both were instrumental in the conceptualization and development of the country's debut sovereign Sukuk.

I firmly believe that this issuance is of particular significance to Africa and will take the lead in opening the doors to many other Sukuk issuances from our African neighbors both near and far.

“ Amendments to the National Taxation Act during 2014 saw the widening of the definition of Sukuk, which allows additional institutions to issue Sukuk ”

Preview of 2015

2015 promises to be a year filled with positive potential. Reports indicate talk of new entrants to the market and existing players scheduling launches of much-needed Islamic financial products. However, as promising as all this sounds, the key element to ensuring success to both new products and new entrants is the matter regarding awareness and education of Islamic finance products. Irrespective of all the legislative changes and developments within the industry, we will not be able to drive the concept of Islamic finance ahead if we cannot secure a trusting and convinced customer.

Even though South Africa has a minority Muslim population, not enough has been done to convince Muslims that they should be banking, investing and financing the Islamic way. It is only through direct intervention that the stated goals can be achieved. To this effect, the Islamic banking sub-committee of the South African Banking Association has embarked on a dedicated campaign to create awareness among potential Islamic banking customers.

Conclusion

I have already committed a significant portion of 2015 to travelling around Africa to meet with customers personally and enlighten them on the potential of Islamic finance on a continent that nearly 500 million Muslims call home. While the economic forecasts for the year ahead signal financial turbulence, we are confident that 2015 will herald Africa as a serious Islamic financial market participant.

I am also confident that the strides that we have taken in developing our Islamic financial capabilities would be of critical importance in assisting our neighbors north of our borders. ☺

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A shift in brand identity is required for a growth of Islamic finance in Sri Lanka

By Imruz Kamil

The prospects for the growth of Islamic finance looks bright; nevertheless, there are several obstacles currently preventing a faster growth of Islamic finance in Sri Lanka. Islamic finance in this country is now completing a second decade of operation with stability and product proliferation.

Review of 2014

2014 has witnessed a number of financial institutions opening windows to cater to the niche segment of the Muslim community in Sri Lanka. However, growth has slowed due to various reasons. The potential market size of Islamic finance in the country is estimated at LKR250-300 billion (US\$1.84-2.21 billion) of which Islamic financial intuitions have a share of around LKR50 billion (US\$367.92 million) during 2014. The journey of the Islamic finance initiative in Sri Lanka has, so far, not been an easy one.

The label 'Islamic' has led many Muslim and non-Muslims to think that this is part of the revealed body of faith of the religion of Islam. This misconception need to be demystified. A shift in brand identity is of paramount importance in a non-Muslim dominated country like Sri Lanka for future growth. Today Islamic banks are altering their image by removing the word 'Islamic' or any other connotative word from the names of banks. What is important to note is that the change in brand identity does not equate to an attitudinal change in compliance to Shariah standards nor does it imply that Islamic principles are being compromised or reduced. On the contrary, Islamic principles are becoming the ethical yardstick for the industry and are, to some extent, influencing conventional markets as well.

Regulation and legal frameworks

The rising demand for Islamic finance has not been matched by development in the regulatory and supervisory architecture in Sri Lanka. There are many Islamic banking windows being established in the country; however, these institutions are not really following the Shariah concept itself. It is a major issue in the industry and therefore a high-quality regulatory framework coupled with a centralized Shariah advisory body must be established within the regulatory institution to see a progressive growth for Islamic finance in the country.

Capital market

Capital market activities recorded a sharp growth in 2014; the initiatives taken by the Security Exchange Commission and Colombo Stock Exchange together with other market participants to organize forums for overseas investors have no doubt contributed to the growth of the capital market. However, there is a need to ask what contribution Islamic finance has made to the capital market growth in Sri Lanka? The answer is nothing. There is no legislation in place covering authorization of issuance of Sukuk or Islamic debentures. Changing the law or introducing legislation takes a lot of persuasion and time.

Many Muslim investors globally as well as locally are enthusiastically waiting for an opportunity to invest in Sri Lanka's

Shariah compliant capital market. Only a handful of corporate entities in Sri Lanka are specialized in providing the services of screening stocks, in order to fill the gap by developing a Shariah compliant securities list to assist Muslim investors who are interested in investing in the Colombo bourse.

