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A volatile year for Islamic finance – the only way is up?

Once again the close of the year has come around more quickly than we ever thought possible, and it is time again for our annual review and outlook of the Islamic finance industry with a comprehensive overview of the highs, lows, peaks and troughs of the last 12 months – and what turbulent months they have been.

The euphoric highs of 2014 saw an explosion of non-Muslim sovereign issuances push Islamic finance into the mainstream public eye and record Sukuk volumes drive the sector forward amid strong interest, robust retail performance and a burgeoning global asset management industry. Increasing awareness of the strength, stability and sovereign support for Islamic banking brought a wider reach and greater diversity to the table, while the sector also gained traction in a broad range of new markets and asset classes.

Yet 2015 brought a rather different flavor to the table. The year started strong with some major Sukuk issuances from the IDB, Dubai Islamic Bank, the government of Ras Al Khaimah and of course the groundbreaking UKEF-backed issuance from Emirates Airline. However, as the year progressed the markets became increasingly turbulent: with oil down over 60% since July 2014 and severe commodity price volatility. The economic outlook of the major economies remained a concern and China's weak performance led to a global backlash that hit emerging economies and Asia particularly hard. With growth forecasts slashed and liquidity tightening, emerging markets saw a flood of capital outflows as foreign investors worried about a US rate hike and falling returns pulled out their cash – while domestic investors also fled to safer havens such as the US and Europe. The low oil prices have already begun to impact monetary policy – Saudi Arabia has pulled in billions of dollars in sovereign wealth investments overseas to plug its widening fiscal deficit, while government bank deposits in the GCC have fallen and public spending sharply contracted, leading to tighter credit conditions, limited liquidity for Gulf banks and an overall slowdown in the market.

However, the year has also seen some major steps forward. Successful talks led to the firm expectation of sanctions on Iran being lifted within the next few months, resulting in an inundation of interest toward the country. Saudi Arabia earlier this year opened the Tadawul to foreign investors in a move that could make for exciting times in the market. Over in Africa, IFN together with the IDB and ICD held the first-ever IDB Islamic Finance Africa Forum in the Cote d'Ivoire this September to massive success, representing the interest and excitement in the huge potential of this final frontier for Islamic finance. Indonesia is growing its capabilities and revising its regulations in order to make a real mark on the industry, while China is taking further steps into the market including a number of recent Sukuk issuances and IFN's first-ever China Forum will be held in Beijing in March 2016 in collaboration with the ICD.

As we move forward into 2016, we leave behind us a year that was both challenging and groundbreaking: rewarding and volatile. The lessons we learned are the importance of collaboration, of corporate governance, and of remaining true to the spirit and principles of Shariah that underpin our industry.

The goal now is to continue to raise awareness, educate the market and offer clear and straightforward solutions to meet the needs of clients across all borders and classes. IFN looks forward to assisting in this goal both through our current platform and with a range of exciting new products in 2016: including the launch of **IFN CORPORATE**, a brand new publication designed to educate the corporate world on the opportunities in Islamic finance, presenting the industry from a simple, straightforward and commercial perspective and specifically designed to raise awareness and generate new business for the Islamic market.

As we move into a brand new year, the prospects are exciting and the horizon is infinite. I hope that you enjoy this comprehensive and content-rich IFN Annual Guide 2016, and I wish all our readers all the best for the coming year. ☺

Lauren McAughtry,
Group Managing Editor, Islamic Finance *news*

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RESPONSIBLE INVESTMENT

SUSTAINABLE DEVELOPMENT





Islamic finance to still grow in 2016 but with a sag

By Mohamed Damak

Growth in Islamic finance will likely slacken in 2016, in Standard & Poor's Ratings Services's opinion. The industry has achieved critical mass, with total assets exceeding US\$2 trillion by our estimate. But we now think the industry faces three main challenges: The decline in oil prices; the rapid changes in the global financial regulation; and its fragmented nature.

Still, Islamic finance will have the impetus to continue progressing and maintaining some growth in our view. Governments in core markets see in Islamic finance a tool to maintain their investment spending, somewhat countering the negative impact of oil prices on their budgets. The regulatory changes could help the industry in resolving issues related to the lack of liquidity management instruments and applying more stringently its principle of profit and loss-sharing. Standardization of documents and Shariah rulings could enhance industry integration and free stakeholders' capacity to focus on innovation.

We expect the industry will be worth US\$3 trillion sometime in the next decade. This growth will likely result from the combination of the efforts of Islamic finance stakeholders and its contribution to the

development of the real economy, which is fueling the interest of major development institutions and some advanced countries.

Commodities super cycle is over

We are currently witnessing the end of the global commodities super cycle that started in 2005, which we think will drag down the economic growth in some core markets and consequently reduce opportunities for Islamic finance. Standard & Poor's now assumes that oil prices will average US\$63 per barrel between 2016 and 2018. The decline in oil prices is taking a toll on oil-exporting countries' governments' public finances, and most of these countries are core markets for Islamic finance.

Positively, we still see some pockets of unexploited growth for Islamic finance. We see Iran, whose banking sector currently represents about 40% of the Islamic finance industry, as one of these pockets. The country has been under sanctions for more than 35 years, hurting its economic performance and investments. If and when sanctions are lifted, we think that a significant amount of investment projects will naturally find its way to the Islamic finance industry, seeking financing. The Iranian banking sector alone cannot cope with these projects because it has its own challenges. Issuing

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Sukuk might be a viable financing route, provided that Iran makes the necessary regulatory adjustments.

Governments in GCC countries maintaining their investment spending will be another source of growth for Islamic finance. We expect these governments to protect their investment spending to support growth. That will undeniably result in higher Sukuk issuance from some of these governments. As an example, since early August 2015, the Saudi Arabian government started to issue conventional debts in local currency in a trend that we expect will continue. We think that at some stage, the Saudi government will target the liquidity sitting in the country's Islamic banks' through Sukuk. We understand Kuwait may also seek to sell local currency sovereign bonds or Sukuk by the end of the year. Some GCC governments still have among the lowest indebtedness indicators globally, meaning they retain leeway to raise funds to continue financing their investments. However, if oil prices fall way below our current expectations, we think GCC governments will cut back on investment spending.

Finally, the list of newcomers to Islamic finance keeps on lengthening. We have recently seen a string of successful Sukuk issues by issuers domiciled in non-core markets. The average participation of Middle Eastern and Asian investors in these Sukuk reached 65% in 2014, with European and US-based investors representing the remainder. We estimate the Islamic Sukuk investor base, those looking primarily for the Shariah compliant nature of the instrument, at just over US\$500 billion, excluding sovereign wealth funds, official investors (central banks and multilateral) and other conventional investors.

“ Islamic finance remains more a collection of small industries in specific geographies than a truly global industry ”

Islamic finance can benefit from the rapid change in financial regulation

The rapid changes in the global financial regulation are also affecting Islamic finance. In particular, Basel III for banks and Solvency II (or risk-based capital requirements for insurance companies), and the implementation of bank resolution regimes in major EU countries are raising the bar for Islamic financial institutions to keep pace with developments in conventional finance. The regulatory changes could help the industry in resolving issues related to the lack of liquidity management instruments and applying more stringently its principle of profit and loss-sharing.

As Basel III helps the banking industry to enhance its capitalization and resilience to unexpected shocks, it will also tackle the lack of available liquidity management instruments for Islamic financial institutions. The International Islamic Liquidity Management Corporation (IILM) was created to offer Islamic banks the necessary instruments for liquidity management by issuing short-term dollar denominated Sukuk. The IILM's second objective is to create an Islamic finance 'profit' curve and reduce the industry's dependence on other headline interest rates associated with conventional financial instruments. However, the IILM cannot deal single-handedly with the weaknesses of a US\$2 trillion industry given the relatively small size of its own issuances. Governments, central banks, and other official organizations have a role to play. Bank Negara Malaysia (BNM) tried to offer solutions for liquidity management for Islamic financial institutions a few years ago and subsequently became the largest issuer of Sukuk globally. However, at the beginning of 2015, BNM withdrew from the Sukuk market because its issuances did

not satisfy the ultimate goal. Instead, its Sukuk instruments became very successful and attracted a broad array of investors. BNM has since switched to other liquidity management instruments reserved for banks. We think that other central banks may emulate BNM over time. The implementation of a liquidity coverage ratio under Basel III will be progressive over the next five years. We will see full implementation only in 2019, as per the recommendation of the Basel Committee for Banking Supervision.

We think bank resolution regimes will be easier to implement for Islamic financial institutions, compared with conventional players in some core countries. We will likely see a stricter application of profit and loss-sharing, a core principle in Islamic finance. A few UAE banks and one Saudi bank have already tried, launching Sukuk eligible for additional Tier 1 capital treatment under Basel III that can absorb losses under specific circumstances. The rollout of resolution regimes in western countries will create an improved financial environment and set precedents that can be built on for Islamic finance. For instance, profit-sharing investment accounts might be used as bailable liabilities, up to the alpha factor recommended in the IFSB standards under the scenario of an Islamic bank resolution. However, this means funding costs will probably increase for Islamic financial institutions, as they will need to compensate depositors for this additional risk.

In insurance, the implementation of Solvency II, or risk-based capital requirements for insurers, could aid in strengthening the resilience of the Takaful industry in our view. Takaful insurance remains small, and lacks scale and profitability compared with conventional insurers. Takaful companies' investment portfolios also remain concentrated on a few risky and volatile asset classes, specifically equity and real estate. The deepening of the Sukuk market could help them to further diversify their investment portfolio and improve performance.

Higher standardization could accelerate innovation

Islamic finance remains more a collection of small industries in specific geographies than a truly global industry. Standardization of documents and Shariah rulings could enhance industry integration. Standardization is happening but not at the market-desired speed. A review of documentation used by some issuers in recent Sukuk transactions illustrates a movement toward increasingly standardized Sukuk legal documents. As recent examples, the legal documents for the Sukuk issued by Luxembourg closely resembled those used in the South African government's issuance. In Asia, the legal documents of the Malaysian government-issued Sukuk resemble those used by the Hong Kong government.

Standardization could also help attract new issuers by reducing the time and costs attached to Sukuk issuance. Today, an issuer that wants to tap the Sukuk market has to go through a complicated process that could last several weeks, months or even years when the issuer regulatory environment is not ready for Sukuk issuance. Longer time, energy and costs make Sukuk issuance sometimes unattractive compared with bonds issuance where the issuer just picks off-the-shelf standard documentation, inputs the amount and the maturity and hits the market.

Finally, standardization could free stakeholders' capacity to focus on innovation in order to create the next generation of products in Islamic finance. One of the common criticisms of market participants toward Islamic finance is that its products usually mimic conventional products using more complicated structures. While we think that Islamic finance principles and their economic added value make the difference between the industry and conventional finance, we believe there is a need to speed up innovation and focus on areas that could spur inclusive growth such as infrastructure financings or SME financings with profit and loss-sharing features.⁽²⁾

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Financial reporting of Islamic financial institutions: The rationale, the present, and the future

In early 2015, the Asian-Oceanian Standard-Setters Group (AOSSG) Islamic Finance Working Group published a study report that was prepared based on their review of the financial statements of 132 Islamic financial institutions in 31 countries. One of the objectives of the study was to determine the financial reporting standards that Islamic financial institutions are legally required to comply with. MEZBAH UDDIN AHMED explores.

The study identified that 38% or 50 Islamic financial institutions apply a differential requirement for the financial reporting of Islamic financial transactions, whereas 60% or 80 Islamic financial institutions do not apply a differential requirement. About 2% or two Islamic financial institutions did not specify the accounting standards that they apply. From the findings of the AOSSG study, it is evident that the Islamic finance world is divided in the financial reporting of Islamic financial transactions, primarily between the International Financial Reporting Standards (IFRS) and the AAOIFI Financial Accounting Standards (FAS).

The IFRS are developed by the International Accounting Standards Board (IASB). The mission of the IASB is to develop a set of standards that bring transparency, accountability and efficiency to global

financial markets. Currently, 116 jurisdictions mandate the IFRS for all or most domestic publicly accountable entities. The IFRS currently have become the de facto global standard for financial reporting.

Amid the wide acceptance of the IFRS by the majority of the countries in the world, the rationale given by AAOIFI in developing a separate set of accounting standards for Islamic financial institutions is that Islamic financial institutions need to demonstrate to the common users of general purpose financial statements that Islamic financial institutions comply with the principles and rules of Shariah in their financial and other dealings. Financial statements as a language of the business may give a wrong signal to users if financial statements of Islamic financial institutions mimic the financial statements of conventional financial institutions.

The relationship between Islamic financial institutions and their clients differ from the relationship between conventional financial institutions and their clients. Islamic financial institutions primarily engage with their clients in trade (for example, Murabahah) and partnership (for example, Mudarabah)-based arrangements, whereas conventional financial institutions engage only in interest-bearing lending and borrowing arrangements.

The information needs of users of the financial statements of Islamic financial institutions are also unique in the sense that the financial statements of Islamic financial institutions need to provide information which can assist users in evaluating the Islamic financial institution's compliance with the principles of Shariah. The financial statements should also provide information regarding the manner in which any prohibited earnings and expenditures were recorded and dealt with. The IFRS do not stipulate any specific recognition, measurement, or disclosure requirement pertinent to these matters that may result in differences in practice across the IFRS regime and with the jurisdictions that adopted the AAOIFI FAS.

However, a full adoption of the AAOIFI FAS is also not the complete solution at the current stage. Unlike the IFRS, the coverage of the AAOIFI FAS is not extensive and the standards deal only with a few Islamic financial contracts. Hence, those who apply the AAOIFI FAS, also apply the IFRS for the financial reporting of activities that are not covered by AAOIFI.

“ With the differences between the IFRS and the AAOIFI FAS in concepts and in requirements, the like-for-like, cross-border comparison may remain as a challenge ”

Review of 2015

In bridging the gap between conventional and Islamic-based financial reporting, the IASB has formed a Consultative Group on Shariah Compliant Instruments and Transactions. The IASB Consultative Group intends to focus on challenges that may arise in the application of the IFRS in the financial reporting of common Islamic financial instruments and transactions and to invite papers on those challenges and to make recommendations about steps that the IASB might take. In December 2014, AAOIFI accepted the membership of this IASB Consultative Group, and in April 2015, AAOIFI and the IASB held an outreach meeting with the international Islamic finance industry in Bahrain. The meeting was attended by 50 participants from over 15 countries. The meeting was a step toward strengthening cooperation between AAOIFI and the IASB toward a better understanding of issues relating to the financial reporting of Islamic financial institutions and reducing the gap between the two sets of standards.

Preview of 2016

The IASB Consultative Group currently calls for papers to determine whether some or all of the Islamic products are classified at amortised cost. If the answer is 'yes', then on what basis? If the answer is 'no', what steps, if any, can the IASB take to clarify the classification of these contracts or to amend IFRS 9 Financial Instruments? However, the IASB Consultative Group has not laid down any timeline for the completion of the project and also has not announced the agendas to be added in the near future. Both the IASB and AAOIFI have also not announced any joint work plan toward harmonization that may reduce financial reporting differences among Islamic financial institutions around the world.

Table 1: Jurisdictions where Islamic financial institutions apply AAOIFI FAS or other Shariah-based accounting standards

Bahrain	Mauritius
Bangladesh	Oman
Egypt	Pakistan
Indonesia	Qatar
Jordan	Sudan
Lebanon	Yemen

Source: Author's own

Table 2: Jurisdictions where Islamic financial institutions apply IFRS or other accounting standards without a differential treatment for Islamic financial transactions

Albania	Kuwait	Thailand
Australia	Malaysia	Turkey
Bosnia	the Philippines	the UAE
Brunei	Saudi Arabia	the UK
India	South Africa	the US
Iran	Sri Lanka	
Kazakhstan	Switzerland	

Source: Author's own

Conclusion

The objective of global standard-setters is to help users of financial statements by providing the ability to compare the financial performance of publicly responsible companies on a like-for-like basis with their international peers. With the differences between the IFRS and the AAOIFI FAS in concepts and in requirements, the like-for-like, cross-border comparison may remain as a challenge. While we may hope for a single set of globally accepted financial reporting standards for Islamic financial institutions in the future, as experience dictates, the development process of new standards may require a number of years to complete. Considering the rapid growth of the global Islamic finance industry and the pressing need, at the initial stage the IASB Consultative Group can prioritize the projects that can be completed sooner. Developing standards on disclosure requirements for Islamic financial institutions can be a good start. ⁽²⁾

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Alternative investments: Growth opportunities?

The market in the UAE has of late seen some activity in the areas of alternative investments, while structural particularities associated with Shariah compliant investments have also resulted in innovative deal structures and several cross-border transactions in the Islamic finance market. AMANJIT K FAGURA surveys the alternative investments space.

Investors are increasingly seeking investment diversification and the Islamic finance alternative investments market in the UAE is adapting, albeit slowly, to meet such demands. With this in mind, and while technically speaking alternative investments include, among other things, venture capital, private equity, hedge funds, real estate, commodities and certain real assets, some unique debt capital markets and structured transactions can also be included in the definition, and the transactions covered in this article reflect this.

Review of 2015

The past 12 months have seen a variety of transactions in the UAE market ranging from private equity and crowdfunding to Sukuk although a focus on banking and finance continued with some

fixed income instruments. A few of the notable transactions are highlighted as follows.

The world's first export credit agency-guaranteed Sukuk

On the 25th March 2015, Emirates Airline completed the world's first export credit agency (ECA)-guaranteed Sukuk worth US\$913.02 million. The Sukuk was guaranteed by the Export Credit Guarantee Department of the UK (ECGD). The transaction involved four aircraft being delivered post-issuance and the Sukuk was tradable from the issuance date. The transaction was the largest ECA-wrapped and ECGD-guaranteed debt capital markets transaction in the aviation industry and the finance market as a whole.

Ras Al-Khaimah's largest public issuance

The government of Ras Al-Khaimah completed the largest public

issuance of a US\$1 billion Sukuk on the 24th March 2015. The Sukuk was structured in accordance to Ijarah principles. The issuance highlighted geographic and investor diversification and was taken up by banks, funds and pension and insurance agencies across the globe.

FWU's Sukuk Wakalah program

A number of innovative structures were also implemented in the region in the past 12-18 months, including the issuance of a US\$100 million Sukuk Wakalah program by a European-based multinational insurance group, FWU Group (FWU). The transaction represented the first Islamic bond structure to be deployed over a block of life insurance contracts. The Sukuk was fully Shariah compliant, with a set of re-Takaful (re-insurance) transactions for one of FWU's five main subsidiaries, ATLANTICLUX Lebensversicherung. Additionally, the Sukuk was asset-backed, representing a true ring-fencing of assets. The program was named 2013 Europe Deal of the Year by Islamic Finance news.

Al Rayan Bank's fixed term deposit account

In an attempt to target an alternative group of customers, Al Rayan Bank launched a 36-month fixed term deposit (FTD) account on the 19th June 2015. Using a Wakalah contract, the bank invested in asset-backed, Shariah compliant activities such as property and metals to generate a profit. The FTD is intended to provide a flexible means of investment through a competitive product attracting Muslim and non-Muslim customers.

Beehive peer-to-peer lender – Shariah certification

The first peer-to-peer lending platform in the UAE, Beehive, received approval by the Shariyah Review Bureau in September 2015. Beehive illustrates the continuing innovation in Islamic finance products generating AED15 million (US\$4.08 million) in loans since November 2014. Beehive is a successful example of crowdfunding, where individual investors can invest from as little as AED100 (US\$27.23) into each business listed on the platform receiving monthly repayments in return.

Private equity portfolio company financing needs also indirectly benefited the industry in the past 12 months particularly where investors were considering mezzanine structures for growth capital purposes. Such mezzanine structures typically afford investors greater returns while exposing them to greater risks and often include convertible Wakalah and Murabahah financings.

We have also seen investments by Takaful companies in Shariah compliant capital-protected notes arranged by international banking institutions. Some of those utilized the Wa'ad (promise or a commitment to undertake an action) structure. Again, FWU has been at the forefront of a number of transactions in such areas which utilize lump sum Takaful and investment products and Shariah compliant payment undertakings from international banking counterparties which are documented through Murabahah and Musawwamah instruments.

In addition, the structuring of Shariah compliant feeder funds and vehicles that seek to invest in conventional master funds appear to be gathering pace through the utilization of highly structured vehicles and negotiation of opt-out clauses (from non-Shariah compliant activities) with the general partner of the master fund.

Finally, and due to geopolitical risks and low oil prices, we have seen a significant increase in private placement transactions aimed at channeling investments by Middle Eastern high-net-worth and institutional investors into income-yielding assets in markets like the US and Europe. These vehicles are structured Islamically and conventionally, with the UAE, or, in some instances, Bahrain-based merchant banks acting as arrangers as well as placement and structuring agents. In parallel, there are increasing signs of growth in the Islamic private placement sphere with Islamic investors seeking alternative types of investments. These include venturing into

non-Islamic markets through Sukuk backed by either commercial or residential real estate assets in the US, Europe and Asia. The majority of these instruments typically utilize Wakalah structures where the underlying asset is Shariah compliant. Ijarah structures also continue to be utilized to create Shariah compliant funding at the asset level.

Preview of 2016

In order for the Islamic industry to develop further, investors and businesses alike need to show more willingness to take calculated risks – looking to horizons beyond their shores and testing new waters. Only then can the UAE market truly become the hub of Islamic finance and an innovator in its own right. The foundations have been set but growth can only be achieved by sophisticated investors and businesses that have grown in this region continuing to explore alternative avenues of income. 2016 should see an increase in venture capital funds which promote entrepreneurs and a rise of crowdfunding. Mezzanine and structured finance transactions and private placements should continue to grow with a larger focus on Sukuk backed by commercial or residential real estate assets in international jurisdictions.

Conclusion

The scope for growth in the UAE is promising, however, the market is still relatively young and risk-averse – although this is slowly changing. The availability of Islamic structures to facilitate development in this area is not the hindrance – the reluctance of the market players is the real roadblock. Nonetheless, the market is slowly beginning to spread its wings and explore new opportunities both locally and internationally and this, it can be said, is the only way in which the most innovative and unique deals can be done and the opportunities in alternative investments truly explored. ☺

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Shariah compliant asset management industry remains fragmented

Islamic asset management is one of the pillars of Islamic finance and as the industry grows, will become increasingly important. Well-developed asset management products will be essential for the Takaful and pension markets as they develop. In 2014, assets under management grew by 5.3% and the number of funds increased by 11%. MARC NORDEN explores.

While managers of Islamic listed equity products are still able to select from a wide universe of securities, even after financial and ethical filters have been applied to ensure compliance with Shariah principles, those managers focused on fixed income products will also require the Islamic capital markets to develop in tandem with the demand for Islamic investment products.

Review of 2015

There has been a slowing of Sukuk issuance during 2015 and global Islamic finance assets have shrunk by 8.5% (The Banker, Top Islamic Financial Institutions Report, 2015). In spite of the disappointing levels of Sukuk issuance during 2015, there have been some interesting new names in the market. In particular, there has been an increase in ethical deals, with two issuers this year affiliated to the World Bank: the International Finance Facility for Immunisation, which funds vaccinations and the International Finance Corporation, which helps private sector development in developing countries. This connection between Shariah compliance and ethical finance is important and will hopefully become increasingly evident as the industry promotes the similarities.

“ In the future, there will be a move toward services and products that target women specifically ”

2015 has also seen innovation in the Sukuk market. The Emirates Airline Sukuk was significant as it was the first Sukuk to be backed by an export credit agency (ECA), namely the UK Export Finance. ECA-backed structures allow issuers with a low or no credit rating to receive a credit enhancement therefore lowering their borrowing costs.

In addition to the core, liquid asset classes of equities and fixed income, asset classes that are deemed 'alternative' in the conventional world will continue to play a major role in Islamic asset management. Asset-backed investments such as real estate, leasing and trade finance are ideal in delivering the principles of Shariah investing while providing investors with excellent diversification both geographically and through their low correlation with equities.

Preview of 2016

Although it has been a slower year, there are signs of a pick-up in Sukuk issuance during the last quarter of 2015 which is likely to continue into 2016 as oil-exporting nations look for a bottom in the oil price weakness, at which point an increase in capital expenditure could be warranted. It is also important to note local rates in the GCC

have been slowly increasing which will lead to issuers diversifying their funding base and tapping the Sukuk market. As well as more issuance, there should be more clarity surrounding monetary policy in the US which could increase trading volumes as directional views are implemented.

The Shariah compliant asset management industry itself remains fragmented and largely sub-scale. Half of the Islamic assets under management are held in funds smaller than US\$10 million (Reuters, Islamic Asset Management Report, 2015). Funds below this threshold struggle to grow and achieve scale and often their management fees are disproportionately high. There is demand for good quality investments from Islamic asset managers and this disconnect between supply and demand is preventing asset managers from reaching scale. Consequently, a period of consolidation within the industry would be beneficial both for the manufacturers and the consumers.

Sukuk: Raising awareness

Sukuk investments form a part of many Shariah compliant funds and are a vital liquidity tool for all Islamic financial institutions. Sukuk remain the most recognized of the Islamic instruments and provide a gateway to the Islamic market for conventional institutions and sovereigns. For Sukuk to continue to drive growth and awareness of Islamic finance, both sovereigns and corporates need to recognize the benefits of issuing Sukuk. Regulators need to support the industry and help grow the supply by implementing a level-playing field for alternative finance providers and the standardization of products.

Women: An underserved market

In the future, there will be a move toward services and products that target women specifically. On a global basis, and particularly in emerging markets, women have entered the workforce in larger numbers and continue to do so. Women are controlling an increasing amount of wealth and taking a more active interest in how that wealth is managed. Islamic financial institutions need to make sure that they have the expertise and products to service this demand.

A move to diversifying advisors and providers

We also expect to see, particularly in the GCC, wealthy clients moving away from a single relationship with one large multinational bank that services all their financial requirements to accessing experts such as local providers, sector specialists (eg property financiers) or Islamic specialists. We see this often in GCC clients approaching us to access the UK real estate market either as a direct purchase or through a fund investment. ☺

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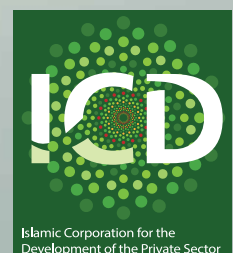
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Ample fertile ground for future growth in Islamic bank debt and loan financing

In terms of overall market share, Shariah compliant bank debt and loan financing has grown quickly over the past years and will continue to rise in the future. Along with Sukuk, it makes up the greatest share of global Islamic finance assets. SARA CARMODY probes the two main drivers for the rapid growth in Shariah compliant bank debt and loan financing, neither of which is likely to change.

Firstly, Muslims make up around 23% of the world's population and Islam is the world's fastest growing religion. Many of these Muslims (whether as individuals or as owners or investors in companies) will, where given a choice, opt for Shariah compliant financing products. At present, the global Islamic finance industry does not have a representative market share, relative to the Muslim population.

Secondly, Shariah compliant financing products have an appeal outside of the Islamic community. Businesses and people make their decisions based on the best financial products to meet their needs. Where there is a benefit for taking out Islamic bank debt and loan financing, such as being able to target a bigger pool of investors or better economic terms, this drives growth in the industry. Within the GCC, where there are a plethora of Islamic financial institutions, many non-Muslim individuals and companies have Shariah compliant bank debt and loan financing in place as these products are the most competitive for their needs. Similarly, many conventional banks have Islamic divisions in order to participate in syndicated loans structured on a Shariah compliant basis.

Review of 2015

According to an IMF report released in March 2015, Islamic finance assets still account for less than 1% of global financial assets, with the GCC, Iran and Malaysia accounting for the largest market penetrations for Islamic finance assets. During 2015, what was interesting to note was a shift in industry focus to emerging markets and also the change in political attitudes toward Iran, which is one of the more mature Islamic markets. Many of the emerging markets with the highest growth potential have a substantial Muslim population without access to basic banking and financial services.

During 2015, many Islamic finance institutions announced a focus on Africa and several international organizations had their first Africa-specific Islamic finance events in Africa. This is logical, as it is estimated that around 45% of the population of Africa is Muslim. Access to banking and financial products in Africa is significantly underdeveloped with two-thirds of the population lacking a bank account, much less access to bank debt and loan financing.

The participation of international conventional banks, acting by their Islamic divisions, into international Islamic syndications is also notable. As an example of this, during June 2015, when the Islamic Corporation for the Development of the Private Sector secured US\$300 million Murabahah facilities, the participants included Mizuho Bank (Malaysia) and Mizuho Bank Nederland.

Preview of 2016

We can anticipate there being growth in Islamic debt and loan finance from customers outside of the usual markets (the GCC, Iran and Malaysia) as customers look to Islamic finance to obtain



funding. As an example of the types of deals we can expect to see, during September 2015 it was announced that HNA Group, the owner of Hainan Airlines, is planning the first Islamic financing deal by a mainland Chinese company. They plan to raise up to US\$150 million in Islamic loans in order to buy ships. The driver for this large Chinese company in turning to Islamic finance is the high cost of funding in China relative to the pricing available in the Islamic market. They also plan on issuing a Sukuk.

The GCC, which has seen some of the most rapid growth in Islamic bank debt and loan financing, is experiencing a number of economic factors which may slow growth during the coming year. As one of the key markets, any events which affect the GCC will potentially impede the growth of Islamic finance.

A report issued by S&P in October 2015 stated that the growth in the industry would slow to single digits during 2016, owing to a number of factors. Factors cited in the S&P report as the drivers for lower growth included the fall in oil prices, rapid changes in the global regulatory framework for banks and insurance companies and the currently fragmented nature of the industry. Two of these factors apply equally to conventional bank debt and loan financing so that, although the outlook for Islamic bank debt and loan financing may not be double-digit growth, Islamic finance is still likely to outstrip growth in the conventional market overall.

Conclusion

The large potential markets for Islamic bank debt and loan financing, coupled with Islamic bank debt and loan financing becoming capable of being truly competitive in the market, make a fertile ground for future growth in Islamic bank debt and loan financing. ⁽²⁾

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Emerging trends in the Sukuk marketplace

During the formative years, the growth of the international Sukuk market primarily came from its traditional stronghold of the GCC and Malaysia. The product range and structures were also limited, aimed mainly at satisfying the financing needs of governments and corporates, and relying on the asset-based structures such as Ijarah (sale and leaseback). However, AHSAN ALI looks at three new trends that have emerged over the past few years which have taken the industry to a whole new level: (i) geographic diversification to new markets, including non-Muslim majority countries, (ii) expansion of product range beyond plain vanilla financing instruments and (iii) innovation in Shariah structuring to reduce reliance on asset-based structures.

Geographic diversification

For non-Muslim majority countries looking to make their first foray into the Sukuk marketplace, the year 2014 proved to be a breakthrough year, when the government of the Hong Kong Special Administrative Region of the People's Republic of China, the UK government, the Grand Duchy of Luxembourg and the Republic of South Africa issued their inaugural sovereign Sukuk. While some of them wanted to position their countries as the hubs of Islamic finance just as they are hubs of conventional finance in their own rights, others wanted to access the growing pool of Islamic liquidity to diversify their sources of funding. The key outcome is that all of these nations have amended their legal, regulatory and taxation frameworks to accommodate Islamic finance in general and Sukuk structures in particular – which means that other quasi-sovereign and corporate entities from these countries can now tap the Sukuk market, confident in the knowledge that legal and taxation hurdles have been overcome.

These issuances have given prominence to the opportunities associated with issuing Sukuk for non-Muslim majority countries. Spurred by these issuances, many other sovereigns throughout the world are now looking to issue Sukuk for similar reasons and have been working with global Islamic industry bodies to make the necessary tax and legal amendments to their regulations to facilitate such issuances. This then opens the door for other semi-government, multinationals and large corporates within these countries to tap the Sukuk marketplace for their own funding requirements, from a new set of potential investors who have become more familiar with the language of Sukuk and Islamic banking and finance. Finally, there are new countries on either side, Muslim and non-Muslim majority countries, that have a local population requesting access to Islamic banking services. Furthermore, the importance of these frontier developments in the Sukuk marketplace stem from the fact that Sukuk issuances can play an important role in financing as most emerging markets require significant infrastructure investments in the next decade.

A natural extension of geographic diversification is the growth of the cross-border issuance market. Currently, the majority of cross-border issuances involve bringing issuers from around the world to issue in Malaysian ringgit, which is the largest local currency Sukuk market in the world. For example, Turkiye Finans, the Turkish participation bank, was the first issuer out of Turkey to issue in Malaysian ringgit, in what was the largest senior single tranche issuance by a foreign financial institution.

Product innovation

The second big theme in the growth of Sukuk market is the development of new product structures in line with the development in the conventional bond market. For most of the period from 2002 to 2012, a vast majority of the Sukuk issued mirrored the senior, unsecured debt structure of the plain vanilla conventional bond. However, from 2013 onwards, we have seen new products in the market such as project finance Sukuk, amortizing Sukuk, export credit agency-based Sukuk, bank capital Tier 1/Tier 2 instruments and corporate hybrid Sukuk having both equity and 'debt'-like features.

Project finance Sukuk structures mirror the risk and cash flow of specific projects and therefore this development augurs well for the financing needs of infrastructure projects in many emerging nations around the world. Similarly, the first export credit agency-backed Sukuk issued by Emirates Airline in March 2015 was fully guaranteed by the Export Credits Guarantee Department of the UK government, which opens up a new market for both sovereigns and corporate entities to issue credit-enhanced instruments, targeting a new investor base and further widening the product suite in the Sukuk space.

Similarly, Tier 1 and Tier 2 bank capital instruments satisfy an increasingly important need for Islamic financial institutions to raise new capital for their ambitious growth targets while managing their capital ratios in compliance with new regulations such as Basel III. On the other hand, corporate hybrid Sukuk provides an innovative instrument for corporates to manage their leverage ratios without raising expensive equity.

A more recent global phenomenon is socially responsible investing or ethical investing, where Shariah compliant instruments should fit in naturally. In 2014, the International Finance Facility for Immunisation issued the first socially responsible and ethical Sukuk to support the immunization and vaccination programs of GAVI – the Vaccine Alliance. A natural extension of ethical investing is a 'green' Sukuk, where the use of proceeds would be for the purposes of satisfying specific criteria for such investments.

Innovation in Shariah structures

Traditionally, the Ijarah (sale and lease-back) or other 100% asset-based structures were the main Shariah structures used by market practitioners for creating the Sukuk, primarily as they were easy to understand by all involved, such as rating agencies, legal counsels, Shariah scholars and the investors themselves.

However, over the past years, we have seen increasing acceptance of asset-light structures as well as industry-specific structures. The main asset-light structure is based on the Wakalah concept, where the proportion of fixed assets required for structuring purposes is being substantially reduced to half or a third of the Sukuk amount by using a commodity Murabahah investment or other non-fixed assets such as services. The government of Malaysia's Sukuk used a combination of Ijarah, sale of certain services and Murabahah investment, while the government of Indonesia's Sukuk is based on completed assets plus projects under construction. Similarly, a popular structure in the Saudi local currency market is the Murabahah/Mudarabah structure, where part of the proceeds are utilized to invest in the (Shariah compliant) business of the issuer and part of it invested in commodity Murabahah. For bank capital

Tier 1 issuance, usually a pure Mudarabah structure is used which aligns well with equity capital-like behavior of the instrument.

Industry-specific structures have been primarily used in the airline and the telecommunication industries. The 'rights to travel' structure is now a well-established structure for the airline industry, having been used for the Emirates, flyDubai and Garuda transactions. Similarly, the airtime structure based on mobile minutes or 'airtime vouchers' is a popular structure used by many telecommunication issuers – both in local currency and US dollar transactions. Going forward, this trend for structural innovation is expected to continue, as the Shariah scholars, rating agencies and investors become more familiar and well-versed with such innovative structures.

Conclusion

Though the first international Sukuk was issued as far back as 2002, up until 2012 the industry was primarily limited to the Islamic hubs in the GCC and Malaysia, with limited product reach and structures. The past three years have seen a major breakout, not only in terms of geographic expansion and cross-border issuance but also in terms of product range as well as Shariah structuring innovation. This bodes well for the long-term growth of the Sukuk market in particular, and also the Islamic finance industry in general. (2)

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Cross-border financing proceeds cautiously with more diversity in the market

There is no doubt that Islamic finance has worldwide appeal. This is evident not only because of the growth of the industry in terms of volume and asset size as well as the number of Islamic financial institutions, but also because a large number of Islamic finance transactions to date are cross-border in nature. In this article, FERZANA HAQ studies the cross-border financing landscape.

The transactions typically involve multiple jurisdictions, in terms of the parties (ie the originators, the financiers, the investors and the trustees may originate from different jurisdictions), the currency of the financing, the governing law of the agreements, the location of the relevant assets or (in the case of Sukuk), the listing venue. While certain domestic markets, such as Malaysia, have grown exponentially due to the regularity and volume of transactions, the cross-border transactions tend to be much larger in scale and attract the most publicity. Moreover, the fact that a single Islamic finance transaction may span several jurisdictions shows how versatile Islamic finance can be as a financing tool. While activity in 2015 has not been robust, there have been a number of innovative cross-border transactions and large debut cross-border issuances. This trend is expected to continue in 2016 although we can expect both issuers and investors/financiers to be cautious in view of the weakening global economic outlook. The transactions in 2015 may be smaller in size, less frequent and confined to tighter windows, but are likely to be more diverse and originate from new countries or sectors.

Review of 2015

2015 stood out in terms of the number of innovative transactions which were structured not only in accordance with Shariah principles, but which also involved the laws of several jurisdictions in a single transaction. Each transaction may involve the interplay of several systems of law – the governing laws of the contracts and the law of the country of incorporation of the obligor. While this may raise additional complexities, it is a sign of the maturity of the market that this melting point of laws may in fact enhance the attractiveness of the transaction.

For example, Emirates Airlines issued close to US\$1 billion trust certificates which are fully guaranteed by an export guarantee from the UK Export Credit Guarantee Department (the ECGD), in order to fund the acquisition of aircraft by the airlines from Airbus. While this was not the airline's first Sukuk issuance, it was the world's first Sukuk financing supported by an export credit agency. The issuance was cross-border on several levels. While the originator was Emirates Airlines, a large corporation owned by the government of Dubai's Investment Corporation, the credit of the Sukuk certificates ultimately rested with the ECGD, an arm of the UK government, which fully guaranteed payments due to investors. The Sukuk certificates were issued to a very wide investor base, including to qualified investors pursuant to Rule 144A of the US Securities Act, and were dual-listed on the London Stock Exchange and the NASDAQ Dubai.

Another notable transaction was the issuance of US\$200 million Sukuk certificates by Sapura Kencana, the Malaysian oil and gas services solutions provider, under its multicurrency Sukuk program. The transaction was novel as although the Sukuk certificates were denominated in US dollars, they were issued to a purely local investor base, making the transaction the first unrated Sukuk issuance offered onshore in US dollars (rather than in Malaysian

ringgit). Another renowned Malaysian institution, Cagamas, the national mortgage corporation, made its debut issuance into Singapore through the issuance of a SG\$162 million (US\$113.69 million) Sukuk, which brought some activity to an otherwise quiet Islamic finance market in Singapore.

Indonesia also experienced a 'first' through the issuance of a US\$500 million Sukuk by Garuda Indonesia, the national airlines, which was the first offshore US dollar issuance by an Indonesian corporate issuer. The transaction represents a significant turning point in Indonesia's Islamic finance industry which had thus far been limited to domestic issuances or cross-border issuances by the Indonesian government. It is hoped that this debut issuance by an Indonesian corporate will pave the way for more issuances by large Indonesian corporates.

Preview of 2016

In view of the sluggish economic forecast, it is expected that issuers, financiers and investors will proceed cautiously in 2016. However, it is anticipated that we will continue to see more diversity in the market and that interest in Islamic finance will come from unexpected places. For example, the HNA Group, the owner of Hainan Airlines in China has already announced that it is planning its first Islamic finance transaction of up to US\$150 million in October 2015 and that it expects to follow this with a large offshore Sukuk issuance in the coming year. This may only be the beginning of Chinese companies tapping the Islamic finance market especially because domestic loans are becoming increasingly expensive. In addition, China has also seen the establishment of its first Islamic finance bank, the Xining Rural Commercial Bank, which may help develop a localized retail Islamic finance market.

Crossing over to Africa, the Ivory Coast has signed an agreement with the Islamic Corporation for the Development of the Private Sector for a US\$490 million Sukuk issuance, to be implemented in two tranches, between 2015 and 2020. This may be a new trend of developing African nations tapping the Islamic finance market to fund social and infrastructure development projects. Although the forecast for global markets is cautious, the Islamic finance market will continue, perhaps not in terms of size or volume, but in terms of new issuers coming to the market, particularly from developing nations. The successes of 2015, such as the Emirates Airlines Sukuk and the Garuda Indonesia Sukuk, may well set a precedent for other similar issuers to consider tapping the market using the same or similar structures. There may also be more supranational Sukuk issuances, for example by the IDB, which has announced its intention to raise financing for countries suffering from humanitarian and refugee crises. The funding raised by such transactions will not only have socioeconomic benefits but will also make Islamic finance truly global, not only in terms of its participants but also in terms of its positive socioeconomic impact on both developed and developing countries. (F)

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Islamic crowdfunding is here to stay

Crowdfunding unites communities online to raise funds for specific projects through bite-sized individual contributions. A recent report by Massolution projected this fast-growing industry to hit a whopping US\$35 billion globally this year. UMAR MUNSHI tries to find out why crowdfunding is all the hype these days.

At its infancy, crowdfunding was mainly a fundraising tool for supporters of musical or arts projects. Then along came Kickstarter and Indiegogo, two pioneering platforms that went viral, and gave the world an idea of the immense scope of applications for crowdfunding. By 2011, more than a million campaigns in North America and Western Europe had been crowdfunded, to the tune of US\$1.5 billion.

Today, crowdfunding has evolved and made strides into the investment world, with real estate crowdfunding one of the fastest-growing segments of this booming industry. The crowdfunding industry is still dominated by the US, but Asia has recently seen strong growth – overtaking Europe as the next-largest crowdfunding region by volume.

Technology is a key driver and enabler for crowdfunding. The ease and speed of online transactions, as well as the ability to fund projects directly, give crowdfunding wide and universal appeal. Investment-based crowdfunding has also benefited from the decline in sentiment toward the financial world. The recent financial crises, continued insipid returns, and stock market volatility have made the capital markets much less appealing. The top-heavy nature of the financial systems and their perceived role in the creation of inequality have also diminished the popularity of capital markets.

Savvy and progressive investors have enthusiastically turned to crowdfunding. Low entry capital makes it especially attractive for the middle income and small-medium business owners.

There are four main types of crowdfunding: debt, equity, rewards and donations, with new variations and hybrids, such as revenue-sharing, continuously emerging.

The object of crowdfunding investments differ. Crowdfunding of start-ups empowers entrepreneurs but has inherently higher risks. The power to create, however, has unique appeal. There is also a recent phenomenon where a start-up's crowdfunding success is taken as proof-of-concept and attracts venture capital. SME crowdfunding helps to bridge funding gaps – exacerbated by the credit crunch – for growing companies looking to expand. Real estate crowdfunding breaks down the capital barrier for this favorite investment of the wealthy, and as it continues to gain traction, has the potential to reduce income inequality over time. The premise is that we can all become landlords or even real estate developers.

Islamic crowdfunding is a new term coined to describe Islamically-inclined or Shariah compliant platforms. Fundamentally from a structural and contractual viewpoint, most crowdfunding categories except debt crowdfunding are Shariah compliant. Of course, the nature of the campaign or business also needs to be ethical and in line with Shariah.

I firmly believe that Islamic crowdfunding will change the Islamic finance landscape.

My belief stems from the fact that the fundamental basis of Islamic crowdfunding is the community, whereas Islamic banks emerged

from a much more corporate environment. When the overriding motive and mechanism revolve around the community, profit motives cease to be at the forefront of decision-making. Logic is based on a more holistic view of community benefit, which results in many wonderful initiatives and movements for the societal good. This is clearly in line with Islamic principles. Islamic crowdfunding has the unique ability to empower the masses to create and re-create products, lifestyles and communities independent of capitalist corporations or bureaucratic governments. In essence, if harnessed properly, society is now able to shape its own world based on its own needs, wants and principles.

Unfortunately, Islamic crowdfunding has taken some time to get off the ground. Up until 2014, there was just a handful of Islamic crowdfunding platforms worldwide, but over the past two years, this sector has suddenly sprung to life.

The Middle East has the most vibrant Islamic crowdfunding scene, with almost 10 platforms spread from the UAE to Egypt, a few of which have venture capital backing. One prominent platform is Liwwa which is Jordan/Palestinian-based and has crowdfunded small businesses with a total of US\$500,000 to date.

A casual estimate puts Islamic crowdfunding globally in 2015 at approximately US\$25million. Two of the larger platforms outside the Middle East are LaunchGood from the US and Club Ethis from Singapore. LaunchGood is focused on reward-based crowdfunding of new ideas or causes, and is leading the market with more than US\$4.5 million to date. Club Ethis focuses on real estate development crowdfunding of affordable housing in Indonesia, and has crowdfunded US\$2.2 million in its first 20 months.

Other prominent Islamic crowdfunding platforms include SkolaFund, Kapital Boost, PitchIn and Blossom Finance from Southeast Asia; Beehive, Shekra, Zoomaal, Eureeca and Aflannah in the Middle East; and Easi Up 570, HalalSky and FundingLab in the west.

The future of Islamic crowdfunding is indeed bright and exciting. The Middle East is expected to continue to lead growth, especially with the recent flurry of venture funding into quality platforms, and the natural acceptance of crowdfunding by the general community there. Malaysia recently issued six equity crowdfunding licenses, and is now exploring issuing peer-to-peer platform licenses too.

This gives current and future Malaysian platforms a regulatory advantage, and may well spur the development of the industry not only in Malaysia but also in Singapore and Indonesia. Western platforms are poised to grow also, especially since crowdfunding itself enjoys higher market acceptance and awareness.