Preview of 2015

There are many challenges that the Islamic finance industry in Sri Lanka needs to pay attention to in the new financial year. A paradigm shift towards reshaping the brand identity is crucial in an environment where Islamic finance is targeted by a certain group. The ability to localize interpretations to best suit the needs of the local community is the real strength of Islamic finance. Do note that the variability in interpretation of Shariah principles does not in any way compromise the integrity of Islamic finance.

More government-initiated financial sector consolidation programs which deal with consolidation of the banking sector and non-banking financial institutions or finance companies are currently in the pipeline. The next concern is how this would impact Islamic financial institutions in Sri Lanka.

According to the proposed plan, Sri Lanka is to have five large banks each with an asset base of over LKR1 trillion (US\$7.66 billion). Considering that at present the total assets of the banking sector amount to less than LKR7 trillion (US\$53.59 billion), the banking sector would be concentrated among a few banks.

Moreover, the recent budget proposal has given plenty of benefits to the leasing industry in Sri Lanka. The VAT component in the lease rental has been completely withdrawn which would benefit Islamic financial institutions to offer Ijarah lease at a very competitive price to customers at large and also the Islamic financial institutions would be able to introduce more innovative sub-products under the Ijarah product profile and Sukuk transactions can also be looked at positively to boost the capital market activities with a change of the tax regime.

The establishment of an Islamic finance house comprising Islamic finance practitioners is of utmost importance to address key issues pertaining to the Islamic finance industry in Sri Lanka. This would help the industry to reach its milestones and more importantly, would be able to establish a level playing field with other competitors in the market.

Conclusion

Although there were several hindrances encountered by the industry in the recent past, but with a change in the political environment of Sri Lanka, the Islamic finance as an industry would rapidly evolve into a viable alternative to conventional sources and forms of capital for Muslim and non-Muslim businesses. It is our intention to illustrate that the fundamentals of Shariah principles transcend a universal set of ideals shared between Muslims and practitioners of other faiths. ☺

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Islamic finance in Tunisia: Evaluation, new perspectives and challenges

By Rihab Grassa

The change of the political landscape in Tunisia after the revolution and the rise of Islamic political parties to power have changed intensely the business landscape in the country by giving much attention to the development of Islamic banking and finance in the country.

For more than 23 years, Tunisia was under an authoritarian regime which was devoted to oppressing Islamic movements. The old regimes did not want the country to become an Islamic state: neither to follow Islamic political movements nor Islamist ideas. The old regimes were oppressive towards Muslim groups and their aspirations. Therefore, not much work has been done to develop Islamic finance in Tunisia. The creation of the first Islamic bank in the country was closely related to the response of Tunisia's ruling authoritarian government. The state was dominating the banking system and was eager to maintain that control. Thus, the regime contained the development of Islamic banking due to it being suspicious of the political vision of Islamic finance and the fear of widespread Islamic inspirations and movements. However, this is all changing quickly after the revolution in a new different political environment.

Review of 2014

The year 2014 has definitely been a year of many important developments for Islamic banking and finance in Tunisia, driven by structural changes within the Islamic finance sector as well as by political influences and most notably the election and the transition of power and the rise of a new government. Indeed, by the end of 2014, a new government has been elected and Tunisia goes towards political stability.

Many events marked the development of Islamic finance in 2014. In the beginning of the year, the financial law of 2014 (Fiscal Law) prepared by the Ministry of Finance has included specific tax instruments for Sukuk and Islamic funds. Nevertheless, due to the political instability in Tunisia and beyond, the issuance of the first Tunisian sovereign Sukuk has been rescheduled first in 2014, then by the beginning of 2015. After more than one year from the date of approving Sukuk law by The National Constituent Assembly, Tunisia is looking to issue a US\$500 million Sukuk by the beginning of 2015. The Tunisian sovereign Sukuk aim to attract a new class of investors.

Furthermore, earlier in 2014, the private sector arm of the IDB teamed up with Tunisia's newly created sovereign wealth fund, Caisse de Depot de Tunisie, to set up a US\$30 million fund to support local businesses.

By the end of the year, Tunisia's Amen Bank, the country's second-largest private sector bank, launched two Islamic mutual funds in December 2014. The two Islamic mutual funds will be managed by Tunis-based United Gulf Financial Services-North Africa.

Meanwhile, a leasing company prepares to convert into a fully-fledged Islamic lender, welcome steps for the industry which has been waiting for the government to issue a first sovereign Sukuk.