Islamic crowdfunding is here to stay, and its rate of growth and impact depends a lot on the support and engagement of the Muslim community, as well as ethical investors subscribing to the same ideology. It is potentially an incredibly powerful tool, one that must be used in unity for maximum impact. ☺

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Outlook for 2016 promising

It is hard to deny that the Sukuk market has faced a slowdown this year despite a much expected strong year for 2015. Nevertheless, the Sukuk market this year has built upon the impressive market development seen in 2014 and observed several notable transactions which can serve as milestones for the years to come. Although the Sukuk market climate for the year 2016 is still uncertain, HITESH ASARPOTA expects that the market will gain traction again on the back of the strong pipeline and the still prevailing demand-supply gap of Sukuk in the market.

The global Sukuk issue volume in 2015 is US\$28.6 billion (as at the 25th November 2015) and unlikely to reach 2014's level of US\$43.5 billion by the end of the year. Not only has the Sukuk issuance volume declined compared to the previous few years, the year 2015 has not met with the same kind of landmark transactions as in 2014 where we witnessed highly-anticipated debut sovereign issues from non-Muslim countries such as the UK, Hong Kong, Luxembourg and South Africa as well as maiden issues by Goldman Sachs and the International Finance Facility for Immunisation (IFFIm).

Review of 2015

Having a notable year in 2014 in terms of Sukuk issue volume and successful debut issues, we started off 2015 with robust momentum and a strong pipeline. The first half of 2015 registered a global Sukuk issue size of US\$20.5 billion, which was only a 14.1% decline from US\$23.8 billion for the same period last year.

Although the second quarter of 2015 maintained a high volume of US\$11.1 billion supported by a few large-ticket deals by sovereign issuers such as Malaysia, Indonesia and Hong Kong, the market began to experience the influences of declining oil prices and a widely-held expectation of the US Federal Reserve increasing its benchmark interest rate within this year. Falling oil prices were in particular expected to take a heavy toll on the availability of liquidity and government spending and investment in the Middle East. As a result, the share of global Sukuk issue from the Middle East in the second quarter of 2015 significantly dropped to 24.4% (from 47.2% in the first quarter of 2015 and 56.9% in the second quarter of 2014) while Southeast Asia's share soured to 65.5%.

The third quarter of 2015 was arguably one of the weakest quarters in recent years. One factor was a long period of market inactivity during the holy month of Ramadan and Eid followed by a summer holiday period. It also continued to be affected by oil prices and Fed rate expectations, coupled with volatile commodity prices and

growing concerns over emerging economics, especially China. The quarter ended with an issue volume of US\$3.2 billion, out of which Middle East issues and US dollar-denominated issues accounted for a paltry 32.3% (US\$1 billion) and 15.5% (US\$500 million) respectively. The tone of global markets shifted into positive territory as we entered the fourth quarter of 2015, and the US dollar Sukuk market started to gain momentum, albeit slowly. Despite a steep decline in Malaysian issues and ringgit-denominated issues to historic lows, the total global Sukuk issue size currently stands at US\$4.9 billion in the fourth quarter to date as at the 25th November 2015.

Against the backdrop of volatile market conditions un conducive to Sukuk issuances in the latter part of the year, however, the year 2015 saw a few significant transactions which have paved the way for further progress of the Sukuk market. In March 2015, UAE-based airline operator Emirates successfully priced a US\$913 million senior unsecured amortizing Sukuk fully backed by the Export Credit Guarantee Department (ECGD) of the UK government. Marking the world's first ECGD-backed Sukuk, the transaction was a strong testament that the Sukuk investor community was increasingly familiar and comfortable with innovative and complex structures involving numerous stakeholders.

In October, we saw the Arab Petroleum Investments Corporation (APICORP) successfully pricing its debut Sukuk in the international capital markets. As a multilateral development bank established in 1975 by the Organization of Arab Petroleum Exporting Countries, APICORP is a significant addition to the list of supranational issuers giving further depth to the highly-rated Sukuk market. In Southeast Asia, Garuda Indonesia, Indonesia's national flag carrier, became the long-awaited first issuer of US dollar Sukuk by non-sovereign Indonesian entities in May 2015. The unrated US\$500 million trade was issued at 6.125% yield on the back of strong feedback from high-quality investors especially from the Middle East, which took 56% of the issue.

In the government and supranational space, such regular issuers as Indonesia, Malaysia, Ras Al Khaimah and the IDB successfully tapped the market. While Hong Kong reinforced its newly-established yet sound Sukuk platform by offering its second US dollar Sukuk on a Wakalah structure, the IFFIm's comeback proved Sukuk investors' support for socially responsible investment (SRI) instruments.

Preview of 2016

We forecast that the Sukuk issue volume for the first half of 2016 will recover moderately. Investors are expected to stay cautious about the market climate, and the impact of low oil prices on the regional liquidity and governmental spending and investment plans in the Middle East is not very likely to be reversed immediately even if there is a recovery in oil prices. However, the pipeline for 2016 is strong as the region's resilient economics continue to require funding and would need to turn to capital markets from tightening bank credit available in the region. The mismatch between Sukuk demand and supply will still be relevant in 2016 given the low issue volume this year.

There are three areas which we identify as potential markets to flourish in 2016 and beyond: SRI Sukuk, securitization and new markets. The IFFIm Sukuk was a strong testament that the Sukuk investor community was ready to embrace SRI, reminding us of the natural match between SRI and ethical principles embedded in Islamic finance. The Sukuk market is on the way to becoming the preferred alternative venue for fundraising by multilateral organizations, development agencies, NGOs and so forth. Securitization Sukuk, which is non-recourse asset-backed Sukuk, is an area expected to gain traction. A wider variety of instruments other than senior unsecured notes are evidently required as Islamic finance markets and economies grow in depth and breadth. In the face of weakened deposit growth, regional Islamic financial institutions will be compelled to consider asset securitization as a means to use their balance sheet more efficiently. Finally, there continues to be a strong interest in Sukuk financing across the world and in 2016, we also anticipate maiden Sukuk issues from new markets that may include Egypt, Morocco and Jordan.

Conclusion

Despite the slowdown in Sukuk issuance in 2015, the outlook for 2016 is promising with market development in the areas of SRI, securitization and new markets. The year 2016 will see the Sukuk market broadening the range of its options to cater to a variety of funding requirements in and outside the traditional Islamic finance markets. We are confident that there will be game-changing transactions which will further reinforce Sukuk as a viable alternative market globally. ⁽²⁾

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Increased need in a volatile market environment

2015 has been a year of volatility and unexpected price movements in global fixed income markets, much of which have been triggered or exacerbated by government policies. Regulatory changes implemented in the wake of the global financial crisis have made it more onerous for banks to trade bonds, for example, and reduced market liquidity substantially. Fewer active liquidity providers in most markets has meant wider bid-offer spreads and the potential for one large secondary market transaction to dramatically move the price of a security. MICHAEL BENNETT and AKINCHAN JAIN delve further.

Central bank interest rate policies have also added to the volatility. In some cases, expected actions have not occurred. For example, as of October, the market was still waiting for the long expected first interest rate increase by the US Federal Reserve since 2006. In other cases, actions had the opposite effect from those predicted. For instance, just as the European Central Bank was stepping up its program of quantitative easing in April 2015, causing many investors to expect even lower yields on core European government bonds, 10-year German government bond yields rocketed from an intraday low of 0.05% in mid-April to a high of 0.8% in just a few weeks.

Financial derivatives and Islamic banks

All of this volatility and uncertainty in the fixed income market exposes banks to significant interest rate risk. One important set of tools that conventional banks use to manage this risk is financial derivatives. Derivative instruments – including swaps, options and futures – provide banks efficient ways to hedge the interest rate exposures that naturally arise from their core activities of lending, borrowing and deposit-taking.

Islamic banks, on the other hand, have many fewer tools available to them to manage this risk. While Shariah compliant derivative instruments exist, they are fewer in type and much less commonly traded than conventional derivatives. In addition, the acceptance of Islamic derivatives differs by institution. For instance, while profit rate swaps, the Shariah compliant instrument most similar to a conventional interest rate swap, have become relatively common in the market, some Islamic banks are still prohibited by the opinions of their Shariah advisors from entering into these contracts. Other institutions are permitted to use profit rate swaps to hedge specifically identified exposures, but may not use them to hedge net exposures on a portfolio basis.

The relative scarcity of Islamic derivatives is not surprising. The prohibitions in Islamic law against the charging of interest (Riba), speculation (Maysir) and excessive uncertainty in commercial transactions (Gharar) raise difficult questions of Shariah interpretation for Islamic legal scholars when applied to financial derivatives. While their usefulness as risk management tools may be undeniable, usefulness alone obviously is not the only factor in determining Shariah compliance.

In addition, Islamic banks' relative lack of exposure to derivatives at the time of the global financial crisis is frequently cited as one of the reasons they fared better during the crisis than their conventional counterparts. Islamic banks did not, for example, participate in

the highly complex, derivative product-based collateralized debt obligation securities that became toxic assets on the balance sheets of many conventional banks. Given the lack of exposure to derivatives has been identified as a strength of the Islamic banking industry in 2008 and 2009, it is not surprising that some banks are reluctant to begin just a few years later to trade in these products. However, the vast majority of financial derivatives that conventional banks use to hedge their interest rate risk have little, if anything, in common with the complex instruments that contributed to the financial crisis. A swap, for instance, that permits a bank which has a significant percentage of fixed rate assets and is concerned about impending interest rate increases to swap a portion of that fixed rate exposure into a floating rate basis is both a simple and highly effective risk management tool. An Islamic bank that is denied equivalent Shariah compliant hedging tools will not be able to manage its risks as efficiently as conventional banks in the same market and therefore will be at a competitive disadvantage.

Summary

Islamic banks have not been immune to the financial market volatility in 2015. In particular, Islamic banks in the Gulf have been impacted by the continued uncertainty over US interest rates (with the majority of Gulf currencies pegged to the US dollar) and by a significant reduction in their liquidity brought on by the fall in the oil price. Similarly, Islamic banks in Southeast Asia have been hit by the dramatic decline in the value of the Malaysian ringgit as well as the general widening of emerging market credit spreads. At the same time, Islamic banks, like their conventional counterparts, are increasingly subject to stricter prudential regulation. Given this difficult market and regulatory backdrop, it is increasingly important for Islamic banks to have access to a full range of tools to hedge interest rate and other risks.

Going into 2016, we hope influential organizations such as the International Islamic Financial Market, the IFSB, the General Council for Islamic Banks and Financial Institutions and the International Swaps and Derivatives Association will continue to use their convening power to bring together experts to spur the development of a more active and liquid Shariah compliant market for derivatives. 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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An exciting year ahead

The decline of the oil price and the subsequent drying out of liquidity, the slowdown of China and the volatility of the global equity markets were some of the main themes of 2015. High-net-worth individuals (HNWIs) from the GCC and Southeast Asia derive their wealth mainly from family-owned businesses and are directly affected by these issues. They have been taking measures to counter existing market risks and are actively structuring their family wealth, by establishing family offices, foundations, trusts or investment funds. BISHR SHIBLAQ scrutinizes the family offices landscape.

Review of 2015

A clear trend in 2015 was the diversification of HNWIs by investing more broadly and becoming less affected by local economic conditions and the regional geopolitical situation. According to the GCC Wealth Insight Report 2015, only 33% of HNWIs in the GCC were affected by local economic conditions and only 24% by the geopolitical situation in the Middle East. This is quite a change from 2014 where 43% were affected by local economic conditions and 46% by the regional geopolitical situation. Almost a quarter of HNWIs were hesitant to make new investments in the Middle East due to the political instability.

It is interesting to note that according to the same report, 72% of HNWIs in the GCC consider it either very important (53%) or somewhat important (19%) that their banking and investment decisions are Shariah compliant, but that only 18% of their transactions in 2015 were Shariah compliant. The lack of availability of products in their home countries is of course one reason, but it is crucial to note that these products and Shariah compliant structures are often not available when investing on a cross-border basis.

A further trend was the creation of more family offices in the Middle East and Southeast Asia, taking a more institutional approach to investing and to risk management. Family offices have become more structured in their approach, with clearer reporting lines, hiring internal advisors and legal counsels, establishing procedures and controls and introducing more regulations. Organizations that grew out of a successful family business are becoming increasingly sophisticated wealth and investment managers that are investing on a cross-border basis, competing with established wealth managers, and starting to attract other families for co-investments.

Some family offices have established themselves in well-regulated jurisdictions, such as London or the Dubai International Financial Center while others have chosen to structure their family assets in investment funds in fund domiciles such as Luxembourg or establish trusts in the Channel Islands. There are internal and external drivers that have caused these changes. Internally, the families try to structure their wealth and ensure that succession planning is in place. Externally, there is an increased amount of global regulations making professional structures indispensable.

Preview of 2016

If we look at next year, than it already appears that the oil price will not recover that quickly and that government spending will subsequently be cut further, putting additional strain on liquidity for family-owned businesses. Family offices are already underway to diversify their investments and are considering alternative strategies to minimize their risk exposure. As emerging markets are becoming less profitable and the real estate market is digesting oversupply in the GCC, family offices are starting to look abroad. Islamic investors



may try to diversify from their home countries and look to invest increasingly into politically and economically stable regions, even if they have to accept lower yields.

The issue of Iran will be an important factor for the development in 2016. There are many questions to be answered, but many investors are gearing up to invest in Iran and to be the first to enter the market. The lifting of US secondary sanctions will allow regional businesses to enter into transactions with Iran. We might also see an increasing amount of Iranian wealth being deployed in financial centers active in Islamic finance such as Dubai, Kuala Lumpur, London or Luxembourg. According to a report of the Organization of Islamic Cooperation Iranian banks accounted for 40% of the global Islamic banking assets in 2014, ahead of Saudi Arabia with 18.5%. This already indicates the wealth that is waiting to be unlocked.

Conclusion

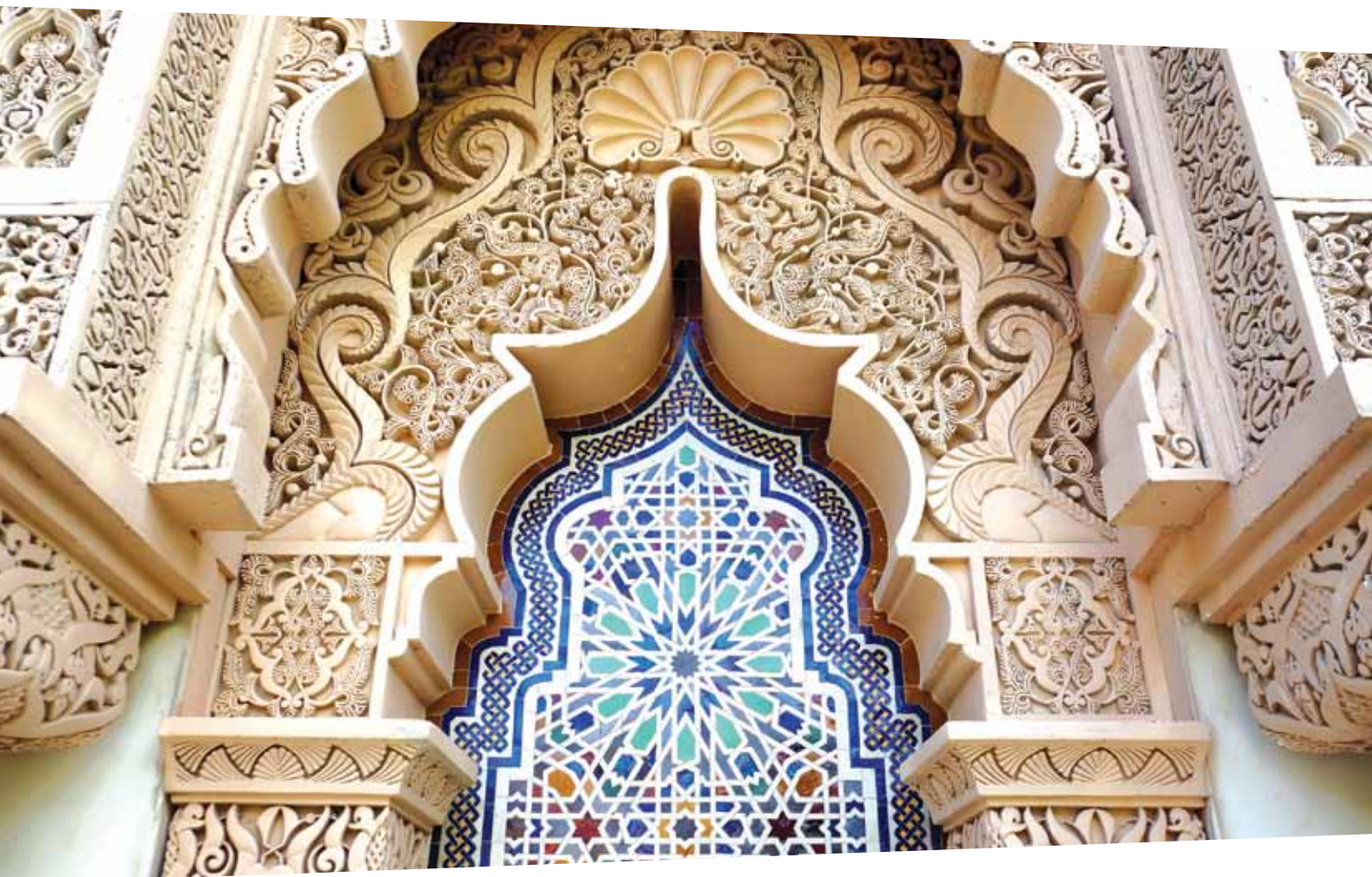
2016 will be an exciting year and we can expect many changes. Shariah compliant family offices seem to already have positioned themselves strongly to navigate through a difficult market; the question is whether they are dynamic enough to adapt to a changing Islamic economy. The development of the oil price, the opening of the Iranian market or the liberalization of the Saudi market are challenges, but also great opportunities for HNWIs. There also seems to be a strong potential for the development of new Shariah compliant products, as the availability of products seems to be far below the demand of those HNWIs who consider Shariah compliant investments to be very important. (☺)

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Abu Dhabi Islamic Bank: A leader in its field

Abu Dhabi Islamic Bank (ADIB) is one of the leaders in the regional corporate finance, capital markets and investment banking space, and has developed its capabilities over the past five years to become a primary player across multiple corporate business lines. One of the world's leading Islamic banks, ADIB has an extensive geographic reach and the third-largest branch network in the UAE, along with a strategic presence across the MENA region and UK.

A fully-fledged bank offering wholesale, retail, business and private banking as well as treasury and wealth management, ADIB has assets of AED116.9 billion (US\$31.82 billion) along with AED89.4 billion (US\$24.33 billion) in deposits and AED14.7 billion (US\$4 billion) in equity as of September 2015. Rated 'A+' by Fitch and 'A2' by Moody's, the bank is majority-owned by the sovereign wealth fund and quasi-sovereign entities. The bank benefits from a strong liquidity position and stable funding resources.

ADIB's corporate finance and investment banking (CFIB) department is part of the wholesale banking franchise headed by Arif Usmani, the global head of the wholesale banking group. The CFIB department had an exceptional year backed by a strong team, led by Amir Riad, the global head of corporate finance and investment banking.

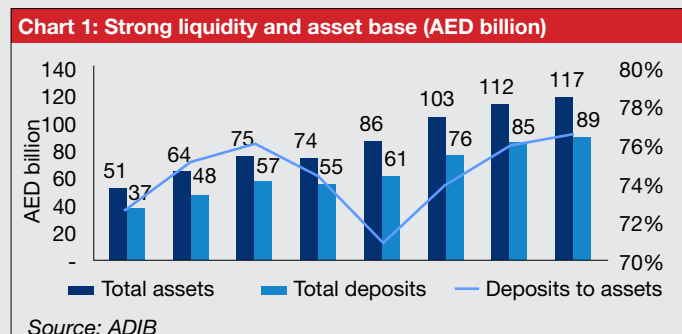
"This is a business that we set up back in 2009 as a complementary product proposition to the wholesale banking and private banking divisions, providing customized financing solutions for debt and equity capital markets" explained Amir. "We cover the entire spectrum of products - from syndications, corporate finance to debt capital markets (DCM) as well as corporate advisory and equity capital markets."

At the forefront of the Islamic capital markets and syndicated financing space, the bank successfully concluded landmark syndicated financing totaling more than US\$5.7 billion during the first nine months of 2015, across a broad spectrum of issues in the corporate and government-related entity sectors; and through a complete service proposition that covers advisory services and capital-raising. In the last two years, ADIB led a deal flow of over 10 major Sukuk transactions worth over US\$7 billion and have been oversubscribed by up to three to four times, demonstrating ADIB's leadership in the Sukuk market.

Landmark deals

ADIB played a major role in some of the year's biggest deals, including acting as the joint lead manager and bookrunner for the Emirates Airlines US\$913 million senior unsecured amortizing Sukuk due in 2025 and backed by the UK Export Finance agency. With proceeds from the issuance used to fund the acquisition of four Airbus A380 aircraft, the transaction saw strong demand with an orderbook of US\$3.3 billion from 49 accounts (a 3.6 times oversubscription) and tight final pricing at midswaps +90bps. The deal achieved several milestones as it is the first corporate issuance in 2015 and the first time a Sukuk was used to pre-fund the acquisition of aircraft; the deal achieved the lowest profit rate of any export-credit agency (ECA)-backed debt capital markets issuance from the GCC at 2.471%.

"This was the world's first Sukuk backed by the UK government's ECA and of course it achieved an optimal pricing. The purpose was to finance aircraft: it was a very specific target and it achieved that very well. The pricing was very competitive in its class," commented Amir. "This is an example of how strong issuers like Emirates have continued to successfully tap into the capital markets with new



structures and innovations, and we are proud to have been part of this landmark deal."

More recently, ADIB was a lead bookrunner and the joint lead manager for Majid Al Futtaim's second foray into the Sukuk market, successfully arranging a US\$500 million unsecured Sukuk due in 2025. The transaction saw robust demand from the global fixed income community garnering an orderbook in excess of US\$1.6 billion with 51% from fund managers, 36% from banks, 10% from private banks and 3% from other institutional accounts. The final book was placed 60% into conventional and 40% into Islamic investors, demonstrating the growing comfort the non-Islamic investor base has toward Sukuk as an asset class. Despite issuing during a softer market backdrop, the issuer achieved an optimal pricing versus their conventional secondary curve and printed one of the longest tenors achieved by any corporate issuer in the Sukuk market from the GCC in 2015.

Commercial real estate focus

On the real estate side, ADIB also has a strong focus. "This is a business where we offer a complete service proposition across the institution and is something that lends itself well to Shariah compliant structured finance," explained Amir. The bank has worked on many of the major real estate deals in the region: including acting as the joint lead manager and bookrunner on the Emaar Malls Group's senior unsecured US\$750 million 10-year debut Sukuk launched in June last year, which was oversubscribed 7.2 times from over 200 accounts and achieved the longest tenor in a senior unsecured Sukuk from a Dubai-based corporate, as well as the tightest spread on a 10-year issuance from Dubai since 2007.

More recently, ADIB led a unique deal for Skai Holding, a private developer in the Palm in Dubai, for a US\$300 million structured syndicated facility for the Viceroy Project. "This was the first of its kind, and it was a very interesting way to use our real estate expertise at a time when the climate for the real estate sector in Dubai is changing. This was a way to bring in new liquidity efficiently," elaborated Amir. "It was a receivable-backed structure, with a conventional and Islamic tranche. A key aspect is that we were able to attract Chinese banks to participate in that deal, which is significant. It was a debut Islamic deal for the issuer. We believe Chinese banks are building momentum in this market."

Figure 1: Wide spectrum of market-leading transactions

 US\$500 million Joint Lead Manager & Bookrunner October 2015	 US\$300 million Mandated Lead Arranger & Bookrunner September 2015	 US\$300 million Mandated Lead Arranger & Bookrunner August 2015	 US\$1,500 million Mandated Lead Arranger & Bookrunner June 2015	 US\$913 million Joint Lead Manager & Bookrunner March 2015	 US\$500 million Joint Lead Manager & Bookrunner March 2015	 US\$600 million Mandated Lead Arranger & Bookrunner January 2015	 US\$450 million Mandated Lead Arranger, Bookrunner & Sole Underwriter November 2014
 AED1,000 million Mandated Lead Arranger, Bookrunner, Security Agent & Account Bank October 2014	 US\$1,300 million Islamic Mandated Lead Arranger & Islamic Facility Agent June 2014	 US\$425 million Joint Bookrunner and Initial Mandated Lead Arranger July 2014	 US\$750 million Joint Lead Manager & Bookrunner June 2014	 US\$650 million Joint Lead Manager & Bookrunner April 2014	 AED1,200 million Mandated Lead Arranger, Investment Agent, Security Agent & Account Bank March 2014	 US\$115 million Mandated Lead Arranger & Bookrunner March 2014	 US\$410 million Mandated Lead Arranger, Sole Bookrunner & Agent Bank February 2014

Source: ADIB

Public and government sector

The bank is also active in the public and government sector, has worked on major deals such as Emirates National Oil Company's US\$1.5 billion nine-year unsecured syndicated facility – a landmark transaction that represented the first general corporate syndicated loan issued by a UAE corporate with a door-to-door tenor of nine years. The deal attracted significant interest and wide participation from UAE and regional-based banks resulting in 1.8 times oversubscription.

Marine and offshore sector

More recently, ADIB has also added capability in the specialized asset financing business – specifically covering marine and aviation financing. “This is a business that lends itself very well to the skills of the bank,” explained Amir. “We have seen a retrenchment in this area from international banks that previously were very active in that space, and we are playing a leading role in this niche market.” ADIB has already structured US\$10 billion in major financing deals and asset finance transactions to fund the acquisition and new build of ships, offshore supply and construction vessels; and is a leading player in the marine industries field.

In the offshore energy sector, at the beginning of 2015, ADIB also concluded the largest-ever financing for a privately-owned offshore supply vessel business for Zakher Marine International. The deal was a 100% Islamic US\$420 million transaction, with strong participation from both conventional and Islamic investors. It also included a facility to allow the company to consolidate and re-profile its facilities. “It was important from this perspective because it was the first time this company had raised financing in the syndicated market,” noted Amir.

Investment banking

In the IPO space, the investment banking team has very strong credentials and has advised on over US\$10 billion of high-profile transactions on the Abu Dhabi Exchange, Dubai Financial Market, NASDAQ Dubai, Tadawul and London Stock Exchange (LSE).

ADIB's equity capital markets team led the AED504 million (US\$137.18 million) rights issue for ADIB as the sole financial advisor and lead manager. The rights issue was concluded successfully in September 2015 and was three times oversubscribed despite volatile market conditions. This is a landmark deal: this is the first-

ever tradable rights issue for a bank in the UAE and the first time digital banking was employed fully for subscription purposes.

ADIB has also acted in leading roles on several IPOs including Damac Real Estate and Gulf Marine Services on the LSE and is currently advising on several bespoke IPOs as the financial advisor and lead manager. On the mergers and acquisition (M&A) side the bank is also active, advising key clients in the region on several sell side mandates; while on the hybrid front, ADIB advised on the first corporate hybrid Sukuk in the world – the US\$200 million GEMS hybrid Sukuk in 2013.

“We are now a one-stop-shop for capital raising for corporates and institutions. We have had very strong success within our various businesses, and we are ranked very highly in the market.” confirmed Amir.

Looking ahead

It has been a busy year across almost all sectors, and ADIB can confirm a very strong pipeline for 2016. “Broadly speaking if you look at where the market is today, things have changed. With a sustained drop in oil prices, the banks in general are slowing down on the lending front,” elaborated Amir. “But we have seen a very positive momentum in our growth trajectory. Islamic banks have been fortunate – our deposit base is growing, and our capabilities are also growing.”

The bank expects local issuance in the GCC to continue growing, in both the public and private sectors. “I think in the Sukuk space we will see new issuers coming to market, and issuance size getting bigger. People are trying to access new funding and also set benchmarks for the industry,” said Amir. “Many issuers are now trying to tap into the liquid debt capital market either to consolidate or to diversify funding sources.”

The bank also expects to see more product innovation, and is optimistic about the private placement in the DCM market, the hybrid space and new product development as well as M&A/corporate advisory business.

“It is about building strong capabilities, products and distributing them to a wider market,” concluded Amir. “We have an exceptional proposition, and we expect further strategic growth based on our robust performance and regional strength. 2016 should be a good year for ADIB.” ☺

Sukuk: An essential tool to mobilize funds

It has been a challenging year for both Islamic banking and the Islamic financial services sector, highlighted by continued uneven global economic growth and the ongoing regional geopolitical tensions. Regardless, many financial institutions are obligated to meet the revised capital structure. Therefore, SAUD AL NAFISI anticipates more Sukuk issuances by financial institutions in 2016.

The global Islamic financial services sector could face further pressure in terms of low demand for Sukuk issuance due to a combination of factors such as fall in oil prices, potential rise in global interest rates and contraction across global emerging markets. However, due to the gradual implementation of Basel III, many Islamic financial institutions are turning toward issuing Basel III compliant Sukuk instruments in order to meet the enhanced capital adequacy and liquidity standards. Further, there are a couple of maturities of Sukuk issued by financial institutions in 2015 and 2016 which will most likely be refinanced by a new Sukuk issuance.

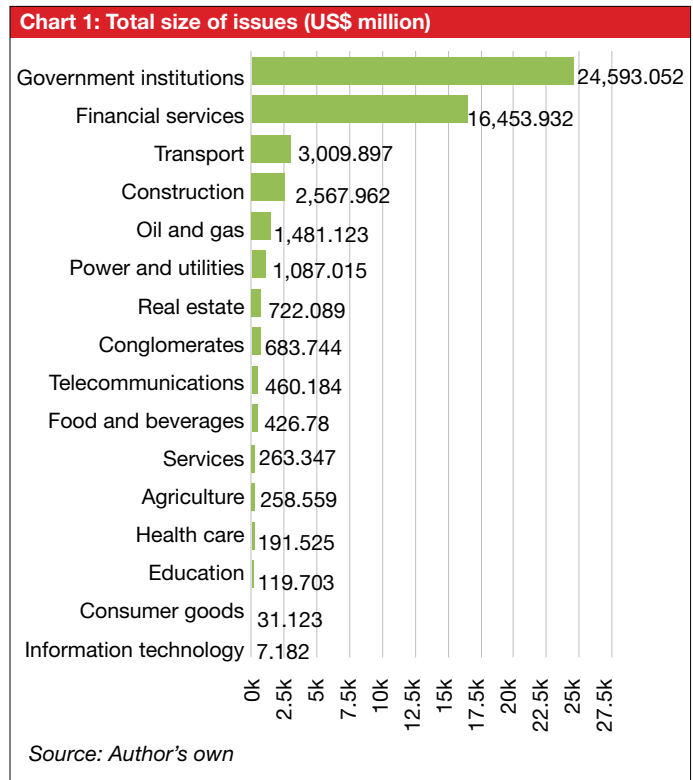
Fitch Ratings said in a recent report that total new bonds and Sukuk (with a maturity of more than 18 months) from the GCC, Malaysia, Indonesia, Turkey, Singapore, Pakistan, Sri Lanka, and Taiwan declined 27% in the first half of 2015 from a year ago. Data for the first half of the year showed bonds were down 30% and Sukuk by 16%. In the second quarter of 2015, Sukuk accounted for 20% of total new issuance, marginally up from 18% in the second quarter of 2014. Global Sukuk issuance in July stood close to US\$1.2 billion; however, over the year to the end of July, the overall issuance volume slipped by 20% as corporations reduced their borrowings. The sovereign issuance is down by 38% year to date, while quasi-sovereign issuance is down by 78%.

Global Sukuk issuance reached US\$48.8 billion in the first nine months of 2015, down 40% from a year earlier after Malaysia's central bank, Bank Negara Malaysia (BNM), the single largest issuer, decided to use other funding tools. In 2014, BNM alone issued about US\$45 billion of Sukuk out of a total issuance of US\$116.4 billion. As a result, S&P anticipates the total issuance to range between US\$50 billion to US\$60 billion by the end of 2015, a reduction of between 40% and 50% on last year.

BNM's decision to stop issuing Sukuk and switch to other instruments leaves the door open to issuers such as the International Islamic Liquidity Management Corporation and the IDB to step up their issuance and provide the industry with liquidity, thereby contributing to the development of an Islamic yield curve. Aside from BNM's decision, the market performed relatively well despite the decline in oil prices. By the 13th October, total Sukuk issuance reached US\$52.4 billion, whereby 47% of the total issuance was from government institutions (266 issuances) and 31.4% comprised of financial institutions (109 issuances).

Increased borrowings by Middle Eastern banks are expected to continue into 2016 as financial institutions try to strengthen their balance sheets while regional liquidity drops amid low oil prices. Many financial institutions, such as Abu Dhabi Islamic Bank and Al Baraka, are planning to issue Sukuk mainly for debt-refinancing purposes. Financial institutions are now aiming to secure longer-term liquidity in the markets. The implementation of Basel III rules with their demands on banks to hold high-quality liquid assets will drive Sukuk growth. Financial institutions will also be looking to boost their Tier 1 and Tier 2 capital and we will see more Basel III-compliant Sukuk in the market.

A recent report suggests regional banks will need to raise around US\$40 billion over the course of the next three to four years to satisfy



capital requirements under Basel III. The implementation of the Basel III liquidity coverage ratio (LCR), for example, will be phased in progressively over several years across individual countries. For some countries, implementation began on the 1st January 2015 with a minimum LCR of 60% increasing by 10% a year to 100% by 2019. This graduated approach is designed to ensure that the LCR can be introduced without material disruption to the orderly strengthening of banking systems or the ongoing financing of economic activity. Financial institutions could also view Basel III as an opportunity to return to the Sukuk market or to step up their issuance.

Although Sukuk, like any other fixed rate instrument, will be affected by changes in the interest rate, massive infrastructure spending across the GCC and budget financing across several emerging Asian and African markets will continue to drive issuance. Moreover, the long-term growth and development of Sukuk will continue regardless of short-term market movements. As Islamic banking continues to grow at a faster rate than conventional banking, and therefore Islamic deposits and investments continue to grow, all this money will need to be placed and invested. Sukuk has become less complex and expensive for borrowers as the market gradually standardizes. And since Sukuk is an asset class which is now well developed and well understood globally, many financial institutions will continue to invest in Sukuk since Sukuk is viewed as an essential tool to mobilize funds. (F)

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Malaysia leads global Islamic finance charge

As the world's leading Islamic economy, Malaysia can sustain its dominant position in Shariah compliant banking through upcoming initiatives such as the Tun Razak Exchange (TRX) financial district.

This can help retain Malaysia's edge in the 'marathon' to create a top Islamic financial center, according to Wellian Wiranto, an economist at the Global Treasury Department at the Oversea-Chinese Banking Corp Bank in Singapore. "It's like you are in the lead in a marathon, and you see others catching up. You run faster," Wiranto said.

Malaysia has had a 'first mover' advantage in Islamic finance through its development of the Islamic finance infrastructure as well as the human capital skillset and legal workforce critical for the industry. "A lot of countries are trying to lead in that front. Malaysia's [current standing] has to do with the infrastructure it already has, and the things the government and central bank did to develop the industry early on," said Wiranto.

Top ranking

According to the recent report by intelligence provider Thomson Reuters, Malaysia is the world leader in Islamic finance development and the top global Islamic economy. The ranking measures a country's level advancement through six indicators: level of governance, transparency, education, finance, corporate social responsibility and overall awareness.

"Malaysia scores very highly on all these indicators. It is currently the world's leading Islamic economy," Thomson Reuters Islamic Finance head Mustafa Adil said in November at the 11th World Islamic Economic Forum. Malaysia also owns more Islamic finance assets than any other country in the world.

Data compiled by ICD-Thomson Reuters Islamic Finance Development Indicator 2014 showed Malaysia's total Islamic finance assets at the time, including banking, Takaful and Sukuk, totaled US\$423.29 billion or 25.53% of the global market.

The Islamic Research and Training Institute (IRTI) projects Malaysia's Islamic banking assets, which totaled US\$141.77 billion at the end of 2013 to reach as high as US\$296.29 billion under a base scenario or US\$385.51 billion in 2019 under an optimal scenario.

The advantage

Having the right factors – strong financial institutions, adequate human resources and domestic stability – means that the government's upcoming financial district can continue to capitalize on the country's position and strengthen Malaysia's existing Islamic finance infrastructure.

TRX will be ‘a big plus point’ for Malaysia’s Islamic finance industry, according to Wiranto. The financial district is a component of Malaysia’s Economic Transformation Program (ETP), a national roadmap designed to advance Malaysia’s international competitiveness and double the country’s per capita income.

Expected to be ready in three years’ time, the 70-acre district is targeting local and international financial institutions as its tenants. While not exclusively catering to Islamic finance, TRX has positioned itself as the newest financial center in Asia, with a definite bend toward Islamic finance. It has announced incentives for both developers and tenants, with a strong focus on spurring the Islamic finance industry, to help further catalyze the depth and breadth of the field.

The clustering of financial players, including a significant showing of Islamic finance institutions, is hoped to increase Malaysia’s profile and create a robust ecosystem within the TRX district that will attract further pedigree, and over the longer term, become self-sustaining.

TRX’s upcoming world-class infrastructure, coming together with Malaysia’s solid financial backbone and Islamic finance expertise, could mean Islamic finance will have its first proper global hub.

‘Shaky and nervous’ global financial markets mean Islamic finance will remain a major alternative to raise funds in the coming years, especially due to its historically low default rate, according to Said Shan Saeed, the chief economist and investment strategist at IQI Group Holdings, an international property and investment company advising clients in Kuala Lumpur, Singapore, Hong Kong, London, Melbourne and Dubai. Recent geopolitical developments in the Middle East have made the region less stable, deterring prospects for an international financial hub in the Gulf.

The foundation

Malaysia’s central bank, Bank Negara Malaysia, has played a key role in pushing for Islamic finance as an important pillar of its economic strategies. Its Financial Sector Blueprint 2011-2020 includes initiatives that are aimed at developing Malaysia into an international Islamic financial center.

In addition, the aggressiveness of Malaysia’s banks such as Maybank and Ambank in pushing Islamic finance in the region could eventually stave off European institutions and preserve the nation’s leading position. “Human resources are Malaysia’s biggest advantage,” said Saeed.

“Singapore and London lack the human capital they will need to overtake Malaysia in Islamic finance, and although they could catch up in the next five to ten years, Malaysia will continue to broaden its market share (in Islamic finance),” said Saeed. The government’s ETP targets 56,000 student enrolment in Islamic finance by 2020.

Malaysia ranks the highest among 38 providers for professional development programs including certification, training, seminars and workshops, according to the IRTI’s 2015 Islamic Finance Country Report.

In 2006, Bank Negara Malaysia launched the International Center for Education in Islamic Finance, the world’s only dedicated university for Islamic finance.

Three years later, the Securities Commission and the Securities Industry Development Corporation launched the Islamic Capital Market Graduate Training Scheme to create more Islamic capital market professionals.

The measures are paying off. From 2011 to 2013, Malaysia published almost a third of all research papers on Islamic finance, and has the most Shariah scholars in the world, according to the IRTI’s Malaysia Islamic Finance Report.

Meanwhile, key and up-to-date regulations such as the Islamic Financial Services Act 2013 are designed to ensure customer protection and financial inclusion, while promoting the concept of risk-sharing.

New guidelines for sustainable and responsible investment Sukuk implemented from August 2014 are expected to assist fundraising in the health and green technology sectors. (☺)



Halal financing booming around the world

Halal financing is currently growing at a rate of 10-15% per year. It has been suggested that Halal financing is as common now in the UK as conventional finance and soon it may be as American as apple pie. CAMILLE PALDI surveys the Halal financing space.

Currently, there are approximately 500 Halal banks operating in 75 countries around the world. In terms of asset base, the share of the GCC Halal banks constitutes 70% of the global total. Halal banking assets in the GCC reached US\$445 billion at the end of 2012. Non-Muslim countries are also tapping into the Sukuk market. For example, Germany issued US\$123 million Sukuk Ijarah in 2004 and in 2006, in the US, East Cameron Gas, a Louisiana-based oil and gas company, issued US\$167 million Sukuk Musharakah.

General Electric (GE) issued US\$500 million Sukuk Ijarah in November 2009 and Goldman-Sachs in New York issued the same in September 2014. In 2014, Luxembourg was the first 'AAA'-rated government to issue a euro-denominated Sukuk in a EUR200 million (US\$213.88 million) five-year Halal bond. Also in 2014, the UK was the first Western nation to issue a GBP200 million (US\$305.17 million) sovereign Sukuk, maturing on the 19th July 2019. In 2015, Australia's SGI-Mitabu issued the first Halal finance offering by an Australian corporate, a AU\$150 million (US\$108.16 million) Sukuk in Labuan to fund its Indonesian 250 megawatt solar project.

Review of 2015

France

The first French Sukuk of US\$6 million or EUR5.61 million was launched in 2011 in the French fast food sector. In 2012, two more Sukuk were issued in France for both individual and institutional investors.

Africa

The Seychelles and Ghana became the first countries in Africa to issue Halal bonds in 2006 and 2007. In 2013, Nigeria issued a US\$62 million Sukuk. Senegal raised US\$200 million through a Sukuk issuance in 2014. South Africa issued a US\$500 million Sukuk in September 2014 which was more than four times subscribed, with an orderbook of US\$2.2 billion. Even Gambia and Sudan have issued Sukuk, albeit, for small amounts and on a short-term basis.

Japan

The first Sukuk was issued in Japan by Aeon Credit Services in Malaysia in 2007. Next, in 2010, Nomura Investment Company issued Sukuk in US dollars. In 2012, Toyota Motor Corp sold US\$88 million of Sukuk in two offers via its unit Toyota Capital Malaysia due for maturity in May 2015. In 2014, Bank of Tokyo-Mitsubishi UFJ (Malaysia) set up a US\$500 million multicurrency Sukuk program and is also considering the world's first yen-denominated Sukuk.

South Korea

South Korea has taken steps toward entering the global Islamic finance market including tabling legislation, joining various Islamic financial regulatory bodies, preparing for Sukuk issuance and tapping into the London Murabahah Exchange. Several Korean companies including GS Caltex, Korean Air, Hyundai, Samsung and others are exploring the possibility of raising funds from the Sukuk market. South Korean 'chaebols' including Lucky Goldstar, Samsung, Korea Shipping and several others have accessed Islamic commodity Murabahah facilities structured through London.



China

The People's Republic of China has been taking the steps necessary to facilitate Halal finance transactions in China and Hong Kong to prepare China for competition in the Sukuk, Halal funds and Islamic finance industries. As of January 2015, the government has approved plans to accelerate 300 infrastructure projects valued at US\$1.1 trillion or CNY7.03 trillion. Since 2006, seven Sukuk with a value of US\$5.8 billion have been listed on the Hong Kong Stock Exchange and there were also two renminbi-denominated Sukuk by Khazanah National and Axiata. Riding on the Sukuk momentum, after Hong Kong's debut US\$1 billion Sukuk, the government of Hong Kong announced another US\$1 billion Sukuk offering. In addition, Ninxia Province plans a US\$1.5 billion debut Sukuk sale in 2015/2016.

Preview of 2016

The Halal financing boom simply cannot sustain itself without a proper regulatory, accounting, financial reporting, and dispute resolution framework including an Islamic finance dispute resolution center and Islamic finance bankruptcy court. Banks across the industry use different accounting methods and reporting techniques and this leads to confusion, inconsistency, non-transparency, and possibly a misleading representation of the true financial health of the Islamic financial institution. The special nature of Halal banking requires tailored standards in order to promote full disclosure and transparency of the Islamic financial institution. It is recommended that the industry adopt the KFH (Bahrain) Public Disclosure Report as a template for financial reporting to be used industry-wide and that regulations including those for capital adequacy and accounting are tailored to and harmonized across the industry.