Indeed, last October, El Wifack Leasing Company had received approval from the central bank to become the country's third fully-fledged Islamic bank, with TND150 million (US\$77.36 million) in capital, with the firm adding that it would bring international shareholders to the venture.

Near the end of the year, the Bahraini Gulf Finance House signed an agreement with a French consortium to start work on the first phase of a US\$3 billion real estate project north of Tunisia's capital.

Preview of 2015

It seems that with the beginning of important changes in 2014, 2015 will witness the rise of Tunisia 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.

Conclusion

On the heels of a successful 2014, it will be exciting to look forward to some important milestones in the Islamic finance industry in Tunisia in 2015. ☺

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Islamic finance in Turkey

By Ali Ceylan and Aytug Buyukatak

With its predominantly Muslim population showing increasing interest in Islamic finance products and the government keen to support their growth, Islamic finance is set to grow in Turkey. With the government having announced plans to launch three state-owned Islamic banks as subsidiaries of the state-run conventional banks, Ziraat Bank, Halkbank and VakıfBank, by the end of 2015, greater depth will be added to the Islamic financial sector. This in turn will encourage new entrants as well as a broadening of the Islamic finance products.

Review of 2014

Banking Regulation and Supervision Agency (BRSA) has reviewed Ziraat Bank's application to obtain approval for carrying out participation bank activities. BRSA approved this application and BRSA's decision was published on the Official Gazette dated the 15th October 2014 and numbered 29146.

According to the abovementioned approval decision, a participation bank will be established with T.C. Ziraat Bankası. being the controlling shareholder and its subsidiaries Ziraat Sigorta, Ziraat Hayat ve Emeklilik, Ziraat Yatırım Menkul Değerler. and Ziraat Teknoloji. being the other shareholders of the participation bank to be established.

BRSA's decision states that the participation bank shall be established in Turkey with a founding capital of US\$300 million.

Earlier this month, Ziraat Bank's general manager Hüseyin Aydın stated that: "I hope a Ziraat participation bank will be established within or towards the end of the first quarter of 2015."

Halkbank Islamic lender

State-run lender Halkbank would increase its paid-in capital by 80% to TRY2.25 billion (US\$918.98 million) to set up an Islamic lender. The bank made the announcement in a filing with the stock exchange. Turkey has four non-state Islamic banks, and state Ziraat Bank has received regulatory approval to establish an Islamic finance unit as well.

Kiler Group Shariah compliant borrowing

In early February, Kiler Holding's subsidiary Turkish food retailer Kiler Alisveris signed a US\$120 million four-year loan deal, including Shariah compliant borrowing, with Bank of America, Merrill Lynch and banks from the Gulf region.

Preview of 2015

According to the authorities in the Islamic finance market in Turkey, the expectation is to reach a growth of 10% in participating banks' share in the Turkish financial market until 2023. The market also believes that the insurance sector also has huge potential although there is a lack of legislative regulations. It is believed that in 2015, there will be a lot of Takaful potential in Turkey, probably accompanied by several regulatory changes concerning/establishing opportunities for the Takaful market since there is also demand from customers in the market for Shariah compliant insurance instruments. There are many compulsory insurance obligations such as earthquake insurance which has become mandatory for homeowners and businesses



in Turkey since 2012 following huge losses from a series of deadly quakes. As a result, the Turkish Catastrophe Insurance Pool has 6.6 million policies written, giving a penetration rate of 37%, according to data from the Turkish Insurance Association. While still short of blanket coverage, the pool represents one of the largest aggregations of issued policies, after compulsory third-party vehicle insurance. Therefore, it is believed that the participation banks in Turkey will concentrate on Islamic finance products newly presented to the Turkish market.

Conclusion

Despite the fast growth and good progress of Turkey in the Islamic finance participating banking field, it should be acknowledged that there is still a long way to go for the Sukuk, Islamic insurance (Takaful) and Islamic capital markets. Although participation banking is considerably settled in Turkey, there is no legal infrastructure for Islamic insurance companies. However, since foreign investors, such as Bahrain-based Albaraka, expressed their interest in Islamic insurance a new regulation may be expected in the near future.

In addition to the new Islamic finance instruments, an increase is forecasted for the participating banks' share within the Turkish banking sector. Participation Banks Association of Turkey stated that the share of participating banks will be 15% in 2023 which is also in line with the government's expectations.