Conclusion

Halal financing is booming around the world and is an alternative source of financing. With proper regulation, financial reporting, and dispute resolution, Halal financing has a healthy and vibrant home alongside and in cooperation with the conventional banking system. (F)

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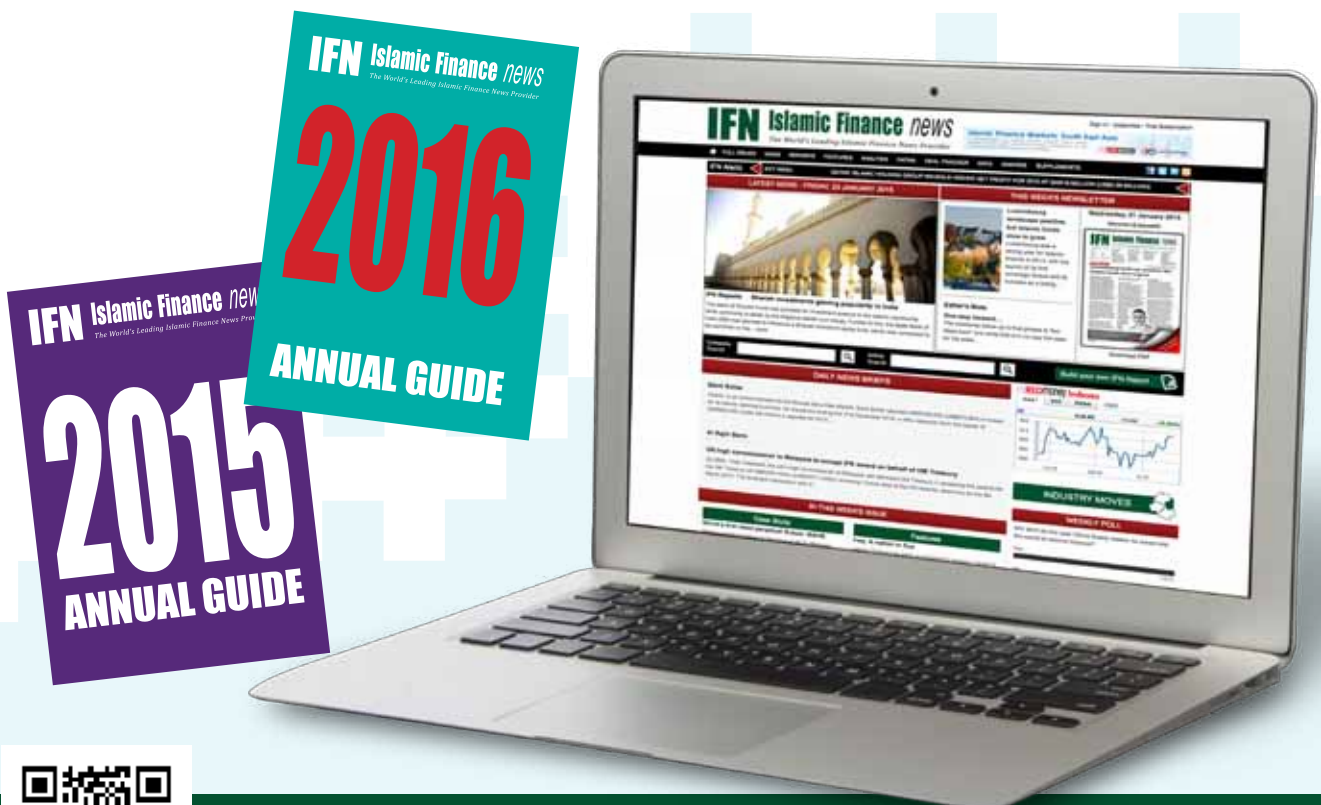


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Human Capital



New frontiers in human capital development

Human capital development is a fundamental need that has to be fulfilled for there to be growth and innovation in any sector. Education, training, learning and development are the building blocks of our progress as an industry, and we are fortunate to have realized this in the early stages of the development of the Islamic banking and finance industry. This is evidenced by the growing number of education and training service providers across the globe, which is not just confined to Muslim-majority markets. In this article, DR AMAT TAAP MANSOR assesses the human capital industry.

The UK is a leading provider in education for the industry, seeing a healthy mix of professional and academic courses. As of 2013, there were 477 education service providers globally, and 1,363 published research papers on Islamic finance (according to the BIBF Knowledge Indicator). The number of education providers are expected to breach the 1,000 mark in 2016 (Yurizk), in tandem with market expansion.

Review of 2015

As we near the end of 2015, there have been several significant strides in the development of human capital for the industry. Aside from the growing number of courses and certificates being introduced into the market, there has been more emphasis on the need for leadership development and skill-building within Islamic finance circles. Widespread media coverage on this issue alone is

testament enough to the increasing awareness for proper structures to be placed around efforts to build a competent workforce to serve the industry, while industry and academia are making a concerted effort to come together and seek solutions to solve the human capital gap.

One of the more resonant catchphrases for 2015 with regards to human capital development in Islamic finance was the need to address the ‘talent mismatch’. The talent mismatch in this sense refers to the disparity in skillsets between what is required by the market, and the skills that fresh Islamic finance graduates currently possess. This was further highlighted by the ostensibly rising number of unemployed graduates in Islamic finance who are said to be unable to gain employment within the sector.

A cursory glance at the sector, however, will tell you that the Islamic finance industry is in dire need of talent. According to reports by the Malaysia International Islamic Financial Center and Kuwait Finance House Research, the industry will require up to one million skilled individuals to enter the workforce by the year 2020. This makes perfect sense, as the growth of Islamic banking assets across the six core markets of Malaysia, Indonesia, Qatar, Saudi Arabia and the UAE alone are expected to touch US\$1.8 trillion by the year 2019, boosting the need for talent to support growth across core sectors.

Why then, despite demand very much exceeding supply, are there still unemployed graduates in this field? Industry players will tell you that these graduates lack many basic skills, such as critical thinking and strategic planning, technical knowledge and practical experience, as well as product development (according to the FAA Talent Development Survey 2014). And until these issues are addressed in a structured and timely manner, this ‘talent mismatch’ will continue to be a hindrance to any meaningful progress in the human capital space.

“ **The goal of the IFPPS is ultimately to serve as a benchmark for all stakeholders within the Islamic finance education sphere** ”

Preview of 2016

As a means of addressing this skills gap and mismatch in talent, as well as enhancing quality learning in the industry, the Finance Accreditation Agency (FAA) has undertaken the development of an industry-wide professional program structure specifically catered to the Islamic finance industry, known as the Islamic Finance Professional Program Structure (IFPPS).

The IFPPS aims to support the strengthening of competencies for human capital across the globe through the provision of guidance on the design, development, delivery and assessment of professional programs in Islamic finance, based on the Finance Qualifications Structure and FAA Learning Standards. As a conceptual tool, it is expected to provide the mechanism to eventually streamline and classify learning levels into a single framework.

The goal of the IFPPS is ultimately to serve as a benchmark for all stakeholders within the Islamic finance education sphere, from regulators and policymakers assessing the relevance and feasibility of professional learning programs within the industry, to training providers seeking the best standards in developing learning programs as well as industry players and students seeking the best Islamic finance programs to support their workplace needs.

It is hoped that this effort, alongside many more industry initiatives, will provide the adequate guidance and structure to produce quality talent in order to successfully address the current human capital issues our industry is facing.

Conclusion

Moving forward, it is also important to keep several things in mind, as we, as industry stakeholders, make crucial decisions related to the industry’s growth and sustainability, as follows:

- 1) **Focus on strengthening the fundamentals:** Human capital and talent are the core building blocks in creating a sustainable industry and propelling growth. Talent needs have to be addressed early on.
- 2) **Have a long-term vision:** The industry as a whole, as well as organizations and stakeholders in Islamic finance must have long-term plans for addressing human capital needs and talent development, as well as leadership succession. Company and industry policies must center around these long-term goals, especially when it comes to recruitment, training and hiring.
- 3) **Knowledge acquisition:** Creating a supportive learning culture is vital to the growth of any organization and industry, as most employees learn on the job – especially in sectors such as banking and finance. A workforce that is able to continuously learn and adapt to overcome new challenges is of incredibly high value, especially when looking to achieve innovation and progress.
- 4) **Design and delivery of learning programs:** Training providers need to give more thought to the design and delivery of learning programs, as effective learning transfer and the ability to implement this knowledge should be the ultimate goal.

With these in mind, it is hoped that we as an industry can collectively address the current issues in human capital development for Islamic finance, and produce quality talent for the benefit of the industry as a whole. ☺

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Sukuk infrastructure financing may be promising but it is not a quantum leap

Islamic finance is systemically important in many jurisdictions including the GCC and Malaysia and is growing in the wider regions of Middle East, Asia and even Africa, where there is significant potential and demand for infrastructure Islamic financing. In this article, BASHAR AL NATOOR takes a look at Sukuk infrastructure financing.

There is actually an infrastructure requirement that could be up to hundreds of billions of dollars a year in additional financing, with primarily young and growing populations and with investment requirements in infrastructure at the gauge of trillions in the years ahead.

However, in reality, 2015 has been no different to previous years in this area, where we have seen very limited activity in relevant regions' infrastructure bond financing, let alone Islamic finance and Sukuk.

“ Infrastructure long-term issuance could be a positive development for the wider Islamic finance industry ”

This can be largely attributed, especially in the GCC, to the reliance on government and the public sector to undertake such project funding, supported by high reserves and to a lesser extent banks as the traditional providers of easy debt finance for infrastructure projects.

Furthermore, infrastructure investment has inherent substantial investment risks due to the technical complexity of the projects, the long-term investment horizons and the typical size of the transactions. Regional factors also add to the uncertainty of the macroeconomic environment, regulatory reliability and political stability.

With the recent weakening in oil prices, declining sovereign reserves and liquidity in the financial systems in general, the equation could now change and infrastructure financing could receive an injection that could ignite expectations of GCC governments reverting to the market to seek alternative forms of funding for long-term infrastructure projects. This could include public-private partnerships (PPPs) that could be used to mobilize significant infrastructure investment needs in many sectors. With several banks withdrawing from this long-term business field or becoming more selective, Sukuk and bonds have become a viable option.

Infrastructure projects may eventually be a key source of Sukuk issuance due to their asset based or asset-backed nature, that in concept make it compatible to build highway networks, ports and other infrastructure projects.

By using Sukuk Istisnah (a form of financing under which a financier commissions the construction or manufacture of an asset) or Sukuk

Ijarah (common form of Islamic project finance structures), this may make arranging deals simpler and potentially more attractive to investors, particularly as the structure is fairly compatible with traditional project finance. However, sovereigns may not be willing to adopt such structures if they risk losing control of the asset or if they do not have the necessary regulation and legislation allowing them to do so. This would result in more work to find an acceptable legal structure or the introduction of new regulations.

Although structures could be found, it would take longer to achieve and may see a slower take-up, especially as innovative structures would have to be approved by a Shariah board, which assesses compliance with Shariah. A transparent framework that investors, issuers and scholars are all comfortable with and which makes clear the rights of all the stakeholders should help attract a significantly wider investor base that would be needed for major infrastructure projects.

These challenges may lead to a longer time frame and higher costs than more established forms of infrastructure funding, at least until a standardized framework is established. However, several important trends could provide the necessary impetus for the development of infrastructure Sukuk. These include growing government support for Islamic finance, increasing acceptance of Sukuk and large investment and financing requirements in the GCC, Turkey, Asia and other emerging market projects.

As well as the G20's initiative, other bodies are also taking steps that may help. These include the IDB's and the Asian Development Bank's reported efforts to provide technical assistance and credit guarantees to member countries that want to fund infrastructure projects and the IMF's creation of a working group to build expertise in Sukuk.

Infrastructure long-term issuance could be a positive development for the wider Islamic finance industry as long-term Sukuk issuance can be particularly attractive to Islamic banks, Takaful companies and Islamic and regional investment funds that have been suffering from the limited long-tenor assets to match their long-tail liabilities and are well protected against inflation and less correlated with the financial market cycle. Some of the challenges for such institutions, however, include possible higher risk charges and their lack of experience with infrastructure investment.

In the GCC, with a less developed financial sector and regulations still being built for PPPs and Islamic finance, 2016 could be a promising year but not yet a quantum leap in Sukuk and bonds infrastructure financing. For the medium term, we still expect the GCC's Sukuk and bond markets to continue to develop with issuance from the broader range of entities accessing capital market funding in the longer term. ⁽²⁾

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More work on primary laws to accommodate Islamic finance

With the rapid growth of Islamic finance recently, it has become incumbent upon the experts of this age that they keep exploring new things and keep adding them to the available avenues of Islamic finance. QAISER IMAM surveys the Islamic finance legal landscape.

It should be understood and realized that Islamic economics and finance is not a one-man drive. It needs development in every ancillary sector like legal frameworking, regulatory set-up, product development, Shariah compliance, trust building, real trade and many others. A little carelessness or less research in any sector might imbalance the whole cart. With respect to law, at secondary level much has been done during the recent past and many things are in the pipeline for the near future. Legal frameworking remained a hot topic and was the subject of serious debates from the national as well as international perspective.

Islamic finance across the border has compelled states as a whole to create room for its evolution. Lawmakers have felt and in some jurisdictions were forced by economic pressure to feel the need and development of relevant law. Except for Malaysia, no jurisdiction has promulgated any primary law for the Islamic finance sector; however, major changes were made in the preceding year with respect to subsidiary legislation (rules and regulations) and to some extent through directives. The regulators have played a pivotal role in introducing new regulations in capital markets for the promotion of the Sukuk sector. The integration of stock markets through statutes and regulations made it more convenient for Islamic finance to develop its derivative arm.

Review of 2015

In the preceding year, for Sukuk, the Asian market has developed many new regulations. These regulations deal with the structuring of Sukuk and their legal construction; particularly, a deviation has been seen from previous structurings wherein SPVs were introduced. Following the way paved by Turkey and Malaysia, Pakistan has introduced Sukuk regulations and also integrated the listing of Sukuk into the stock market.

Pakistan is the only jurisdiction where the corporate Mudarabah structure is available since the promulgation of the Mudarabah Ordinance. However in the preceding year, European states have introduced new legal frameworks to facilitate corporate Mudarabah with sovereign guarantee.

An important development in legal structuring has been seen in Gulf states where Tawarruq-based products which previously were legalized are under great Islamic legal stress and Malaysia being a pioneer in these products has already legislated against Tawarruq and Eina-based products.

Central Asian states including Kazakhstan, Azerbaijan and Tajikistan have also entered into many contracts with international legal and financial firms for the development of legal frameworking which has the ability to pull conventional and Islamic financial needs together from the beginning. Azerbaijan has also promulgated regulations for Islamic banking.

All these developments suggest two things: the expansion of the

Islamic financial market in terms of volume as well as in terms of allied facilities; and the seriousness of states in adopting such modalities in law and legal frameworking to facilitate Islamic finance. The most important development is the rehearing of the Riba case by the Federal Shariat Court (FSC) of Pakistan (a constitutional court for revisiting laws which are repugnant to injunctions of Islam). Previously, the court declared interest in all of its forms as prohibited and this decision was challenged before the Shariat Appellate Bench of the Supreme Court of Pakistan which upheld the decision of the FSC. However on review, the same case was remanded to the FSC and is now being heard. This would be a great step in the provision of a foundation to develop a purely Islamized legal framework that excludes interest as a whole.

It is observed that instead of bringing new Islamic financial sector primary laws, a specific mindset of introducing amendments in primary statutes which were actually legislated to provide a legal framework for conventional finance is still prevailing globally irrespective of common law states, civil law states, religious law states or pluralistic law states.

Preview of 2016

In the coming days, it is expected that the necessary development in laws at the domestic level will be taken for making intra-jurisdictional laws more harmonized and secured for the players in Islamic finance. It is also under consideration that product development and contractual engineering should not be mixed with legal frameworking.

The most important achievement in the coming days will be in the shape of a provision of legal forums by international organizations like the United Nations for the development and sustainability of the Islamic finance sector including dispute resolutions. Furthermore, a concept to provide a forum for a joint team of legal experts from almost all the jurisdictions is also to be considered for the preparation of principally agreed general legal principles for harmonizing the legal differences in different jurisdictions, a necessary assignment.

Conclusion

Although it has been realized that law-making is the basic step to initiate and perform any activity particularly in the financial sector and issue-based legislation has been done in a huge volume, work still needs to be done on primary laws so as to give a fair chance to Islamic finance to play its role independently and not through dependent and evasive techniques. One thing that is very important is that with each passing day, conventional finance while feeling itself under threat from Islamic finance will come forward with new strategies and these strategies will undoubtedly be based upon law and legal frameworking. ☺

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Ijarah industry at the crossroads

The Islamic finance industry has had an unprecedented growth spurt over the last couple of years. The latest projections by the global recruitment consultancy Morgan McKinley indicate that the total global value of Islamic assets are to reach upwards of US\$6.5 trillion by 2020; this is compared to just US\$150 billion in the mid-1990s. This rocket-like growth, that left conventional financial institutions scrambling to get a piece of the action, was a result of many factors; most notable of which is the innovative spirit embodied by the industry professionals. In this article, YOUSSEF ABOUL-NAJA expounds on the Islamic leasing industry.

Scholars and professionals alike sought to create and optimize various Islamic modes to facilitate a streamlined transactional environment. To that end, in order for the Islamic finance industry to grow toward, and subsequently break through, this US\$6.5 trillion mark, a new breed of innovative spirit is required; ingenuity must come from how new markets are approached. Current Islamic modes are fairly evolved; it is mainstream acceptability that is now needed. As the efficiency lines blare between that of conventional and Islamic modes, new tactics are required to unlock a wider client base. This is especially crucial for Ijarah, considering its similarities to conventional leasing. Ijarah can easily pave the path for more complex Islamic modes in countries lacking Shariah compliant laws, should it become widely accepted.



Review of 2015

The Ijarah industry has been exclusively focused on market penetration issues, specifically:

- to ensure their offered rates are comparable to prevailing market rates, and
- to target piety-centric clients (those looking to move away from Riba (usury)).

Other important issues such as innovation have taken a backseat. The industry's main goal is achieving market breakthroughs.

This resulted in the emergence of an Ijarah culture vying for a rates war, where the competition is any entity offering financial services. This mentality is obviously flawed; for example, Ijarah is nothing more than a complementary financial avenue compared to banks. To make matters worse, given the lack of Islamic finance talent, the majority of Ijarah senior management come from the conventional industry; implying poor access to clients seeking Islamic products. As a result, the performance of Ijarah companies has been, at best, as good as other conventional leasing companies.

This is of course not to say that successful Ijarah companies do not exist; but the general global trend with Ijarah companies is that they are scrambling to win market share. The problem becomes muddled when an Ijarah company is trying to break through in a country that lacks Shariah compliant laws.

Preview of 2016

Ijarah is a fairly straightforward Islamic mode, and its existing contracts are well defined. Albeit some work is needed when it comes to insurance and maintenance liability, but such rework, when completed, will not result in additional markets being unlocked. What the Ijarah industry needs to do is lead the way with respect

to leasing innovations. Ijarah companies need to infuse technology in such a way that conventional leasing clients feel the necessity to move their business to them. The Islamicity part of the service should merely be the 'cherry-on-the-top'.

Presently, Ijarah companies have been inheriting the current mode of operations of leasing companies and making them 'Islamic'. But these operational modes are outdated; the leasing industry has not been changing at the same pace as the business environments its clients are operating in. A departure from the norm is what is needed, given the dire need for change by leasing clients. Such a proactive approach would not only unlock new markets for the Ijarah industry, but create awareness and acceptability.

Conclusion

It is true that economies rise and fall, but what remains certain is that SMEs are the propellant engine of any economy. As such, considering that SMEs constitute the main client base of leasing companies, the leasing industry is poised to stay. To date, the Ijarah industry has been going through the 'self-exploration' phase, a necessary step toward product maturity. But given the product's state of sophistication, should the Ijarah industry elect to maintain its reactive stance, more harm will follow than good. The Ijarah industry is currently standing at a unique crossroad; only the innovative path will make it soar. At the end of the day, the Ijarah industry's life cycle is no different than that of other industries; as the old adage warns: "Innovate or die."^(f)

Any public opinion or media appearance is the author's independent personal opinion and should not be construed to represent any institution with whom the author is affiliated.

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Maritime finance in the Middle East: The Islamic finance solution

The maritime and ship-owning sector is a capital intensive business. The capital costs incurred to purchase assets and the cash flows required to operate the assets are high. Over the last eight years, as the debt markets entered the more difficult phase of the cycle, offshore marine companies with steady cash flows, creditworthy counterparts and physical assets that were available to financiers as security, started looking for other financing options. TIEN TAI and IAN CHUNG review Islamic finance as a solution for the maritime industry.

A lot of time and effort were expended on looking at the availability of Islamic finance to operators within the Gulf. The maritime sector's asset-based businesses offer Islamic financiers with an attractive asset class that fits into traditional Islamic financing structures, with assets over which security can be taken. As a consequence, Islamic banks have increasingly competed for the maritime business. These aspects, together with the fact that many of the region's offshore marine operators have good working relationships and a large number of contracts with national oil companies or multinational oil companies, have made offshore marine operators attractive customers with Islamic finance growing.

Over the last decade, there has been a growing amount of activity in the marine Islamic finance market. Standard Chartered Bank (SCB), Noor Bank and Abu Dhabi Islamic Bank (ADIB) have been involved in a number of Islamic finance transactions with companies such as the Stanford Marine Group, the Abu Dhabi-based Gulf Marine Services and Zakher Marine. Dubai Islamic Bank, together with Tufton Oceanic, created Islamic compliant investment funds so that investors would be able to participate in investments in the global shipping markets.

“ Ultimately, both the banks and their customers have benefited from the development of this niche industry and the sector looks reasonably strong ”

More recently, the local markets have seen a number of significant Islamic finance transactions in the offshore marine sector. Deals such as the AED1.2 billion (US\$326.64 million) Islamic financing transaction provided to the Stanford Marine Group (led by Noor Bank) and the US\$420 Ijarah financing facility made available to Zakher Marine (arranged by ADIB) are all good examples of how Islamic banks have increased their market share within the offshore marine market in the UAE. The US\$1.04 billion Sukuk issued by Bahri emphasizes that not just Islamic banks can be a source of financing. Finally, the US\$550 million dual-tranche conventional/Islamic financing to Topaz Marine (arranged by HSBC and SCB) shows how Islamic finance can even work together with conventional finance.

Holman Fenwick Willan (HFW) has acted on many of the aforementioned transactions and the following features are what HFW believes to have encouraged the growth of this area:

- (1) **Liquidity:** Following the global financial crisis, it was clear that most conventional European banks were adversely affected by the downturn, had limited funds to deploy, and so were less interested in developing a shipping or offshore marine portfolio. However, many Islamic banks based in the Middle East had excess liquidity and were looking for customers that would help diversify their customer base – with such banks having a significant exposure to the property market or property market-related businesses.
- (2) **Asset-backed financing:** One of the most difficult aspects in Islamic finance is to structure the transaction to enable the customer to obtain the commercial terms required. Financing physical, registrable assets such as vessels is conceptually more appealing for traditional Islamic finance techniques such as leases.
- (3) **Strength of businesses:** While the shipping and transportation markets experienced one of the worst downturns in the history of shipping, the offshore marine/oilfield services market remained quite buoyant due to the strength of the counterparts, being national oil companies, international oil companies and other oil and gas contractors.
- (4) **Increasing sophistication:** The regional Gulf banks have been investing in developing their know-how and as more funds have been deployed into the maritime sector, the types of products available and the expertise of the banks have increased significantly. The types of structures we have seen have evolved significantly from traditional Ijarah transactions to commodity Murabahah-based transactions, to the dual-tranche Islamic/conventional transactions. This has provided customers with a very broad spectrum of products and increased flexibility within which their commercial needs can be met.

Ultimately, both the banks and their customers have benefited from the development of this niche industry and the sector looks reasonably strong. Of course, the recent fall in oil prices does create some challenges for offshore marine companies and their financiers. However, many of the Islamic finance products that are in operation are not 'non-recourse' transactions where the only recourse is to the underlying asset and the transactions are very much based on the corporate strength of the customer, together with the customer's track record in operating offshore. As a consequence, we continue to expect Islamic finance to be an important part of the marine finance market in the Middle East for the foreseeable future. ☺

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Islamic microfinance needs to embrace technology to move forward

The Islamic microfinance sector has potential for rapid growth. Currently, the sector only forms 1% of all of Islamic finance globally. With the continued expansion of Islamic finance, there remains an opportunity for Islamic microfinance to continue to scale existing operations and create new opportunities in new markets that are simultaneously opening its doors to the wider Islamic finance space. MOHAMMAD RAAFI HOSSAIN contemplates the outlook of Islamic microfinance.

As the sector and its related Islamic microfinance product offerings mature, more microfinance institutions are looking to open windows of Shariah compliant products to their consumers and increase their footprint among their microfinance clients.

Interestingly, Islamic microfinance also only forms 1% of the total microfinance sector. The global microfinance sector has been expanding at the rate of 15% over the past couple of years and there are no signs of that pace slowing down. With new technologies around mobile banking and credit scoring, the costs of microfinance are declining which is inviting new players into the space. Islamic microfinance is seeking to follow suit.

They key barriers to Islamic microfinance's increased penetration in the overall sector's market share has been financing costs. Shariah compliant debt-financing instruments are costlier than those of their conventional counterparts due to the associated procedures in making these products Shariah compliant. With equity-based products, there are issues with mitigating risks and various other information asymmetries that make microfinance institutions still remain uncomfortable with this mode of financing.

Overall, microfinance will continue to play a big role in creating jobs and spurring economic development in emerging markets. With labor markets not organically creating opportunities for young people, there is an inherent demand to develop the micro and small-business segments of the economy in many of the same markets in which Islamic finance is just entering. Creating products that cater to this segment of the economy will be critical for Islamic microfinance institutions to be able to show value and create significant impact opportunities.

Review of 2015

The past year was highlighted by the continued growth of Islamic finance and the ramifications that it has had on Islamic microfinance. Jordan saw its first fully Shariah compliant microfinance institution formed, Ithmar, which was met with higher than expected demand from local constituents. This follows an announcement by government officials to create more opportunities for Islamic finance in the nation. Meanwhile, Morocco passed its first set of Islamic banking laws that consequently opened the doors for its first Islamic microfinance portfolio with the support of the IDB.

There has also been a wider interest by multiple organizations to continue to spur further innovation within the sector. In addition to the Islamic Microfinance Challenge sponsored by CGAP and others, this year the State Bank of Pakistan, in corporation with the UK, launched the Financial Innovation Challenge Fund, which focuses on Islamic microfinance. These types of challenges increase the pace of innovation and adoption of a more diversified pool of Islamic

microfinance product offerings that are beyond the heavily relied upon Murabahah mode of financing.

Preview of 2016

According to multiple reports, Islamic microfinance is expected to continue to grow at a compound annual growth rate of 20% for the next few years. These forecasts are supported by the opening of new Islamic finance markets such as Morocco and with the ongoing formation of new, wholly compliant Islamic microfinance institutions in other frontier markets. Additionally, new opportunities to tap the SRI (sustainable and responsible investment) Sukuk markets may enable new investors to finance portfolios of Islamic microfinance institutions.

Additionally, with the launch of Narwi, a crowdfunding platform that caters to only Islamic microfinance institutions, there can be an expected rise in both financing going to Islamic microfinance institutions as well as the awareness and education of a potentially new set of future investors. The platform will also help spur conventional microfinance institutions to create Shariah compliant windows and target a new set of potential clients due to the lower costs of capital associated with the platform.

Conclusion

Much of Islamic microfinance's future success will depend on how the sector embraces technology moving forward. More than any other domain within microfinance, the utilization of technology enables Islamic microfinance to roll out products that reflect its focus on cooperation and risk-sharing. Additionally, seeking to mitigate risk and information asymmetries through new forms of credit assessment may help Islamic microfinance institutions roll out more robust forms of equity-based products. In this case, collateralizing data and integrating mechanisms such as psychometric analysis will go a long way toward achieving more reliable forms of assessing the creditworthiness of prospective clients.

Incorporating both elements within Islamic microfinance products will help create a stronger value proposition among financial institutions and enable its continued growth within the overall microfinance sector. Finally, support from larger financial institutions within the Islamic finance sector and increased participation from domestic regulators will help establish more robust Islamic microfinance frameworks across the globe. ☺

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A snapshot of the pension industry: Its recent trend and future forecast

The global ageing population is considered as one of the main issues to be addressed by most governments. Its impact is not only on the budget but also on pension policies. FAIZAL AHMAD MANJOO briefly analyzes the pension changes that took place in 2014/15 and what can be expected for 2016.

Helping the greying population to maintain a sustainable consumption smoothing is becoming a challenge both for funded and unfunded pension schemes. Much legislation has been enacted, mainly in western countries, in order to address this malaise. Failure to do so might lead to a chronic social problem for at least another 50 years when the dependency ratio will decrease again with an increase in a younger working population in some countries.

Review of 2015

The various Organization for Economic Cooperation and Development (OECD) reports on pensions provide a deep insight into the pension market trajectory on OECD member states and also the G20. The statistics reveal that pension funds' assets exceeded US\$25 trillion in the OECD countries with US\$21.7 trillion or more than 85% of OECD pension funds' assets emanating from the US, Australia, Canada and the Netherlands. This skewed distribution of pension funds is a clear indication that the pension industry situation in the OECD is alarming in sustaining the ageing and retiring population. Despite the weighted average asset-to-GDP ratio reaching 86% for these countries, the majority of them witnessed the market value of assets accumulated in pension funds relative to the size of their economies at below 10%.

Legal reforms have been accelerated in almost 34 member states of the OECD, mainly to improve pension coverage and safety net benefits as part of their efforts to fight poverty in old age more effectively. Unfortunately, due to the global financial downturn, some countries such as Greece, Italy and Portugal are still facing economic difficulties. The ongoing areas for pension reforms are:

1. Pension system coverage in both mandatory and voluntary schemes
2. Adequacy of retirement benefits
3. The financial sustainability and affordability of pension promises to taxpayers and contributors
4. Incentives that encourage people to work for longer parts of their lifetimes and to save more while in employment
5. Administrative efficiency to minimize running costs of the pension system
6. The diversification of retirement income sources across providers (public and private), the three pillars (public, industry-wide and personal), and financing forms (pay-as-you-go and funded), and
7. The need for the residual category to cover other types of change, such as temporary measures and those designed to stimulate economic recovery.

Other countries like India and Chile are making efforts to improve their systems while others are really lagging behind.

Preview and forecast of 2016

The main challenges for the industry are not only to provide cash annuities but also to develop products in kind. This is due to a shortage of energy, health products, housing, etc. The British National Employment Saving Trust is a practical model for other countries

to simulate as it will encourage more people from lower-income groups to access a portable pension scheme via the auto-enrolment mechanism. Another product to be considered in order to mitigate the longevity risk is the issuance of a longevity bond by the states to cushion the aggregate longevity risk. The UK and Chile have worked in this area but without the support of the insurance industry it might be problematic.

A major change in UK pension industry is the introduction of pension freedom effective from April 2016, i.e. people can opt for a drawdown from their pension pot without the need to buy annuities. This approach is a bone of contention because it has been argued by the government that people are intelligent enough to look after their wealth, but this needs to be proved over time. This approach has attracted lot of criticism and has dictated industry readjustment with new products. A product which might attract the attention of some firms is the Swiss model of book reserve pension. This new product has many advantages but the main issue is the employer's bankruptcy. So, massive insurance support will be needed to mitigate the bankruptcy risk. Interestingly, the regulators have not imposed a capital adequacy regime on the pension industry yet. Should this happen, it will create more liquidity problems. The EU directives have been drafted however.

As far as the Muslim world is concerned, the demographic physiognomy is relatively young compared to many western countries; however, the ageing population is catching up. Muslim countries can be divided into three groups: the under-developed, the developing and the oil-rich countries. Unfortunately, very few countries have adopted a stance to develop the funded pension industry. The focus is mainly on unfunded state pension. This precarious situation is difficult to manage and demands immediate remedial actions. The average purchasing power parity of OIC countries is US\$10,825 which is relatively low compared to OECD countries. The low human development index in most Muslim countries also explains why the disposable income to purchase pension plans are limited. The drastic drop in oil prices is a signal that Gulf states cannot rely on oil only.

However, there are opportunities in the Muslim world in terms of having Islamic pension due to the social construction and awareness. Some countries like Turkey and Indonesia are becoming emerging economies with a young population which has the potential for disposable income to buy pension products. In other countries like Egypt and Pakistan, though they are facing political unrest, the potential market should not be discarded. Malaysia has set the pace in developing Islamic pension though there is still work to be done to bring it to a mature level.

Conclusion

2016 might not appear promising for the pension industry in general; however, more stability is warranted to meet the longevity risk hovering over the ageing population. Efficient legal reform is needed not only to encourage more product innovation with appropriate returns, but also to guarantee pensioners a good income smoothing. For the Muslim world, a more concerted effort is required before it is too late. ☹️

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Islamic private equity growing as a vibrant segment of the Islamic finance industry

With falling crude oil prices, the slowing Chinese economy, and a struggling eurozone, it is no surprise that private equity (PE) activity in the Middle East has been challenging, although PE activity overall looked respectable with a strong showing of US\$2.7 billion in deal value by the end of September 2015. However, total deals fell by over 50% compared to last year. Perhaps, SUHAIL AHMAD believes, the decline in crude oil prices may have a silver lining for Islamic PE as countries reliant on oil revenue may finally see the benefits of a diversified economy and support regional PE growth to help diversify the region's economic base.

Review of 2015

According to Al Masah Capital, a total of 24 PE deals worth US\$2.7 billion were reported as of September 2015 compared to a total of 58 deals worth US\$285.3 million during the same period in 2014. On the other hand, there were just five PE exit deals reported until September 2015 worth US\$36.21 million, compared to 16 PE exits during the same period in 2014 worth US\$167.43 million.

If we were to exclude the US\$2.64 billion deal in Algeria, the total values of deals in the MENA region were only US\$34.25 million. The slowdown can directly be attributed to the decline in oil prices and increasing geopolitical uncertainty with civil wars in Syria and Yemen.

Al Masah Capital founder and CEO Shailesh Dash said: "Our experience in market research suggests a pick-up in private equity activity during the second half of 2015 with stabilization in oil prices especially in consumption-led sectors such as health care, education, retail and food and beverage. The UAE, Saudi Arabia, Lebanon and Egypt are expected to be frontrunners in private equity activity during the second half of 2015."

Sectors like IT, retail and health care followed by telecom, financial services, industrial, manufacturing, food and agriculture, oil and gas and media observed dynamic movements in private equity during 2015.

Some of the key PE transactions this year include the one by Dubai International Capital, the private equity arm of Dubai Holding, which announced the completion of the sale of Almatris, the world's leading supplier of premium alumina for the refractory, ceramic and polishing industries to OYAK, Turkey's largest private pension fund. The completion of the sale was after receiving all relevant regulatory approvals.

The Abraaj Group was particularly active in the year with its announced acquisition of Yu-Ce Medical, a leading disposable medical supplies manufacturer in Turkey and the acquisition of a majority stake in Urbano Express, a leading courier and light logistics solutions company in Latin America with operations in Peru, Ecuador and El Salvador. Abraaj Group also announced the final close of its second dedicated North Africa private equity fund at US\$375 million and brings the total amount raised by Abraaj for the African continent in 2015 to a solid US\$1.37 billion. The funds will target the

well-managed, mid-market businesses in the core geographies of Algeria, Egypt, Morocco and Tunisia. Its primary aim is to develop investments within local industries, thereby accelerating growth and economic diversification in Qatar through support for the private sector.

Preview of 2016

With a strong showing in 2015, Islamic PE growth looks promising next year. The key for Islamic PE to continue growing is the emphasis of the close relationship it has with conventional PE, particularly the concept of equity ownership, risk-sharing and mutual benefit compared to risk transfer which is still often the case in Islamic banking.

With a focus on development capital rather than a leveraged buy-out (LBO) and distressed buy-out transactions, Islamic PE firms can build an attractive risk profile and differentiate themselves better from the conventional PE firms.

A good example is the new private equity offering announced by Qatar Development Bank (QDB) worth almost US\$100 million and designed to support Qatari SMEs. The goal of the fund is to actively contribute to the country's economic diversification. The term of the SME Equity Fund is expected to be up to ten years, with five years for deployment and a holding period of three to five years. QDB was established in 1997 as the Qatar Industrial Development Bank, a 100% government-owned developmental organization.

Conclusion

Islamic PE no doubt has its growth challenges but considering the increasing awareness of the benefits of PE as a source for economic growth and diversification, the industry needs to capitalize on this aspect to continue charging forward. Only then can Islamic PE be considered a formidable force for job creation and economic development in the Islamic economies of the Middle East and Far East Asia and attract significant capital from Islamic institutional investors (Islamic banks and sovereign wealth funds) to become a vibrant segment of the Islamic finance industry.⁽²⁾

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Islamic project finance: Down but not out

Islamic project finance's rapid rise hit snags in 2015 and was slowed down by depressed oil prices. Nevertheless, SAJJAD KHOSHROO expects to see more expansions and more Sukuk and Iran deals in 2016.

Islamic project finance in the Middle East — backed by mammoth public spending on capital-intensive mega-projects funded by healthy oil revenues — grew rapidly in the past few years. This increased deal-flow and liquidity led to the growth of dedicated Islamic finance institutions offering a full range of Shariah compliant products with longer tenors. Sustained downward pressure on oil prices is reversing this trend.

Down in 2015

Oil fell to a six-year low in August 2015 and has not recovered much since. This has caused many energy projects that often use Islamic finance to be shelved. Shell and Qatar Petroleum's canceled Al Karaana petrochemicals project is a prominent example. As a sign of troubled times ahead, S&P downgraded a slew of Saudi banks and placed others on a negative outlook in November 2015. Most of these banks are key players in the Islamic project finance market. According to Dealogic, project finance in the Middle East and Africa saw a 10% drop since the first half of 2014. Global project finance volume stood at US\$279.5 billion in the first nine months of 2015, the lowest total since the same period of 2012 (US\$277.9 billion). Oil and gas volume dropped to US\$38.2 billion in the first half of 2015, down 23% year-on-year (US\$47.1 billion) and the second consecutive year-on-year decrease since 2013 (US\$58.9 billion). But it was not all bad news. The petrochemical sector saw the largest year-on-year increase with a volume of US\$12.1 billion in the first half (H1) of 2015, up from US\$1.1 billion the previous year and the highest H1 volume since 2013 (US\$22.1 billion). This increase was driven by the US\$8.1 billion Rabigh 2 petrochemical project in Saudi Arabia — the third-largest project closed globally in the first nine months of 2015.

But not out in 2016

Project expansions

As seen in Rabigh 2, expansion financings of existing projects are set to take on increased momentum. Liquidity constraints of cash-strapped industry players will reshape the investment landscape in 2016. Investors are increasingly wary of greenfield projects, so maximizing returns from existing assets will be the name of the game. The advantages are clear:

- reduced costs through economies of scale and sharing facilities
- expansions are funded with less credit and equity, and
- the project has survived start-up risks and there is value already in the ground.

Project Sukuk

The Istisnah-ljarah and Wakalah-ljarah structures will continue to dominate the Islamic project finance market. These structures are well-suited to project finance. They allow Islamic financiers to combine the phased payments of the construction price with rental payments matching the cash flows of the conventional financiers — achieving the same exposures, margins, and tenors.

Project Sukuk is a recent addition to Islamic project finance instruments. Making its debut on SATORP (2011) and reappearing on Sadara (2013), it is set to become a permanent presence in the Islamic project finance scene, particularly in Saudi Arabia. Sukuk is

a low-cost funding alternative and taps into the strong appetite to fund in local currency, such as the Saudi riyal. As a sign of market sentiment, large-scale projects, such as Rabigh 2, often pre-structure the Sukuk in the documentation as replacement financing at a deal's outset. Strong demand from regional and domestic investors, the lower cost of issuance compared to conventional bonds, attractive pricing, increased standardization and political commitment to develop the region's capital markets have all contributed to the growth of project Sukuk.

Iran opening

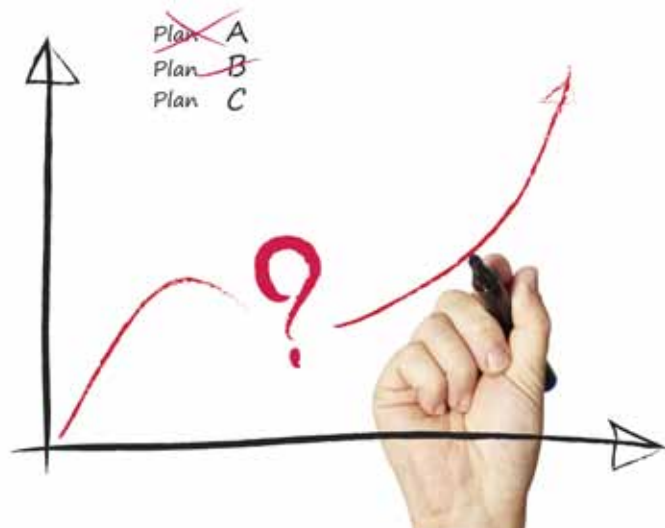
Iran, with its entirely Shariah compliant banking system and the world's largest pool of Islamic banking assets, can be a game changer for both Islamic finance and project finance. With investment needs estimated at US\$1 trillion, it appears to be a great opening at a time when other doors are shutting. Of course, it must first get to 'Implementation Day' under the nuclear agreement (expected first quarter of 2016) when it will receive relief from certain sanctions.

But the opportunity is undeniable. According to BP, Iran holds the world's largest gas reserves and fourth-largest oil reserves. Iranian oil and gas production coming back online could spell continued downward pressure on global energy prices and consequently, a continued slowdown of energy projects. However, given Iran's previous isolation, investment opportunities are abundant across various sectors. Mining, aviation, rail, power, petrochemicals, pipelines, and upgrading existing facilities and infrastructure are all candidates for Islamic project finance in 2016.

Way forward

Depressed oil prices means it won't be business as usual for Islamic project finance in 2016. To prosper it must change its strategy — focus on expansions and Sukuk — and enter new sectors in post-sanctions Iran. ☺

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Corporate sector issuances core to Malaysian Sukuk resilience

The strong appeal for Sukuk lies in its value proposition. For issuers, Sukuk offers the opportunity to tap an enlarged investor base with strong demand for Shariah compliant investments, while investors benefit from portfolio-diversification opportunities and investment options in a fast-growing fixed-income asset class. The tipping point centers on costs competitiveness which encompasses issuance costs and the time to market for Sukuk. RUSLENA RAMLI writes.

In Malaysia, to encourage the private sector (or corporate issuers) to play a significant role in the development of the bond market (both Sukuk and conventional bonds) concerted efforts were undertaken by the government and regulators. Several fiscal and financial incentives were introduced, including a tax-neutral framework and tax deductions of issuance expenses on qualified Islamic securities. As a result, Malaysia has become the world's largest Sukuk market historically contributing more than 50% to total global Sukuk issuance with the corporate sector representing on average of 30% of the total. The balance of issuance comprises approximately 40% of Bank Negara

Malaysia (BNM)'s Islamic securities, 20% from the government and 10% from quasi-government issuance.

In analysing the growth of the Malaysian Sukuk market, the barometer of performance is better depicted by zooming in on the issuance trends from the corporate sector instead of the total Sukuk market data. This headline number could include large issuances of BNM's Islamic securities designed as a market liquidity instrument, which could sometimes obscure the underlying Sukuk market issuance trends.

Chart 1: Malaysian Sukuk PDS issuances by sector (including quasi-government Sukuk)

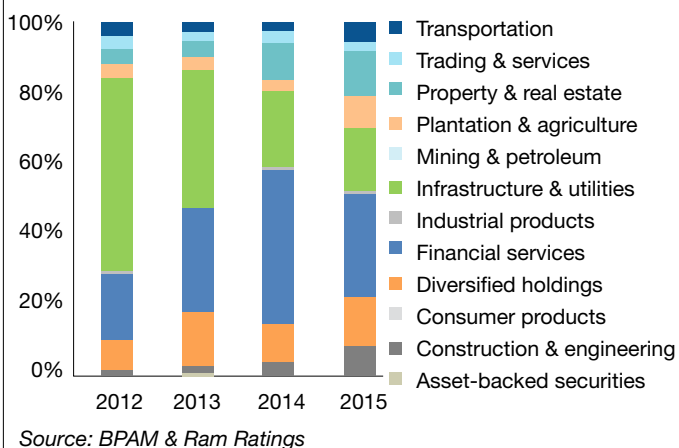
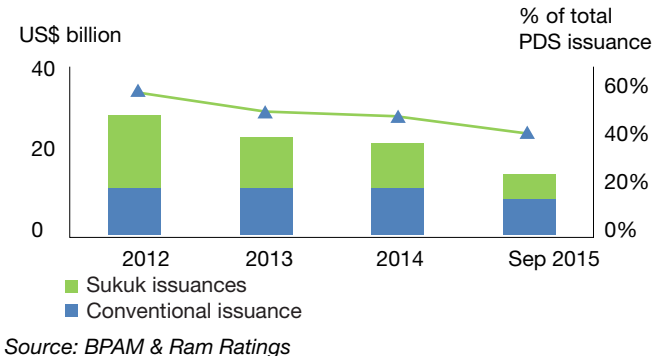


Chart 2: Percentage of Malaysian corporate Sukuk issuances of total PDS issuance



Islamic securities as well as SRI Sukuk was accorded in line with the government's aspirations to turn the nation into a global Islamic financial center. This, coupled with current market conditions where demand outstrips supply for Sukuk, has led to the trajectory issuance of corporate Sukuk to remain above the 50% mark of total corporate bond issuance. In promoting innovative structures, the SRI Sukuk issued by Khazanah became a landmark issuance and has propelled Malaysia ahead of the curve in encouraging the development of a new asset class that has a distinctive feature not comparable to conventional bonds. With the stimulus provided for SRI Sukuk in projects such as wind, solar power generation or affordable housing, the government has remained steadfast in encouraging the private sector to play a prominent role in the years ahead.

Conclusion

“ The value proposition offered by the local Sukuk market shall continue to prevail in the funding transaction decisions of key market players ”

The Malaysian corporate Sukuk market is expected to show resilience with key sectors to remain dominated by infrastructure and utilities as well as financial services. RAM Ratings had, in June 2015, revised its projected gross PDS issuance downward to around US\$18-20 billion (based on RAM Ratings's press release dated the 16th June 2015, 'RAM Ratings revises projected gross PDS issuance down to RM75-85 billion for 2015') for 2015 due to mounting uncertainties that had affected market sentiment. As at September 2015, total PDS issuance reached US\$14.5 billion, of which corporate Sukuk accounted for 43% or US\$6.2 billion. Despite the headwinds, RAM Ratings expects potential infrastructure Sukuk issuance in the fourth quarter of 2015 to shore up total issuance to between US\$8 billion and US\$10 billion, which is still a respectable level given the challenging market conditions.

Sukuk issuance reaching the financial close will still be dependent on the ever-changing market conditions and sentiment. Nevertheless, the value proposition offered by the local Sukuk market (ie competitive pricing, tax incentives, ability to access the wide investor base, etc) shall continue to prevail in the funding transaction decisions of key market players. ☺

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Review of 2015

Over the past 25 years, RAM Ratings's rated portfolio of private debt securities (PDS) grew to US\$262.4 billion as at September 2015. From the total, US\$125 billion or 48% represent Sukuk issuance which includes many pioneer structures that have contributed to the breadth and diversity of Sukuk products in the Malaysian bond market. In 2015, RAM Ratings's rated portfolio of foreign entities expanded to include Turkey's largest Islamic bank, Kuyeyt Turk Katilim Bankasi's RM2 billion (US\$453.36 million) Sukuk Wakalah program to be issued through its funding conduit, Kira Sertifikalari Varlik Kiralama. To date, RAM Ratings's portfolio of foreign issuers and/or related credit assessments include 26 foreign entities across 14 countries. While market conditions still dictate the decision to issue and the timing of issuance, the success of attracting cross-border Sukuk issuance was largely driven by Malaysia's strong regulatory drive as well as having a supportive tax and legal framework.

Following the introduction of Malaysia's sustainable and responsible investment Sukuk (SRI) guidelines in August 2014, Khazanah National (Khazanah) was the first corporate to take up the government's call by putting in place a RM1 billion (US\$226.68 million) SRI Sukuk program. The first RM100 million (US\$22.67 million) seven-year tranche was successfully issued in June 2015 and fully subscribed by a diverse investor group including foundations, corporations, banks, pension funds and asset management companies (based on Khazanah's press release dated the 4th June 2015, 'Khazanah issues world's first ringgit-denominated sustainable and responsible investment Sukuk'). The assigned AAA-rating by RAM Ratings reflects the credit strength of Khazanah as the ultimate obligor to the financing structure. Other notable issuances include infrastructure and utility companies that have raised Sukuk to fund its ongoing infrastructure projects and/or refinance existing borrowings as well as Islamic financial institutions tapping the Sukuk market to meet its capital requirements.

In light of the economic slowdown affecting the Malaysian economy in tandem with the ringgit's depreciation, RAM Ratings had stress-tested its rated portfolio of companies. The analysis concluded that the stress test had exerted minimal impact on the credit profiles of the companies. Even though foreign-currency debts form a large proportion of the debt profiles (ie about half of the rated corporates), the downside risks were mitigated by the natural hedge in the form of foreign-currency assets and/or earnings while credit quality (ie 90% of RAM Ratings-rated issuers are rated 'AA' and above) are supported by moderate leverage and strong liquidity.

Preview of 2016

Following the Malaysian 2016 budget announced in October 2015, the extension of tax deduction on the issuance cost of qualified

Real estate remains attractive to many

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 reviews 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 2015

2015 was an extremely positive year for Shariah compliant investors, with appetite growing across almost all sectors and an increasing number of geographies.

Investment into the US continued its strong growth. While sovereign-related investors retained a preference for the gateway cities of New York, San Francisco and Los Angeles, many institutional and private investors saw better value in other cities across the US, with investment decisions based on achieving more attractive returns and the local market dynamics. The competitive US banking system for finance provided attractive levered returns for investors, ahead of where they had been in previous years.

If anything, investment into the UK slowed slightly as yields reached recent lows. Many new investments remained outside of London, across the country, while a number of Islamic investors chose 2015 as the year to realize the gains they had made on their London assets. This was most visible with Malaysian investors, who benefited from the strengthening of the pound sterling against the ringgit, albeit at the expense of making new investments, at least for the time being.

With a reduction in the number of attractive opportunities in the UK, investors increasingly looked at continental Europe to satisfy their investment requirements, with Germany the first port of call for most. While Islamic investors found Germany highly competitive in securing opportunities, competing against both domestic and international monies from around the world, a number of transactions were successfully completed.

Meanwhile, activity also pushed beyond Germany with notable investment activity in France, the Netherlands and Norway. Investors were increasingly flexible in order to achieve the risk-adjusted returns they favored.

Finally, a fully Shariah compliant commercial insurance option was made available to the UK market, completing the jigsaw of elements required to conduct a fully Islamic real estate investment.

Preview of 2016

2016 should start in a similar manner to where 2015 finished, with investors wanting to continue to invest internationally into real estate, many motivated unfortunately by the geopolitical situation in the Middle East.

However, investment decisions will be driven by the wider global economy. Inflation remains low and even in the context of the US and other nations considering an increase in short-term finance costs, the longer term rates against which Islamic investors fix their finance cost remain historically low.

For many investors, the levered returns available from real estate investors will remain highly attractive, particularly where they are secured against long leases and modern properties. They will need to remain open to new locations and sectors to achieve their investment wishes.

Considering development transactions, Islamic investor appetite already exceeds the number of attractive opportunities, with many considering the general stability and growth of the world economy as an opportunity to take on more risk. The unanswered question is whether this will encourage such development equity to look beyond the capital cities.

It will be interesting to see whether the Malaysian ringgit will improve against international currencies or whether everyone gets used to this level being the new norm. The level of demand for real estate assets remains high in Malaysia, with solely domestic investment risks fueling a local asset price bubble.

Speaking to finance banks in various geographies around the world, the one thing that unites them are central banks looking to avoid another finance-fuelled boom market. With their requirements to hold more capital against their real estate finance increasing, we should expect pricing to rise slightly, despite the competition among the banks themselves.

Conclusion

Islamic investors are going into 2016 in an optimistic mood, but very mindful of continuing to make prudent investment decisions. Real estate returns remain attractive to many, underpinned by the 'bricks and mortar' nature of such investments.

As central banks seek to dampen the chance of an asset price boom, so Islamic investors remain comforted by the economic optimism that is driving the slow increase in benchmark finance costs. (2)

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US financial regulatory reforms and their impact on the financial industry worldwide

Ever since the collapse of Lehman Brothers and the ensuing financial crisis in the US and Europe, governments in many major financial hubs have taken various steps to address issues that are related to the financial crisis and to take investors to the next level. HAMUD BALFAS expounds further.

The US legislative branches have for instance submitted and passed a law that is known as the Dodd–Frank Wall Street Reform and Consumer Protection Act (the Dodd–Frank Act).

The Dodd Frank Act contains various provisions including various matters with respect to the following issues:

- a. The consolidation of regulatory agencies and a new oversight council to evaluate systemic risk
- b. Comprehensive regulation of financial markets, including increased transparency of derivatives and other financial products that financial institutions sell to its customers (both individuals as well as institutions)
- c. Consumer protection reforms including the introduction of a new consumer protection agency
- d. Tools for financial crises, including a ‘resolution regime’ (complementing the existing authority of the Federal Deposit Insurance Corporation that allows for the orderly winding down of bankrupt firms)
- e. Various measures aimed at increasing international standards and cooperation
- f. Proposals related to improved accounting and tightened regulations of credit rating agencies which many experts consider as sources of financial crisis
- g. Improvement to the regulations of asset-backed securities, and
- h. Improvement to regulatory enforcement and remedies.

One of the most influential provisions of the Dodd Frank Act that has affected many financial institutions is the introduction of the Volker Rule in the Act that basically restricts (the US) banks from making certain kinds of speculative investments that do not benefit their customers.

On the regulatory enforcement issue, the Dodd Frank Act clearly has enhanced the ability of regulators and other law enforcement agencies and pushes them further to pursuing irregularities in the market as well as monitoring the behavior of financial institutions. This has resulted not only in prosecutions and fines imposed on financial institutions by their respective regulators but also the widening of participation of other law enforcement agencies.

Prosecutions do not only involve securities and banking laws but also money laundering activities, interest rate and exchange rate manipulation as well as illegal practices related to the marketing of a bank’s products such as credit cards and investment products. All of a sudden there is a lot of news in the media that big banks that are long believed to have ‘first class’ compliance with laws and regulations have become suspects in the crackdowns. The prosecutions have also eroded banking secrecy laws in countries like Switzerland which has long been regarded as the country with the safest banks for keeping banking secrets in the world.

What surprises us in cases where the US government pursues money laundering activities are that those money laundering activities do not only involve governments that are under sanctions by the United

Nations or the US government, but also involve the laundering of money from drug dealers and cartels.

Bloomberg has recently reported on many cases involving these big banks. HSBC, for instance, has been accused of failing to monitor more than US\$670 billion in wire transfers and more than US\$9.4 billion in purchases of the US currency from HSBC Mexico, allowing for money laundering, prosecutors said. The bank also violated US economic sanctions against Iran, Libya, Sudan, Burma and Cuba, according to criminal information filed in the case.

On another report published by Bloomberg, a branch of the huge Dutch co-operative bank Rabobank in the US-Mexican border town of Calexico is reported to have been involved in money laundering activities that involved money from Mexican drug cartels. The report states that US investigators now have evidence that some bank officials may have impeded internal efforts to scrutinize customer accounts and to report suspicious transactions. Some of the activities the authorities are said to be looking at occurred under the watch of a compliance officer who Rabobank poached directly from its regulator to get its house in order.

For Rabobank itself, the criminal action related to the anti-money laundering probe brought against its branch in Calexico would become ‘double trouble’ for it as it is still bound by the 2013 deferred prosecution agreement with the US Justice Department over a case involving its manipulation of benchmark interest rates. The deferred prosecution agreement which expired on the 29th October 2015 would only allow the bank to escape criminal charges if Rabobank avoids further criminal allegations in the US.

Various US government prosecutions over criminal activities of the big banks have not only damaged the banks’ reputations but has also resulted in billions of dollars of damages that the banks have to pay. Big banks like JPMorgan and HSBC have each paid around US\$2 billion each to settle their disputes with the US over violations of money laundering laws, while other banks like Commerzbank has paid US\$1.45 billion, Standard Chartered US\$740 million and Citigroup US\$140 million. In addition to the US\$140 million for money laundering activities, Citigroup has also been ordered to pay the US government US\$925 million as a result of a guilty plea by its unit Citicorp to a felony charge of conspiring to manipulate the price of US dollars and euros. The Consumer Financial Protection Bureau also ordered the bank to pay US\$700 million to its customers for illegal practices related to the marketing of credit card add-on products.

The long arm of US law has not only reached banks that operate in the US. Many private banks operating out of Switzerland have also been subject to investigation by the US Justice Department over allegations of tax evasion by US citizens. As a result of the investigations and their process of collecting information from the Swiss banks, the US authorities have now been able to build cases on other banks in other ‘tax heavens’ including Singapore, Israel and other jurisdictions where its citizens try to hide their money and run from their obligations at home.⁽²⁾

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Are the woes of the Islamic finance industry only a passing phase? Time will tell

Against the backdrop of a global financial crisis that has only barely passed, 2015 has seen yet another year of robust growth for the Islamic finance industry. The coming years are also expected to see increasing demand for Islamic consumer financing and Shariah compliant insurance products in many countries with a significant number of Muslims not yet served by Islamic banks and Takaful companies, including emerging economies in Africa and CIS countries (formerly part of the Soviet Republic). These countries are planning to, or indeed in the process of, developing their legal, tax, and regulatory infrastructures in order to accommodate this growth. DR KEN BALDWIN summarizes the development of the Islamic finance industry and the road ahead.

Economies of scale

While undoubtedly many would-be users of Islamic finance at the retail level in these countries are motivated by religious principles, it is natural to ask whether there will be sufficient demand for Islamic banking to provide the economies of scale for international banks looking to grow outside of their domestic markets. Certainly, GCC-based institutions are known to be looking to expand, but is it economically viable to set up and operate foreign branches or subsidiaries? One indicator of this in early 2015 was the resounding 'no' from DBS Group Holdings, Singapore's biggest lender, which announced a progressive winding-down of its Islamic banking unit, the Islamic Bank of Asia, established in 2007 as a joint venture between the bank and Gulf-based investors. From a risk management perspective, Singapore is very well developed, having an Islamic deposit insurance scheme that was established in 2006, as well as a monetary authority that would act as lender of last resort if needed.

Having a large number of users of consumer financing is good for risk diversification. It provides Islamic banks a heterogeneous pool of receivables, and lots of small customers are better than a few large ones. But a few large ones are cheaper to service, so the counterbalance to the scale argument is a risk management argument. This challenge is greater in developing countries since depositors as well as recipients of finances are small, eg individuals and small businesses.

Financial inclusion

One of the most important justifications the Islamic banking industry puts forward for its own existence is social responsibility. Indeed, the IFSB has announced in 2015 that it is launching initiatives aimed at widening the reach of Shariah compliant banking to include the poor, especially farmers, small traders and poor households. This is a commendable initiative. In addition, the IFSB has also disclosed the forthcoming issuance of guidance on surveillance by regulatory supervisory authorities, which is intended to bring about increased monitoring of institutions and an early warning system which could reduce the probability of bank failures.

Systemic risk

This is a move in the right direction by the IFSB. But notably, few studies, if any, exist to describe how Islamic banks contribute to systemic risk in ways similar to, or different from, conventional banks. Systemic risk is a complex issue concerning contagion and propagation of financial distress when one or a number of

banks fail, and banks are interconnected. Even in studies of conventional banking systems, there is no leading model which has emerged to describe this phenomenon. Having more equity than conventional peers, Islamic banks should, all other things being equal, be more stable. And more equity, as well as better quality equity, is exactly what Basel III is calling upon conventional banks to have in place. However, Islamic banks suffer from a lack of tradable liquid securities, leading to liquidity management problems which the International Islamic Liquidity Management continues to work to resolve through its product development initiatives.

Competition and margins

Retaining higher levels of liquidity in low-yielding assets manifests a drag on the income of Islamic banks. Islamic banks seek to recover profitability by levying higher financing charges on their assets, which renders them less competitive than conventional counterparts. Developing products which can ameliorate this situation is of paramount importance, but until that can happen, Islamic banks will continue to be considered an expensive alternative.

The future

Islamic banking has come a long way since the renaissance of Islamic finance in the 1970s. But growth from a low base is not an indicator of success. Several fundamental conundrums must be solved. One of these is the very basis of risk-sharing in investment accounts. There is little purpose in structuring investment accounts to allow participants exposure to risk, and then managing account return streams to transform their economic profile to that of conventional deposits.

The fundamental issue seems to be that investment account holders do not have the appetite for risk required of them. Nor do regulators have the appetite for systemic risk which variable account return streams could create (through bank runs following poor performance). There are, however, plenty of users of finance, many of whom are religiously motivated, who would like to be financed by Islamic banks. The intermediation model deployed by Islamic banks is being forced to run as hard as it possibly can, with workarounds and interim measures deployed to keep it viable. Perhaps, the woes of the Islamic finance industry are only a passing phase. Time will tell. ☺

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Sukuk: Turbulent waters

Despite a strong year for the Sukuk market in 2014, general market turbulence and the decision by the central bank of Malaysia to stop issuing Sukuk has led to a weaker than expected global Sukuk market in 2015 in terms of aggregate issuance. Despite continued uncertainty looking forward to 2016, DEBASHIS DEY feels there are some potential positives if current lower commodity prices instigate an increase in sovereign issuances and, separately, the continuing implementation of Basel III continues to have the potential to lift the Sukuk market in the medium term.

Review of 2015

As at June 2015, worldwide primary market issuance of Sukuk reached US\$38.6 billion, down from the US\$67.2 billion seen in the same period in 2014. This points to an expected Sukuk issuance total of no more than US\$60 billion for 2015, a significant decline from the US\$116.4 billion seen in 2014. In our view, there are three main causes for this decline as follows.

Oil prices: A continued drop in oil prices over the course of 2015 has had a disruptive economic effect on growth in core Sukuk markets which has also led to a decline in infrastructure-related financing.

Market uncertainty: The anticipation of a potential increase of interest rates by the US Federal Reserve and the turbulence in the global stock exchanges due to the collapse of the Chinese equity markets have led to a 'wait and see' attitude for many investors in Sukuk over the last several months.

Pullback by central bank of Malaysia: The central bank of Malaysia accounted for approximately 35% (about US\$45 billion) of the total Sukuk issued in 2014. The decision by the central bank of Malaysia to cease issuing Sukuk in 2015 has thus far had a significant impact on the total global Sukuk issuance for the year to date.

Despite this, removing the effect of the central bank of Malaysia, global Sukuk markets only saw a small decrease in performance compared with 2014. In the end, 2015 looks to present a mixed picture as the lower than expected volume of issuance is offset by some positive signs such as the continued entry into the market of new issuers (including more debut sovereign issuance) and separately, the start of the implementation of Basel III is seen by many market participants as a good opportunity to return to the Sukuk market.

Preview of 2016

One key theme for the upcoming 2016 Sukuk market is uncertainty. The performance of the Sukuk market is inextricably linked to the health of Islamic economies and as we have seen from 2015, the headwinds caused by market uncertainty and lower oil prices will continue to present challenges going forward. Nevertheless, there are some potential positives for 2016 as follows:

Potential increase in sovereign and first time issuance: Many governments in the commodity-reliant GCC countries decided to initially withstand the economic effects of falling oil prices by tapping their fiscal reserves rather than increase debt levels. Given that experts predict a subdued commodities market in the near-to-medium term, there is some indication from affected sovereigns that they may look to the capital markets to slow the depletion of their fiscal reserves. In addition, as the pricing gap between Sukuk and conventional counterparts continue to narrow, there is a renewed



interest from new sovereign and other first-time issuers who are looking to broaden their investor base and tap into the traditionally liquid Islamic market. The latter half of 2015 has seen the first-ever issuance by Oman and the trend may continue into 2016.

Basel III to continue to buoy the market: Sukuk continue to play a role in addressing the liquidity and capital adequacy needs of Islamic banks as required by Basel III. The continuing lack of high-quality liquid assets in the Islamic finance space continues to pose a challenge to compliance with the liquidity coverage ratio mandated by Basel III. Moving forward, more Islamic banks and sovereigns are expected to issue Basel III compliant regulatory capital Sukuk which will further fuel the momentum in the global Sukuk market.

Conclusion

Despite a significant decline in 2015 and an uncertain 2016, the global Sukuk market continues to prove to be resilient. It is possible that the dip in issuance seen in 2015 is merely a correction of the inflated figures dominated by large scale issuance out of Malaysia in the past few years, rather than a sign of a global market decline generally. The growth of Islamic finance products (including Sukuk) continues to outpace their conventional counterparts and the continued growth of Sukuk in non-core markets bodes well for the industry in the medium to long term. ☺

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Shariah governance crucial in uplifting the Islamic finance ecosystem

It is undeniable that Shariah scholars are the backbone behind the proliferation of Islamic finance and are responsible for ensuring the end-to-end Shariah compliance of Islamic financial institutions ranging from product structuring to product offerings and marketing. Nonetheless, scholars would not be able to perform their fullest functions without supportive infrastructures. In this article, DR MARJAN MUHAMMAD puts Shariah governance under scrutiny.

Islamic finance is one of the fastest-growing segments in the global financial industry with an estimated market size ranging from US\$1.66 trillion to US\$2.1 trillion in 2015. This, therefore, has necessitated the establishment of Shariah governance frameworks (SGFs) to warrant transparency and efficiency of Islamic financial institutions, and hence promote confidence to the general public and the financial markets on the credibility of Islamic financial operations.

Recent developments in SGFs

The year 2015 has witnessed more awareness among industry players on the significance of Shariah governance to ensure Shariah compliance remains as a focal pillar to cater to the expansion of the Islamic finance industry. One aspect of ensuring Shariah compliance is via the issuance of Shariah standards as guidance for the industry.

The central bank of Malaysia, Bank Negara Malaysia (BNM) for instance, through a contract-based framework promulgated in the Islamic Financial Services Act (IFSA) 2013, has issued Shariah standards together with the operational standards on Shariah matters in one single document. These standards, according to the IFSB's Stability Report 2015, are meant to outline the Shariah principles adopted by Islamic financial institutions and to support the effective application of Shariah contracts in the offering of Islamic financial products and services.

This effort signifies another milestone in providing a comprehensive regulatory framework that promotes legal and operational certainty in Islamic finance, and facilitates the future direction of the Islamic banking business for the shift from mere financial intermediation to real sector participation. As at November 2015, BNM has issued three standards, namely (i) the Shariah standard on Murabahah, (ii) the Shariah standard on Mudarabah, and (iii) the Shariah standard on Musharakah. Meanwhile, the remaining Shariah standards on Ijarah, Istisnah, Tawarruq, Wadiah, Hibah, Wakalah, Kafalah, Qard and Wa'd are being finalized. In addition, BNM has recently issued another two exposure drafts of the Shariah standard on Sarf and Rahn.

At the international level, AAOIFI has issued in 2015 six new Shariah standards on Wa'd (promise) and Muwa'adah (bilateral promise); Musaqat (irrigation partnership); options of properness; options of reflection/consideration; Urbun (earnest money); and the conditional termination of contracts.

This therefore, according to the Islamic Commercial Law Report (ICLR) 2016 published by ISRA and Thomson Reuters, has contributed to a total number of 93 standards issued by AAOIFI thus far (ie 54 Shariah standards, 25 accounting standards, five auditing standards, seven governance standards and two ethics codes).

Apart from Shariah standards issuance, the number of countries which have adopted a centralized approach of Shariah governance has increased. According to the Shariah Governance sub-indicator of the Islamic Finance Development Indicator (IFDI) 2015 produced by Thomson Reuters, as of to date there are at least nine countries including Bahrain, Bangladesh, Brunei, Indonesia, Malaysia, Oman, Pakistan, the UAE and Sudan which have implemented a centralized Shariah committee to reduce conflict of interests and divergent of opinions.

In a similar vein, Morocco which gazetted its new law on participative banks in November 2014, has established one Shariah committee at the national level to only promote the standardization of Fatwas. Nonetheless, this 'one-tier centralized model' as observed by Dr Younes Soualhi in ISRA-Thomson Reuters ICLR 2016 remains unclear in terms of its practicality as opposed to the 'two-tier centralized model' which has both a Shariah advisory committee at the national level and a Shariah committee at the individual Islamic financial institution level practised by other countries.

Future outlook of Shariah governance across jurisdictions

Considering the importance of Shariah governance in uplifting the Islamic finance ecosystem to the next level, there is a dire need for more comprehensive frameworks regulating Shariah compliance of Islamic financial institutions. The regulation should look into broader dimensions including risk management, market conducts, accounting treatment, and internal and external audits.

At the jurisdictional level, the adoption of the 'two-tier centralized model' might be a viable solution to avoid conflict of interests and hence promote more transparency. In addition, Shariah scholars need to work hand-in-hand with practitioners and to acquire a wider set of skills and competencies to enable them to discharge their roles and duties effectively. Qualified Shariah scholars who possess both Shariah and practical knowledge are crucial for the growth of the Islamic finance industry.

Meanwhile, at the global level, some have suggested to establish an international SGF overseeing the whole Islamic financial markets. Yet, this idea requires further scrutiny, especially in terms of its implementation, as different jurisdictions have their own legal systems which may not able to cater to such unification. The year 2016 should start looking into this idea seriously in order to promote more harmonization, if not standardization, among countries offering Islamic financial services.⁽²⁾

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Indexing essential to development of the Islamic finance market

Shariah-based investments have grown considerably in recent decades, as the Islamic investment community demands increasingly sophisticated investment solutions that are in accordance with Islamic law. As a result, the need for high-quality, transparent Shariah compliant benchmarks has developed. Today, Islamic indices serve an essential role in Islamic finance; these unique indices identify the universe of securities available for investment and define the way investors measure the Islamic financial markets. SABRINA SALEMI puts Islamic indices under the microscope.

Although Islamic equity indices may be limited in coverage due to rules-based screening processes, particularly in certain sectors such as financials, they maintain a high correlation and have comparable risk/return characteristics to conventional underlying indices. Representative of each market, each index provides investors with Shariah compliant versions of various major benchmarks. For example, the S&P 500 Shariah Index is a subset of the widely recognized S&P 500 Index and includes only Shariah compliant constituents of the S&P 500 Index.

Review of 2015

While most of the global benchmark indices were in the red over the last year, the Shariah subsets of these indices generally mitigated losses and outperformed conventional indices. The S&P Global BMI Shariah and the Dow Jones Islamic Market World – two major global Shariah compliant benchmarks – each declined 8.8% in the third quarter, but outperformed their conventional counterparts by 130bps as greater exposure to the US boosted performance. This has also been the trend for the past 12 months, as the two indices outperformed their conventional benchmarks by 140bps and 120bps respectively.

All major regional equity markets finished the quarter in the red in US dollar terms. However, the 6.7% decline experienced by the S&P 500 Shariah and the S&P Europe BMI Shariah indices fared well relative to the double-digit losses experienced in Asia and emerging markets. Furthermore, all of these regional Shariah indices outperformed their respective benchmark index on a quarter-to-date basis.

Other noteworthy movements over the past year have stemmed from plunging oil prices, which have had a significant impact on the industry performance and weighed on the MENA equity market. Over the past 12 months, the S&P Pan Arab Composite Shariah lost 32.7%, while GGC countries were hit even harder as the S&P GCC Composite Shariah Index dropped 33%.

Preview of 2016

While Islamic finance and Shariah-based investments have experienced healthy and encouraging growth over the past decade, the industry's development can be significantly improved by broadening the base of issuers and investors, expanding geographic reach, and building scale. Sustaining the rapid growth achieved will necessitate greater breadth and diversity in products and solutions offered. As global markets continue to develop infrastructure that supports the Islamic finance industry, Shariah-based investments will also continue to develop and expand through new international opportunities.

In addition to geographic and product expansion requirements, the Islamic finance industry will need to raise more investor awareness and

“ For investors who wish to diversify their portfolio while adhering to prescribed Shariah law, Islamic indices provide market participants with a comprehensive set of benchmarks ”

confidence in order to successfully progress. Many investors are under the impression that Shariah products do not provide similar risk/return profiles as conventional products, which is not the case. With time, it will also become increasingly important for the Islamic finance industry to harmonize and better define regulations with respect to Shariah laws, so all stakeholders can invest with confidence and greater transparency.

As an index provider, we believe that indices have a key role to play in accelerating this trend. The S&P Shariah Indices and Dow Jones Islamic Market Indices, for instance, adopt investment criteria defined by Islamic law and represent the most extensive and comprehensive suite of indices available to regional and global Shariah investors. The series includes developed, emerging and frontier benchmarks, regional and country-level investable indices in addition to indices in specific strategies and sectors. Furthermore, Sukuk indices have also been developed at a faster pace to meet the demand for Shariah compliant fixed income solutions. The availability of these financial benchmarks benefits investors globally with a deeper understanding of and greater accessibility to the Islamic finance market.

Conclusion

For investors who wish to diversify their portfolio while adhering to prescribed Shariah law, Islamic indices provide market participants with a comprehensive set of benchmarks. As the industry evolves, index providers continue to meet the demands of a growing market by introducing innovative indices catered to Shariah compliant investors. And in the latest phase of development, the introduction of smart beta and mixed asset class strategies specialized for Shariah compliant investors denotes the promising growth of the Islamic finance market. ⁽²⁾

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SMEs and entrepreneurship: Engines of economic growth

One of the most impressive economic developments of the past 40 years has been the emergence of Silicon Valley. By tapping into global talent, driven by the zeal of innovation and fueled by risk capital, Silicon Valley has come to represent the pinnacle of the modern economy. The technology sector in the US, largely driven by Silicon Valley, has been a tremendous engine of both US and global growth over the past few decades, and it continues to serve as a hub for global progress. In turning to the intersection of SME and entrepreneurship with Islamic finance, 2015 saw the initial stages of a Silicon Valley-like cluster emerging, and KAVILASH CHAWLA believes 2016 promises to be a more disruptive year in driving change.

Review of 2015

Looking back over the past 12 months, one phrase comes to mind when we examine the SME and entrepreneurship landscape – identify driven innovation. First and foremost, 2015 saw the recognition and acceptance that a unique set of needs and preferences exists among the Ummah and the Muslim consumer. Moreover, and especially relevant to the Islamic finance community, 2015 saw the initial development and preliminary adoption of business models that seek to monetize the Islamic value proposition. From a business model perspective, this not only means the delivery of commercial and financial returns, but, for many SMEs and start-ups, it also means delivering on social impact and ethical imperatives as required by Islam.

Some notable milestones within 2015 include the acceptance of a Pakistan-based social enterprise into the prestigious Y-Combinator incubator. At the Islamic Society of North America's annual meeting in Chicago this year, entrepreneurs were strongly represented and supported through a start-up marketplace, where start-ups could sell and pitch their goods and services to consumers and investors alike. In 2015, we also witnessed the development of technology-enabled platforms for delivering goods, services, and funding within the finance and Halal fast-moving consumer goods space. 2015 was a good year when it comes to the supply of start-ups and SMEs.

2015 was also a good year when it comes to the funding side of the equation. In many of the GCC countries, we saw national governments announce plans to seed or establish investment funds to provide angel investment, venture capital, and growth funding to entrepreneurs and SMEs, with Kuwait committing roughly US\$2 billion in support. In the private markets, we saw US-based angel investors and venture capital deliberately fund business models that focus on delivering value to the Muslim consumer through market-based solutions that generate commercial rates of return and social impact. And in the OIC countries, we saw high-net-worth-individuals warm to the possibility of deploying some capital to SMEs and high-growth start-ups. Overall, 2015 was a positive year of developing the foundation of a vibrant SME and entrepreneurship space.

Preview of 2016

Whereas 2015 was about investing in a strong foundation, 2016 is going to be about execution. On the funding side, national governments, private investors, and incubators and accelerators are going to have to prove that they can not only find enough deal flow,

but that they can diligence deals and deploy capital productively. For the Islamic finance industry, this means an opportunity to partner with large national funds as well as private investors to help them source, assess, diligence, and execute deals. That means either investing in developing in-house capabilities and capacity to work with early-stage investors and early-stage companies, or partnering with organizations and advisors who have the experience and expertise to operate within the start-up and SME spaces.

It also creates a need for financial innovation within the Islamic finance space, especially in the development of angel and VC funds to help create streamlined, cost-effective mechanisms to raise and deploy capital, and to diligence, execute, and manage deals. On the entrepreneurship and SME side, the drive toward the formalization of the funding landscape within 2016 highlights an opportunity but also a need for SMEs and entrepreneurs to equally professionalize. Due diligence is a detailed and rigorous process not well suited to the faint of heart.

In addition to professionalization, 2016 also represents disruption. Technology-based funding and marketplace platforms will continue to come online throughout 2016, and will challenge Islamic finance and other financial services providers for market share within both the funding and also the banking space. For the Islamic finance industry, this represents a threat that will require adaptation. Fintech in the conventional space has played a critical role in not only funding SMEs and start-ups, but in helping financial services providers develop new streams of revenue and access new markets and consumers. Fintech within the Islamic finance space is where 2016 is going to create significant opportunities, but the first-mover advantage is going to be limited, and many institutions may already find themselves lagging well behind the leaders.

Conclusion

SMEs and entrepreneurship are the engines of economic growth. While traditional wholesale banking, capital markets, and retail finance will continue to dominate the Islamic finance landscape in 2016, the SME and start-up space represents exciting opportunities for 2016. Technology is the catalyst for 2016; those who accept and adapt will find the SME and start-up space in 2016 to be a very attractive proposition. Silicon Valley is a global phenomenon, and is coming to Islamic finance in 2016. ⁽³⁾

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Desire for benchmarks to drive sovereign Sukuk issuances outside of traditional markets

In recent years, the international Sukuk market has grown considerably, with Sukuk issuances surging not only by volume and value, but also in the geographical scope of the issuing markets. LEE IRVINE studies the Sukuk market, particularly sovereign Sukuk.

Many countries and territories have recently issued their first Sukuk and, in many cases, a sovereign or a quasi-sovereign issuer has led the way in those markets. This has been true of Malaysia, Bahrain, Qatar, Pakistan, Indonesia, the UAE, Germany (where the issuer was the state of Saxony-Anhalt), and Saudi Arabia (where the issuer was the IDB).

Several factors are driving sovereigns to participate in the Sukuk market, including: the desire to establish a benchmark and to encourage the development of a corporate Sukuk market in the relevant country or territory, as well as the need to develop a legal and regulatory framework that recognizes and facilitates the issuance of Sukuk — especially in jurisdictions where Islamic principles are not enshrined in national law. As a result of these drivers, sovereign issuers constitute a greater proportion of the global Sukuk market than of the conventional bond markets. The value of international bond issuances reached around US\$6.4 trillion in 2014, only around 10% of which was issued by sovereign and quasi-sovereign entities. In comparison, the value of international sukuk issued in 2014 reached US\$114 billion, of which 85% was issued by sovereign and quasi-sovereign entities.

The UK issued Sukuk in 2014, the first western country to do so, attracting orders of more than GBP2 billion (US\$3.05 billion) from global investors. The UK government's desire to secure London as a global hub of Islamic finance and, in the longer term, the center of the global financial system, largely drove the issuance. Similarly, Luxembourg issued Sukuk to diversify its status as a financial center and differentiate it from other European financial centers.

However, the expectation that sovereign and quasi-sovereign issuances would pave the way for corporates to issue Sukuk has not so far materialized. While several governments issued debut Sukuk in 2014 (the UK, Hong Kong, Luxembourg, Senegal and South Africa), no corporate has yet issued a Sukuk in any of those countries and — outside of Malaysia, Saudi Arabia and the UAE — corporate Sukuk issuances are relatively infrequent.

Despite the dearth of corporate issuances, the entrance of new issuers to the Sukuk market, particularly those governments representing strong credit, will nevertheless support growth in the Sukuk market over the longer term and help attract new investors to the sector, providing additional depth and liquidity to the Sukuk market.

Review of 2015

While volumes of sovereign Sukuk have increased significantly over the last three years, as governments in Asia, the GCC countries, Europe and Africa have sought to tap the increased demand for Shariah compliant financial assets, the Sukuk market and, particularly the sovereign Sukuk market, has been more subdued in 2015. Declining oil prices have resulted in a slowdown in the economies of the main Sukuk-issuing countries of the GCC. Additionally, the

Malaysian central bank, Bank Negara, ceased further issuances of short-dated ringgit-denominated Sukuk and looked for alternative ways to improve liquidity in its domestic financial market.

Industry observers expect these factors will result in a noticeable slowdown in global Sukuk activity in 2015, with S&P estimating that global Sukuk issuances in 2015 will only reach US\$50-60 billion, a significant decline from 2014.

Nevertheless, certain Sukuk markets have remained relatively active during 2015, with Hong Kong issuing its second Sukuk of US\$1 billion in May and Oman issuing its first sovereign Sukuk in October. The Southeast Asian sovereigns of Malaysia and Indonesia were also able to print record-equalling issuances, with Malaysia issuing a 30-year Sukuk (the longest maturity for a sovereign), and Indonesia issuing a US\$2 billion Sukuk.

Preview of 2016

While the sovereign Sukuk market has been relatively slow during 2015, a number of sovereigns look set to issue their inaugural Sukuk in 2016, including a number of African nations, such as Kenya, Ivory Coast, Tunisia, Niger and Nigeria, each hoping to follow the lead of South Africa and Senegal. Other sovereigns rumored to be considering debut Sukuk issuances in 2016 include Jordan and Kazakhstan. While some sovereigns have traditionally been constrained — from a structuring perspective — by a shortage of tangible assets, continued innovation in Islamic structuring (particularly in the corporate sector) has enabled issuances which utilize assets for the underlying structure which issuers would not previously have considered, allowing potential issuances by such sovereigns.

The majority of sovereign Sukuk have traditionally been issued in the local currency and targeted at domestic investors. However, as global investors become increasingly familiar with Islamic debt instruments, we expect an increasing volume of issuances of cross-border instruments from jurisdictions with predominantly domestic markets — such as Indonesia and Malaysia — as they seek to tap the increasing demand from international investors.

Conclusion

In Malaysia and the Gulf, investors are familiar enough with Sukuk to demand little, if any, premium to buy them. Indeed, in the Gulf, in certain instances issuing conventional bonds has actually been more expensive for corporates than selling Sukuk. This situation, however, represents the exception rather than the rule. For the time being, we expect the desire for benchmarks, rather than simple funding requirements, will drive sovereign Sukuk issuances outside of these markets. (2)

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Responsible investment and Islamic finance: Can they work together?

Global sustainable, responsible and impact (SRI) investments have been growing rapidly over the years, but became a major focus for investors since the 2008 crisis. MAHINAZ EL-AASSER anticipates that sustainable investing will grow in the coming years taking into consideration the policy development happening in the markets relevant to corporate environmental, social and governance (ESG) disclosure.

Investors have been considering revising the stocks they are acquiring in order to avoid getting hammered again. The market has shown a growth of 61% in almost two years; from US\$13.3 trillion at the start of 2012 to US\$21.4 trillion at the beginning of 2014. The main focus in the market is in Europe, Canada and the US, dominating almost 99% of global sustainable investing assets.

With such concentration in the developed markets, we find that on the other hand the Islamic finance industry is mainly focused in the GCC and Asian markets, where the latter dominates almost more than 50% of global Islamic financial assets. The industry that is currently estimated to exceed US\$2 trillion globally has set solid grounds in developing and emerging countries, mainly fostered by the base of the Muslim population already there. With the current global downturn, Islamic finance might face one of its toughest times with its core markets slowing down, expecting to reach significantly less growth rates than the previous decades.

The two markets, sustainable investments and Islamic finance, seem to be different in terms of market focus, prospect growth rates, and even market share of global assets. Despite such discrepancies, there is, however, huge overlap between the two industries such as: taking care of social aspects which is reflected in community development programs in ESG and in Zakat in Islamic finance; exclusion of sectors that cause social harm; promoting better environmental, social and governance aspects in business as reflected in Maqasid Al Shariah in Islamic finance; and many more overlying facets. Recently, an incident occurred that could be a case study of a possible integration of the two growing and complementing industries. Volkswagen, which mockingly has repeated the word 'environment' in its 2014 sustainability report 355 times, is currently facing relevant accusations from the US Environmental Protection Agency of devising a software installed in its diesel vehicles, known as the 'defeat device', that cheated on emission tests. The software switches the engine to a low-emission mode when being tested, and once the cars are on the road the mode is switched off leading to higher emissions that allowed almost 40 times the legal limit of nitrogen oxide (N2O).

On the corporate level, the scandal affected Volkswagen's stocks, which plummeted by more than 40% since the announcement of the news. Moreover, with the heavy reliance on the car industry, Germany might face a significant monetary damage besides the potential threat on the 'Made in Germany' image that always reflected high quality and trust. The company has set aside GBP6.5 billion (US\$9.89 billion) to cover the expected costs of such a fallout, which might scale up with the prospected car buybacks and other problems that could occur such as the violation of the green guide of the Federal Trade Commission. In addition to this, the level of expected pollution and its effect on people's health is undeniable.

Now that we know the scandal details and its aftermath, it's time for a question: Does this pose a threat on the ESG industry? Could have ethical and/or religious filters helped to avoid such a problem?

Table 1: Proportion of SRI relative to total managed assets

	2012	2014
Europe	49%	58.8%
Canada	20.2%	31.3
US	11.2%	17.9%
Australia	12.5%	16.6%
Asia	0.6%	0.8%
Global	21.5%	30.2%

Source: Global Sustainable Investment Review

Volkswagen, the company that was ranked as one of the highest performing companies in its industry, has been removed from positive and responsible indexes worldwide. But is it enough? The scandal showed a massive problem of reliance on companies' self-reporting. Once a piece of information is available, complete transparency is assumed and the company passes on one of the screening aspects. Several companies look at sustainability as a selling edge for them, though what's behind the scenes might be contradicting to what is being reported leading to problems of asymmetric information.

It is, however, interesting to note that as per the internal research of IdealRatings, Volkswagen has been considered as non-compliant for Islamic finance investors, and as such was also non-compliant for ESG investors even before its latest problem appeared on the scene. Volkswagen has both excessive interest-bearing investments and interest-bearing debts, approximately 146.93% and 144.86% of market cap respectively. This should have clearly removed Volkswagen from any ESG and/or Shariah compliant-based investment universe, if and only if the ESG methodology had such filters like interest-bearing debt, which Islamic finance investors use.

The bottom line is sustainability should not be an ad hoc process; it should be fully integrated in the company's business. To truly implement this, four focus points are highly recommended. First, a third-party assurance should be a must on companies providing sustainability reports, just like the independent auditing assurance done on financial aspects. Moreover, since all employees respond to their paychecks, it is highly recommended to tie the company's sustainability goals with the employees' incentive plans. A prominent example is Intel's greenhouse gas emissions that were 35% reduced by 2012 when it applied this method. The latter recommendation is on the way of implementation globally though with a minimal percentage; as per IdealRatings statistics almost 70% of global listed companies do not tie their executives' compensations. By making sustainability goals everyone's job, more effective performance can be guaranteed. Another recommendation which is really important is to incorporate filters like interest-bearing debt to market capitalization as a way to measure management effectiveness as in the case of Volkswagen. (2)

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Challenges and achievements

Standards and standardization are a vital tool and concept in the modern Islamic finance industry. They ensure transparency, consistency and predictability. They lend support to better governance and more importantly, they render financial stability in the market. NOOR SUHAIDA KASRI and IBRAHEEM MUSA TIJANI walk us through the tremendous efforts made toward achieving standardization in the industry.

Islamic financial institutions exist within the global financial system, hence the urge for it to adhere to global financial standards set by the Basel Committee on Banking Supervision, the International Financial Reporting Standards, the International Accounting Standards Board and the like. In addition, Islamic financial institutions must also consider standards issued by Islamic finance standard-setting bodies like AAOIFI, the IFSB and for a country like Malaysia, Bank Negara Malaysia (BNM)'s Shariah standards.

Review of 2015

Looking back at this year, the growth in the Islamic finance industry remains steady with the industry expected to reach US\$3 trillion within the next decade according to S&P's estimates. The growth is hailed as a positive hint of resilience and soundness of the Islamic finance industry. However, there are still great concerns regarding implementation and enforcement of Islamic finance standards within the industry. The IMF at the beginning of the year gave its endorsement for Islamic finance standards; however, it raised concerns regarding the lack of adequate rules. Christopher Towe, the deputy director of the IMF's Monetary and Capital Markets Department, was quoted in an article by Reuters as saying that "our analysis suggests that these standards are not being applied consistently, and this could either stifle the development of Islamic finance or encourage its growth in a manner that creates systemic vulnerabilities".

The reasons perhaps, based on a latest survey on factors affecting the implementation of the IFSB standards (2015 Survey), are due to the difficulties found in the structure and drafting of the IFSB standard; in the structure and institutional capacity of the regulatory and supervisory authorities as well as the general institutional climate of certain jurisdictions.

Shariah standards are also beset with difficulties and challenges. One of the major issues lies in the differences in Shariah views; each Islamic finance Shariah body issues its own resolutions, Fatwas, parameters or guidelines, which are often divergent or even contradictory. As mentioned earlier, differences in jurisdictions and regulatory frameworks also create hindrance and pose challenges to individual countries.

This year the IFSB has issued one new standard, Core Principles for Islamic Finance Regulation (IFSB-17), and one highly important guiding note (GN-6). The GN-6, guidance for Islamic banks on the quantitative measures for liquidity risk management, is important as it clarifies the tools that Islamic banks could use in meeting the liquidity coverage ratio requirement. It defines the types of high-quality liquid assets that Islamic banks can hold and the weights or run-off rates that should be assigned to Islamic deposits.

This year AAOIFI has issued six new Shariah standards, ie Shariah Standard No. 49: Promise and Promising; Shariah Standard No. 50: Musaqah; Shariah Standard No. 51: Option of Properness; Shariah Standard No. 52: Options of Reflection/

Reconsideration; Shariah Standard No. 53: Urboun (Earnest Money); and Shariah Standard No. 54: Conditional Termination of Contracts. The AAOIFI Shariah standards are currently adopted mainly in Bahrain, Sudan and Pakistan, while other jurisdictions implement the standards partially by adjusting them to fit within their regulations. BNM has issued two new Shariah standards this year on Sarf and Rahn. BNM's Shariah standards are produced through years of rigorous discussions held with the International Shariah Research Academy for Islamic Finance along with other institutions.

Preview of 2016

The growing interest of global standard setting-bodies, such as the IMF, World Bank, etc, in the Islamic finance industry will spur closer interactions between these bodies and the Islamic finance standard setting-bodies. This would perhaps lead to convergence in standards, which is necessary to keep up with competition and innovation.

The IFSB in developing its Strategic Performance Plan 2016-2018 would be expected to take into consideration the findings of the 2015 Survey particularly on the standard development and implementation support.

BNM is expected to continue releasing more draft exposures of Shariah standards in order to ensure that all Islamic contracts used in the local Islamic finance industry are covered, in line with BNM's Financial Sector Blueprint 2011-2020. One of the objectives of the blueprint is to strengthen and support the efforts undertaken by international Islamic finance organizations like the IFSB and AAOIFI. The AAOIFI Shariah standards may still remain as the most influential Shariah standards for years to come.

Conclusion

Moving ahead, the need to deconstruct or 'delocalize' international standards and implement them within the context of the local regulatory framework is vital. Thus, divergence of standards does not necessarily produce negative results, rather it accommodates creativity and innovation. However, what is expected in the move toward greater standardization and harmonization is to minimize the various risks, whether financial, legal, Shariah non-compliance, etc, in a more efficient and effective manner. ☺

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Sukuk market has grown a lot but remains a niche market

In what has been a difficult year for emerging markets (EM) fixed income, JAMIL MUFTI is of the view that the lack of issuance has helped support the Sukuk market as demand continues to outstrip supply. Adding to that is the low-beta nature of the Sukuk market due to the stickiness of buy and hold Islamic investors.

There have been a number of external shocks, most of which can be attributed to the anticipation of a rate rise in the US. The fear of a potential rate rise in the US has spooked market participants on both sides of the fence, investors and borrowers. On the supply side, issuers are worried about the uncertainty surrounded by the timing of a rate rise and the volatility arising from such an unknown variable. The demand side has been affected by apprehension toward EM fixed income while sovereign wealth funds of oil-exporting countries have reigned in cash as revenue from hydrocarbon sources decrease.

Review of 2015

There has been a preference to issue Sukuk in EM currencies recently as opposed to US dollars. This has been due to the appreciation in the US dollar versus the EM foreign exchange thereby inflating the hard currency debt load of EM issuers as their currencies weaken. In the GCC, there has also been a preference to tap the local loan market, a trend we have seen for some time now, as liquid banks are willing to lend at cheaper rates to regional institutions as the cost of capital remains low.

Staying on the subject of issuance, there has been an increase in ethical deals, with two issuers this year being World Bank-related: the International Finance Facility for Immunisation, which funds vaccinations, and the International Finance Corporation, which helps private sector development in developing countries. The IDB has also been a regular issuer over the years with no exception this year, issuing a five-year Sukuk, helping liquidity in the Sukuk market as well as funding various programs in developing Muslim countries.