It is hoped that 2015 will provide a boost for Islamic finance in Turkey with many new Islamic finance deals hopefully taking place especially in the real estate market. The government will also be expected to take steps to enhance Islamic insurance opportunities. (2)

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UAE's Islamic finance evolution gathers speed

By Rima Mrad

The UAE's Islamic economy witnessed a considerable growth throughout 2014. A number of groundbreaking commitments and achievements have been made with the purpose of making Dubai the global capital of the Islamic economy.

Review of 2014

A significant number of Shariah compliant transactions have been announced and completed in the UAE in the past year. The interest in Islamic products is growing on different levels and this is mainly due to the government's commitment towards the development of this sector. This commitment was the main driver behind the achievements seen in 2014 and for giving confidence to investors, banks and financial advisors for the future of this industry. There was the entry of international players to the market to offer Islamic compliant products among which was Goldman Sachs who had successfully issued a sizeable US dollar-denominated Sukuk with a Wakalah structure earlier in September 2014 becoming the first conventional US bank to issue Sukuk.

In the past year, the developments in the Islamic economy also included a number of regulatory changes that were mainly related to Sukuk and bonds:

- Dubai Financial Market (DFM) issuing its 'Standard for issuing, acquiring, and trading Sukuk' on the 2nd April 2014. After researching and reviewing the existing Shariah Sukuk standards with Islamic scholars and various regulatory bodies, the DFM issued the Standard to ensure Shariah compliance in the owning and trading of Sukuk. The Standard outlines the definition, purpose and tradability of Sukuk and emphasizes that all Sukuk elements must be Shariah compliant, from the underlying contract to the income derived from the Sukuk.
- Securities and Commodities Authority (SCA) of the UAE approving the new regulation for Sukuk. The regulation enumerates the rules for the issuance and principal listing of Sukuk; rules for Sukuk trading, clearance and settlement; and rules for the issuance and listing of Sukuk concerning applicants.

A leading role was given this year to the Dubai Islamic Economy Development Center (DIEDC) which was created by the end of 2013 pursuant to Dubai Law No 13 of 2013 with the purpose of focusing on finance, the Halal industry, tourism, digital infrastructure, art, knowledge and Islamic standards. The DIEDC is mandated to establish a sound infrastructure and a comprehensive framework to oversee the implementation of initiatives that help achieve the tenets of an enabling Islamic economy.

The DIEDC issued a number of initiatives throughout the past year and entered into important strategic partnerships, the last of which was with Thomson Reuters with the purpose of developing a global Islamic economy portal. The portal will serve as a pioneering initiative for the Islamic digital economy and a global reference for the emerging Islamic economy sector. Among the initiatives made by the DIEDC was the creation of the Dubai Global Sukuk Center which was widely supported by a number of

leading national institutions and ranked third among the world's Sukuk listing centers.

According to the center's statistics, the total value of the Sukuk listed on the Dubai markets, the Dubai Financial Market and Nasdaq Dubai since the launch of the initiative at the end of October 2013 was approximately US\$5.4 billion. Another initiative of DIEDC included the creation of the Hamdan Mohammed e-University Center for Islamic Banking and Finance to provide education, training, research and community service and to promote best practice in the area of Islamic banking and finance through an e-learning environment.

On another level, different important announcements have been made last year including:

- Dubai Multi Commodities Center Authority (DMCC)'s announcement to partner with an international brokerage firm to promote a Shariah compliant commodity murabahah mechanism where they will offer an efficient method of trading Murabahah products that are structured in a similar format to conventional structures.
- Obaid Humaid Al Tayer, UAE Minister of State for Financial Affairs and Pierre Gramegna, Luxembourg's Minister of Finance signed a Memorandum of Understanding (MoU) on cooperation in the field of Islamic banking services. This MoU was signed in recognition of the two countries' commitment to the field of Islamic banking and a further recognition of the anticipated growth of this industry.
- NASDAQ Dubai's Murabahah platform being created as a tailored platform for Islamic financing established by NASDAQ Dubai in collaboration with Emirates Islamic and Emirates Islamic Financial Brokerage. The platform has completed so far a total of more than AED21 billion (US\$5.72 billion) of transactions.