Sovereigns have helped widen the scope of the Sukuk market. Last year, a number of debut issuances from non-Muslim nations – including the UK, South Africa, Luxembourg and Hong Kong – showed the investment community that Sukuk is a good way to diversify a borrower's funding source and widen the investor base.



In fact, Hong Kong tapped the market again this year, this time issuing a Wakalah structure which is not as asset-heavy as the Ijarah structure they used in last year's issuance to provide a benchmark for corporates.

In terms of innovation within the Sukuk market this year, the Sukuk by Emirates Airlines stands out as it was the first Sukuk to be backed by an export credit agency (ECA), namely UK Export Finance. ECA-backed structures allow issuers with a low or no credit rating to receive a credit enhancement therefore lowering their borrowing costs.

As alluded to earlier, the Sukuk market has weathered the volatility in the markets this year and, at the time of writing, returned 2.23% as measured by the Dow Jones Sukuk Index, compared to a return of 1.31% for the Bloomberg Emerging Market Composite Bond Index. High-grade Sukuk have performed well due to a bid for safe haven assets as well as a positive credit move on the back of good sets of financial results out of the GCC, particularly the regional banks.

Preview of 2016

Although issuers have been apprehensive this year due to uncertainty surrounding a rate decision in the US, the Federal Open Market Committee (FOMC) has mentioned that the pace of hikes will be gradual which has flattened the rate curve and should help allay fears of tightening monetary policy hindering growth in the US and to a certain extent borrowers of US dollar debt. In fact, certain EM central bankers were reported to have said that the FOMC should hike sooner rather than later to dispel the volatility in the market. Sukuk issuance could see an increase next year as oil-exporting nations look for a bottom in the oil price weakness, at which point an increase in capital expenditure could be warranted. Also, GCC local rates have been slowly increasing recently, which should encourage issuers to tap the Sukuk market in order to diversify their funding base. As well as more issuances, there should be more clarity surrounding monetary policy in the US which could increase trading volumes as directional views are implemented.

Conclusion

The Sukuk market has grown a lot over the years but still remains a niche market. However, there are a number of ways in which to expand the depth of the market, with the key theme being education. The public should be informed about the availability of Islamic and ethical pension alternatives while issuers should be told of the wider investor base as conventional as well as Islamic investors can participate in Sukuk issuances.

The oil price weakness has slowed the GCC primary market somewhat, but the market has benefited from geographic diversification as issuances from Asia have helped to hedge to some degree the credit move from a lower oil price. ☺

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The current status and future of the Takaful industry

The Takaful industry grew at a dizzying pace in the last 10 to 15 years but the last five years or so have seen it slowing down. There have been some stories of success but several others have been trying their best but not quite getting there. Learning from past experiences, CEOs and the boards of these companies must position themselves for the next phase in supporting the development of the Halal industry and benefiting from its success to become strong and rated Takaful providers. AJMAL BHATTY takes a quick look at the current status of the industry, and what the future holds provided some of the roadblocks that exist in the industry are taken care of.

Takaful providers need to think differently from the ways of the last 10 years, equip themselves with cutting-edge technology of social media to reach out to customers more effectively and build the overall brand of Takaful.

It will not be an understatement to say that the insurance industry (and Takaful) in the Middle East needs rationalization to move forward. The markets are fragmented with too many players chasing a finite number of customers. The irony of it is that Takaful has not managed to create new segments. This has resulted in weaker structures with capital overly exposed to inadequacies of pricing and reserving affecting both Takaful and conventional companies.

Malaysia has done comparatively better in developing Family Takaful, while Indonesia and Pakistan are biding their time in allowing market realities of 'real' demand for Takaful to boost growth through windows of established players rather than through independent but new and 'yet to stabilize' Takaful companies.

Africa is now getting into Takaful more actively since the last five years, and looks toward established Takaful players and Takaful consultants in other markets to help them set up start-ups and seek advice for existing operations to function more efficiently. Sudan, of course, is an exception that has been in Takaful from the very beginning.

Europe, which has a much better appetite for anything ethical, has been in the start-stop mode for several years for Shariah compliant ethical offerings. The reason for the one-and-only Takaful company to go down in the UK in 2009 after only one year of operations had nothing to do with the demand for Takaful but rather about the strategy to enter the market with the most capital-intensive product: motor. Not much has happened in North America in Takaful, but Islamic finance in its various forms has grown there at a wholesale level.

The re-Takaful companies have had a similarly mixed pattern of success and sluggish existence. Not enough was done by these companies to handhold the direct companies in various processes and aspects of risk management, primarily because these entities were also new and were going through their own stabilizing phase. Looking forward, Europe is likely to see Takaful structures and products in the coming years, and Turkey in particular is a market to watch. The Islamic Insurance Association of London is a welcome addition to the global Takaful industry and is likely to be actively involved in helping to find Takaful solutions in the UK and elsewhere. The lead taken by the UAE and Dubai in becoming a global hub for Islamic economy adds a tremendous weight to Halal initiatives around the world.

With so much to handle by the Takaful industry as part of their growing pains, very little happened in microTakaful, certainly nothing on the scale where microinsurance serves some 263 million people. It is incumbent upon institutions like the IDB and state bodies to encourage the development of microTakaful in serving the segment of society that longs to be financially independent.

“ Takaful, with its risk-sharing DNA, works best on a purely mutual company basis where there are no external shareholders and the policyholders themselves own the risk funds ”

Looking at its evolution, it has only been around 38 years since Takaful made its mark in the global insurance space, the latter starting on a commercial footing around 380 years before Takaful. The intrinsic need for financial protection, however, has been there ever since trade and entrepreneurship took roots in the pursuit of maintaining the social wellbeing of society and economy, dating back to the days of Hammurabi in written records some 3,800 years ago, and possibly before that.

So within a space of 38 years, a new system (of Takaful) got established with 224 Takaful companies globally as of 2012, writing an estimated US\$12 billion of premiums by 2013. This is expected to reach US\$25.5 million by 2020. Takaful has grown in double digits ever since, albeit from a small base. However, Takaful is yet to make sufficient inroads, especially in Family Takaful in segments that are severely underpenetrated so far. Takaful has not yet grown at levels to keep pace with the growth in Islamic banking and finance which has assets of US\$2.1 trillion as of 2014 and projected to grow to US\$3.4 trillion by 2018. The game changers for Islamic finance and Takaful in the coming years are various initiatives to develop Halal industry in all areas of the economy.

Preview of 2016

The Takaful industry has been going through a lot of introspection

and quite rightly as the potential for growth remains very high and yet unrealized. (global Takaful premiums of US\$25.5 million in 2020 with Takaful assets of double this amount if Family Takaful picks up). The success lies in fixing a range of areas, the biggest of all being the one that was the very reason why Islamic finance and Takaful came into being: it is a system and not a product. And that the ethical impact of this system must be understood and positively impact the daily lives of people, businesses and investors.

In order for the system to work within another conventional and established system, there needs to be a more concerted effort among its proponents to help it get entrenched in the market. Starting from markets where the majority of people would prefer Shariah compliant products (Muslim-majority countries), the policymakers in these markets need to consider making all types of insurance to be Shariah compliant. That would bring a sea of change in conventional reinsurance markets setting up Takaful structures to accommodate the ceded risk. On the contrary, with customers being used to conventional products, there is a general feeling that the Shariah compliant product is simply a label.

What we know of Takaful is a commercial (Tejari) entity with investors expecting profits. Takaful, with its risk-sharing DNA, works best on a purely mutual company basis where there are no external shareholders and the policyholders themselves own the risk funds. But so long as there are external shareholders, the mind-set needs to work around the fact that shareholders and policyholders (participants) are part of the ‘cooperation within society (of the haves and have-nots)’ in helping bring financial solidarity benefiting people, businesses and investors within the parameters of fairness of the ethical system.

We live in an increasingly competitive world where technology, information and globalization are constantly and rapidly creating complex risk structures that trade and entrepreneurship need to be one step ahead of. This creates huge imbalances of wealth in the hands of a few, where greed takes over to drive business profits leveraged by powerful political lobbying such as by the pharmaceutical and tobacco industries and other industries of similar ilk, and which create huge carbon footprints with little regard to the people and the environment, and where debt continues to chain millions into financial shackles they find unable to get out of. The system of Islamic finance keeps these kinds of imbalances in check, and Takaful is, of course, very much part of this system. ☺

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Slowdown in the improvement of tax legislation for Islamic finance

In 2015, there have been no significant changes in the taxation of Islamic finance around the globe. This is partly due to the economic downturn and partly to the success of efforts to neutralize taxation of Islamic finance instruments around the globe. In this article, ROUSTAM VAKHITOV examines taxation of Islamic finance.

There were significant changes introduced to tax laws in major categories of countries which introduced new laws including capital importing countries and international financial centers such as Hong-Kong and Singapore, among others.

The absence of such locations in this article as London, Kuala Lumpur, Dubai, Amsterdam, Luxembourg, etc, in no way means the absence of relevant legislation, but rather it could be that either relevant amendments have been brought to local laws earlier, which is the case for London and Kuala Lumpur, or that the environment is not discriminatory against Islamic finance solutions (Amsterdam, Luxembourg).

Country developments

Significant changes have been brought into the legislation of South Africa. Following the success of its first US\$500 million sovereign Sukuk in 2014, South Africa introduced changes into tax legislation

“ The next step in legislative developments is to neutralize tax and regulatory effects not just for Islamic finance transactions, but for doing business in a Shariah compliant way in a more general sense ”

opening the door for listed companies to issue Sukuk as of 2016. Such listed companies will be entitled to benefit from incentives from issuing Sukuk and entering Murabahah deals.

Kazakhstan also continued to improve its regulatory and tax environment to facilitate Islamic finance development in the country. Such instruments as Islamic insurance, Murabahah and Ijarah have been the primary focus of the amendments to make operations in these areas tax neutral.

For the first time, discussions to amend Russian legislation to facilitate Islamic finance in Russia have reached the parliament. A working group has been established in the Upper Chamber (Council of Federation) to investigate necessary steps to neutralize the tax effect of conducting financial transactions in a Shariah compliant way.

General observations

The relative slowdown in the improvement of tax legislation in various countries may be explained by significant progress made by a number of countries in the past to neutralize the tax effect for Islamic finance transactions, ie there might be just not that much room for improvement. At the same time, previous changes in tax laws have not always been successful in boosting the domestic Islamic finance industry. The simple reason for this is that Islamic finance is a derivative from the Islamic economy and in the absence of the latter, cannot develop on its own.

Therefore, it would be reasonable to expect that the next step in legislative developments is to neutralize tax and regulatory effects not just for Islamic finance transactions, but for doing business in a Shariah compliant way in a more general sense. ⁽²⁾

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Financial institutions in a heated battle for market share

While the financial services industry has been the fastest-moving sector over the past 30 years, the industry undoubtedly is being and will continue to be affected by weighted shortfalls that it is experiencing currently and those that would show up in the future. ROSIE KMEID analyzes the main initiatives that have floated to the top of most financial institutions in 2015, with a key focus on regulatory compliance.

Although major reform initiatives undertaken by governments aim to strengthen the sector, the financial services industry is undeniably engaging in a battle with three frontiers that are security, regulatory compliance and revenue growth. For the financial services industry, security and regulatory compliance go side by side as strategic concerns, which in turn directly affect revenue growth.

Security

In today's digital age, and fraud taking on an intensified role, the topic of IT security has quickly ascended the attention scale and has become unquestionably a C-suite priority. While the sector may be ahead of many industries in terms of prevention and detection of security crime, it remains a prime target as data is considered a high-value commodity for IT criminals, and financial institutions are struggling to achieve or sustain best-in-class practice in this particular area.

But the news is not all bad. According to experts, the outlook for increased budgets to address security concerns is good. With public perception of the financial services industry sector still at rock bottom, it is worth mentioning that smaller IT security budgets are on the decline these days and security spending is on the rise.

As technology plays a fast-growing role, it has been noted that in 2015 there was a massive spending on IT security initiatives among financial institutions worldwide and this was the biggest jump ever in spending. Large financial institutions have spent vast amounts of money on diversified security technologies and worked on increasing security awareness on the sophistication of cyber attacks. Yet, they found out later that there may still be gaps in spotting potential vulnerabilities before they become a major problem, as with the high upsurge in data, devices and connections, security challenges have increased in number and scope.

The industry is thus more reliant than ever before on technology as many of its advances, i.e. mobile, analytics and cloud, have a direct role to play in the area of IT security. Forward-thinking financial institutions began to leverage and exploit innovative security tools such as advanced authentication and biometrics, many of them cloud-enabled. The top-ranked IT security for the fourth year in a row is further evidence to the increased reliance on technology to help achieve a secure, sustainable financial environment.

Financial institutions are aware that the threat landscape is constantly evolving; nevertheless, they find it difficult to keep up with the latest developments. But no financial institution can afford to be complacent because any organization can be the victim of a costly security breach, regardless of size. Security is too important not to be given due consideration, and the threats against the financial sector look like they will only continue to escalate.

Regulatory compliance

On the other hand, the more invasive regulations to curb undue risk-taking by financial institutions aim at regaining and maintaining high performance. It is becoming increasingly clear that the historical approach to dealing with regulations and compliance will no longer work. Financial institutions are being asked to comply with a steadily increasing number of international, local and industry regulations and standards with each having its own rules and reporting requirements, and these include the Sarbanes-Oxley (SOX), J-SOX, CCAR, COSO, COBIT, IFRS, IAS 7, FATCA, various ISO/IEC international standards, the EU Data Protection Directive and the Directive on Payment Services 2, Basel II and the new Basel III frameworks. Likewise, Islamic financial institutions are advised to comply with AAOIFI accounting and auditing standards and IFSB capital adequacy guidelines for a greater harmonization of international Islamic finance practices, to achieve operational excellence and to strengthen the sector.

Although we noticed that in 2015 the vast majority of nations started to reshape their laws and regulations to comply with a series of international banking rules, following these directives often takes a significant amount of time and effort whether in developing appropriate internal controls, or during implementation and monitoring compliance.

The Basel accords for instance, which were endorsed by the G20 nations, are voluntary agreements among national banking authorities. This means that recommendations are enforced through national laws and regulations, rather than as a result of the Basel Committee on Banking Supervision's recommendations; thus some nations tend not to implement the committee's policies at all, and if they do, some time may pass between recommendations and implementation of the law at the national level.

For Islamic financial institutions, compliance with the legal framework referred to as Shariah law is mandatory, but compliance with AAOIFI and IFSB (two international Shariah standard-setting bodies) is not, and that explains why their recommendations are not implemented by all Islamic financial institutions and also explains the availability of a Shariah board for each individual institution.

The dilemma currently experienced in terms of the divergence of AAOIFI accounting standards implementations and the inconsistency of financial reporting, and the IFSB's capital adequacy, risk management and corporate governance standards, which serve to complement the guidelines of the Basel committee by catering to the specificities of Islamic financial institutions, poses a great threat to the sustainability of the industry. The latter even went as far as to clarify the tools that Islamic financial institutions can use to meet Basel III regulatory requirements. Both institutions' frameworks are currently the subject of much discussion and review to determine the factors associated with nations' and Islamic financial institutions' non-compliance.

On one hand, it is undisputable that compliance with Shariah is necessary to ensure that all matters related to Islamic financial institutions are within a legal framework which is acceptable to the entire Muslim community. But on the other, there isn't a coordinated and unified approach among Islamic nations as to the interpretation of pertinent Shariah laws. Serious attempts are being made by AAOIFI and IFSB to gather support to identify the gaps at various stages of implementing their initiatives; as yet, no such progress has been noticed.

The financial regulatory landscape is getting crowded and there are numerous initiatives scheduled for both short and medium-term implementations which need to be addressed through robust technology platforms capable of reacting quickly to changing market conditions, and more effectively managing complexity.

Revenue growth

It is evident that the top priority for financial institutions across the globe is growth. The two most important constituents that need to achieve this target are IT security and regulatory compliance to contribute together to that growth.

Increased growth of revenue, greater reduction of cost, and more effective handling of internal risks and external threats are reflected in financial institutions that swiftly react and adapt to changing environmental conditions. They can not only respond quickly to detected IT security threats, but they can also anticipate the imposition of new regulations and adapt quickly to changing circumstances.

But adapting quickly to a changing competitive landscape in the financial services sector is easier said than done. The progressively tightening regulatory frameworks and evolving threat of cybercrime are fast-integrating and burgeoning. Despite an unusually uncertain economic outlook, financial institutions remain determined to find ways to maintain profitability and expand their market share. In 2015, many financial institutions have been responding to the new challenges by modernizing their legacy systems. Nonetheless, others remained skeptical and uncertain about how to adapt their businesses and operations to new security and regulatory demands and are far from discarding their old technologies to adopt new ones.

Conclusion

Looking back at 2015, after a long latency, the reforms have helped most, if not all financial institutions to reposition themselves and try to adjust and capitalize on new opportunities for growth. Early results of these strategic priorities were evident in industry performance last year.

Going into 2016, we are likely to see more of these initiatives in one of the most transformative periods in the financial services industry. In pursuit of growth and profitability, the industry will seek to better acclimate to regulatory pressure by investing in compliance infrastructure and enhancing IT security. These trends will keep profitability front and center as the sector improves in the years to come.

The future of financial services promises to be one of the most important and challenging journeys in the decades ahead, and technology's role, being a level-playing field will become even more vital for the industry to perform better.

Make no mistake – the stakes are high and will only increase over time. The challenge for financial institutions will be to leverage the power of technology by achieving a global operating model that would give them the edge in this dynamic environment. ☺

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Spotlight on Islamic trade finance: ITFC's new drive to reach out to SMEs and expand regional presence

Fully cognizant of the fast-changing global environment and the ramifications on its business, the INTERNATIONAL ISLAMIC TRADE FINANCE CORPORATION (ITFC) in this article details how it is gearing itself to effectively deal with the prevailing challenges and its strategic direction for the future.

Key challenges in 2016

In addition to those challenges deemed to have a direct impact on the business, namely the drop in oil prices and the slump in commodities in general, there is also the challenge of a lack of clear visibility on the stability of global markets and the competitive pressure from other players moving aggressively into our niche markets (Islamic finance and structured trade finance (STF)) through alliances with specialized partners thus reducing the barriers to their entry.

2016 and beyond

The momentum for diversification gathered pace in 2015 and the ITFC succeeded in extending its trade solutions to more countries and clients. During the year, the ITFC saw its opportunities expanded with the addition of new clients to the portfolio and re-adjustment in exposures with top clients.

This in part is due to the ITFC's strategic drive for growing field presence and client proximity, which helped improve the overall

business portfolio. The ITFC started its push for regional presence in 2014; however, this got into full swing in 2015 with the relocation of client-coverage staff from its headquarters to field offices in Turkey, Indonesia, and Senegal. So far, the early result is promising as we see the investment in regional presence paying off. Overall, the ITFC is building its strength on the Regional Presence Strategy and 2016 is expected to see further expansion, resulting in more diversification and client proximity.

Overcoming challenges: Economic and political instabilities affecting trade financing in member countries

Economic and political instabilities in some of our major member countries have affected trade financing volumes in some countries. For instance, the volume of business for petroleum financing for the government of Bangladesh witnessed a sharp fall due to the IMF's conditionality on the government of Bangladesh capping the ceiling on short-term borrowings. In addition, there is the lower

wheat production outlook in Kazakhstan, affecting the Central Asia trade financing approvals in 2015. Notwithstanding this, the main driver for the Asian business has come from Turkey, following the successful launch of the ITFC's field presence in the IDB Gateway Office in Istanbul.

Due to rapid changes in the market, there will be a shift over the coming years that will allow the ITFC to diversify its portfolio further and penetrate new markets and new countries geographically. Though the aforementioned unforeseen events unfolded beginning in 2015, they also accelerated diversification in the products and countries. Over the next three years, the ASIA/Central Asia Team is expected to strengthen its STF business in Turkey, Central Asia, Indonesia and Bangladesh. It is expected to represent around 60% of growth and the remaining increments are expected to be from the organic growth from the other regions.

The MENA/South America portfolio growth in 2016 will focus on consolidating the gains in the previous years in Egypt, Tunisia and Jordan as well as ensuring the sustainability of the newly acquired sovereign business in Djibouti, Comoros and Suriname.

It is worth noting that the MENA region has made a quantum leap in its business since 2014 whereby the volume grew by over 50% in one year, pushing the region to have a bigger slice of the ITFC portfolio of around 44%, up from the traditional 28% that was prevailing in the previous years. The challenge, however, will be to maintain and grow that percentage.

The ITFC's financing for sub-Saharan Africa (SSA) witnessed stellar growth over the past two years with the portfolio nearly doubling. The ITFC revamped the team managing the SSA portfolio and added new headcount, which led to a significant scaling up of the business. Overall, in 2015, the ITFC was able to consolidate its SSA portfolio as well as add new sovereign deals from countries in West Africa while growing its portfolio in Nigeria. As we move into 2016, a renewed focus will be on Eastern Africa, where the portfolio needs a push with deals expected to be structured transactions covering commodities such as petroleum, rice, fertilizers and agro products. African economies are witnessing strong growth with seven out of the ten fastest-growing economies being from Africa. This offers the ITFC enormous opportunity for growth and expansion while fulfilling its mandate of contributing to economic and social development through the provision of trade.

Private sector development

The only way for member countries to achieve sustainable economic development is through the development of a vibrant private sector. A strong private sector will lead to a diversified economy which will be better equipped to absorb shocks and minimize the effect of downturns which are becoming more frequent, the recent drop in oil prices being a case in point.

The ITFC will continue to pursue a strategy of increasing its financing portfolio to the private sector while at the same time ensuring that the quality of the portfolio remains sound, underpinned by the use of innovative and secure financing structures. It is the ITFC's objective to encourage interaction with private sector players to assist member countries to have access to private and public funds, including access to financial markets for the purpose of financing trade.

Enhancing access to finance for SMEs in member countries

SMEs are major contributors to the economic development in member countries particularly as they relate to job creation and revenue generation. This is even more so for emerging and developing countries. In the least developed member countries (LDMCs), SMEs face the daunting challenge of securing access to financing, a huge constraint to growing their business. A number of

studies have revealed the huge financing gap facing SMEs. Experts indicate that the key obstacle hindering SMEs, particularly in LDMCs, is their inability to access working capital and trade finance. According to studies by industry experts, sub-Saharan Africa alone has registered a financing gap estimated at US\$100 billion.

ITFC instruments for reaching out to SMEs are primarily through partnership with local and regional banks by extending fully funded lines of financing. The ITFC shall be more confident to increase its support to SMEs and given its growing geographic footprint, it shall be able to reach and serve more SMEs in various member countries. In recent years, this portfolio has expanded, reflecting the ITFC's renewed focus on supporting SMEs to gain access to adequate financing, particularly in member countries in Africa and Asia/Central Asia.

Over the next three years, support to SMEs will be one of the key pillars in the ITFC's strategy. This will not only help member countries achieve a balanced economic development and job creation, but with the ability to extend euro-denominated financing operations to cater to the private sector in certain geographical areas where our financing will be a catalyst filling the gap created by the departure of traditional commercial financiers.

Leveraging customized solutions: Using STF to support the private sector

Several international banks have re-tapped the STF markets in recent years, putting the ITFC in face-to-face competition over clients in some instances. The ITFC will not only work toward maintaining its role as a major STF player, but will also entrench itself as a global leader in this field.

Currently, the ITFC uses STF to provide financing mainly to private sector companies in all three regions, namely Asia/CIS, MENA, and Africa. The ITFC envisages growing this product in the coming years and it will serve as the main instrument to reach private sector companies in member countries. The commodities financed include strategic commodities such as petroleum and agro products. Using STF, the ITFC plans to expand into new commodities as well as add new companies in new markets. This will create a win-win solution whereby the ITFC will be able to extend its reach to the private sector and grow its business while at the same time maintaining a healthy portfolio with secured financing. It will help the ITFC fulfill its mandate of supporting the private sector while contributing to diversification and reducing the trade finance portfolio risk profile.

Conclusion

In line with the overall strategic direction, the ITFC will continue to cater to the needs of the public sector in member countries by financing trade for major commodities imported.

The ITFC will continue to make a push to grow its 2-Step Murabahah Financing and Line of Finance to serve the SME sector, while employing innovative solutions such as STF to provide financing to players in the private sector. (3)

This article was contributed by the International Islamic Trade Finance Corporation.



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Building private equity and venture capital investments through diversification within the Muslim world

As a World Bank official recently observed, SMEs are the lifeblood of Muslim communities around the world, keeping local economies humming. The number of middle-class and affluent consumers in Muslim communities worldwide remains small compared with the Organization for Economic Co-operation and Development (OECD), yet contained within them one finds emerging conditions for the widespread promotion of venture and growth investment. ARSHAD A AHMED opines that it remains to be seen whether the Islamic finance industry – debt oriented as it is – will find a way to embrace these equity-based investment opportunities.

Fortunately for the Islamic finance industry, the Muslim world comprises numerous pockets of rapid economic transformation, where discretionary consumption is on the rise and structural dislocations abound. These pockets dot Southern Asia from Indonesia in the east to Saudi Arabia and Turkey in the west, albeit the nascent scenes in Morocco and Nigeria must also be noted, as should the rise of Halal-cognizant enterprises in the west.

Review of 2015

Emerging and frontier markets generally lack the business conditions necessary for repeat occurrences of leveraged buyouts (LBOs). In a sense, this is fortunate because in the writer's own private equity/venture capital (PE/VC) career spanning nearly two decades, the most lucrative PE/VC deals relied on no leverage at all, whether inside or outside an emerging market. They were 100% equity investments in growing businesses that generated returns 10 times over in just a few years. Growth equity, venture capital, and unleveraged mergers and acquisitions (M&A) do not rely on debt, and they generally prefer investing in businesses that are debt-free.

All the ingredients needed are willing entrepreneurs, growing SMEs, and a tolerable corporate governance regime (and having viable exit options would help, although China and India have shown this is not necessary). Growth equity, venture capital, and unleveraged M&A, in that order, continue to be the most common varieties of PE/VC deals in emerging markets generally. 2015 is unlikely to match last year's record heights in terms of global PE/VC value.

2015 turned out to be the year when legal reforms that favor PE/VC investments did not take place in Muslim countries in key areas such corporate governance and bankruptcy. Legal reform to support PE/VC investment in SMEs continued to be haphazard among Muslim countries vis-à-vis leading emerging markets such as China and India, let alone OECD markets. For example, the Indonesian investment coordinating board's 'Negative List' may be well intentioned to protect infant industries in Indonesia, but digital technologies, including consumer internet – common sectors for PE/VC investment – are designed to ignore political borders, a truth that the Indonesian government in 2015 not only failed to recognize, but as a result failed to develop more nuanced policies beneficial to local entrepreneurs by which locals might gain access to the strategic guidance and best practices that investment from a global investment firm would undoubtedly bring.

Unfortunately, the series of policy measures issued in 2015 by Indonesia's president Joko Widodo (popularly known as Jokowi) were intended to benefit huge government-level investments rather than to sustain SME funding. "We want to give a strong impression that we are undertaking a fundamental transformation," Jokowi told ministers this year, but investment regulations relating to SMEs – and by extension to PE/VC – were unimproved this year. In contrast, Indonesia's smaller neighbors, Malaysia and Singapore, were more active in promoting SME integration into global technology investing scenes.

On the continent's western end, Turkey remained home to the Islamic world's most robust native PE/VC ecosystem. In the nearby Arabian markets, regulators continued to suffer unique circumstances and issues to address, such as a general dearth of entrepreneurial talent, a lack of enthusiasm among investors to take PE/VC positions and the overreliance on debt instruments on the one hand, and real estate as an asset class on the other. However, most encouragingly, a Saudi VC and Turkish VC in early 2015 teamed to co-invest in Turkey's leading online retailer of Muslim fashions, which was organized via Borsa Istanbul's Private Market platform – a model program for encouraging PE/VC investments in SMEs.

Preview of 2016

Will PE/VC's exit activity – the generator of returns – be strong enough in 2016 to attract more PE/VC to Muslim countries at a time when dollar rates start to rise? History tells us that regulatory reforms will be lacking, so the force of attraction rests squarely on entrepreneurs throughout Southern Asian emerging markets such as Indonesia, Turkey, Saudi Arabia, Malaysia, the UAE and Bangladesh. These markets can learn from one another because how an economy like Turkey, for example, must deal with secular trends such as climate change, youth demography, mobile and internet penetration, etc, has more in common with Indonesia or Malaysia, than, for example, it does with Germany, Japan or Singapore. It is the recognition of these common traits that leads to the conclusion that one can build an internally synergistic portfolio of PE/VC investments just by diversifying within the Muslim world. PE/VC actors outside of the Islamic finance industry have already started to learn this, and in 2016 we expect to see it start to trickle into Islamic finance thinking, at least a little. ☺

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The Islamic wealth management industry: An alternative approach

Islamic wealth management is the fastest-growing financial segment in the Middle East, with the industry already beginning to gain a foothold in various Islamic financial markets, due to the rising affluence of like-minded investors worldwide. AKASH ANAND dissects the Islamic wealth management industry.

In 2014 for instance, the number of ultra high-net-worth individuals (UHNWI) (defined as having a net worth of at least US\$30 million) residing in the UAE grew at a rate of 5%, according to global property consultancy Knight Frank. Indeed, total UHNWI wealth in the Middle East is currently estimated at US\$700 billion according to the same report, and is set to grow by 40% over the next 10 years.

Naturally, these types of investors are spreading over the world with significant wealth, and coupled with the 'ethical aspect of investment and banking', have created a demand for Islamic wealth management services. In the core Muslim-majority markets, the share of Islamic assets is steadily rising: Saudi Arabia's Islamic assets, for instance, have already reached 52%, with various other markets expanding at double-digit growth rates.

Furthermore, a number of conventional banks have established Islamic wealth management windows in line with Shariah principles - investments that are free of interest and on a risk-shared basis. Multinational private banks have also begun to cater to this trend, by partnering with locally-based Islamic asset managers. This allows banks to share expertise and increase the number of client offerings like Murabahah, Sukuk or Shariah compliant equity investment opportunities, through direct lines, diversified funds or discretionary mandates, and through a philosophy of responsible investment.

The private banking and wealth management sector appears to be on the right track, as evidenced by the growing number of asset and wealth management players. This indicates that the field is developing a strong footing, and, it would seem, is poised to enjoy a vibrant future.

Despite the global financial crisis, the majority of investors and asset managers still believe that performance and efficiency during the past five years remained the same or surpassed expectations. Building on this momentum, most asset managers are willing to increase their Islamic investment holdings in the next 12 months.

While the GCC has emerged as the most preferred investment destination for investors and asset managers, Sukuk and equities are equally popular asset types for 2015 and 2016. Most asset managers also highlighted a preference for a more supportive Shariah framework within their markets.

The key areas of opportunity available to the Islamic asset management industry include Islamic wealth management, private equity, crowdfunding, sustainable investing, and socially responsible investments.

Almost 70% of Middle Eastern wealth is transferred overseas. To attract this wealth, Islamic asset managers need to compete with institutions overseas by providing both attractive yields and a superior level of service quality and product customization.

Contribution of technology

As it becomes apparent that the demand for Shariah compliant wealth management business is growing significantly, it is therefore important to understand the role and importance of world-class solutions that

can address the complex requirements of this business. Wealth management is introducing new players, new business models and giving the power to the customer. For instance, wealth managers and customers nowadays require use and information while on the go, ie mobility. The products offered by Islamic business follow certain accounting standards adhering to AAOIFI: asset classes to have different treatment, portfolio composition needs extra filters, calculations, etc. Therefore it is very important for this business to invest in robust solutions that can address these requirements seamlessly. The interpretation of Shariah may differ from one country to another and from one region to another. Unfortunately, in Islamic finance there is no set of financial standards until today that forces all banks across the world to adhere to as is the case in conventional finance.

For example in Malaysia, there is a Shariah board at the country level, and in coordination with the central bank of Malaysia, Bank Negara Malaysia, they regulate this industry. In other countries, central banks set burdensome laws and regulations, and each bank has its own Shariah board to interpret the Shariah and create financial products that fit the board's interpretation. The only way to adhere to these multiple sets of heavy rules and regulations is to have flexible technologies, all-embracing regulatory reporting tools pre-built in the system, to anticipate and address pending regulatory changes while maintaining compliance in the most cost-effective and efficient manner. This means that the system has to be completely parametric, flexible and customizable to allow these differences in implementation.

Elements that contribute to the competitiveness of the Islamic finance institutions include the following:

- Digital services and advice available to clients
- Strengthen an outcome-oriented portfolio construction
- Better collaboration of wealth and asset managers to deliver stronger investment propositions
- Transparency is key across all models (discretionary, advisory, execution-only) so that automation and efficiency are achieved
- Enhance the frontline productivity
- Comprehensive regulatory reporting coverage with a flexible and robust rules engine
- Customized product definition and accounting coverage, and
- Multicurrency, multilingual, multi-asset class, omni/multi-channel coverage.

In terms of technology, mobile and cloud technologies have been utilized to offer more capabilities to the industry ranging from providing a personalized client service with a unique experience in the design to cost efficiencies since in some cases there is the freedom of no internal IT infrastructure but with the option of a private or public cloud with utmost security by the provider, which always needs to be verified. Such tools enable Islamic finance institutions to enhance their services and to stand out from the crowd. ⁽²⁾

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NBF Islamic: Steadfast in growing market share

The UAE Islamic banking market is competitive to say the least, yet, in the short 12 months since its launch, NBF Islamic — the Shariah banking window of National Bank of Fujairah (NBF) — has managed to turn a profit and attract over AED1 billion (US\$272.2 million) in deposits. VINEETA TAN speaks to the person driving the success of the business, CEO Vince Cook, and asks what else we can expect from one of the emirates' youngest Islamic banking players.

NBF Islamic has been keeping busy. From developing new retail products to widening its customer base, the Islamic unit has also been hard at work enhancing its services to better capture the corporate and SME segment. "We have been busy integrating Shariah compliant services with our wholesale business; a good example of this being the Islamic tranche that we helped structure as part of a broader club financing for Pacific Controls, a client in the global information technology business," shared Cook.

As with most Islamic windows, NBF Islamic draws strength and support from its parent bank — a long-established player with over three decades of experience in the banking landscape of Fujairah.

"Our status at Fujairah's national bank provides us with a home ground advantage that manifests itself in everything from high brand awareness and preference to strong government and client relationship — factors that we actively leverage to stay ahead," said Cook who further added that: "Most importantly, there is growing recognition for the value of the carefully segmented industry specializations we develop to understand our customer needs across a variety of targeted industry and business segments. The establishment of our Islamic banking services clearly adds to the breadth of the solutions we can provide."

“ As regards the capital markets, we are already active as an investor and trader in the various market instruments, including Sukuk ”

Yet, for all the lead that NBF has in its home market, it is interesting to note that operations in Fujairah only accounts for 20% of the bank's total business. The bulk of the business comes from its pan-UAE network which stretches beyond its home emirate to the key business and trade hubs of Abu Dhabi, Dubai and Sharjah; and Cook expects NBF Islamic's growth story to develop in a similar fashion with an immediate primary focus on the consumer banking as well as corporate and SME segments.

"Our focus in the coming months would be to scale up our commercialization efforts and seek customer feedback so as to improve on our product and service mix," he said. And the bank is indeed constantly innovating. Earlier this month, in response to



the growing sophistication of the banking market, NBF rolled out a dedicated unit — staffed by local female corporate bankers — to support emirati female business leaders and entrepreneurs.

"The increasingly crucial role that emirati business women play in the future of the UAE requires little explanation, and as a customer segment, it is certainly deserving of greater attention from the local banking sector," commented Cook on the launch of NBF Elham.

With the bank surging forward in the retail and wholesale space, what then of capital markets?

"As regards the capital markets, we are already active as an investor and trader in the various market instruments, including Sukuk. However, we will want to build a broader distribution capability before we seek mandates for primary issues," explained Cook. "I am sure this will happen in the years ahead but it is not an immediate priority."

So it seems that while the Shariah window is still at a nascent stage, its progress is commendable and most certainly not only reflects on the parent bank's strategy and execution, but also the opportunities available in the UAE Islamic banking market — despite the current global market turmoil.

"We have had a number of very strong years, so we are likely to see more moderate growth in the near future, but the UAE still represents great opportunity for many; it has developed an increasingly diversified economy and has built substantial reserves that will help it weather the current challenges."

And with domestic Islamic assets expected to double to US\$260 billion by 2019, Cook stands firm that there is enormous potential for the Islamic banking sector to thrive in the UAE. ☺

Path Solutions

The Islamic banking and finance industry may still be posting positive growth but the industry has recognized that to move forward and be at par with the conventional, digital innovation is imperative. In this exclusive interview with MOHAMMED KATEEB, the group chairman and CEO of Path Solutions, we explore latest banking technology trends, market outlook and gain an insight into the firm's strategy, aspirations and achievements.

2015 has been an interesting year with a strong technological focus on mobile banking, branchless banking, fintech, digital currencies and cloud platform among others. What are some of the most exciting trends you've witnessed in 2015, and what are some of the most momentous achievements for Path Solutions?

The financial services industry is undergoing significant structural and regulatory changes as a consequence of changing customer behavior, channel proliferation and the digitization of operations in general. Financial institutions are responding by making significant investments in core banking systems' replacement, digital channels and data analytics to ensure their ongoing competitiveness.

As you know, Path Solutions' operations focus around a very specific area of expertise to a niche market which is developing software solutions for the Islamic finance sector. Our multi-award-winning Shariah compliant solution offers extensive coverage of compliance and reporting with robust capabilities focused on mitigating risk, reducing costs, automating and streamlining processes, and improving customer responsiveness across the organization, all top priorities toward achieving Islamic financial institutions' continued growth and profitability.

“ Our company's business strategy is reflected in our approach to providing next-generation Shariah compliant software solutions and services to a booming Islamic financial services industry ”

Geographically, we have witnessed traction and were winning contracts last year in Oman following the new CBO's Islamic Banking Regulatory Framework which opened the door for both conventional and Islamic banks to market Shariah compliant products, and where Islamic banking services could make up to 20% of the country's overall financial services sector in the future. This was one of our greatest achievements to date, as Path Solutions won the contracts of six out of eight new Islamic banks in just one year in the Sultanate.

Which markets were most interesting in the Islamic banking technology space in 2015 and why?

Our company's business strategy is reflected in our approach to providing next-generation Shariah compliant software solutions and services to a booming Islamic financial services industry, which

would position Path Solutions as the undisputed market leader in this segment globally.

Geographically, in 2015 we shifted our focus to North Africa. We have been monitoring countries like Tunisia, Morocco and Algeria for accurate forecasting of industry trends to effectively cater to market requirements from an IT perspective. In 2015, major reforms were announced in Morocco and the liberalization process got started by adjusting regulatory frameworks to accommodate Islamic finance. The North African countries are still in their early development stages, far from achieving a completely rational exploitation of their full potential in this sector, therefore the growth of Islamic finance in North Africa denotes lots of opportunities for us, and hence Africa remains a focal point of our upcoming agenda.

What is your 2016 market outlook for the Islamic banking technology market?

Islamic finance, along with underlying technologies, continues to develop in various parts of the world, each of which is at a different level of development. In some markets, the industry is mature with very strong fundamentals and regulations, and in others like in the west, it is just starting to wake up to its potential.

We saw some markets go through consolidations in the last few years and other new markets came to existence. Due to the political and economic turbulence in the Middle East and Europe, the last few years experienced tremendous slowdown in key Shariah compliant financial markets like Iraq, Syria, Egypt, Yemen, Libya and others. In Europe, many key initiatives either halted or slowed down. The demand for Islamic banking technologies in those markets specifically decreased as it is no longer a priority. On the other hand, Africa continues to grow as an emerging market as we've seen rapid growth in several regions in which we find greater opportunities for our Shariah compliant software solutions and services. Southeast Asia continues to be a stable and mature market and Central Asia is a key emerging region, forecasted to be the next center of Islamic finance, but still at its infancy stage right now.

What do you hope to achieve next year?

This year, we have brought in the mobility and the cloud to our offerings, and introduced new and improved Business Intelligence and Risk Management solutions characterized by flexible technical architectures and an expanding data warehouse. We are also upgrading and expanding our eChannels, so that our clients could offer the best digital services to their customers, run more efficient operations and gain insight into their businesses. In addition, we will continue to grow our line of Shariah compliant software solutions, invest and launch next-generation banking applications, thus meeting clients' and market expectations. Of course, we are determined to continue our expansion into new geographic markets such as the CIS countries, and thus broaden further our client base. ⁽²⁾

Mohammed Kateeb is the group chairman and CEO of Path Solutions. He can be contacted at info@path-solutions.com.

Australia slow to capitalize on Islamic finance opportunities

By Dr George Mickhail

Australia has one of the most efficient and competitive 'full service' financial sectors in the Asia Pacific region and is situated close to the fastest-growing region in the world. The Islamic finance industry is not only growing rapidly in the world, but is also showing stability and resilience in the face of instability in the global markets. However, Australia has been slow to capitalize on the opportunity to develop and export Islamic finance services.

The weak demand for Islamic finance products and a small Australian market that has not grown much in the last few years are primarily due to a taxation system that penalizes Shariah-based transactions. Debt finance that is Shariah compliant is primarily offered by banking institutions with Islamic capital market practices, whereas a small number of Islamic investment funds offer Islamic superannuation, property, cash, Australian and international shares.

The government's inaction in introducing regulatory reforms to a small fragmented market is no doubt mirroring public opinion poll ratings that gauge the community's ambivalence about Islam due to a number of Australian Jihadists joining ISIS in the Middle East, a few cases of terror financing and rare terror attacks on home soil.

Review of 2015

Regulatory changes

The signing of the China–Australia Free Trade Agreement (ChAFTA) on the 17th June was significant due to China drawing upon funding sources, especially Islamic finance, to fund its continental Silk (land and maritime) Road through Central and Southern Asia in the direction of Europe. This is a historic opportunity for the Australian Islamic finance industry to grow and capitalize on international demand when demand is weak at home. On the 30th July, the Australian Prudential Regulatory Authority, the banking regulator, signed an MoU with its counterpart in the UAE, the Dubai Financial Services Authority concerning cooperation in banking and insurance supervision (including Islamic finance).

On the 20th October, the government's response to the Financial System Inquiry Report with its 44 recommendations and 237 submissions (including 11 submissions which referred to Islamic finance) did not make a single reference to Islamic finance. To date, there has been no response by the government regarding the unreleased Board of Taxation Report on Islamic Finance from 2011, which was subject to criticism by a number of institutions that included, among others, the Australian Stock Exchange, the Australian Bankers Association, and the Financial Services Council.

Key transactions

On the 2nd April, Amanie Advisors announced that they would target co-investments in asset leasing in the infrastructure, aircraft and property sectors in Australia, while on the 14th April, the Australia-based Waratah Resources entered into a non-binding agreement with the Malaysia-based Amanie Holdings to form a joint venture for the purpose of funding and expanding its commodity trading business. The main deal of the year was on the 26th August, when National Australia Bank (NAB) concluded its first Shariah compliant structure (Wakalah) for AU\$20 million (US\$14.11 million) with Crescent Wealth to fund its AU\$30 million (US\$21.16 million) real estate purchase in Melbourne.

Industry participants

In February, the CIMB Group of Malaysia closed down its investment

banking operations in Australia, less than three years after acquiring the Royal Bank of Scotland business in Australia. Meanwhile in April, Crescent Wealth announced that it had set up an office in Malaysia.

New product developments

On the 21st September, Australian law firm Ashurst announced the development of a Shariah compliant structure that suited the Australian legal, taxation and stamp duty regimes. It builds on its experience with CIMB-Trust Capital Advisors that structured and executed a Shariah compliant real estate financing structure of a commercial property in Melbourne for one of Malaysia's largest pension funds, Tabung Haji.

Challenges

Treasurer Scott Morrison, whose federal electoral platform was vehemently anti-Muslim, is certainly not a proponent of Islam or the Islamic finance industry. In late October, a new anti-Islam Australian Liberty Alliance (ALA) political party was launched by no other than the leading anti-Islam Dutch politician, Geert Wilders. The anti-Islam movements in Australia use social media to organize nationwide rallies that are hostile to Islam under the guise of rejecting Islamist violence, which they claim is being financed by Shariah compliant Halal products. Companies understand the unpredictable, spontaneous, and potentially viral nature of social media such as Facebook which is the largest source of news and drives more traffic to media sites than Google. Accordingly, large financial institutions do not promote their Islamic products on their websites due to concerns about reputation risk.

Preview of 2016

The lack of growth in the industry may be offset by the growing international demand for Islamic finance. A case in point is funding required by China to finance its strategic Silk Road infrastructure project, and it is increasingly being sought from Middle Eastern and Islamic countries, which opens the door for the Australian Islamic finance industry to grow and participate under the favorable conditions of ChAFTA.

Conclusion

ChAFTA will enable the Australian Islamic finance industry to fulfill China's appetite for Islamic finance partnerships to fund its new Silk Road, which may live up to its medieval legacy in boosting entrepreneurship and spreading Islamic financial innovations along its route. China's infrastructure-driven alliances will not only bring prosperity to its underdeveloped western part, but to Russia (its ideological partner to contain US influence in Eurasia), and to other economically vulnerable nations along its new Silk Route, which no doubt would help neutralize the existential threat of Islamist fundamentalism in the long run.

The ethical character and financial stability of Shariah compliant investments coupled with social cohesion through geo-economic alliances may bring about much-needed economic prosperity and sustainable development to a world divided by crippling national debts and the rise of the extreme right in Europe. (F)

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Bahrain: Keeping pace with competitiveness

By Dr Hatim El Tahir

For over two decades, the Kingdom of Bahrain led a strong base in the financial services and other non-oil sector services. And increasingly, young and well-educated people are engaged in boosting the pace of economic development in the country.