Preview of 2015

The performance of the Islamic economy in the past year was promising and the investors are looking forward for future development and growth in this market in the coming years. From the behavior and interest witnessed lately, the local Islamic financial market is about to go through a mature evolution particularly with a number of leading national and government institutions interested in considering Islamic financial structures for their financial needs. The UAE government confirmed its commitment to continue to support the growth of the Islamic economy in 2015. A number of groundbreaking announcements are expected to be made especially in matters relating to new regulations tailored for Islamic products.

Conclusion

Based on the different news coming from the market, the plan for 2015 will mainly focus on increasing the level of awareness regarding Islamic products and services and on the creation of regulatory standards for the different sectors forming part of this economy. ☺

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The UK continues cementing its position as the western Islamic financial hub

By Fara Mohammad

The UK has one of the most advanced Islamic financial markets in the Western world and has the largest Islamic banking sector outside the Middle East and Asia. Backed by the UK government who has played an instrumental role in laying the foundation for the development of Islamic financing in the UK by altering and clarifying its regulatory practices and tax laws, Islamic finance in the UK has created an opportunity for many institutions to become integrated and competitive in the global Islamic finance markets. The UK bolstered by its extensive skill set, expertise and flexibility, continuously cements its position as a hub for Islamic finance in the western world.

Review of 2014

There has been a clear shift in interest from retail Islamic banking to Islamic capital markets. This was demonstrated by the issuance of sovereign Sukuk worth GBP200 million (US\$308.54 million) by the UK government. It is the first country outside the Islamic world to issue Sukuk. The Sukuk was structured based on the principles of Ijarah and matures on the 22nd July 2019.

There was strong demand with orders totaling approximately GBP2.3 billion (US\$3.55 billion) and allocations were made to a wide range of investors including sovereign wealth funds, central banks and domestic and international financial institutions. The Sukuk was underpinned by three central UK government properties and was listed on the London Stock Exchange, which has also introduced an Islamic index.

The Sukuk issuance was part of the UK's long-term economic plan to make the UK the undisputed center of the global financial system. It further demonstrated that it was possible to create a successful British base for Islamic finance.

The main objective for the Sukuk issuance was to be a catalyst and encouragement for further private sector issuances of Sukuk in the UK. It opens up and provides a guideline for a whole new source of funding available to issuers within Europe and proposes another opportunity for entities looking to access the liquidity in the Islamic market. What is now desired is for corporate borrowers to take the baton and continue the race started by the UK government.

UK real estate remains a noteworthy area as there are still many significant real estate transactions financed utilizing Islamic finance principles. Islamic finance also plays a crucial role in infrastructure development in the UK. Several real estate investment funds were set up as well utilizing Islamic finance principles. In response to growing demand from property investors, the first Shariah compliant commercial real estate insurance was launched.

The retail market has developed with the launch of a series of new Shariah compliant products including cash individual savings accounts and the home purchase plan under the UK government scheme, to assist individuals with the purchase of homes. Other important milestones in the UK include the introduction of Islamic student financing and start-up financing. A Shariah compliant pension scheme was also introduced for employees and workers in the UK. In addition, this year saw the education sector expand with the proliferation of various Islamic finance programs established in universities and educational institutions in the UK.

Preview of 2015

Following from the UK Sukuk, it is unclear whether there will be any corporate entities that would take the lead and issue a Sukuk. However, it is apparent that the legal and regulatory framework governing Islamic capital markets in general is an area that would require further attention. There is a need to further develop the framework for corporate entities to ensure that there is regulatory clarity at the outset through a distinct Islamic banking regulatory framework. This is seen by industry players as essential as many benefits are seen through the certainty that comes with setting clear rules.

Market players predict that real estate will remain an area that will keep on attracting investors in the UK. Gulf sovereign wealth funds are seen as a continued source of investment in the UK, including real estate investment in education, healthcare and local/social housing sectors. Geographical outlook for property investment is also expected to advance beyond the city of London to other areas such as Manchester, Birmingham, Bristol and Scotland.

Establishing a Shariah compliant facility for purposes of liquidity management is yet another area that should be assessed. The development of such a facility would be a significant step forward in the liquidity management capabilities of Islamic financial institutions.

Conclusion

The UK has a strong commendable platform from which to consolidate its position as the western Islamic financial center. It has a wealth of experience and professionalism in services such as tax, regulations, accounting, law, product technology and innovation and education.