“ A focus on financial services and social and civic and human capital needs would drive further stability and growth in the Kingdom ”

By all measures, the year 2015 was not as good as many industry analysts have anticipated. The GCC region has been faced with the challenges of budget deficits due to the sharp fall of oil prices. However, some of the major social infrastructure projects may go ahead with financing and constructions. Others may have to wait until global economy recovery materializes and oil and energy prices get back to better rates that generate enough income to finance projects in the GCC.

Evidently, growth in non-oil sectors of the GCC showed relative

Table 1: GDP growth in 2014 and forecasted growth for 2016

	2014	2015 forecasted	2016 forecasted
Real GDP growth %	4.5	3.6	3.2
Nominal GDP growth %	2.9	-3.2	8.6
GDP (BD Billion)	10.82	11.17	11.60
Consumer price index %	2.8	3	3

Sources: Bahrain Economic Development Board, Bahrain Economic Quarterly, September 2015; Oxford Business Group, The Report Bahrain 2015

economic stability and helped consumer confidence. According to the Economic Development Board in Bahrain, the forecasted growth for the Kingdom's non-oil sectors for 2015 was estimated at 4.6% and real GDP growth during the year at 3.6%. That is less than 1% (0.9%), also less than the previous year. Table 1 shows the changes of GDP growth between the year 2014 and forecasted growth for 2016.

Bahrain's transportation and communication sectors have been experiencing the greatest amount of year-on-year growth at 6.7% in the second quarter of 2015, followed by construction at 6.4%, and social and personal services at 6.2% (see Chart 1).

Oxford Business Group reports that the country's finance sector is one of its main economic drivers, with financial services constituting 25% of the country's GDP. The energy sector continues to account for the majority of the government's revenue; however, the proportion of GDP that it constitutes has recently been decreasing.

The regulatory environment

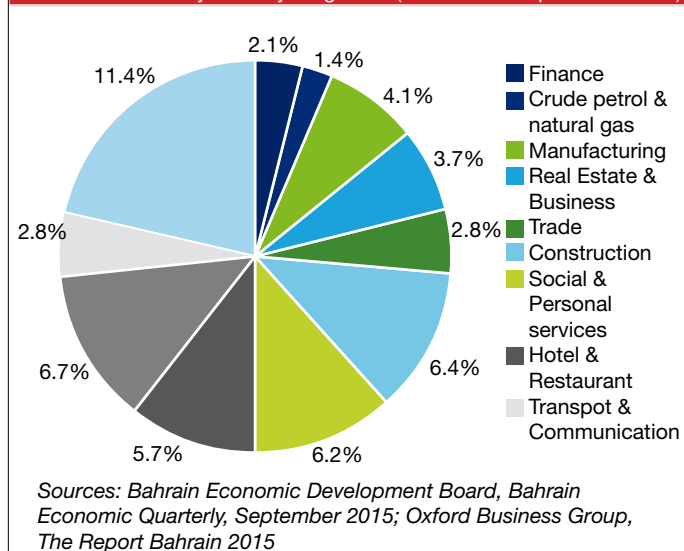
The Central Bank of Bahrain (CBB) continued to provide strong support to the financial industry which provides a significant percentage to the country's GDP and economy as a whole. One of the recent initiatives in the Islamic finance space is that the CBB is currently working on providing a framework for Shariah governance of institutions offering Islamic financial services.

The proposed centralized Shariah Committee will organize and agree on practices that all institutions offering Islamic financial services in Bahrain should follow (as opposed to each institution having its own Shariah board to govern only their own products and services). This approach to harmonize practices of issues relating to Fatwas and Shariah operational practices is embraced in several countries around the world including, Malaysia, Pakistan and Sudan. By doing so, the CBB like other regulators aims to reduce the level of inconsistency in product offerings and Fatwas in the industry. As rightly reported by the CBB, the lack of uniformity in the past of service provisions has the potential to harm consumer confidence in the industry and may have customers questioning the belief as to whether these institutions are truly Shariah compliant. The CBB's key objective is to have a comprehensive national approach to Shariah governance.

Other regulatory developments include the introduction of a new Islamic finance liquidity instrument which was based on the International Islamic Financial Market (IIFM)'s Wakalah Master Agreement. The instrument allows institutions offering Islamic financial services with excess liquidity to transfer these funds to the CBB and to have CBB invest the cash on their behalf.

Similarly, the Bahrain Bourse launched a new index in September, the Bahrain Islamic Index. The index shows the changes in the values of Shariah compliant securities and will list 17 different stocks.

Chart 1: Bahrain's year-on-year growth (as of second quarter of 2015)



In April 2015, the AAOIFI organized an outreach meeting with the International Accounting Standards Board to discuss strengthening their collaboration, specifically to support the financial reporting requirements the regulatory bodies require from institutions offering Islamic financial services.

The IIFM and the International Capital Market Association hosted a workshop in London which aimed to promote the IIFM's release of their Master Collateralized Murabahah Agreement. The new standard provides new guidelines to institutions offering Islamic financial services to access liquidity that is collateralized using Sukuk and other Islamic securities.

The market practice front

Tamkeen, a Bahraini financial supporter of SMEs, has continued to partner with Islamic banks in Bahrain in order to ensure all its lending transactions are Shariah compliant. A key development was evident when Khaleeji Commercial Bank added BHD10 million (US\$26.29 million) to Tamkeen's portfolio to support the growth of SMEs. A similar initiative was taken by Ithmaar Bank which provided BHD10 million to Tamkeen's joint portfolio to support this important niche market in the country.

Outlook for 2016

Looking to the future, the CBB remains consistent with its encouragement of the consolidation of Islamic banks in order to improve their strength in the industry as well as their ability to compete on a higher level. Consolidation coupled with the shift away from heavy investment in real estate will result in more resilient institutions that can cope in the face of economic downturns. There is great change and growth occurring in the worldwide Islamic finance industry and with the help of the CBB and this year's developments, Bahrain appears to be moving in the right direction in order to further capitalize on the market.

However, it is important that the strong government policies and effective regulatory implementation, and the sound and friendly business infrastructure environment that the country enjoys should continue. Moreover, a focus on financial services and social and civic and human capital needs would drive further stability and growth in the Kingdom. ☺

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The Islamic economy in Belgium: Evolution and perspectives

By *Ihssane Bouhyaoui*

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

A survey by Association for the Development of Islamic Finance (ADEFI) points to a very strong interest from local Muslim consumers in Islamic finance products and services. The vast majority of the respondents interviewed have indicated their likelihood to take up such services if local banks were to begin offering them.

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

In Europe, with Brussels being the capital of Europe, many Halal certification institutions can be found but no standardization has been achieved yet. The Halal market in Europe represents approximately US\$67 billion of turnover a year and Europe's Muslim population is estimated at 51.1 million, around 2.8% of its total population.

Review of 2015

Belgium is a strategic place for Halal development due to its proximity with European institutions. Based in Brussels, the Halal Food Council of Europe is a major Halal certification organization in Europe that is recognized by Malaysia, Indonesia, Singapore, the GCC countries, Iran and many other Muslim countries around the world. It is the Halal certifier of the Port of Zeebrugge in Belgium, one of the major seaports in the world that figures among the few existing Halal hubs.

According to the Flemish department of agriculture and fishing, the Halal market generates EUR1.7 billion (US\$1.87 billion) per year. This segment is growing even faster than the organic market with a rising interest for 'quality Halal' or 'green Halal' (mainly meat) for Muslims that want to consume ethically.

In Wallonia, this market represents EUR620 million (US\$682.08 million), as mentioned by the Wallonia Foreign Trade and Investment Agency. The Walloon region was a pioneer in this sector and as such created in 2011 the cluster 'Halal Club' that is now composed of more than 75 Belgian companies, with an impressive broad range of Halal products and services.

Islamic finance in Europe finds itself in a steady pattern of increase. In fact, different European countries have adapted their fiscal and legal policies to introduce some Islamic finance products on the market. Belgium represents a specific market, as stated by ADEFI and IFAAS (Islamic Finance Advisory and Assurances Services). These associations carried out a poll where Belgian consumers stated whether they were interested in Shariah compliant banking products or not. The study, based on a sample of 500 people, showed that 70% answered positively and showed interest in these types of products.

Preview of 2016

Islamic finance in Belgium needs to develop simultaneously on two lines: political and public initiatives. In November 2014, ISFIN



accompanied the Belgian Princely Economic Mission in Malaysia and Singapore and organized a seminar on Shariah compliant investment in Belgium. Another mission was successfully led in the GCC (the UAE and Qatar) in March 2015 with Princess Astrid of Belgium and ministers together with a delegation of 400 European CEOs. The next one is scheduled for March 2016, showing the growing interest of Belgium for Islamic markets.

There is clearly an initiative in Belgium to create a friendly environment for Islamic finance.

Major local economic actors like Febelfin and the Brussels Chamber of Commerce are organizing conferences with financial actors to clarify the needs and the regulatory framework for Islamic finance in the Kingdom.

With the University of Louvain, ISFIN created the first Islamic Finance University Certificate in the Benelux Union on the initiative of Laurent Marliere, the ISFIN CEO who lectures on marketing for Shariah compliant products in several universities.

Islamic finance is a key prospect in Belgium but has to be preceded by the development of the Halal industry in order to thrive. Belgium is exporting Halal-labeled products such as FMCG products, cosmetics, packaging, etc, allowing Belgium to be a credible stakeholder in this market.

Conclusion

With more than 700,000 Muslims in Belgium (6.25% of the Belgian population) and 1.6 billion worldwide, Halal exported goods are a key market segment for exporters. This market represents worldwide approximately US\$600 billion (around 15% of the global volume of transactions of the world food industry according to Halal Expo Europe).

Islamic finance and the Halal industry have a significant opportunity to grow in Belgium in 2016. Public regulators and private initiatives have to join forces to shape, enhance and facilitate the Islamic market in Belgium. The legal and tax regime are inherently well suited to shelter Islamic finance transactions. Belgium with its central European position and a large retail opportunity could become a reference in the market of Islamic products in the near future. (2)

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Bosna Bank International: A lodestone for foreign direct investments

By Amer Bukvic and Elma Agic-Sabeta

Bosna Bank International (BBI), the only Islamic bank in South-east Europe, has a unique business model that successfully weds Islamic banking with socially-responsible projects. One of the bank's important activities has been to create a platform for new business development and investment from the Middle East. The final outcome of this business model is that BBI managed to increase its market share while improving efficiency and profitability ratios. For these reasons, it was no coincidence that a leading financial portal in the UK, the Global Banking and Finance Review, honored BBI with the 'Best Corporate Social Responsibility Bank Award' in Bosnia and Herzegovina in 2015.

Review of 2015

BBI's efforts to attract foreign direct investment (FDI) were very successful in 2015. Through BBI's Sarajevo Business Forum (SBF) and the VIP Business Club, the bank was able to attract EUR100 million (US\$109.19 million) in agriculture investment to Bosnia. The resulting agriculture company had its sights set on developing Bosnia's entire value chain and quickly made an investment in Bosnaplod, a historically-significant agriculture company. Early returns are promising; Bosnaplod has already completed two harvests and created many jobs. More investments in the companies and people of Bosnia are to come.

An increase in FDI was a result of BBI's long-term commitment to its annual SBF, an international investor conference in Sarajevo. The bank took major steps to revitalize SBF in 2015. For the first time, BBI gave project owners the opportunity to present their ideas to a live audience. NGOs and other important value multipliers were given an opportunity to show how investment in Bosnia can develop quickly and effectively. The forum's ever-popular panel discussions were a huge success, attracting top regional representatives from Fortune 500 companies. Finally, BBI strengthened SBF's feedback procedures to make sure 2016 is an even better year.

The BBI VIP Business Club improved BBI's international presence in 2015. The club not only added a greater number of regional businesses partners but also created important relationships in India and strengthened business ties to Malaysia. The club's strong relationship with Malaysia in particular has reaped dividends. In October, the VIP Business Club and the Perdana Global Peace Foundation organized another Malaysia-driven conference celebrating 20 years of peace in the region. In November, Malaysian businesspeople will come to Bosnia to participate in an investment conference in Srebrenica. By re-emphasizing Bosnia's civil stability to Malaysian investors, BBI anticipates that the peace conference and investment conference will continue BBI's success in attracting FDI.

BBI improved its outreach efforts to the community in 2015. The bank opened its first call center to enhance community outreach. BBI also expanded its presence in cyberspace with a Facebook page. With over 15,000 likes in a matter of a few months, the page has been a success for keeping in touch with the needs of customers and informing the community about the bank's promotions. In combination with BBI's Facebook efforts, the bank also increased its web presence on several other Bosnian internet portals.

Based on 2015 results to date, BBI ranked fourth among banks in the growth of total assets, financing and deposits in Bosnia and Herzegovina. According to September 2015 financial results,



annual growth of total assets was 12% year-on-year (y-o-y), deposit volumes grew 16% y-o-y, and financing volumes 20% grew y-o-y. This represents extraordinary growth while the rest of the local banking market remains stagnant. Moreover, the bank managed to improve its profitability and efficiency ratios. The net profit of the bank rose 57.1% y-o-y whereas the cost income ratio fell to 69% from 73% in the same period of the previous year and is expected to reach 66% by year-end.

Preview of 2016

BBI will continue to grow and raise its share of Islamic finance in the country, as it is the only bank in the region that offers Islamic banking. The bank strengthened its position as a mid-size bank in the country in the past year. The total assets of the bank grew by 21.8% in compounded annual growth rate from 2011-14, driven by customer deposit growth of 16.7% and finance growth of 19.1%. Though this period was marked with a strong fall of foreign credit lines for local banks, BBI managed to attract new credit lines totaling EUR100 million from the Turkish government. These funds were aimed at enhancing refugees' return.

The focus for 2016 will be to continue BBI's 2015 growth momentum from previous years, engage in consulting services for the newly-formed agricultural company and start a BBI Takaful company. Starting a Takaful company would enrich the spectrum of Islamic finance products in this part of Europe. Furthermore, the BBI team plans to bring more innovations to the 7th annual SBF, which is anticipated to increase the flow of foreign investments in the country. As a look back at 2015 has shown, the BBI business model can serve as an example to other Islamic banks in Europe on how to achieve efficiency and access sources of investment from the Middle East. (2)

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Islamic finance in Brunei well on track for 2016 and beyond

By Dr Aimi Zulhazmi

According to the central bank of Brunei, **Autoriti Monetari Brunei Darussalam (AMBD)**'s report, the financial sector currently contributes about 3% of the country's GDP. A large portion of this contribution is from the banking industry followed by the insurance and Takaful industry along with some fund management/investment activities. There is a growing pressure on Brunei to diversify its economic reliance from oil and gas, which makes up 90% of current exports. Of concern is not only the fast-depleting oil resources that are estimated to only last another two decades, but also the tumbling crude oil price which has dropped more than 60%. Nonetheless, the strong financial reserves accumulated over the decades will sustain the country in its transition period.

The financial sector has vast potential to increase its contribution to GDP especially in the areas of Islamic finance and capital market activities. From the establishment of AMBD in 2011 to the implementation of the new Securities Market Order in 2014, these developments paved the way for a better financial structure, hence establishing the capital market in the Brunei Exchange that is targeted for 2017.

There were also several key milestones in the development of financial infrastructure which contributed to the productivity of the financial sector. First, it was the introduction of the Credit Bureau Self-Inquiry and Dispute Resolution services to the public which has allowed borrowers to access their own credit reports. The service is aimed to generate more transparency, greater credit awareness, and incentivize borrowers to maintain a good credit reputation. Second, it was the launching of the Real-Time Gross Settlement System that allows the efficient and timely transfers of large value funds between banks. AMBD has also taken over the Brunei Association of Banks's cheque-clearing system through its Automated Clearing House.

These milestones were acknowledged by the IMF's most recent report, published in June 2015, where it said: "Brunei Darussalam has stepped up its commitment to market reforms in recent years, developing a credit information bureau and launching a national payments and settlement system."

With the global Islamic finance market doubling in size since 2011 to an estimated US\$2 trillion in 2015, Brunei's plans also coincide with the growing contribution of Islamic financial services to the local economy. Bank Islam Brunei Darussalam (BIBD), the country's largest Islamic bank, reflects the strong growth driven by the demand for Islamic banking in the country. In May 2015, BIBD announced its international banking aspiration with the opening of its representative office in Singapore, which set the tone for BIBD's global expansion strategy, as it plans to open two more international offices in the near future. BIBD is ranked 14th by the Asian Banker in the Asia Pacific 500 Strongest Banks by balance sheet list in the year 2014.

Industry stakeholders in Brunei, including the regulators, policymakers and practitioners, should be commended for facilitating local, regional and international efforts to advance Islamic finance. Brunei's conducive and enabling economic environment, together with a strong demand for Islamic finance, is leading to the deepening of the Islamic banking market share. Brunei in 2016 and beyond

Brunei is a strong, stable, and important market for Islamic financial services. The tiny energy-rich state located on Borneo island in



Southeast Asia benefits from a tiny 600,000 population enjoying one of the highest gross national incomes in the world of US\$31,500. According to Thomson Reuters Global Islamic Economy Index, the country is rated in the top 15 and is particularly strong in a number of sectors including food, finance, travel and pharmaceuticals. Brunei scored 33.3 in the overall index score; in comparison, Indonesia scored 33.8 and Saudi Arabia 46.6.

The government views the financial services sector as a key area for Brunei's long-term growth and prosperity and is keen to promote Islamic finance as a key driver of growth within the financial services sector. The plan to develop the Bruneian capital market with the launching of a securities exchange in 2017 is well on schedule. This will help Brunei to diversify its economy away from a total reliance on the oil and gas industry.

The Bruneian government is also committed to grow the country's talent pool to support the Islamic finance industry and one way is through collaboration with leading education centers in the UK. Indeed, investment in the education sector is one of the means to achieve Brunei's ambition to establish itself as one of the Islamic financial centers in Southeast Asia.

When it comes to Sukuk or debt capital markets, clearly there are opportunities. High-quality issuers from Brunei could look to raise money domestically and internationally. In the international markets, they may find demand in both the Singapore dollar and the US dollar. This is illustrated by the recent Islamic financing: BIBD raising debt-financing for Icon Offshore's vessel purchase in the oil and gas industry. The corporate financing transaction of a Bai Bithaman Ajil-term financing facility was worth BN\$37 million (US\$26.07 million). This indicates that there is certainly space and room for issuers from Brunei to tap the Islamic debt capital markets or Sukuk to raise money for productive investments.

According to the Global Islamic Finance Report, by 2020 Brunei will be one of just six countries where Islamic banking and finance accounts for more than half of the financial sector. Islamic banks already hold a 41% share of total banking deposits in the Sultanate, with forecasts suggesting this will rise to 50% in the next two to three years. Brunei can also be developed as a base for manufacturing Halal pharmaceuticals and cosmetics given its strategic location and the government's funding support for research and development. The Sultanate has implemented standards that cover different aspects of the Halal food industry and appropriate networks through the ASEAN trading system. All in all, Islamic finance in Brunei is well on track, with the country's financial blueprint well-planned and executed for 2016 and beyond.

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Islamic finance continues to grow in the British Virgin Islands

By Ian Montgomery and Hamish Masson

The British Virgin Islands (BVI) remain the most popular international financial center for incorporating companies due to it being tax-neutral and politically stable with a flexible legal system based on English common law and it is a ready-made platform for the needs of the Islamic finance market. BVI companies are commonly used as holding companies for cross-border investments into many developing markets including those where Islamic financing is increasingly popular. BVI companies are also used as holding companies for Islamic high-net-worth individuals or families for owning assets in the developed markets.

As the Islamic finance market is growing and maturing, the advantages offered by international financial centers such as the BVI are being sought to facilitate and lower the transaction and regulatory costs incurred in (i) structuring Islamic finance products and transactions such as Sukuk and Musharakah, and (ii) the incorporation of investment funds and corporate structures.

Review of 2015

In June 2015, the BVI brought in two new fund products under the Securities and Investment Business (Incubator and Approved Funds) Regulations 2015. The 'incubator fund' and the 'approved' fund are two lightly regulated funds aimed at start-up managers and those managing funds for smaller groups of closely connected investors. Each type of fund has a maximum of 20 investors and a cap on investments of US\$20 million for incubator funds and US\$100 million for approved funds. These should prove attractive to the Islamic asset managers or advisors of high-net-worth individuals and families from the traditional Islamic finance regions of the Middle East and Southeast Asia.

In 2015, we saw the continued growth of Islamic finance products in the BVI. Building on the BVI's close connection with the UK real estate market, BVI companies held by Islamic high-net-worth individuals or families are being increasingly used in Islamic financing (mainly Murabahah) of UK real estate by European private banks. There certainly seems to be increased awareness of Islamic financing in the BVI and several of the BVI's private banks have revised their private banking documents to become Shariah compliant.

As well as replacing conventional financing, Islamic financing is being increasingly seen in the BVI as going hand in hand with conventional financing. An example of this joint financing with a BVI element was the Abu Dhabi Islamic Bank's involvement in the

US\$125 million (combined conventional and Murabahah) facilities to a group within the oil/gas sector in the Middle East and North Africa.

Preview of 2016

Globally the Islamic finance market is growing with the past five years having seen compound annual growth of 17%. It is estimated that the current size of the Islamic finance market is between US\$1.6-2 trillion (amounting to 1% of the global finance market) and this is expected to grow to US\$3.4 trillion by 2018. Not only is the Islamic finance market growing within its traditional user base, such as Islamic banks, Islamic banking departments of conventional banks and governments of Islamic countries, but now Western firms are starting to use Islamic finance products. This predicted continual growth of the market through 2018, coupled with the ever-growing diversification and sophistication of users is very promising for the continual growth of the market within the BVI (which is already a leading international financial center and popular for Islamic finance) during 2016 and beyond.

The BVI is tax-neutral, politically stable and has a legal system based on English common law and has final recourse to the English Privy Council (which is important for the use of Islamic finance as the courts will uphold a Fatwa from a Shariah board that a contract complies with Shariah), all of which are attractive to users of Islamic finance products. Furthermore, BVI companies offer a number of benefits in terms of legal flexibility and low cost (incorporation and maintenance), which make them very popular in such transactions. For example, the BVI allows a wide range of corporate entities including restricted purpose vehicles which are commonly used for structured finance transactions including Sukuk. There is a valuable element of flexibility for joint venture or Musharakah directors compared to other offshore jurisdictions: a director of a joint venture company can act in the best interests of one of the joint venture partners rather than the company. Finally, BVI companies can have an additional name in Arabic which is of further attraction to the Islamic market.

Based on the aforementioned points, we expect to see an increase in Islamic asset managers using the BVI, among other things, to take advantage of the new BVI fund products launched during 2015. In addition, we expect to see a continual increase in Islamic financial institutions and investors using BVI companies in Islamic finance structures such as Musharakah and Murabahah, particularly in respect of investment into the Middle East, Africa and the Far East. Specifically, we expect that it is only a matter of time until existing BVI structures holding high-profile hotels and other real estate assets in the Middle East will be refinanced using Islamic finance products.

Conclusion

It is exciting times for Islamic finance globally with the last five years having seen unprecedented growth in the market. This growth is predicted to continue into the foreseeable future, and given the role of the BVI in the global financial markets, the BVI will continue to be a major player in international Islamic finance through the use of its flexible and progressive legal system which is ready-made for the needs of Islamic finance. ⁽⁵⁾

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Canada: Progress continues to be made

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 2015

In the fall of 2014, as a follow-up to pronouncements earlier in the year, the then Canadian minister of foreign affairs, John Baird, led a Canadian delegation to Abu Dhabi to receive a report on the status and development of a Canada-UAE Business Council (Council). The report of the organizing committee of the Council identified a number of promising areas for future collaboration including Islamic finance. It was noted that Canada had expressed interest in making Toronto the North American center of Islamic finance. In addition, it was noted that the UAE had expressed interest in supporting Canada to better understand the regulatory requirements to allow for Islamic finance. Subsequently, there have been efforts to form a committee that can support the development of Islamic finance in Canada, as part of a larger effort to organize the Council.

The first steps to the formation of a robust consultative dialogue have been taken between the Toronto Financial Services Alliance (TFSA) and the International Islamic Financial Market (IIFM) organization based in Bahrain. The TFSA and members of the Toronto legal community are now being included in discussions with respect to consultation documentation being developed by IIFM.

In the early part of 2015, a delegation of senior business leaders from the Kingdom of Saudi Arabia visited Canada and held meetings with elected officials from all three levels of government in Canada – federal, provincial and municipal. In addition, the delegation hosted a major business forum in Canada in Toronto where representatives from various sectors of the Canadian economy were in attendance, including the financial sector. While the discussion was not focused on forms of finance, it was clear that investment in Canada, in either a conventional form or in an Islamically compliant manner, was being welcomed by the Canadian hosts. A new Canada-Saudi Business Council has been formed to take advantage of the positive energy and shared interests of the business and financial communities of both jurisdictions.

Subsequently, a very respected Saudi-based investment firm, Al Awwal Capital, has signaled its intention to establish a permanent presence in Toronto and has moved a senior executive to Canada to oversee the development of Islamic funds that would be offered to Canadian and Saudi investors. The initial focus of fund-related investing will be the real estate and health technology sectors. These are natural choices given the stability of the Canadian real estate sector and the world leadership that Canada has in a number of emerging areas of technology, including technology relevant to human health care.

In the last several months a couple of new players have entered the Canadian Islamic finance market in different ways. Canaccord Genuity Group, Canada's largest independent investment dealer,



has opened an office in the Dubai International Financial Center, with objectives that include helping Canadian issuers access the global Islamic capital markets. A new Canadian financial advisory firm, Avicenna Capital, has been formed in Toronto for the purpose of developing new Islamic financial products for Canadian corporate investors.

In October 2015, 35 Islamic bankers from Bahrain were in Toronto to participate in a leadership program being offered by the Ivey Business School of Western University. The bankers heard from a number of members of the financial community in Toronto, including Janet Ecker, the president and CEO of the TFSA and Professor Walid Hejazi, the head of the Islamic finance program at the Rotman Business School at the University of Toronto.

Finally, representatives of the TFSA will be attending the World Islamic Banking Conference in Bahrain in early December. During that time, a report will be released that is being prepared for the TFSA by Thomson Reuters on the prospects of Islamic finance in Canada. This report will be an important benchmark for Canada in its continuing efforts to raise its profile as a jurisdiction in which Islamic finance has a bright future.

Preview of 2016

There is a new majority federal government in Canada. The new Liberal government will have the support of Canadians interested in seeing Canada emerge as a more active jurisdiction for Islamic finance. While progress has been slow, there is reason to be very optimistic that Canada is poised to join the community of nations that have embraced Islamic finance as an important and permanent complement of the global financial system. (2)

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Diversification of Islamic finance in Europe continues

By Farmida Bi

If 2014 was the year of the debut sovereign Sukuk, with the UK and Luxembourg entering the market (as well as Hong Kong and South Africa), in Europe, 2015 has been more about consolidation in the industry. Certainly, there have been eye-catching deals such as the establishment of the first Islamic bank in the eurozone with Germany's KT Bank and the UK Export Finance (UKEF)'s backing of the US\$913 million Sukuk by Emirates, as well as the ongoing development of Halal industries with long-term potential.

Review of 2015

The two most exciting new developments in Europe in 2015 were the establishment of KT Bank in Germany and the UKEF-backed Sukuk by the Emirates.

KT Bank is a subsidiary of Kuveyt Turk (itself the Turkish subsidiary of Kuwait Finance House) and was launched in July with EUR45 million (US\$49.57 million) of capital, half of which is paid up. This is the first Islamic bank in the eurozone and offers products to both retail and corporate customers.

Although it will obviously target Germany's substantial Muslim population (approximately 4.8 million), its goal is also to use its connections with its Turkish and Kuwaiti parents to facilitate business in Turkey and the Middle East. The bank has also stated its intention to issue a EUR100 million (US\$110.16 million) Sukuk by 2017.

For the UK, this year's biggest deal to date was the US\$913 million Sukuk by the Emirates backed by the UKEF. The government announced that the UKEF intended to incorporate a Sukuk guarantee into its standard product range and will actively seek additional Shariah compliant transactions. In particular, the UKEF has demonstrated that it is in a position to provide export credit agency-backing for Sukuk that can be used to fund project finance transactions in the Middle East and elsewhere.

However, despite these headline deals there were fewer flashy developments in the industry that showed the continued progress of Islamic finance in Europe. One such development was the launch through Lloyd's of London of the Islamic Insurance Association of London (IIAL) in July. Market penetration by Takaful has been slow but steady, and the launch of Cobalt, the world's first Shariah compliant underwriting agency, in 2014 signaled the intent of London's insurance market to gain a bigger share of the market. The creation of the IIAL is another component of London's increasing capacity in this facet of Islamic finance.

Takaful is also steadily gaining ground in France and Germany. The German FWU Group launched a life insurance policy in France, and both the Islamic banking and Takaful sectors in France are becoming increasingly well developed, making this the most exciting time for Islamic finance in France for some years.

Finally, there are intriguing developments in Europe in industries such as Halal food, modest fashion and travel that could stimulate additional growth in Islamic finance. For example, the expansion of Halal food ranges throughout Europe (particularly the UK and Germany) in 2015 recalls the EUR500,000 (US\$550,775) Sukuk from Bibars in 2012 in France, and how this growing industry could look to Islamic finance for funding.



Preview of 2016

Although Luxembourg has not had a similarly high profile this year after its sovereign Sukuk launch in 2014, in March its finance minister Pierre Gramegna confirmed that it has plans to issue a second sovereign Sukuk in the first half of 2016. He also said that the license for Eurisbank, an Islamic bank backed by investors in the GCC, is "currently being processed", which could allow Luxembourg to join Germany and become the second eurozone country to have a fully Islamic bank.

The UK government continues to build on the commitment to Islamic finance demonstrated by its sovereign Sukuk in 2014. On the 30th July, UK Trade & Investment published a groundbreaking brochure setting out 18 selected regeneration projects and explicitly seeking Shariah compliant investment in them, the first such initiative by a G7 or EU country. When combined with the potential of the new UKEF facility to back Sukuk, this could herald interesting developments in 2016 and beyond.

The 'Cordoba Halal' initiative in Spain and the rise of Halal travel agencies in the UK and elsewhere also highlight a growing sector which again could look to Islamic finance. An increase in the number of Shariah compliant businesses in European countries can only increase the demand for Islamic finance and create opportunities in the market.

Conclusion

The diversification of Islamic finance in Europe has continued, which is good news for the industry. Although 2015 did not bring a flood of high-profile deals in the wake of the UK and Luxembourg sovereign Sukuk, the governments in both countries have continued the patient groundwork that could yield dividends in 2016.

Elsewhere, the continued growth and diversification of a variety of Shariah compliant businesses suggests that demand for Islamic finance products of all types will increase. ☺

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Egypt continues to be the Islamic finance market of the future

By Dr Walid Hegazy and Phil Zager

Since the establishment of the Mit Ghamr Savings Bank in 1963, the Egyptian Islamic finance sector has grown in fits and starts. Egypt has over 90 million people, and over 90% of those people are Muslims.

As seen most recently with ENI's discovery of massive offshore natural gas fields, Egypt has substantial natural resources. This combination of a large Muslim population and natural resources suggests that Egypt should be a leading market for Islamic finance. However, the volume of Islamic banking in Egypt is currently estimated at less than 10% of the market.

In 2013, Egypt passed a law on Sukuk, but this law had minimal market impact as the ouster of president Muhammad Morsi led other governmental authorities into not implementing regulations. This delay in turning the Sukuk law into any Sukuk issuances is indicative of how Egypt remains the Islamic finance market of the future instead of the present.

Review of 2015

The first notable event in the Egyptian Islamic finance market in 2015 was the March 2015 Economic Development Conference in Sharm el Shiekh. At this conference, Egypt secured sizable investment deals worth US\$36 billion, external financing worth US\$24 billion and announced a new Gulf support package worth US\$12.5 billion. This surge of investment into Egypt from across the world was primarily conventional, but increased funding by GCC countries, which have larger Islamic finance sectors than Egypt in both relative and absolute terms, should translate into increased Islamic finance.

Egypt's economy grew 5.6% in the first half of 2015, its highest growth rate in nearly a decade. Investors seem more confident in Egypt's ability to sustain this heightened growth, as shown when Egypt successfully raised US\$1.5 billion in conventional external bonds in June. This offering drew over US\$4.5 billion of investor orders, which indicates that investors are willing to contribute capital to Egypt's development.

Gains in the Egyptian Islamic finance sector, while material, have been quieter. In August, the Egyptian Islamic Finance Association (EIFA) obtained a license from Bahrain-based AAOIFI. This license allows EIFA, led by Dr Mohamed Al-Beltagy, to conduct accreditation tests for bankers and auditors of Islamic banking on behalf of AAOIFI in Egypt. This license, and the work that EIFA has begun under the license, is an important step in bringing Egypt's Islamic banking capacity up to international standards.

Tourism in Egypt has declined precipitously since 2011, and the Egyptian army's attack on Mexican tourists in September 2015 will likely continue to keep tourism in decline. Tourism is an important source of foreign currency, and reduced tourism translates into reduced foreign reserves. During the September 2015 Euromoney conference, multiple Egyptian officials stated that sovereign Sukuk would provide a sensible channel for partially alleviating Egypt's foreign reserve issues.

Preview of 2016

When discussing AAOIFI certification for EIFA, Mohamed Al-Beltagy stated that he expects the volume of Islamic banking to grow from its current almost 10% to 15% by 2020. 2016 is a pivotal year in ensuring that sector growth stays on pace for that ambitious goal.



It is anticipated that there will be two main pathways for the Islamic finance industry to develop in Egypt in 2016.

Firstly, there needs to be action on Sukuk. In September, finance minister Hany Kadry Dimian stated that Sukuk regulations will be introduced in 2016. Egypt's financial regulatory structure is fractured between multiple competing authorities, and these authorities need to coordinate to develop reasonable regulations. Outside of inter-ministry cooperation, the Egyptian government needs to consult informed parties in ensuring that Sukuk regulations are responsive to market demands. A sovereign Sukuk issuance in 2016 would be as useful as a gesture alongside Egypt's 2015 conventional external bond offering, but it is not as important as issuing Sukuk regulations.

Secondly, Islamic finance should be used as a tool for inclusive growth. One of the main factors behind the 2011 revolution was inequality under the Mubarak regime. Now, president Sisi has committed the Egyptian government to fighting poverty. Generally, Islamic financial tools such as Takaful, Mudarabah, and Qard Hasan can provide people with access to insurance, financing for small enterprises, and beneficial loans. One example of Islamic finance for inclusive growth is a recent set of social housing proposals from Faisal Islamic Bank of Egypt to the Central Bank of Egypt.

Conclusion

Egypt's location, size, and large Muslim population mean that it has massive potential for Islamic finance. The Islamic finance industry in Egypt needs clear regulations from the Egyptian government, with support from both its political and regulatory branches, to turn this potential into progress. Without sensible regulation, Egypt will continue to be the Islamic finance market of the future. ^(f)

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Islamic finance in India no longer a distant dream



By H Jayesh and Aaheree Mukherjee

Islamic finance in India has been a slow starter unlike its global counterparts. While there have been various reasons for the rather lackluster show to date, there appears to be a change in the momentum in the past few months.

The market and the regulators appear to be warming up to the idea of Islamic banking and finance gradually. Islamic finance does have immense potential and scope in India and there is a latent demand for products and services based on Shariah principles. The infrastructure deficit in India is also one of the key areas which would benefit in the event Islamic finance is brought into effect.

Review of 2015

In late 2014, one of the largest public sector banks in India, the State Bank of India (SBI), had proposed to introduce a Shariah compliant equity fund. It even announced the launch. The scheme had received approvals from the capital market regulator, the Securities Exchange Board of India (SEBI). Unfortunately, the launch of the fund was indefinitely deferred. It has been gathered that the fund was to be reoffered in a better and more attractive format, but there has been no development in this regard to date. The fund could have been an opportunity to provide medium to long-term capital gains by investing in Shariah compliant equity and equity-related instruments.

Certain developments were also seen on the academic front. The Maulana Azad National Urdu University and the Bombay Stock Exchange Institute have collaborated to introduce courses on Islamic finance and banking. Several leading corporates across varied industries such as manufacturing, financial services, education and skill development have signed MoUs with this university to train its students to enhance their employability skills.

The regulatory front also saw considerable movement in the past year. On one hand, the draft Indian Financial Code is in its final stages, which is set to revamp the regulatory framework by replacing almost 20 legislation in India. On the other hand, an inter-departmental group on alternative banking was set up within the Reserve Bank of India (RBI) on the advice of the government, to examine the legal and technical issues on introducing Islamic banking in India. The group

has submitted its report to the RBI for its consideration. The RBI has also constituted a committee with the objective of working out a five year action plan for financial inclusion. These developments together evidence that a change in the regulatory scenario is being contemplated and has been set in motion.

In the capital market sector, the RBI has recently issued guidelines for the issuance of rupee-denominated bonds overseas. This ushers a completely new era for debt-raising by Indian companies, and will integrate financial markets in India further with the rest of the world. The move also follows robust demand for such bonds issued by the International Finance Corporation (IFC) and the Asian Development Bank. In November 2014, the IFC raised US\$250 million equivalent of 10-year 'Masala bonds' at 6.45% listed on the London Stock Exchange to increase foreign investment in India, mobilizing international capital markets to support infrastructure development in the country. This paves the way for the issuance of Sukuk, particularly rupee-denominated.

Preview of 2016

The Indian Financial Code which is proposed to be implemented in the next few months is much-awaited to bring about coherence and efficacy in the financial regulatory framework. Meanwhile, the RBI can also be expected to take forward the report submitted by the inter-departmental committee on the feasibility of introducing Islamic finance. Though the Indian Financial Code does not explicitly permit Islamic banking, it will certainly promulgate an Islamic finance-friendly regulatory environment. The introduction and implementation of Islamic finance within the regulatory framework may well be a long-drawn-out process. However, active consideration by the regulators is a concrete first step toward achieving the end goal. Even though there has been a huge time lapse in actively taking this up, the fact that it is being considered once again enthusiastically is a definite positive move.

It has been proposed that a US\$75 billion dollar fund will be created jointly by the UAE and India to invest in Indian infrastructure. The fund is to support the expansion of India's network of railways, ports, roads, airports and industrial corridors. The countries also aim to increase trade by 60% in the next five years. The UAE, being one of the major players in the global Islamic finance sector, would give tremendous impetus to the introduction of financing models based on Shariah principles and Sukuk issuances. This would attract investors across the globe and in turn benefit the Indian economy.

Pursuant to the SEBI granting permission to issue rupee-denominated bonds overseas, Sukuk may also be considered as a suitable instrument under this route.

Conclusion

Investments based on Shariah rules have been slowly gaining traction in India. The RBI has found Islamic banking and finance as "inconsistent with the existing laws" and hence not been permitted. However, the stringent views appear to be changing. The regulators and the common person have become more pragmatic in their views and accepting of change. Though not a short-term goal, the inclusion of Islamic finance within the regulatory framework does not seem like a very distant dream anymore.⁽²⁾

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Indonesian Islamic finance industry in 2015: Government Sukuk's strengthening role

By Farouk Abdullah Alwyni

The year 2015 is so far a year of stagnation faced by the Islamic banking industry. Up to August 2015, the latest available data showed the growth of the Islamic banking industry is only at 0.42% (Table 1). This will be the slowest-ever growth of the industry in the last five years. Indeed, the figure may change by the end of the year, but it is most likely that the growth in 2015 will not exceed the already slow growth in 2014, when the Islamic banking industry only recorded 12.4% growth.

Like 2014, the year 2015 also shows the increasingly important role played by government Sukuk issuance in maintaining the growth of the Islamic finance industry. In fact, 2015 marks the first time that the amount of Islamic securities issued by the government has outpaced Islamic banking assets. Thus, government Islamic securities issuance is now the most dominant player in the Indonesian Islamic finance industry.

Actually, although they are not that significant compared to the government Islamic securities issuance and the Islamic banking assets, there is still growth in other segments of the Islamic finance industry such as corporate Sukuk, insurance, and rural banks. Islamic life insurance assets seem to have made relatively faster growth in the last four years compared to the Islamic banking industry. Corporate Sukuk, although still small, has also recorded better growth compared to 2014.

Apart from the aforementioned industry perspectives, macro factors such as the effect of increase of electricity and gasoline prices initiated toward the end of 2014, the significant depreciation of the rupiah throughout 2015, the drop of the Indonesian stock index, and sociopolitical issues related to the seemingly weakening anti-graft body under the new administration, somehow contributed to the slower economic growth in the country, which in turn, also affects the growth of the Islamic banking industry.

Review of 2015

The growth of the Islamic banking industry in the last two years (2014 and 2015) was actually in stark contrast compared to 2010 and 2011 when the industry recorded growth of 50% and 33.8% respectively. There had been a deceleration of growth of course, but the slowest recorded stood at 23.6% in 2013, still almost double compared to 2014's growth of 12.4%. The problems facing the Indonesian Islamic banking industry mainly come from two major Islamic banks in the

country: Bank Syariah Mandiri and Bank Muamalat Indonesia (BMI). The assets of these two banks account for almost half of the total Islamic banking assets in the country.

The aforementioned two banks had struggled with the issues of quality assets left by their previous executive managements. Significant write-offs were undertaken affecting the equity of the banks, with BMI's equity experiencing a 20.95% plunge to IDR3.55 trillion (US\$261.7 million) in June 2015 from IDR4.49 trillion (US\$331 million) in June 2014. BMI even needed to slash its 2013 profits to IDR165.14 billion (US\$12.17 million) in its 2014 audited accounts (restatement), so as to avoid a loss in 2014. Consequently, the asset growth of the banks in 2014 and 2015 has been constrained due to the need of the new management to steer carefully in terms of financing new transactions.

As predicted in the IFN Guide 2015 analysis, the cumulative issuance of government Islamic securities has now exceeded Islamic banking assets. For 2015 (up to the 22nd October 2015), the growth has reached 39.8%. The figure is even higher compared to the 34.3% growth for the whole year in 2014. The government Islamic securities consist of Islamic fixed rate securities, retail Sukuk (SR), US dollar-denominated global Sukuk (SNI), Islamic T-bills, Hajj Fund Sukuk and project-based Sukuk (PBS). PBS followed by SNI are the first and second-largest government Sukuk issuance accounting for almost 65% of total government Islamic securities issuance in 2015. SR was also increasingly important, successfully raising IDR21.96 trillion (US\$1.62 billion).

The growing importance of Sukuk as a means of international fund mobilization for Indonesia was also signified by the listing of its four global Sukuk amounting to US\$6 billion in NASDAQ Dubai on the 31st May 2015; one of the Sukuk amounting to US\$2 billion was issued in 2015.

On the corporate side, progress has not been like its sovereign counterpart although there is a sign of progress compared to 2014. Up to the end of September 2015, there were at least nine corporate Sukuk issued amounting to IDR1.52 trillion (US\$112.05 million), accounting for an 11.7% increase compared to the total issuance in 2014. This figure is higher compared to the growth in 2014, accounting for 8.1%.

Another major progress in the area of corporate Sukuk in 2015 was the issuance of the US\$500 million global un-rated Sukuk by Garuda

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

	2011	2012	2013	2014	2015
Assets of Islamic commercial banks and Islamic windows	145.47	195.02	242.28	272.34	273.49*
Assets of Islamic rural banks	3.52	4.70	5.83	6.57	7.09*
Sovereign Sukuk issuance [^] (cumulative)	81.53	138.62	186.22	250.17	349.79***
Corporate Sukuk issuance (cumulative)	7.92	9.79	11.99	12.96	14.48**
Islamic mutual funds (net asset value)	5.56	8.05	9.43	11.16	10.11**
Assets of Islamic life insurance	7.25	9.83	N/A	18.05	19.23*
Assets of Islamic general insurance and re-insurance	1.91	3.23	N/A	4.31	4.67*

Sources: Alwyni (2015), the OJK, Ministry of Finance, and calculated further.

Notes: *As of August 2015; **As of September 2015; *** As of the 22nd October 2015; [^]includes all government Islamic securities issuance; US\$1 = IDR13,640 (22nd October 2015).



Indonesia, the state-owned Indonesian airline. The investors of this Sukuk come from the Middle East (56%), Asia (32%), and Europe (12%). This is the first Indonesian non-sovereign US dollar Sukuk – opening the way for other Indonesian state-owned enterprises and corporates to access the market. It is important to note here, however, that it seems this Sukuk issuance has not been recorded in the Indonesia Financial Service Authority (OJK)'s statistical data.

Other area of the Islamic finance industry showing a potential to grow further is Islamic life insurance. Although growth in 2015 is relatively small, in the last three years there was a 100% growth of Islamic life insurance assets in the country. Similar progress is not seen in its general insurance and re-insurance counterparts. For Islamic mutual funds, there was almost a 10% drop in the net asset value up to September 2015, but this drop seems to be something unavoidable due to the general decline in the country's stock index.

Preview of 2016

Indonesia has a lot to do to catch up with its Malaysian and Gulf counterparts in strengthening the role of Islamic finance in the country's economy, especially its Islamic banking sector. The Indonesian Islamic banks' market share of around 5% is still very small compared with 20% and 50% market shares of the same in Malaysia and Gulf countries respectively.

The possibility for the Islamic banking industry to resume its pre-2014 growth in 2016 will depend on a number of micro and macro factors affecting the industry as well as the economy. The level of success of the current administration in dealing with the impact of the global financial uncertainty will contribute to the growth recovery of the industry. Apart from these macro factors, policymakers need to do more than just talk about the desire in positioning Islamic finance industry as an important player in the country.

Susilo Bambang Yudhoyono during his presidency once declared the Islamic economic movement as a national agenda and called for all people in the country to promote the Islamic economy. Furthermore, he even envisioned the prospect of making Indonesia a world Islamic financial center integrated with Shariah-based international

systems. Now, president Joko Widodo is also backing a national campaign called 'I love Shariah Finance' in cities across Indonesia. Previously, at the beginning of 2015, the OJK also declared the year of 2015 as 'the Islamic Capital Market Year'.