Coupled with the UK government's clear support and intention to lay the foundation and framework for further Islamic financing in the UK, efforts should continue to integrate the UK industry with the international Islamic financial sector, as well as showcasing UK expertise, which has yet to be seriously rivaled by any other European financial center. ⁽²⁾

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All quiet on the US front

By David Loundy

2014 was a slow year for Islamic finance in the United States as it continues the recovery from the Great Recession. Overseas investors are showing renewed interest in the US markets. Local providers are starting to expand back out previously contracted business. Many businesses are again looking to grow and are seeking suitable financing. The overhang of foreclosed properties has decreased, but some markets are still challenged and the foreclosure rate is still high in some areas. One of the biggest challenges facing Islamic finance came from within the Muslim community itself—a Fatwa released by the Assembly of Muslim Jurists of America (AMJA).

Review of 2014

(It is worth pointing out that it is difficult to measure the amount of Islamic finance business being done in the US, as much of it is done quietly without publicity or the need to report it to regulators. Thus many large private transactions go unnoticed.)

2014 was a year that showed little industry development in the US. There was little new product development, and no known new retail-level providers.

In the world of 'big real estate' that dominates the industry in terms of dollars deployed using Islamic structuring, 90 North, which provides Shariah compliant real estate investments, opened a Chicago office and purchased interests in buildings near Chicago and in Denver.

Also on the investment side, the Azzad Mutual Funds was awarded a Lipper Fund Award in the Global Bond (Sukuk) category for its Azzad Wise Capital Fund. Devon Bank put together the first known inter-bank syndication for a large Islamic school financing project. The heat in Congress to dismantle Freddie Mac (and Fannie Mae) cooled off a bit this year. This proposal had made many in the Islamic finance industry nervous, as Freddie Mac is the largest investor providing the bulk of the liquidity for the retail Islamic finance industry in the US.

In terms of home finance, both Devon Bank and University Islamic expanded their reach, and all of the major providers claimed to have strong volume, even in spite of a challenging year for conventional mortgages as rates began to rise causing refinance business to die off. Islamic home finance is more focused on new home purchases, and that market has remained strong.

On the regulatory front, not much of note changed in 2014, but providers are all gearing up for major changes in the residential mortgage market anticipated in early 2015. One change in 2014 that did occur is the accounting for mortgage servicing rights under Basel III, but the impact is not likely to substantially affect the Islamic finance industry.

On the academic front, Dr. Nazim Ali retired from the Harvard Islamic Legal Studies Program, sponsor of the best-known annual academic Islamic finance conference, and was succeeded by Law Professors Intisar Rabb and Kristin Stilt. The US Islamic and Economic Conference was held in Chicago - the first major US industry conference in several years.



One of the largest developments was the AMJA Fatwa on Islamic home finance providers. As a trade association of the US Imams, which maintains a Fatwa service, AMJA is frequently asked about the acceptability of the products of the various home finance providers. It organized a conference of Imams to focus on the Islamic home finance products available in the US. The AMJA invited the providers and representatives of their Shariah boards to present their products. The AMJA did further research, had meetings with its Fiqh Committee Resident Fatwa Committee, and in October released its evaluative Fatwa covering the various providers. The Fatwa held that none of the providers' products are acceptable - all are more or less deficient in some way. This has created quite a bit of concern and confusion with existing customers who have used products now declared unacceptable, and for people wondering what to do now if they wish to buy homes in an acceptable manner. The providers of these products have raised concerns about the evaluation process being flawed from the beginning, have responded to criticisms and felt that their responses were ignored, and are now resorting to essentially obtaining counter-Fatwa from other scholars stating that their products really are Shariah compliant. All of this will leave lingering distrust for the entire industry.

Preview of 2015

In 2015, the AMJA Fatwa debate will eventually be largely shunted aside, though some people will continue to distrust the whole industry. Commercial real estate finance will grow in volume, but slowly. More investors will return to the market, but it will produce a change in volume, and not likely yet a change in kind.

Conclusion

The US is a viable market for Islamic finance, but it does not yet have the support of needed investors with sufficient size and creativity to allow the industry to shine. Large US banks that provide Islamic finance overseas do not yet see the interest in providing such services in their country of origin. That has left the US market with options for commodity home finance and limited commercial finance. Fund development has been well received and will continue, as a well-performing fund can achieve 'crossover' appeal to both the Muslim and non-Muslim communities that is not yet present in other aspects of Islamic finance. (F)

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