While creating awareness among the population is indeed a promising step, to translate that into real quantitative achievements will require more concrete actions. There has to be more coordinated policies between the Ministry of Finance, the OJK and the central bank in making conducive conditions for the growth of Islamic finance. One of the important aspects is related to fiscal incentives.

While Malaysia has given tax incentives to Islamic banks in its early stages of operations and until now still gives more tax advantages for the issuance of Sukuk compared to conventional bonds, Indonesia has yet to provide similar incentives. Areas that require serious considerations in this respect include firstly, the possibility of reducing the tax on the profit margin received from the deposits in the investment accounts of Islamic banks to 10% from 20% currently applied to Islamic and conventional banks.

Secondly, there has to be a streamlining of the rules related to corporate Sukuk issuance, especially on the issue of SPVs. In addition, corporates issuing Sukuk should be given tax incentives in the form of lower taxes compared to companies issuing conventional bonds. Finally, fiscal incentives for companies sending their employees for Islamic finance education will also boost the level of acceptance of the industry at the corporate level.

Notwithstanding the aforementioned issues, Indonesia as the largest Muslim country and at the same time a member of the G20 (the top 20 largest economies in the world) certainly has a lot of potential to be an alternative hub for the Islamic finance industry. But it needs more concrete actions to be put in place by the government.⁽²⁾

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The Iranian capital market in 2016: Deepening the current instruments

By Majid Pireh

Iran is a country in which all financial instruments should comply with Shariah rules and regulations. For this, it is not lawful in the capital market to trade any conventional financial instruments nor to establish any financial institution where its performance contradicts Islamic rules and regulations.

In 2015, the Iranian financial market faced new economic and political situations. Talks between Iran and powerful economies in the globe for Iran nuclear programs and a reduction of inflation through some deflationary monetary policies resulted in some changes in financing tools and the Islamic equities market.

Review of 2015

What Iranian investors witnessed in 2015 may be categorized in Table 1.

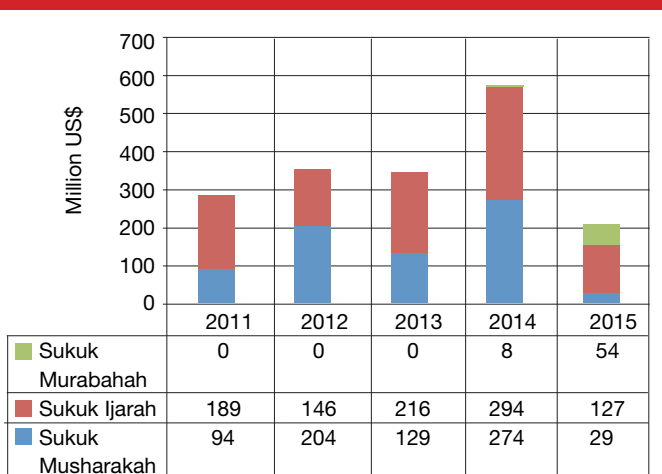
Preview of 2016

The Securities and Exchange Organization (SEO) as the supervisory and regulatory body of the Iranian capital market is planning for developments as well as to strengthen current situations as in Table 2.

Conclusion

In the Iranian financial system, all market instruments should follow Shariah, but above all, it is the regulatory body of the market that regulates and supervises the issues within the system; in the other words, there should be a strong Shariah governance framework for

Chart 1: Value of outstanding Sukuk in the Iranian capital market as of the 4th October 2015



Source: Author's own

supervising Islamic issues. The Iranian capital market is going to find more diversity in Islamic financial instruments and derivatives. Moreover, the lifting of sanctions may witness more investment demands in the Iranian wholly Shariah compatible market. (3)

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Table 1

Islamic equity market	As indicated before, nuclear talks between Iran and six other powerful economies (ie the US, Russia, China, England, Germany and France) finished with a decision to lift many sanctions against the Iranian financial system. This affected listed companies which were mainly active in the trade business.
Islamic derivatives market	The Islamic gold coin futures market in Iran, as a result of US dollar to Iranian rial fluctuations and also global gold price changes, was facing many alternations. There was no important change in the underlying assets in Islamic futures contracts in Iran in 2015 but some new arrivals has been planned that would be described in the preview of 2016.
Sukuk market	Sukuk Ijarah, Musharakah, Murabahah, Salam and Istisnah are the five types of Sukuk as issued in the Iranian capital market in 2015. The market value is shown in Chart 1. One important modification in the Sukuk market in 2015 was the new procedure for subscription which was based on investor valuation in IPOs. Previously, Sukuk in Iran was issued at a nominal value, but according to the modification, investors may pay different amounts than the nominal value.

Table 2

Islamic equity market	The macroeconomic condition of the country is going to be in more vibrant situations. The state is planning for more protection of investors as well as listed companies. Lifting of sanctions will also broaden Iranian financing opportunities as the current low P/E ratio seems to make the market attractive to many foreign investors. Hopefully, there would be better conditions for the development of the Islamic equity market in Iran. The Islamic gold coin futures market in Iran, as a result of US dollar to Iranian rial fluctuations and also global gold price changes, was facing many alternations. There was no important change in the underlying assets in Islamic futures contracts in Iran in 2015 but some new arrivals has been planned that would be described in the preview of 2016.
Islamic derivatives market	For derivatives, the market is planning to welcome currency futures in a Shariah compliant model. This would bring more opportunities for development in the Iranian Islamic futures market. Currently, gold coins are the main underlying assets in Islamic futures contracts. The SEO has announced its plans for the establishment of a 'currency exchange'. While in 2015 currencies were traded traditionally by exchanges, the new scheme may structure the market in a better format. Islamic currency futures contracts are going to be launched and traded in the new exchange.
Sukuk market	For Sukuk, the SEO is planning for the development of the market in both value and volume in 2016. While the Shariah Board of SEO resolved that "Ijarah, Murabahah and Musharakah types of Sukuk may be initially issued at market price", the SEO implemented this technique to make Iranian Sukuk more attractive to investors as they may gain more in profits. Additionally, in 2016 the SEO is going to use Sukuk Istisnah more widely as a financing tool for many contractors. While currently there are not many Sukuk Istisnah issuances in the Iranian capital market, the SEO is planning to have more in the coming year.

Source: Author's own

The Islamic finance industry in Ireland

By Simon O'Neill

The Irish government continues to build upon the steps contained in the Finance Act 2010 to support and provide equivalent taxation treatment for Shariah compliant transactions. Implementation of the International Financial Services Strategy (IFS 2020) launched in 2015, of which Islamic finance is a part, is well underway with specialized subcommittees established and due to report to the government shortly on the progress and implementation of the action points. Significant milestones in 2015 involved the hosting by University College Dublin of the inaugural Islamic Finance and Law Conference in May 2015; the launch of the Islamic Finance Council of Ireland (IFCI); competitive bidding by sovereign wealth funds for Irish assets, including Kuwait Investment Authority and Abu Dhabi Investment Authority (ADIA); and the listing of the US\$500 Million APICORP Sukuk on the Irish Stock Exchange.



Review of 2015

2015 has been a year of consolidation as the Irish economy has returned to stable and sustained growth. The Irish property market in particular returned to buoyant condition at all levels, including large asset and loan portfolio disposals, with some investors exiting particular investments and realizing significant profits. There has been a significant growth in non-banking finance in the Irish market as borrowers and companies seek to access credit and investment to grow their businesses and refinance existing loan facilities.

“ The growing emphasis internationally not only on Islamic finance but on ethical and sustainable responsible investment is shifting the focus of investment firms and the investing public ”

International investors have been extremely active in the market, bidding on the large portfolio disposals undertaken by NAMA and the ‘pillar banks’ (AIB and Bank of Ireland) involving some of the largest transactions in the history of the Irish state. In addition, there have been significant portfolio disposals by Ulster Bank Ireland and Permanent TSB. The Project Jewel portfolio sale saw intense bidding for loans attaching to the prestigious Dundrum Town Center and 50% of the Ilac Shopping Center and Pavilions Shopping Center for a reported EUR1.85 billion (US\$2 billion) to Allianz and London-based Hammerson.

Separately, the Project Trinity portfolio involved a sale of what was once dubbed the ‘Knightsbridge of Dublin’ being acquired by Chartered Land and ADIA, representing a landmark acquisition in Ireland by ADIA. This acquisition of a prime 6.8 acre site located in Ballsbridge, Dublin 4, comprised two well-known existing hotels with the benefit of planning permission, valid until December 2021, for a new 1.5 million square feet new urban quarter comprising 490 apartments, a 152-room stand-alone hotel and 77,000 square feet of retail and associated commercial and leisure space. This acquisition by ADIA, a sovereign wealth fund owned by the emirate of Abu Dhabi, marked a significant commitment and deployment of capital from the Middle East in the Irish market.

It is anticipated by CBRE that up to EUR400 million (US\$433.37 million) of retail investment opportunities and another EUR400 million of office investment opportunities will be formally launched for sale in the closing months of 2015.

The IFCI formed in 2015 is a not-for-profit entity promoting the development and growth of Islamic finance in Ireland and providing information about the principles and operation of Islamic finance. The IFCI is a private sector initiative which, coupled with the government focus on Islamic finance through subcommittees established under the IFS 2020, will shine the spotlight on opportunities for Islamic finance in Ireland.

Preview of 2016

As Middle East investors continue to seek new markets offering attractive investment returns, further opportunities will no doubt come to the market in 2016.

While the sale of interest-bearing loan portfolios would not be appropriate for Shariah compliant investment, further property portfolio disposals by banks, receivers and loan acquirers will give rise to investment opportunities for sophisticated investors to add value through asset management.

It is inevitable that further opportunities will arise from the significant loan portfolio acquisitions in 2015 as investors seek to fund acquisitions from entities which have purchased distressed loan portfolios or from borrowers seeking investment to refinance portfolio loans.

The growing emphasis internationally not only on Islamic finance but on ethical and sustainable responsible investment is shifting the focus of investment firms and the investing public. Further growth in the corporate Sukuk market should be anticipated and also to meet the growing requirement for non-traditional bank finance.

Conclusion

There is substantial growth opportunity for Islamic finance as Middle East investors become more aware of the Irish market, the breadth of investment opportunities available, the availability of Shariah compliant solutions and the requirement and growing acceptance of corporates and borrowers to avail of non-bank/non-traditional finance options. ^(f)

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Jordan continues to be main player in the Islamic finance industry

By Nafith Al Hersh Nazzal

Islamic banking is a global player in the increasingly sophisticated current business environment in the world. The first idea was initiated in 1963 by Dr Ahmad El-Najjar when he founded a microfinance program based on profit-sharing according to Shariah compliant financial services. Later on, the project became the Nasser Social Bank.

According to the 2015/2016 State of the Global Islamic Economy Report issued by Thomson Reuters, Jordan ranked ninth among the top ten countries in Islamic finance. Islamic finance received strong support from the Jordanian government despite being a small part of the Jordanian banking system.

The government issued a special law for the establishment of the first Islamic bank in Jordan in 1987. In 2000, the law was replaced by the private law for Islamic banks – this law organized the operations for Islamic banks and its own regulatory issues. The Jordanian banking system consists of 16 local banks (13 conventional and three Islamic); and nine foreign banks (eight conventional and one Islamic). These banks present innovative banking tools that are harmonized with modernity and the requirements of modern technology.

Review of 2015

Jordan has a unique experience in Islamic banking and finance. The formative years began by establishing Jordan Islamic Bank as the first Islamic bank in 1978. The Islamic International Arab Bank followed after two decades in 1997. In 2010 and 2011, the Jordan Dubai Islamic Bank and Al Rajhi Bank were established respectively. Currently, Jordan has four operating Islamic banks, six Islamic finance and investment companies and two Islamic insurance companies. Islamic banks inside Jordan have around 140 branches in 2015.

In terms of financial figures, total deposits for Islamic banks are expected to be around 18% of total deposits, while total equities are expected to be around 11% of total equities for working banks in Jordan. Total assets were 14.9% in 2014 and expected to reach 15-17% of total assets of the banking system in 2015. In addition, total liabilities for Islamic banks were 21.8% in 2014 and expected to reach 22-25% of total liabilities of the banking system in 2015.

In 2015; Islamic banks introduced a wide range of diversified products. For example, the retail sector introduced customer accounts such as current, savings, Wakalah, joint investment, portfolio of Sanadat Muqarada and investment through certificates of deposits. Retail facilities were also introduced through products structured with Qard Hasan, Murabahah, Musawwamah, Ijarah, Ju'alah and also products for the financing of benefits and car and housing financings. The retail sector presented other products such as Visa cards, transfers (inward and outward), foreign exchange and safe boxes. For the corporate sector, a wide range of financial services was introduced such as different client accounts, trade finance services such as letters of credit, letters of guarantee and bills of collection.

Corporate sector financing relies on Murabahah, forward selling, Ijarah, Musharakah, Mudarabah, Istisnah, Salam and other Shariah compliant tools. Islamic banking focuses on replicating traditional banking activities with Shariah compliant standards, with Islamic banks being retail and trade finance-oriented. Recently, Islamic banks in Jordan have become more sophisticated with new financial

products reaching into every field of treasury and investment such as money markets, capital markets and wealth management.

For capital markets, the government plans to support the first sovereign Sukuk in the Kingdom and provide technical support for Sukuk issuance denominated in Jordanian dinars.

Preview of 2016

Financial experts expect that the Jordanian government will benefit extensively from issuing sovereign Sukuk. The Central Bank of Jordan (CBJ) is a regular player in the bonds market. A clear signal was sent previously to local financiers in order to participate in any coming Sukuk issues. The CBJ is expected to begin managing the first issue of sovereign Sukuk in 2016. This issue will be directed toward financing part of the accumulated deficit in the government and independent public department's budgets after the official institutions have succeeded in endorsing the Sukuk law and its related regulations. This action will benefit the government and Islamic banks operating in Jordan as they have a liquidity surplus of around JOD1.4 billion (US\$1.97 billion).

Conclusion

Indeed, experts are expecting the number of Islamic banks in Jordan to increase due to its political and economic stability. In addition to sustainable growth for all financial figures for Islamic banks, Jordan has significantly contributed to the Islamic banking industry. For example, Jordanian Islamic banks were the first Islamic banks to apply Islamic finance tools such as Istisnah and Ijarah in modern contracts.

In addition, Dr Sami Hamoud, a Jordanian entrepreneur, was the first person who introduced the Murabahah contract which was traded widely in Islamic banks in 1970 at Dubai Islamic Bank. Not only that, Jordan was the first country which organized special laws for Sukuk. This law was called the Muqarada bond law and was issued in 1982. It is no surprise then that Jordan is a main player in the Islamic finance industry.⁽²⁾

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Islamic finance stepping up in Kazakhstan

By Timur Rustemov

Due to the increasing interest in Islamic finance, the government of the Republic of Kazakhstan adopted the 'Roadmap of Development of Islamic Finance until 2020', which is currently in the process of active implementation. In addition, the National Bank of Kazakhstan has set a goal to establish Almaty as a regional Islamic financial hub of Central Asia. This goal is materializing with joint activities directed to enhance institutional support, support of human capital initiatives in Islamic finance and development of international linkages with foreign investors and global Islamic finance infrastructure supporting institutions.

In February 2015, following the goals of program implementation, the National Bank of the Republic of Kazakhstan has signed a memorandum of long-term cooperation with the Association for Development of Islamic Finance (ADIF). It covered several areas, such as: education and public awareness programs; facilitation and implementation of Islamic finance products and services; initiation of legislative changes in the Islamic finance industry; and representation of Kazakhstan among potential investors. As of today, ADIF has launched a seven-month education program titled 'Islamic Finance Professional' and conducted a few other notable education events inside and outside of Kazakhstan.

Another highly expected event happened on the 9th May 2015, when several legislative Acts on insurance and Islamic financing law came into force after the Republic modified and added provisions to accommodate changes of the growing industry. Specifically, the amendments to the law introduced Islamic insurance to the system of obligatory insurance of employees. It also created favorable conditions for the appropriate functioning of Islamic banks, helping them to develop a fully-fledged Islamic financial system in Kazakhstan.

The next important event was held on the 20th-21st May 2015, where Islamic finance regulators and industry leaders met in Almaty for the 12th Annual Summit of the IFSB. It was an honor for Kazakhstan to host such a highly reputable international event. The theme of the event was 'Core Principles for Islamic Finance: Integrating to the Global Regulatory Framework'.

From a practical perspective, in 2015, ADIF undertook multiple attempts to introduce several Islamic banking products into conventional institutions. Although current regulations do not authorize conventional banks to open Islamic windows for clients, the banks are allowed to provide Islamic products to customers on a pilot basis. As a result, a few institutions were shortlisted to launch Islamic financial products that are currently under development. It is an important step forward, because it will provide a clear picture of the level of customer demand for retail Islamic financial products, such as Islamic deposits and home financing.

At the beginning of 2016, Kazakhstan's Finance Ministry is expected to propose a bill to regulate the first sovereign Sukuk issue. The anticipated legislation change is also due to the joint efforts of the National Bank of Kazakhstan and the IDB in preparation of a stand-alone Islamic finance law that will cover every aspect of the Islamic finance industry in detail including banking, Takaful and the capital market.

Being a secular state, Kazakhstan government bodies by law are not allowed to have any Islamic entities in their structure. That is why the National Bank of Kazakhstan has decided to establish a Central Shariah Board under the auspices of ADIF. With strong support from AAOIFI, the IFSB and the IDB, the Central Shariah Board in



Kazakhstan will be launched soon in line with best international practice and standards.

Due to the fact that educating human resources in Islamic finance, especially in new markets is crucial, market players are most likely to send their staff for certification and training in globally recognized institutions. In this regard, ADIF, in collaboration with the Academy of Regional Financial Center of Almaty, has announced its desire to work closely with the Finance Accreditation Agency of Malaysia in order to get international recognition of education programs in 2016.

This initiative will set standards for the preparation of human capital in Islamic finance, not only in Kazakhstan, but in other Central Asian states. In addition, leading educational institutions, such as INCEIF (Malaysia) and CIBAFI (Bahrain) support the realization of other initiatives. For example, beginning from 2016, INCEIF, being one of the leading universities in the world, will commence the Masters in Islamic Finance Practice degree program for professionals in Kazakhstan.

Chapter 71 of the recently announced presidential address titled '100 Concrete Steps to Implement Five Institutional Reforms' clearly states that the government must focus on the development of the Islamic finance industry in Kazakhstan. This statement is supported by several ongoing activities, such as the establishment of the Astana International Financial Center that prepares a favorable tax and legal environment for Islamic financial institutions to attract foreign investors in the coming years. (f)

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Kenya cementing itself as a leading Islamic financial and investment hub in Africa

By Mona Doshi

Over the past year, Kenya has witnessed considerable growth in Shariah compliant banking, a testimony of the vast potential of Islamic finance in Kenya.

Kenya remains a potentially lucrative market for Islamic banking and a vast array of Islamic financial products continue to be offered by fully-fledged Islamic banks and other conventional banks. The government and regulatory bodies have expressed support of Islamic finance. In fact, Kenya recently signed an MoU with the State of Qatar to strengthen Islamic finance opportunities as well as enhance cooperation in the development of the Nairobi International Financial Center (NIFC).

Upon completion and establishment of the NIFC, Kenya is set to become a hub for Shariah compliant financing. Without a doubt, Kenya is positioning itself as a financial and investment hub to tap the growing capital inflows into Africa. However, despite the sustained demand for Islamic banking services, Shariah compliant lenders are yet to make significant inroads into the country's competitive banking sector.

Review of 2015

2015 has been a year of steady growth in the Islamic financing sector in Kenya. Already, Kenya is home to two fully-fledged Islamic banks offering a wide range of Shariah compliant financial products. Six other conventional banks offer Shariah compliant products on a window basis. Several other commercial banks are also in the process of opening Islamic banking windows to capture their market share in the Islamic finance sector.

The Takaful Insurance Regulations were drafted by the Insurance Regulatory Authority. Their purpose was to permit insurance companies to open Takaful windows, provide guidance for Takaful operators and establish the duties and responsibilities of Takaful operators. It was widely expected that the guidelines would come into effect on the 1st June, 2015. However to date, the guidelines are still awaiting parliamentary approval. Hopefully once operationalized, this will mark the entry of more players into the Islamic insurance market.

Kenya also nominated members of the Capital Markets Master Plan Implementation Steering Committee which is tasked with the overall responsibility of oversight in the implementation of the Kenya Capital Markets Master Plan. Its duties among others include facilitating the alignment and establishment of Kenya as the heart of capital markets financing and investment in Africa and the supervision of the establishment of a platform within the capital markets for Islamic compliant financial products.

The East African Business Network is organizing the East Africa Islamic Finance Summit in Kenya in February 2016 to focus on the potential of Islamic finance and investment. The summit comes at a critical point when Kenya is considering issuing its debut Sukuk, following other African countries like South Africa and Senegal.

The summit's discussion areas include a regulatory framework, opportunities for financing and financial inclusion, Sukuk, corporate governance, challenges faced and potential solutions, how to steer growth and much more. The National Treasury, regulators, key industry players and stakeholders are expected to attend the summit for fruitful discussions. If solutions are implemented, it will go a long way in positioning Kenya as Africa's financial capital.



Preview of 2016

Kenya may be ready to issue its eagerly awaited debut Sukuk in the financial year 2016/2017 following the successful issue of the US\$2 million sovereign bond by the government of Kenya in June 2014. Without a doubt, Sukuk bonds offer more favorable repayment terms than conventional bonds as they are an attractive product for infrastructure financing. However, Kenya is not out of the woods yet; the lack of a proper regulatory framework remains the biggest challenge to the issuance of a Sukuk.

Regulators remain alive to the fact that changes need to be made to current legislation to provide an enabling environment for Shariah compliant products. The cabinet secretary for the National Treasury, Henry Rotich, admitted as much when in an interview he maintained that although the government is still keen on the issuance of a Sukuk, a number of legislation need to be reviewed and where necessary amended. He also pointed to the fact that Kenya will have to adjust its tax regime in order to encourage the issuance of the Sukuk.

The government also intends to establish a National Shariah Supervisory Council which shall advise on the development of products that are compliant with Shariah law. By and large, Islamic financial institutions have relied on Shariah advisory councils constituted within the respective institutions. This has led to an overlap of functions and a lack of harmonization of the products offered in the market. Market players agree that a National Shariah Supervisory Council will set the stage for standardization and convergence of products, with a great positive impact on Islamic financial markets.

Conclusion

Though regulatory hurdles abound, it is hoped that legislative amendments are made soon so that Kenya is able to issue its debut Sukuk in the financial year 2016/2017. It is also hoped that deliberations at the summit to be held next February will go a long way in helping to promote the Islamic finance industry not only in Kenya but in the greater East Africa region too. Kenya is on its way to cement itself as a leading Islamic financial and investment hub in Africa in days to come. (2)

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Kuwait introduces new Sukuk regulation

By Hossam Abdullah

Effective the 10th November 2015, Law 22/2015 (amending Law 7/2010) (CMA (Capital Markets Authority) Law) and full new executive regulations thereof No. 27/2015 (CMA Executive Regulations) came into force (collectively, the New Rules).

The CMA Law amended the Kuwaiti Companies Law 10/2012 by canceling Articles 178 to 207 of the Companies Law. Most important result is the removal of the mandatory restriction on the size of the Sukuk an operating company can issue.

The Sukuk regulation under the New Rules can be summarized as follows:

- 1) Allows different types of Sukuk issuance either directly by a company or through an SPV. There are also detailed rules for an issuer, obligor and originator of the Sukuk. The role, rights and obligations of a trustee, custodian of Sukuk assets, payment agent, pledger, guarantor, clearing agent, and settlement agent are also well defined.
- 2) Defines the line between a private offering and a public offering of Sukuk in a clearer manner. In a public offering, no redemption of the Sukuk is permitted before one year upon issuance and periodical distributions are a must. A private offering is not allowed in cases where Sukuk are issued by a public entity.
- 3) Convertible Sukuk are now expressly regulated which should also apply to exchangeable Sukuk. Corporate approvals to issue the conversion shares must be obtained in advance (such as the approval of the board of directors and the extraordinary general meeting). The conversion option must be granted to the Sukukholders and not to the issuer and allow for the conversion price adjustment due to corporate events.
- 4) Types of Sukuk assets are defined providing Sukukholders a direct and indirect right to such assets and providing for a protection against other creditors and allowing for such assets to be used as a source of payment and/or risk participation.
- 5) The issuer, obligor and originator are obliged to make mandatory disclosures of major events to regulators and Sukukholders.
- 6) Defines the investment grade rating of the Sukuk (not a corporate rating). Rating is mandatory in a public offering and in the case of listing in an exchange and optional to the CMA in other cases which can impose a periodical rating update.
- 7) Provides for detailed SPV rules and recognize for the first time in Kuwait an orphan SPV and its bankruptcy remote concept. The share capital of an SPV can be owned by up to three shareholders as nominees (eg CMA-licensed person, a law firm or the obligor) which makes the share capital protected from creditors of shareholders and also makes it immune from attachments and bankruptcy events.

It also defines the deed of trust (financial trust by contract) recognizing the Amanah concept under Shariah principles. All

Sukuk documents and agreements are to be filed with the CMA. The obligor must also provide the full undertaking cost.

- 8) Provides for detailed rules for the Sukukholders Association and its meetings (prior five-day notice in newspapers or by letters or three days by hand). Quorum and voting do not change from those thresholds provided in the canceled provisions under the Companies Law (Quorum must be two-thirds in the first meeting and one-third in the second meeting. Voting must be by two-thirds of the quorum. Major decisions affecting holders require a quorum of two-thirds).⁽⁵⁾



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With more than 28 years of comprehensive legal experience on almost all major landmark transactions in Kuwait, partners of Al-Hossam Legal are well known among clients and peers as the city's best professional legal service providers in terms of quality, delivery time and creative legal structures within the boundaries of traditional laws and court precedents.

Even though Al-Hossam Legal as a law firm has been established only during last quarter of 2015, it is the most rapidly growing law firm in the city and has successfully attracted major local, regional and international banks, financial institutions, companies and high-net-worth individuals.

Luxembourg: A year of consolidation in Islamic finance

By Said Qaceme

In 2015, Islamic finance made slower progress than expected in Luxembourg. Indeed, although the industry continued to benefit from strong government support through the Luxembourg for Finance (LFF) and the Association of the Luxembourg Fund Industry (ALFI), the high expectations raised by some local private promoters in 2014 were not met. Nevertheless, it is encouraging to note the growing interest by prominent Middle-Eastern Shariah compliant financial institutions in developing Islamic banking in Europe through a Luxembourg subsidiary. Various local conventional banks and service providers have recently set up a presence in the UAE to be closer to a promising market. Based on this trend, we believe 2015 has been a year of transition in Luxembourg.

Review of 2015

The IFN Europe conference was held in Luxembourg for the second year, underlining Luxembourg's role as a European Islamic financial center, especially in the Sukuk (commonly referred to as Shariah compliant bonds) and investment funds sectors.

Luxembourg's prime minister, Xavier Bettel gave a keynote speech at the October 2014 World Islamic Economic Forum in Dubai. In March 2015, Luxembourg's hereditary Grand Duke Guillaume and his wife Grand Duchess Stephanie, along with a delegation of local businesses led by the minister of finance participated in seminars in Dubai and Doha covering topics such as private banking, investment funds and Islamic finance. This demonstrates Luxembourg's strong willingness to be recognized as an Islamic financial center in Europe.

According to the LFF, factors encouraging the growing Luxembourg Sukuk market include its fast securities listing procedures (a maximum of two days in 99% of the cases). Luxembourg is also able to offer full service processes including listing, trading and reporting. Sukuk listed on the Luxembourg Stock Exchange (LuxSE) are attractive to European and international investors.

The strategic progress in this market allied with recognition in capital markets took Luxembourg to important landmarks such as being the first European country to list a Sukuk in 2002. It was also recently the domicile of the first sovereign Sukuk denominated in the euro.

Twenty Sukuk have been listed on the LuxSE, with 11 ongoing or yet to reach maturity. Issuers include the IDB, South Africa, Pakistan, PETRONAS, Merrill Lynch, Goldman Sachs and Emirates Airlines. The most recent issuers were Goldman Sachs and South Africa with total amounts of US\$500 million each.

The year 2015 confirms the position of Luxembourg as an ideal location for the domiciliation and administration of Shariah compliant investment vehicles. The country is the third-largest domicile for Islamic investment funds and it should be noted that various initiatives in the fields of product innovation and client protection are helping to strengthen the market.

For instance, over the past year, two local Shariah compliant fund management companies have embraced the notion of compliance with a wider set of environmental, social and governance (ESG) targets. Encouraging compliance with international ESG norms helps to promote cross-sector sales.

According to the ALFI, the year 2015 has been mainly characterized by the creation of new conventional funds from Middle East promoters.

Currently, the ALFI is completing the update to their publication aggregating the best practices for setting-up and servicing Shariah compliant funds in Luxembourg.

Finally, Luxembourg is playing an active role in the field of 'responsible investing' with a market share of more than 50% of global assets under management in microfinance investment vehicles, representing 30% of all European funds with a 'responsible' investment strategy (with 35% of assets under management).

The local Islamic banking industry is making slower progress than expected in Luxembourg. This may be partly explained by Islamic finance not being a current priority among the local conventional banks due to their focus on anticipating and adapting to new European regulatory requirements and on consolidating their client base in Europe. Another issue may be that the focus of Middle Eastern banks has so far been on Muslim-majority markets such as Asia rather than Europe. However, through various interviews with UAE financial firms, we understand some may now be ready to target the EU market via a subsidiary in Luxembourg.

Meanwhile, various local financial groups such as SGG and Banque Internationale à Luxembourg (BIL) opened branches in Dubai. Moreover, the LFF confirmed that other projects existed and might come to fruition during 2016.

Finally, in the Takaful area, FWU, Swiss Life, Chaabi and Vitis Life are all selling Takaful products on a cross-border basis out of Luxembourg.

Preview of 2016

The outlook for 2016 is promising, with strong foundations developed in 2015. We may see the issuance of another local or foreign sovereign Sukuk, following the successful South African sovereign Sukuk listing.

Corporate Sukuk may be suggested in both the Gulf and the EU as a form of reaching new customers and broadening the investor's base as indicated by the demand for the first Goldman Sachs Sukuk listing in Luxembourg.

Other Shariah compliant products are also expected to expand such as Takaful. Recent performance and cross-border sales show an increasing interest for these wealth management solutions.

Finally, on the 5th October 2015, the Qatari and local regulatory authorities (QFMA and the CSSF), signed an MoU on mutual assistance and the exchange of information relating to the supervision of securities markets. The aim of this memorandum is to promote the exchange of regulatory and technical information, as well as cooperation as regards supervision and inquiries. This agreement between both authorities foresees the further expansion of the Islamic finance industry in Luxembourg.

Conclusion

Over recent years, Luxembourg has demonstrated its strong commitment to be recognized as an Islamic financial center in Europe. Despite the fact that 2015 did not meet the expected growth for the Islamic finance industry, Luxembourg consolidated the foundations for a stronger performance in 2016 with many positive announcements from the local government and its agencies. We believe that innovation in the field will be developed by foreign Shariah compliant players from the UAE or Asia rather than by local promoters. (2)

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A more challenging road ahead for Islamic finance in Malaysia

By Ahmad Mukarrami Ab Mumin

The year 2015 has been a phenomenal one for Malaysia, be it from the political, economic or social segment of the country. Surrounded by economic uncertainties, the Islamic banking and finance industry in Malaysia endured a challenging year. Nevertheless, the country itself has been able to maintain its composure and is still moving forward while preserving its spot as the center of the global Islamic banking and finance industry.

It remains to be seen how well the industry in Malaysia will perform in the coming year, while many are predicting the sluggishness of the economy will further obstruct the growth of Islamic finance. 2016 will be a year where support from regulators and the government will be as vital as ever in the resilience of the Islamic finance industry in Malaysia.

The year 2015 post-IFSA

The enactment of the Islamic Financial Services Act (IFSA) 2013 has further strengthened the governance of the industry as a whole as well as each Islamic financial institution as entities.

Islamic deposit products in Malaysia had to be revamped pursuant to this Act. The year 2015 witnessed the effective implementation of the Investment Account (IA) framework which created further innovation as well as greater distinction between conventional and Islamic finance. Islamic financial institutions were given a grace period to implement such enforcements, and by mid-2015, products based on the IA framework were introduced to the market.

The implementation of IFSA 2013 also brought about changes in the industry, for example, the inclination of structuring a demand deposit product based on commodity Murabahah by some Islamic financial institutions, whereby the idea of such a product was previously shrugged off due to higher costs incurred by the Islamic financial institutions. This type of product was launched recently this year and was the first of its kind in Malaysia.

As a result of such a new development in Islamic banking deposit products, it is expected that more Islamic financial institutions will follow suit in structuring other variant products which in turn will enable the industry to become more competitive under a strengthened governance law.

New Shariah standards

Bank Negara Malaysia (BNM) has been diligently rolling out policy documents in relation to Shariah contracts. These documents are issued in stages and upon finalization, the documents (referred to as the Standards) will be given an effective implementation date where all Islamic financial institutions must abide the Standards by then.

In 2015, two new Standards were issued, ie Musharakah and Mudarabah, where the Standards will come into effect on the 1st June 2016. These Standards are important for the strengthening of Shariah governance in legal documentation and the structuring of Islamic financial institutions' products and services. Other Shariah contracts will be covered later once the current concept papers have been finalized.

The Standards also come with operational requirements set by BNM which will see Islamic products be more customer-centric, protecting the rights of customers from the Shariah-structuring point of view.



The impact of Malaysia's 2016 budget on the Islamic capital market In the spectrum of Sukuk issuance, Malaysia has been performing relatively well in contrast to the anticipated performance of 2015. Several corporations have indicated their interest in issuing Sukuk in the near future; these Sukuk may be targeted to be issued within the year or by 2016.

The prime minister of Malaysia recently presented the 2016 budget in the parliament, whereby the Islamic finance industry has yet again received support from the government in order to spur the industry. In the budget, the main highlight is the incentives given on issuing sustainable and responsible investment Sukuk whereby tax deductions were given on its issuance costs for five years. Other similar incentives were given to the issuance of retail Sukuk and on income from managing Shariah compliant funds.

EPF to set up Shariah compliant account

Another milestone in the industry is the amendment of the Employees Provident Fund (EPF) Act to complement the establishment of Shariah compliant accounts. The EPF announced that upon approval, there will be a dedicated Shariah compliant account created that will be provided as an optional account to members of the fund. Upon enactment of the amended bill, a Shariah committee must be appointed to oversee the upcoming dedicated Shariah compliant accounts. In general, by the size of the fund managed by the EPF, this move would further support the development of the Islamic capital market in Malaysia. The EPF is the largest social security institution in Malaysia which provides retirement benefits by investing the saving contributions of its members.

What's next?

Although Malaysia has been tirelessly reinforcing the Islamic finance industry as can be witnessed in the year 2015, it is expected that the road ahead will be more challenging. Therefore, greater cooperation between the government, regulators and industry players will be pertinent to further develop, stabilize and attract more interest to this industry. (2)

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Time to make hay as the future is bright and sunny in the Maldives

By Dr Aishath Muneeza

Maldives is a famous tourist destination that is unique not only geographically, but it is also a 100% Muslim country that has a homogenous language and culture across the whole country that consists of 1,190 small islands.

Though the economy and the financial landscape of the country is predominated by conventional financing methods and ideas, since the formation of the first Islamic bank of the country, Maldives Islamic Bank in 2011, the development of Islamic finance has grown exponentially. Since then, the country has witnessed a rapid and remarkable growth in Islamic finance that is worth studying. The year 2015 can be considered as a significant year that has brought the importance of Islamic finance in Maldives to the limelight. The largest national bank, previously conventional, introduced Islamic banking and for the very first time in the history of the country, the vice-president of the country inaugurated the special Islamic finance scheme for micro, small and medium enterprises. These two events alone prove that Islamic finance is an essential concept in the country today that is fully backed by the government.

Review of 2015

The year 2015 brought new players and innovative products to the market. In the month of January, the biggest conventional bank in the country which is also the national bank, introduced Islamic banking. However, the initial products offered are only deposit products. In the same month, Maldives Hajj Corporation invested in the oil business by buying a paper issued by State Trading Organization. In February, the deputy managing director of Housing Development Corporation (HDC) announced the formation of its Shariah Advisory Committee that will Islamize conventional loans into Islamic products.

In March, the first and the only fully-fledged Islamic bank in the country, Maldives Islamic Bank, introduced internet banking through 'Faisa net'. The introduction of internet banking gave opportunities for customers of the bank in other islands except for Male' and Addu City to engage in more transactions without being physically present at the bank. In April, Housing Development Finance Corporation, the only specialized housing mortgaged financier in the country, announced that the financing rate for Islamic products and conventional products offered by the company would be made lower by 50bps than the existing rate and the tenure of the facilities has been extended from 15 years to 20 years. In the same month, Maldives Transport and Contracting Company introduced a Shariah compliant engine financing scheme.

In May, a special Takaful package for Umrah and Hajj was introduced by Allied Ayady Takaful in affiliation with Maldives Hajj Corporation. The scheme was introduced by the first lady of the country, Fathimath Ibrahim. In the same month, a Saudi company, Al Huzam Management Company, announced that it is going to carry out a feasibility study in Maldives to determine whether it is feasible to open an Islamic resort. In June, the Addu City council announced that it intends to build and develop the Waqf property which was to be developed under the Island Waqf project carried out by the Ministry of Islamic Affairs. The IDB also sent a team to study the project. The main objective of this project is to ensure the money received by leasing the property developed is dedicated to building and renovating mosques. In the same month, for the first time, Maldives Islamic Bank introduced Zakat payment via its ATM machines, internet banking and via POS machines kept at the Ministry of Islamic Affairs.



In July, a bill was ratified by the president to create the first Islamic university of the country that will create an Islamic trust fund. In August, the Ministry of Economic Development in affiliation with Maldives Islamic Bank introduced an Islamic finance scheme worth of MVR30 million (US\$1.93 million) for the micro, small and medium enterprises in the name of 'Faseyha Madadu'. This scheme was introduced with the assistance from Asian Development Bank and the IDB. In the ceremony to introduce the scheme, it was also announced that the minimum reserve requirement of banks were reduced to 10% from 20%, which is a positive incentive for the growth of Islamic banks. Throughout the year, Islamic finance awareness events were held and the Masters in Islamic Finance Practice program of the International Center for Education in Islamic Finance (INCEIF) also continued in affiliation with Capital Market Development Authority and the Islamic University of Maldives (previously known as the College of Islamic Studies). Also in the struggle to create an adequate talent pool for the Islamic finance industry of the country, education minister Dr Aishath Shiham visited INCEIF and scholarships were offered via the ministry to complete the Master's degree program in Islamic finance. Islamic liquidity management instruments via securitizing generator sets and an airplane were also offered by the government of Maldives.

Preview of 2016

The year 2016 will boost the number of Islamic finance products in the country. It is hoped that the Bank of Maldives will commence the offering of financing products and the HDC will be prepared to offer the Islamic products to the public. Allied Ayady Takaful is in the midst of preparation to offer Family Takaful for the first time in the country. More short-term liquidity management products will be introduced. A government-owned SPV will also be created with Maldives Islamic Finance Center. In short, with the government's will and full support, the year 2016 will be a dynamic and prolific year for Islamic finance in Maldives.

Conclusion

It is anticipated that the year 2016 will bring more positive changes to the Islamic finance landscape of the country as the government has new plans to introduce a regional Islamic finance centre in the country that will act as the hub of Islamic finance in the South Asian region. As such, it is important to make hay while the sun shines as now is the best time to head forward, strengthen and sustain Islamic finance in the small island nation. (F)

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Participative finance in Morocco: Implementation process ongoing

By Dr Ahmed Tahiri Jouti

After the publication of the new banking law in the official bulletin, the implementation process of a participative banking sector in Morocco has started. The main challenges facing this process are the implementation of a central Shariah governance system, the preparation of a suitable regulatory framework and the licensing process.

Review of 2015

The year 2015 was a preparatory year for launching participative banks and involving all the stakeholders in drafting the regulatory framework such as the Higher Council of Ulama, the Ministry of Finance, etc.

The Shariah governance system

The Royal Decree published on the 9th February 2015 related to the reorganization of the Higher Council of Ulama created officially a new commission specialized in participative finance. This new commission will play the role of a central Shariah board for the whole participative finance industry and will be in charge the issuance of Fatwas and opinions related to the Shariah compliance of:

- the products offered and the contracts used by participative banks, finance companies and microfinance institutions
- the central bank regulatory framework for participative banks (products offered, investment deposits and operations of the guarantee fund of deposits)
- the Takaful and re-Takaful operations and transactions, and
- the Sukuk issuances.

The new commission is composed of 10 scholars with a deep knowledge of Islamic law appointed by the general secretary of the Higher Council of Ulama from among the council's members, at least five permanent members with a proven expertise in participative finance and experts in different fields to help the commission to have a better understanding of different issues.

The members of the participative finance commission were appointed in July 2015.

The regulatory framework

On several occasions, the governor of the central bank (Bank Al Maghrib) reassured the different stakeholders about the willingness of the financial authorities to issue an adequate and a comprehensive regulatory framework for participative banks. However, this would take a bit more time because of the multiplicity of stakeholders that are participating in drafting the circulars and standards for the industry (Higher Council of Ulama, central bank, Ministry of Finance, etc).

The central bank is willing to anticipate all the industry issues and provide the necessary solutions on the basis of an international benchmarking of best practices to ensure the soundness of the participative banking sector.

Moreover, Bank Al Maghrib plans to launch an Islamic interbank market based on Wakalah agreements to ensure liquidity for participative banks, which is a very important component that will guarantee the performance of the whole Islamic financial sector.

The main circulars to be issued by the financial authorities are:

- Guidelines about participative financial products (including investment accounts)
- Guidelines about participative windows
- Guidelines about capital adequacy ratio and the risk management framework, and
- Guidelines about Shariah governance in participative institutions.

The licensing process

The circular related to the licensing process published on the 23rd July 2015 lists the documents and the different information to be provided by investors willing to apply for a license. Furthermore, the article n°4 lists the necessary documents to be presented by investors willing to launch participative finance activities (for banks, finance companies, microfinance institutions and investment banks):

- A memorandum related to the Shariah governance system to be implemented by the institution to ensure its global compliance to the opinions of the Higher Council of Ulama.
- A memorandum related to the management system of investment accounts and the relationships with the investment account holders.

This memorandum needs to describe:

- The strategy and policies adopted for the management of investment accounts
- The procedures adopted to protect investment account holders. (The distinction between investment accounts and other resources), and
- The procedures adopted to handle situations of conflict of interests between shareholders and investment account holders.

According to Bank Al Maghrib, the 16th November was the deadline for all investors willing to launch a participative institution to apply for a license. The circular does not address the issues related to Islamic windows and is limited to fully-fledged Islamic financial institutions (banks, finance companies, microfinance institutions and investment banks).

Preview of 2016

In 2016, Bank Al Maghrib will grant licenses to participative financial institutions and the whole regulatory framework governing the industry will be issued. By the end of 2016, the first participative institutions will launch their offerings in the market.

In addition, the legal framework for Takaful will go through the legislative process and the implementation process of Takaful and re-Takaful operators will start.

Conclusion

Despite the slowness of the implementation process of participative banks, the Moroccan financial authorities are confident about the potential of the industry and many local and foreign operators are interested in launching participative finance activities. 2016 is expected to be a decisive year for launching participative financial institutions in Morocco.⁽²⁾

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New Zealand presents great investment opportunities to the Islamic finance industry

By Mohamed Nalar

New Zealand has one of the highest living standards in the OECD. The New Zealand economy has recorded five years of growth and is set to continue to expand over the coming years. New Zealand has a strong banking sector that weathered the global economic crisis well. It stands out with its health status, social connections as well as civic engagement and governance.

New Zealand is recognized globally as being a safe place to invest and do business. It ranks first in the world for protecting minority investors and ease of starting a business (World Bank, 'Doing Business' 2016).

The Heritage Foundation Index of Economic Freedom ranked New Zealand third in 2015, behind Hong Kong and Singapore.

Review of 2015

New Zealand is enjoying a strong, broad-based economic expansion with economic growth tracking around 3% over the past three years. This expansion has been driven mainly by a large increase in the terms of trade (mainly contributed by high dairy prices), the post-2011 earthquake reconstruction in Canterbury and construction activity in Auckland.

Net immigration has increased to record rates of around 1.1% of the total population per year, easing labor-market tensions but exacerbating housing shortages in Auckland. Infrastructure and residential construction activity are growing strongly in Auckland in response to rapid population increases and past shortages and are likely to continue to do so for the next few years.

In per capita terms, increases in real GDP and real gross national income reached almost 2% and 3% respectively in 2014. These rates are higher than in most other OECD countries.

Foreign direct investment is a lever to fuel economic prosperity in New Zealand and is an important contributor to the nation's prosperity. Particularly where it results in investment into new productive assets and the development of export-focused business ventures. Strong trade relationships and the creation of employment opportunities for the next generation underpin a healthy economy.

During the two-year period from January 2013 to December 2014, the Overseas Investment Office approved approximately US\$14.2 billion-worth of applications. The US, Canada, Europe and Australia account for 59% of the total investments followed by China at 14%. Canada is by far the largest investor with approximately 22%.

Unfortunately, no significant or visible investment was made by the Muslim world in New Zealand.

Preview of 2016

Growth of over 3% is expected in the year ahead, supported by net migration inflows, labor income growth, stimulatory interest rates and construction activity. Real GDP growth is expected to moderate as migration inflows ease, construction growth slows and interest rates rise in response to increasing capacity pressures. Government expenditure growth is forecast to remain subdued, exerting a mild constraining influence on demand in most years of the forecast.

The high exchange rate remains a headwind for export growth but households will benefit from increased purchasing power.

The Business Growth Agenda: 'Toward 2025'

Building a more competitive and productive economy for New Zealand is one of the key priorities the prime minister has laid out for this government to achieve. The Business Growth Agenda drives this by ensuring the government stays focused on what matters to business, to encourage confidence and further investment.

The 'Toward 2025' Report launched earlier in 2015 marks a full refresh of the governments' Business Growth Agenda and will be a catalyst to propel New Zealand forward.

Six key inputs that businesses need to succeed and grow have been identified. These are:

- Investment
- Infrastructure
- Export markets
- Innovation
- Natural resources, and
- Skills and a safe workplace.

The government is holding itself accountable to the business community and to the public to achieve tangible progress in each of these areas.

Conclusion

New Zealand is fortunate to be in a good place compared to most other countries. We will continue to see a steady performance in the next two to three years underpinned by global demand for quality food, steady growth in net migration and infrastructure spend across New Zealand.

In the medium to long term, the New Zealand government needs an additional US\$160-200 billion in foreign investment to meet its target of boosting exports to 40% of GDP by 2025.

Lifting foreign direct investment in all parts of New Zealand by US\$5 billion over the next three years is one of the targets released by economic development minister Steven Joyce in an update on the building investment chapter of the government's Business Growth Agenda.

Other targets include attracting at least 10 new international companies to undertake research and development activity in New Zealand over the next five years and doubling the amount of capital that investor and entrepreneur migrants bring into the country to US\$7 billion over three years.

The New Zealand market across the board presents great investment opportunities to the Islamic finance industry, Islamic sovereign funds and individual investors from the Islamic world to explore in the coming year and beyond.⁽²⁾

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Nigeria: A potential world player in the Islamic finance industry

By Auwalu Ado

Nigeria, the most populous black nation in the world and the biggest economy in Africa, is slowly but steadily taking its position as the leader in the Islamic finance industry across the African continent. The country boasts one fully-fledged Islamic bank, two conventional banks operating Islamic banking on a window basis and a single fully-fledged Islamic microfinance bank. The country had a single experience of Sukuk issuance by the Osun state government and it also has three insurance companies offering Takaful products on a window basis. The success of these institutions toward the provision of Shariah compliant products have attracted the attention of many foreign investors and local players (conventional banks and conventional insurance) by making efforts in establishing one form of an Islamic or Shariah compliant company or another.

Review of 2015

The year 2015 has been a success story for the Islamic finance industry in the country. In the Islamic banking sub-industry, the country recorded huge success. Jaiz Bank, which is the only fully-fledged Islamic bank in the country, succeeded in achieving break-even by recording a profit after tax of NGN126 million (US\$633,007) and had during the third quarter of the year obtained an approval in principle (AIP) to operate as a national bank from a regional bank. This will give the bank the opportunity to expand to the southern part of the country including Lagos which is the commercial center of the country. The bank has also initiated discussions with a Qatari-based investment firm for investment of about US\$100 million into the bank.

In addition, Jaiz Bank has also increased its branch network from 10 in 2014 to 20 by the end of 2015. Another bank making successful inroads in the country is Sterling Bank, which has increased its balance sheet size by 300% as at October 2015 and has improved more of its non-interest alternative finance products. Likewise, the Islamic banking sub-sector witnessed efforts by some institutions at securing operating licenses for non-interest banking; among which is Key Stone Bank which is expecting AIP from the apex bank before the end of the year.

In the Takaful sub-sector, the National Insurance Commission (NAICOM), the country's insurance watchdog, has issued AIP to a Takaful operator called Nur Takaful to operate as a fully-fledged Takaful operator while two other applications are awaiting final approval. To strengthen its effort of a successful Takaful operation in the country, NAICOM has approved an Advisory Council of Experts to guide the commission on Shariah compliance. Other areas that witnessed improvement during the year under review include the capital market where the Securities and Exchange Commission (SEC) is working round the clock to ensure that the Islamic capital market developed to its optimal level. The SEC convened a stakeholders' forum where it unveiled its 10-year master plan for the development of the Islamic capital market.

Meanwhile, aside from the Islamic finance industry, the economy witnessed a lot of changes during the year under review which affected both the interest-based and the non-interest banks in one way or another. One major issue that affected the economy is the dwindling fall in oil prices which continued from the last quarter of 2014. The country's income from the oil sector, which is the major source of revenue, reduced drastically while the position of the naira against the US dollar fell to its lowest-ever at NGN230 to US\$1 especially in the parallel market which forced the Central Bank of



Nigeria (CBN) to restrict the use of foreign currencies in certain transactions. Another policy introduced by the new government and which affected the banking industry indirectly is the Treasury Single Account which requires movement of all government-related deposits from commercial banks including non-interest banks to a single account with the Central Bank. This reduced the liquidity position of all the banks in the country from posing a challenging crisis, thanks to the quick intervention of the CBN.

Above all, the Islamic finance industry has fared well in the country but not yet to its optimal level considering the potential of the market due to the size of the economy and the Muslim population.

Preview of 2016

As previously mentioned, the market is performing below its potential. It is expected that the year 2016 will be better in terms of the increase in the market share as well as the number of industry operators. In 2016, there will be an Islamic bank with a national presence and it is likely that another bank, Keystone, will obtain a window license for its operation. The country may also witness the emergence of new fully-fledged Takaful operators in the coming year. Based on the awareness created and the level of commitment from the SEC in launching its 10-year 'Master Plan on the Islamic Capital Market', additional Sukuk is likely to be issued by some state governments to finance infrastructure projects. More investors are likely to explore the market potential by investing in either fully-fledged Islamic banks or Takaful operators. The CBN is likely to conclude arrangements for financial instruments that will support market players and may also release a guiding framework for Islamic microfinance in order to enhance its drive for financial inclusion.

Conclusion

Nigeria, a leading oil exporter with abundant human and natural resources and one of the leading economies in Africa, is always a potential market for Islamic finance. The growth rate of the existing industry players is an indication of where the country will reach in the next five or 10 years. The country can be Africa's Islamic finance hub and compete with the leading major Islamic finance players of the world. It is expected that the present government's efforts in curbing corruption and battling with the dwindling oil revenue may include the option of using Islamic finance instruments like sovereign Sukuk to finance development projects. With proper strategy and government support, the country stands a chance of being a world player rather than a regional player in the Islamic finance industry. ☺

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Challenging times but significant demand for Islamic finance in Oman

By Anthony Coleby

After a sluggish end to 2014, much was expected of the Islamic finance sector in Oman in 2015. There were initial teething problems such as trying to complete staff training at participating banks and achieving customer awareness of Islamic finance products available. However, at the same time, the installation of a central Islamic finance supervisory board by the Central Bank of Oman and Oman's Capital Market Authority was largely addressed by the new year.

Oman's first sovereign Sukuk issue – anticipated since as early as the second quarter of 2014 – was regarded as imminent, and likely to lead to the wider use in the Sultanate of this most broadly-used Islamic finance instrument globally, and this added to the general sense of expectation.

Review of 2015

To a great extent, that expectation has been met; Islamic finance has had a good year. Islamic bank assets have increased by some 53% to September year-on-year, to almost OMR2 billion (US\$5.18 billion) and some 6.5% of total bank assets. A good proportion of this growth has been provided in the retail credit sector, with strong demand for Islamic finance home mortgages, vehicle financing, credit cards, bank accounts and loans (amid the government's concern of excessive 'consumerism', that is to say, aggregate individual consumer indebtedness levels).

“ Key fundamentals that two years ago made it compelling to utilize Sukuk as a means to balance the public budget have altered significantly ”

The OMR200 million (US\$517.61 million) debut sovereign Sukuk was finally underway at the end of October and was very well received – it was increased by 25% to part-satisfy a total orderbook of around OMR350 million (US\$905.82 million), reflective of the high level of Islamic finance asset liquidity among the banks and financial institutions joining in the private placement; conventional banks also participated, mainly to diversify investment portfolios.

Additionally, there is clear evidence of Islamic finance structures being used increasingly in development projects, following the Kempinski hotel construction at The Wave complex last year: Bank Dhofar, through its Islamic finance window Maisarah, is financing the completion of the new Copthorne Millennium Hotel at Muscat's Grand Mall scheduled for soft completion in December. It is believed that this funding will be provided on the same basis as for the Kempinski – an Istisnah with deferred Ijarah structure. Four other luxury hotels across the country are also slated to use Islamic funding.

The International Medical City project at Salalah scheduled for completion in two phases through 2016/20 will also use Islamic

finance for the debt component (US\$1 billion). The exact structure to be adopted is as yet unknown.

Preview of 2016

While the aforementioned events justify a degree of optimism for the continued development of the Islamic finance sector, there are issues that will need to be addressed to ensure the 2015 momentum is sustained.

First, there is the persistently low level of the price of crude oil. Oman's credit rating has been downgraded twice in the last six months, due to an increasing public budget deficit. The pricing of future sovereign Sukuk will therefore necessarily rise, removing one of the leading attractions to the government of issuing this kind of debt. Were the government to determine instead to raise its ongoing borrowing requirement by other means, this would deny the excess Islamic finance liquidity in Oman a domestic home, with implications for the whole sector.

Next, despite the prodigious increase in Islamic finance bank assets from 2015 as noted previously, the eight banks participating in the sector still struggle to make significant profits from the Islamic finance products on offer; there is a need to be competitive with conventional equivalent instruments to attract custom volume but besides this, the sharing of risk between customers and the bank inherent in all Islamic finance products means that the risk to be apportioned to the bank makes the cost of funds somewhat higher than in conventional banking. These factors combined spell trouble for profitability.

Further, the two Islamic banks participating in the Islamic finance sector (Alizz Bank and Bank Nizwa) complain that the six other participants (with dedicated Islamic finance windows) enjoy a cost advantage compared to them since the conventional bank operation can serve directly as a sharer of costs and resources and that all such windows should be incorporated as subsidiaries to level the playing field. If the government follows this line of thinking, this would place further pressure on the sector's overall profitability.

Lastly, it is widely expected that 2016 will see further moves toward consolidation among participating banks due not only to the economies of scale but also (as in the Omani banking sector as a whole) to the quite apparent presence of oversupply.

Conclusion

There are important challenges to be addressed in the coming year. A sustained low crude oil price will increase the government's need to borrow and make it more expensive for it to do so. Key fundamentals that two years ago made it compelling to utilize Sukuk as a means to balance the public budget have altered significantly.

On the plus side, it is evident that there is significant public demand for Islamic finance products, although a major priority for participating banks is to convert that demand into a sustainable profit. At the same time, the increasing use of Islamic finance structures in major development projects is very good news for the sector and should help the sector to sustain the momentum seen in 2015. ⁽²⁾

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Islamic finance in Pakistan attaining new heights

By Muhammad Shoaib Ibrahim

The Islamic financial services industry has become an important component of the financial system in an increasing number of jurisdictions. The industry is performing at a remarkable rate and becoming a competitive alternative to conventional banking around the world. The segment has witnessed considerable developments and is now regarded as one of the fastest-growing industries of the global financial system particularly in the unbanked Muslim population.

The excellent performance is due to strong demand, quality research and product innovation. The progress is also supported by a strong financial infrastructure which includes an effective supervisory structure, credible standards and an effective risk management system. At present, total global financial assets of the Islamic financial industry is estimated to be around US\$2 trillion and is expected to double in the next five to seven years.

Likewise in Pakistan, on the backdrop of excellent growth globally, Islamic finance is expanding sensibly across the country in an

impressive manner. Pakistan, with a large Muslim population, remains at the forefront in promoting Islamic finance. The country has an important strategic geographical location which, along with a rich source of minerals and a large and highly productive agricultural region, makes it a marketplace with ample business opportunities for trade and finance.

At present, the Islamic financial services industry of Pakistan consists of Islamic banks, microfinance banks, Islamic mutual funds, Modaraba entities, Takaful companies and Islamic REITs. Commercial and microfinance banks operate under the State Bank of Pakistan (SBP) while the rest of the sector is supervised by the Securities and Exchange Commission of Pakistan (SECP).

Review of 2015

The Islamic banking industry in Pakistan has progressed considerably and its share has increased from scratch in 2002 to nearly 12% of the overall banking industry in terms of its asset size. The branch network of Islamic banking is continuously expanding throughout the country at a fast pace and catering to the demand for Shariah compliant banking

products. The stability and resilience of the Islamic financial industry had attracted wider acceptability of this system as a viable alternative to the conventional financial system. No doubt, under the dynamic leadership of Saeed Ahmed, the deputy governor, the SBP has played a leading role in further promoting and developing Islamic banking within the country on sound footings.

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

“ The major challenges are to educate the masses and widen the outreach to improve the visibility and accessibility of Islamic products ”

During the year, the SBP issued the Shariah Governance Framework for Islamic Banking. The primary objective of this framework is to strengthen the overall Shariah compliance environment of Islamic banking institutions and explicitly define the roles and responsibilities of various organs of Islamic banking institutions including the board of directors, the executive management, the Shariah Board, the Shariah Compliance Department, etc.

The SBP had also announced the establishment of a center of excellence for the development of high-quality human resources required for the Islamic finance industry. The center will further strengthen the foundations of Islamic finance within the country through rigorous research and effectively address the challenge of a shortage of human resources. The five-year strategic plan which was launched last year is gradually being implemented in phases. The key focus areas/objectives of the strategic plan are:

- enabling a policy environment
- Shariah governance and compliance
- awareness and capacity-building, and
- market development.

The SECP has also provided various incentives for the promotion of Islamic finance at the country level. Under the progressive leadership of Zafar Hijazi, the chairman of the SECP, the commission has become very active in promoting Islamic finance. The major breakthrough was the establishment of a separate Islamic Finance Department (IFD). According to the mandate, the IFD will carry out the functions of Shariah regulation and compliance, product development and market awareness. The head of department of the IFD is Bilal Rasul who has vast experience in Islamic finance.

The IFD has also envisaged a roadmap for restructuring and reorganizing the Islamic capital market. The roadmap entails the introduction of uniform Shariah regulation for Takaful, Modaraba entities, Islamic mutual funds, Islamic pension funds, Islamic REITs, Islamic financial institutions other than banking, Shariah compliant (non-financial) companies, Islamic products and instruments. Within the SECP's jurisdiction, Islamic mutual funds, Modaraba and Takaful companies are growing very well particularly the Modaraba sector which is performing very well and contributing to the promotion of Islamic finance in the country. Modaraba entities have the unique nature of a Shariah compliant

corporate entity and have completed almost three decades of business operation within Pakistan's financial market as Islamic financial institutions.

During the year, Takaful windows with conventional insurance companies were also allowed to start their Takaful operations. The first Shariah compliant REIT fund also started its business in 2015. The Islamic REIT fund was a good development for the promotion of the Shariah compliant property market in Pakistan. The SECP has also formed a new Shariah Advisory Board within the IFD in order to harmonize the Shariah-related business, operations and structure of the instruments of Islamic finance and to adopt a standardized approach for the practical application of various modes.

Preview of 2016

Keeping in view the growth potential of the Islamic finance market, the government seems quite determined to push ahead with this industry in Pakistan. The present government has showed their commitment in facilitating the development of the Islamic finance industry by creating an enabling environment. Last year, the government constituted a high-level steering committee for the promotion of Islamic banking and finance in the country under the chairmanship of Saeed. Significant progress has been made by the committee in key areas including a review of the legal, regulatory and taxation frameworks as well as the development of liquidity management solutions and the Islamic capital market which will greatly support further development of this industry.

The establishment of a separate Islamic division within the SECP is also an excellent step in the promotion of Islamic finance. The development of capital markets, mutual funds, Modaraba and Takaful companies complements the growth of the Islamic banking industry. Realizing the crucial need for close collaboration in the overall financial system, a joint forum of regulators from the SBP and the SECP has been established. This forum will help in creating a conducive environment and developing the necessary regulatory standards for the Islamic financial industry. It is a very positive move from both regulators and will greatly support the overall expansion of Islamic finance in the country.

Recently, the SBP has issued the first license to a microfinance bank for Islamic banking. This will definitely provide support in addressing issues of financial inclusion and the development of Islamic finance as an alternative and compatible system at the micro level. This will not only provide investment avenues to Islamic financial institutions but will also enable these institutions to make significant contributions toward poverty alleviation as well. Another landmark move was made by the central bank with the issuance of the first Islamic subsidiary bank license to a conventional bank. This initiative will further encourage major conventional banks to have a fully-fledged Islamic bank as a subsidiary under their conventional banking arm.

Conclusion

The future outlook of the Islamic finance industry in Pakistan is very promising with bright prospects. Both the regulators, the SBP and the SECP, are playing vital roles for the growth and promotion of the Islamic finance industry in the country. Pakistan is the world's second-most populous Muslim nation and has great potential for the expansion of Islamic finance which is largely an untapped industry. The major challenges are to educate the masses and widen the outreach to improve the visibility and accessibility of Islamic products so as to encompass the financially excluded segment as well. Although the industry has shown rapid growth, concerted and proactive efforts are still required for areas that need further developing in order to nurture this industry.

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Islamic finance in Palestine

By Dr Hisham Jabr

Islamic finance in Palestine goes back to about two decades ago, when the Palestine Finance House was established in 1994 as the first Islamic financial institution in the country, followed by four Islamic banks established in the late 1990s.

Islamic banks

The first Islamic banks in Palestine were: Arab Islamic Bank, Palestine Islamic Bank, Cairo Amman Bank Islamic branches (four branches) and Al Aqsa Islamic Bank. Palestine Islamic Bank then acquired Cairo Amman Bank's Islamic branches in 2005, and followed up with the purchase of Al Aqsa Islamic Bank, resulting in only two Islamic banks today: Arab Islamic Bank and Palestine Islamic Bank. Table 1 gives a snapshot of these two banks. Total assets of Islamic banks represent about 10% of total banks' assets, while deposits with Islamic banks represent about 10.6% of total deposits with the banking system. As for credit facilities, they represent about 12.5% of total credit facilities of the banking system. Owners' equity represents about 9.3% of all bank owners' equity.

Insurance companies

There are two Islamic insurance companies operating in Palestine as follows:

- Al Takaful Islamic Insurance Company operates in the West Bank of Palestine and was established in 2008 to provide all types of insurance based on Shariah principles. It provides insurance through 30 branches and 17 agents. Its insurance portfolio reached JOD20 million (US\$28.05 million) by the end of 2014 with an increase of about 33% from 2013. The insurance portfolio represents about 14% of the insurance portfolios of all insurance companies operating in Palestine. Insurance growth in Palestine was about 5% annually, while for Al Takaful it was about 33% annually which means good prospects for Islamic insurance in Palestine.
- Al-Multazem Insurance Company operates in the Gaza Strip with four branches conducting all insurance and investment activities according to Shariah principles. It started operations on the 17th February 2008 with a capital of US\$8.5 million as a shareholding company. The company is engaged with Islamic reinsurance companies. The company's total assets reached US\$17.4 million by the end of 2014 with its total owners' equity reaching US\$12.2 million. Its net profit of 2014 was US\$765,000.

The Shariah jurisdiction commission of each company which consists of three people verifies all insurance policies, accounts and reinsurance treaties from an Islamic perspective.

Islamic microfinance firms

There are several microfinance firms in Palestine that offer Islamic finance, with some of them offering both Islamic finance and

Table 2: Islamic microfinance firms in Palestine

Name of institution	No of branches	Total financing balance as at the end of 2014 in US\$
Faten	24	12 million
Reef	10	3.6 million
Acad	8	0.7 million
Asala	7	0.47 million
Ibdaa	3	5,000
Total	54	16.361 million

Source: Author's own

conventional finance. Table 2 shows the institutions which offer Islamic finance. The total number of beneficiaries from these institutions reached 9,055, ie about US\$1,800 on the average for each customer.

Palestine Ijarah Company

The Palestine Ijarah Company was established as a shareholding company in October 2013 and started operations by the mid of 2014. The main shareholders are: Palestine Investment Fund, Palestine Islamic Bank and the Islamic Corporation for the Development of the Private Sector (based in Jeddah). The company offers different types of Ijarah such as for equipment, machines, vehicles, production lines, etc. All assets leased will be insured by Al Takaful Insurance Company. No financial data was available at the time of this article.

Conclusion

Different types of Islamic financial institutions are currently operating in Palestine: Islamic banks, insurance companies, microfinance firms, Ijarah company, etc. Their performance is still very low compared with conventional finance, but there is a very good prospect for Islamic finance in Palestine. It is expected by the beginning of 2016 that a new Islamic bank will be established. Existing Islamic banks are growing rapidly and Islamic insurance is growing at a rapid rate about 33% annually. Microfinance firms which were providing conventional finance have started to provide Islamic finance, encouraged to do so by the Deprived families Economic Empowerment Program (DEEP) executed by United Nations Development Program. DEEP made a manual for Islamic banking operations and accounting for each Islamic banking tool, and provided training for these institutions.

It is expected that Islamic banks will introduce more new Islamic financial instruments, and not concentrate only on Murabahah as the main financial instrument. New technology will be introduced and there will be more training courses for employees. New marketing strategies will also be introduced and new Islamic banks will be established. ☺

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Table 1: Islamic banks in Palestine

Bank	Branches and offices	No of ATMs	Assets as of end of 2014 (US\$ million)	Owners' equity	Deposits (US\$ million)	Credit facilities on an Islamic basis	No of Employees	Net profit before tax
Arab Islamic Bank	11	41	562	67.7	425.	247.1	314	4.1
Palestine Islamic Bank	19	45	595	67.5	455.9	353.	461	7.5
Islamic National Bank*	NA	NA	76.1	19.4	55.4	61.5	NA	1.5
Total	30	86	1233.1	154.4	937.1	661.6	755	13.1

*Operates only in Gaza, not licensed by the Palestinian Monetary Authority

Source: Author's own

Islamic investing moving forward in the Philippines

By the Philippine Stock Exchange

The Philippine Stock Exchange (PSE) developed its Shariah compliance program in line with its goal of expanding the investor base of the Philippine stock market. About 11% (as of 2011) of the population in the Philippines are Muslim Filipinos. The Shariah program aims to attract Muslim investors in the Philippines and worldwide through opening up more investment opportunities in the local capital market.

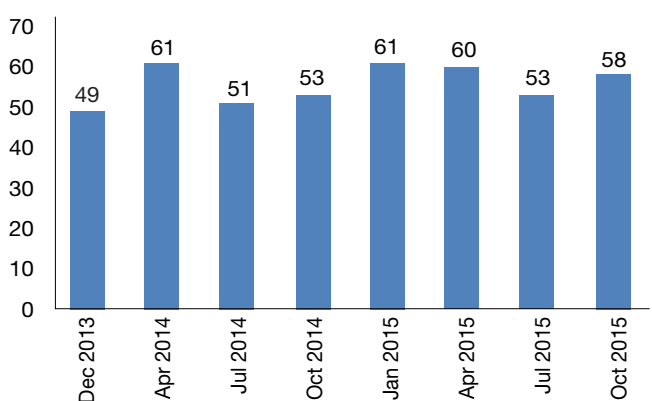
Shariah compliance at the PSE

The PSE engaged the services of IdealRatings to screen securities for Shariah compliance. IdealRatings is a provider of Islamic finance information that specializes in screening securities for Shariah compliance. The screening process is in accordance with the standards stipulated by AAOIFI, and includes business screening and financial ratios screening to determine Shariah compliant companies.

Generally, the nature of a company's primary business must not involve any of the prohibited activities such as conventional interest-based financial institutions, pork, alcohol, intoxicants, tobacco, arms and weapons, gambling, casinos, derivatives, adult entertainment, music and human stem cell research, to become Shariah compliant. Any revenue derived from these activities must not exceed 5% of its gross revenue.

The AAOIFI standards also stipulate the maximum tolerance for financial ratios of the company as a percentage to market capitalization. The company's interest-bearing debt as well as the total amount of interest-bearing deposits/investments should not exceed 30% against its 12-month trailing average market capitalization. Meanwhile, a company's accounts receivable should not exceed 67% against its 12-month trailing average market capitalization.

Chart 1: Number of Shariah compliant securities



Source: PSE

Shariah compliant securities

The first list of Shariah compliant securities at the PSE was launched on the 16th December 2013 with 49 securities. Securities are screened for Shariah compliance on a quarterly basis. Qualified securities are disseminated to the public through the PSE website.

As of October 2015, there are 58 Shariah compliant securities (57 companies) which account for 21.7% of all listed companies at the PSE. These securities have an aggregate market capitalization (MCAP) of PHP2.84 trillion (US\$60.05 billion) or 20.8% of the total MCAP of all listed securities as of the 15th October 2015.

Of the 58 Shariah compliant securities, 21 issues or 36% are classified under the industrial sector; 15 issues or 26% are under the services sector; 10 companies or 17% are from the mining and oil sector; six securities or 10% are from the holding firms sector;

Table 1: List of Shariah compliant securities as of October 2015

	Company Name	Stock Code	Sector	Subsector
1	A. Soriano Corporation	ANS	Holding firms	Holding firms
2	Abra Mining and Industrial Corporation	AR	Mining and oil	Mining
3	Apex Mining Company	APX	Mining and oil	Mining
4	Araneta Properties	ARA	Property	Property
5	Asian Terminals	ATI	Services	Transportation services
6	ATN Holdings 'A'	ATN	Holding firms	Holding firms
7	ATN Holdings 'B'	ATNB	Holding firms	Holding firms
8	Centro Escolar University	CEU	Services	Education
9	Cirtek Holdings Philippines Corporation	TECH	Industrial	Electrical components and equipment
10	Concepcion Industrial Corporation	CIC	Industrial	Electrical components and equipment
11	Crown Asia Chemicals Corporation	CROWN	Industrial	Chemicals
12	D&L Industries	DNL	Industrial	Food, beverage and tobacco
13	Da Vinci Capital Holdings	DAVIN	Industrial	Construction, infrastructure and allied services
14	DMCI Holdings	DMC	Holding firms	Holding firms
15	Easycall Communications Philippines	ECP	Services	Other services
16	EEL Corporation	EEL	Industrial	Construction, infrastructure and allied services
17	Far Eastern University	FEU	Services	Education
18	Global Ferronickel Holdings	FNI	Mining and oil	Mining
19	Globe Telecom	GLO	Services	Telecommunications
20	Holcim Philippines	HLCM	Industrial	Construction, infrastructure and allied services
21	iPeople	IPO	Services	Education
22	IRC Properties	IRC	Property	Property

Table 1: List of Shariah compliant securities as of October 2015

23	Island Information and Technology	IS	Services	Information technology
24	Jollibee Foods Corporation	JFC	Industrial	Food, beverage and tobacco
25	Keppel Philippines Properties	KEP	Property	Property
26	Lafarge Republic	LRI	Industrial	Construction, infrastructure and allied services
27	Liberty Flour Mills.	LFM	Industrial	Food, beverage and tobacco
28	Liberty Telecoms Holdings	LIB	Services	Telecommunications
29	Mabuhay Vinyl Corporation	MVC	Industrial	Chemicals
30	MacroAsia Corporation	MAC	Services	Transportation services
31	Manila Bulletin Publishing Corporation	MB	Services	Media
32	Manila Electric Company	MER	Industrial	Electricity, energy, power and water
33	Marcventures Holdings	MARC	Mining and oil	Mining
34	Minerales Industrias Corporation	MIC	Holding firms	Holding firms
35	Nickel Asia Corporation	NIKL	Mining and oil	Mining
36	Now Corporation	NOW	Services	Information technology
37	Oriental Peninsula Resources Group	ORE	Mining and oil	Mining
38	Pepsi-Cola Products Philippines	PIP	Industrial	Food, beverage and tobacco
39	Philex Mining Corporation	PX	Mining and oil	Mining
40	Philippine H2O Ventures Corporation	H2O	Industrial	Electricity, energy, power and water
41	Philippine Long Distance Telephone Company	TEL	Services	Telecommunications
42	The Philodrill Corporation	OV	Mining and oil	Oil
43	Robinsons Land Corporation	RLC	Property	Property
44	Roxas and Company	RCI	Industrial	Food, beverage and tobacco
45	SBS Philippines Corporation	SBS	Services	Other services
46	Semirara Mining and Power Corporation	SCC	Mining and oil	Mining
47	SPC Power Corporation	SPC	Industrial	Electricity, energy, power and water
48	SSI Group	SSI	Services	Retail
49	Starmalls	STR	Property	Property
50	STI Education Systems Holdings	STI	Services	Education
51	Swift Foods	SFI	Industrial	Food, beverage and tobacco
52	United Paragon Mining Corporation	UPM	Mining and oil	Mining
53	Universal Robina Corporation	URC	Industrial	Food, beverage and tobacco
54	Vitarich Corporation	VITA	Industrial	Food, beverage and tobacco
55	Vivant Corporation	VVT	Industrial	Electricity, energy, power and water
56	Vulcan Industrial and Mining Corporation	VUL	Industrial	Construction, infrastructure and allied services
57	Wellex Industries	WIN	Holding firms	Holding firms
58	Xurpas	X	SME	SME

Source: PSE

and five or 9% are from the property sector. One Shariah compliant security is classified under the small, medium, and emerging boards.

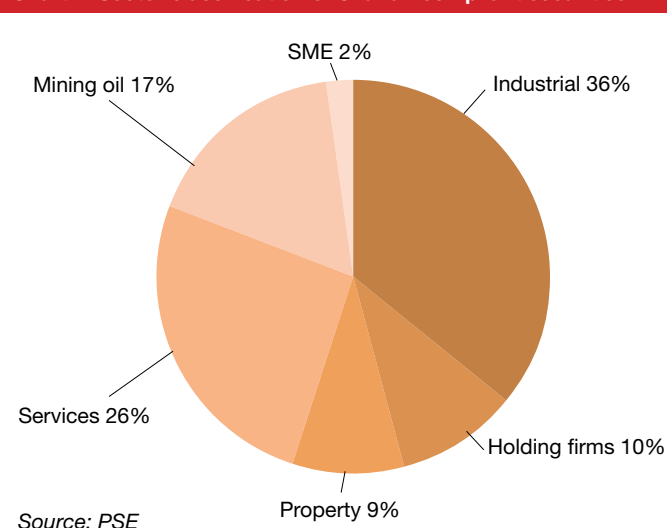
Moving forward

The PSE continues to include Islamic investing in its market education campaign especially in the conduct of roadshows. The exchange is also currently studying the possibility of launching a Shariah index to aid investors in tracking the performance of PSE's Shariah compliant stocks. Fund managers may also utilize such an index to create Shariah-based ETFs.

Adopting the Shariah compliance screening process is PSE's thrust to encourage Muslim Filipinos and fund managers who use Shariah as ethical filters to invest in the Philippine stock market and participate in the growth of the Philippine economy through equity investments. ☺

The article was contributed by the Business Development Department of the Philippine Stock Exchange and queries can be directed to bdd@pse.com.ph.

Chart 2: Sector classification of Shariah compliant securities



Qatar: A year of mixed fortunes

By Amjad Hussain

This past year has been a challenging year in Qatar. Turbulent conditions in the region and the substantial decrease in oil and gas prices have had an appreciable impact on the Qatari market. Such is the concern that, once the powerhouse of the Qatari economy, Qatar Petroleum canceled projects worth more US\$15 billion dollars to carry out a remarkable redundancy program.

Review of 2015

Earlier this year, the Ministry of Finance announced that the fiscal year 2014/15 for the State of Qatar will be extended until the end of 2015 as a transitional period prior to the harmonization of the fiscal year with the calendar year, starting in January 2016. Budget estimates of revenue and expenditure for the fiscal 2014/15 budget will be extended until the end of 2015, on a pro rata basis. However, Qatar's minister of finance indicated that the next nine months will be considered as an extension of the 2014/15 budget, such that the current fiscal year will cover a period of 21 months, adding that the budgeted average oil price for this period will remain at US\$65 per barrel. He explained that the estimated revenue for the extended nine months is QAR169.3 billion (US\$46.45 billion), with total revenue during the full 21 months at QAR395 billion (US\$108.38 billion). The estimated expenditure for the next nine months is QAR163.8 billion (US\$44.94 billion), with total expenditure during the full 21 months estimated at QAR382.2 billion (US\$104.87 billion).

In June 2015, the government of Qatar predicted that it is likely to run a fiscal deficit of 4.9% of GDP next year, and 3.7% of GDP the following year. The government earlier predicted a budget surplus of 4.7% of GDP next year. Nevertheless, in October 2015, the IMF announced that Qatar's fiscal reserves are sufficient to meet the country's requirements for the next 20 years. The IMF also reported that Qatar is likely to report a surplus this year and, although inflation rates will drop down to 1.6%, it is expected to increase to 2.3% in 2016.

Interestingly, Islamic banks in Qatar, led by Masraf Al Rayan and Qatar International Islamic Bank (QIIB), have been recognized as being the most efficient in the global Islamic finance industry in terms of the cost-to-income ratio. Masraf Al Rayan's cost-to-income ratio was 20.6%, QIIB's was 24.47%, Qatar Islamic Bank (QIB)'s was 31.78% and Barwa Bank was at 39.56%.

Islamic banks have also started to publish their third quarter results. QIIB saw growth in net profit to QAR657 million (US\$180.26 million) for the July-August period of 2015, up 5.1% from the prior corresponding period. This suggests that the bank is moving in tandem with the Qatari economy. Earnings per share reached QAR4.34 (US\$1.19) over the period compared to QAR4.13 (US\$1.13) achieved in 2014. QIB also announced the results for the nine-month period ending the 30th September 2015 with net profit attributable to shareholders of the bank amounting to QAR1.4 billion (US\$384.12 million) representing a growth of 24.8% over the same period in 2014.

Islamic banks have remained active in transactions during the course of the year. In February, Qatar First Bank (QFB) announced the acquisition of a 49% stake in Food Services Company (FSC). FSC is a leading food and beverages company that operates a 16-branch network of five brands: Opera Patisserie, Opera Café, Opera Catering, Take Away and Kanafji. The acquisition marked QFB's second investment in the food and beverages sector and the fourth in the Qatari market. In September, The First Investor, the investment arm of Barwa Bank, announced the acquisition of a



49% shareholding in Shater Abbas Restaurants International Group, a local restaurant food company operating the restaurant chain Shater Abbas. Finally, in October, QIB, rated 'A-' by S&P and 'A+' by Fitch (both with a stable outlook), priced a highly successful US\$750 million five-year Sukuk offering. The Sukuk was issued at par with a profit rate of 2.754%, representing a spread of 135bps over five-year midswaps. The final orderbook closed in excess of US\$1.75 billion, representing an oversubscription of 2.33 times from 105 accounts. Despite changing conditions in the market, Fitch granted Qatar an 'AA' rating (stable outlook), one of the highest investment grade levels. Fitch has highlighted Qatar's strong economic performance despite the dip in oil prices. Fitch's rating is in line with those issued by other major credit rating agencies such as S&P ('AA') and Moody's ('Aa2').

Preview of 2016

Going forward, despite the difficulties in the oil and gas sector, Qatar has announced its commitment to continue spending on projects ahead of the World Cup in 2022. The claw back in the oil and gas sector will stimulate new projects in different sectors. Qatar is also pressing ahead full speed with its diversification drive as seen by the focus on the economic and logistics zones in Qatar. These are likely to open for business in 2016.

The dynamic landscape of the Islamic banking sector in Qatar is bound to transform following the recent announcement by Sheikh Abdullah Saud Al-Thani, the governor of the Qatar Central Bank, recently announced that the Central Bank shall grant licenses to banks in the GCC to establish branches in Qatar. Licenses for the new banks will be given according to criteria set by the Central Bank. It is likely that this will lead to further entrants coming to the already crowded Islamic finance market in 2016, a development which should be kept on the radar.

Conclusion

Overall, 2015 has been a tough but productive year for Islamic banks in Qatar. They have showed continued resilience to the geopolitical uncertainties of the wider region and the economic challenges that have visited the doors of hydrocarbon-dependent countries. However, with its relatively small population and prudent management of cash reserves, Qatar is unlikely to suffer the consequences that other global energy players will be worrying about. The drive toward diversification is continuing in earnest and this will pan out further next year. 2016 is therefore likely to continue to be a solid year for the local banks. ☺

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Islamic finance in Russia: Ready, steady, go?

By Irina Magon and Roustam Vakhitov

Islamic finance in Russia is still not a fully operational business segment, though it is rapidly developing.

But in 2015, Islamic financing in Russia is perceived as a more attractive option, an alternative to the West-European model. The possibility of the introduction of amendments to the legislation for the development of Islamic banking in Russia is seriously being considered at the state level.

Review of 2015

In 2015, a wide range of forums on the development of Islamic banking took place in Russia.

In April, the Lower Chamber of the Russian Parliament's Committee on Financial Markets held a meeting with the theme 'Practical aspects of the introduction of Islamic banking products – Necessary legislative initiatives.' As one of the major issues for the development of Islamic banking and Islamic finance in Russia is the lack of the necessary legal framework, changes in the existing legislation were discussed.

Under the agreement between the government of the Republic of Tatarstan and the Russian-Malaysian consortium that was signed at the Kazan Sukuk Conference in April 2015, a working group to develop proposals to introduce relevant changes to Russian legislation was established.

On the 7th October, the Central Bank of Russia, together with the representatives of State Duma, the Association of Russian Banks, the Association of Regional Banks of Russia and the largest players in the financial market of the Russian Federation, held expert hearings within the final stage of the feasibility study for the launching of Islamic banking in Tatarstan, as a pilot project for the launch of Islamic banking and finance in the Russian Federation. These studies will form the basis for amending the legislation for the development of Islamic banking in the country.

As a result, the Central Bank appears to support the idea of introducing Islamic banking standards in a number of regions of the Russian Federation. If the government's decision is positive, and the project develops well, the Central Bank will be ready to continue the dialogue on the draft law on Islamic banking, which had been previously submitted to the State Duma.

On a more practical level, in early October 2015, the company LaRiba Finance, which provides services in the field of Islamic finance, signed a contract with the large retail network Eldorado. LaRiba will provide financial services to customers of Eldorado. This financial services is based on a Murabahah model. In addition to Eldorado, the company provides its services in another two big retail supermarkets in Makhachkala, the capital of Dagestan.

In late October, a large Bahraini bank proposed to establish a joint Russian-Bahraini bank in Russia that will work with the principles of Islam.

Overall, the prospects for the development of the Islamic finance sector are high and cooperation in this area will contribute to socio-economic development.

Preview of 2016

The further development of Islamic finance in Russia will very much



depend on the decisions of the Central Bank of Russia and the government on whether or not to establish a regional pilot project on Islamic finance implementation in Tatarstan. Should the proposal succeed, we may finally see the establishment of a fully-fledged Islamic bank in Russia. Otherwise, it may take a few more years to reach this stage.

Another major boost for the development of Islamic finance in Russia is the stronger cooperation and multiplication of Islamic businesses, which naturally require genuine Islamic finance. Therefore, the development of small and medium Islamic businesses in Russia may encourage the development of Islamic finance in Russia as well. (F)

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Saudi Arabian markets continue to expand

By Nabil A Issa and Faris Al Louzi

The Kingdom of Saudi Arabia has historically been characterized by a booming and stable economy that is primarily driven by abundant oil reserves and related hydrocarbon industries. Saudi Arabia is the largest economy in the Middle East. While Saudi Arabia has been working toward diversifying its economy, the recent slump in oil prices along with a war in neighboring Yemen have caused some stress on government finances. In response to the predicted deficit, in mid-2015, Saudi Arabia issued its first sovereign bond in eight years, selling approximately SAR15 billion (US\$4 billion) of bonds to local banks.

Saudi Arabia is home to the largest number of investment funds domiciled in the GCC. With the support of the Capital Market Authority (CMA) and other Saudi government institutions such as Takamol, funds and asset managers have diversified from real estate into other parts of the economy, with a particular focus on listed equities, and now with financial assistance from a Ministry of Labor initiative, into venture capital and SME private equity investments. Additionally, managers are being encouraged to reinvest capital and proceeds into Saudi Arabia rather than deploying funds into foreign investments.

Review of 2015

Some of the legal updates include the following:

Companies Law

On the 9th November 2015, the Council of Ministers approved the new Saudi Arabian Companies Law which will be put into force 150 days after it is issued in the Official Gazette.

The new law introduces numerous positive amendments, such as allowing a single shareholder to establish a limited liability company; the reduction of the minimum number of shareholders in a joint stock company from five to two; the ability of a company to buy or mortgage its own shares; and other amendments in relation to the ability of joint stock companies to issue debt instruments as well as overall enhanced corporate governance.

Labor Law

The Ministry of Labor announced a comprehensive set of amendments to the Labor and Workmen's Law (Labor Law) with a total of 38 amendments.

The amendments provide for a potentially longer probationary period and ability to agree on a set amount in the event of a disputed termination of an employee, among other revisions. The fundamental

aim of the amendments is to make it easier for employers to employ Saudi nationals by making it easier to terminate non-performing employees.

The amendments took effect on the 25th October 2015, six months after the amendments were published.

Insolvency

A policy paper titled the 'General Policies of Bankruptcy' was issued by the Ministry of Commerce and Industry (MOCI) for public comment in preparation for a proposed new insolvency law.

Liberalization of Tadawul

On the 21st August 2014, the CMA issued draft rules and announcements related to the liberalization of foreign investment in listed shares on Saudi Arabia's sole stock exchange, Tadawul, for certain foreign investors.

On the 6th May 2015, the CMA issued the final rules for Qualified Foreign Investors to invest in listed shares on Tadawul. The final rules came into effect on the 15th June 2015.

Disposal of finance assets

The Saudi Arabian Monetary Agency has now issued rules governing the disposal of finance assets and their contractual rights (the Rules). The Rules provide that a disposal can be effected by way of a sale, factoring, pledging or assignment and can be with recourse, without recourse or with partial recourse to the disposing finance company. The Rules contemplate disposals of real estate and non-real estate assets but stipulate certain requirements as to the length of time that such assets have been in existence depending on the type and tenor of the relevant assets.

The introduction of the Rules is a positive development and can be seen as the next step in facilitating securitization and structured finance transactions in the Kingdom.

Commercial agencies

The MOCI published a circular advising commercial agents and distributors to comply with the requirement of registering their agency or distributorship in the agents and distributors record at the MOCI. Failure to comply within a period of six months starting from the 21st March 2015 renders the possibility of the MOCI writing off any unregistered agency or distributorship administratively.

Real estate

The Off-plan Sales Program related to the MOCI has approved the standard contract of off-plan property sales in Saudi Arabia. The MOCI has previously announced launching the standard contract publicly in order to get people's comments and suggestions.

The standard off-plan sales contract guarantees developers' and customers' commitments and rights including the needed guarantees on concrete works, electricity and drainage, in addition to maintenance and restoration works. The contract also considers the defined time periods between all contract parties and overdue commitments in cases where time schedules are breached.

Preview of 2016

Saudi Arabia has the largest economy in the Middle East, and despite the significant slump in the price of oil, the Saudi Arabian government is maintaining aggressive plans to grow and diversify its economy. Additionally, the funds industry in Saudi Arabia has been a success story compared with the rest of the GCC, and locally domiciled funds have flourished. It is widely speculated, however, that the government will also tap into international debt markets for a US dollar bond to cover the deficit and to avoid further deterioration of its reserves. We note a number of companies are also issuing Sukuk to shore up their finances.

The government has empowered forward-thinking regulators that

have implemented relatively clear, stable and predictable funds and capital markets regimes. As a result, it is widely expected that MSCI will add Saudi Arabia to its indices within two years, in particular to the emerging market index, a move that would potentially foster more growth and lead to a greater influx of capital into the country's markets. In terms of diversification, we expect the Saudi government to further focus on public-private partnerships to meet the demand for middle-income housing, utilities, schools and healthcare centers in the Kingdom.

A new land tax on vacant land is widely expected to come into law in early 2016. The nervousness in the market has also spurred otherwise reluctant sellers to create opportunities for private equity groups, Shariah compliant funds and others interested in investing in companies in real estate in Saudi Arabia at reasonable valuations. As such, it is expected that Saudi Arabian markets will continue to expand in the coming year.⁽³⁾

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Singapore: Silver linings

By Suhaimi Zainul-Abidin

2015 represented a curious year for Islamic finance in Singapore. At the 6th World Islamic Banking Conference Asia Summit held on the 3rd June 2015, the Monetary Authority of Singapore (MAS)'s deputy managing director delivered a succinct speech highlighting, among other things, a growth in Islamic banking assets in Singapore by 73% since 2010, a 22% rise in assets under management since 2010, and a higher amount of outstanding Sukuk issuances in Singapore than any other conventional jurisdiction, reaching a high of SG\$3.8 billion (US\$2.71 billion) in 2014.

The MAS also cited the conclusion of a comprehensive free trade agreement with the GCC as one of the reasons for increasing trade interlinkages between Singapore and the GCC, resulting in the trend of GCC banks expanding their operations in Singapore to support the deployment of Islamic funds to corporates in the region through Islamic banking transactions and Sukuk issuances.

Despite these positive numbers and trends, there is a feeling among industry participants and watchers that the industry has stagnated in the face of strong headwinds, and lacks the optimism it enjoyed a decade ago. This feeling was compounded by the announcement by DBS Bank of its decision to gradually exit from Singapore's only fully-fledged Islamic bank, The Islamic Bank of Asia (IB Asia). The establishment of IB Asia in 2007 was accompanied by much fanfare and excitement as industry watchers took it as a clear sign of Singapore being serious about developing Islamic finance. However, in a relatively short span of time, the bank went through a number of significant changes such as the departure of former CEO Vince Cook in 2009, a year in which the bank suffered a loss of US\$77.1 million after making specific allowances on debt owned by customers in the Gulf region; and multiple shifts in business focus, to direct investments and of late to fee-based investment banking and private equity activities. When the announcement was made in 2015, there was noticeably a greater sense of sadness at an opportunity lost, rather than surprise.

The landscape

Singapore's early focus on leveling the playing field for Islamic finance was highly encouraging. Between 2005 and 2009, the MAS introduced a slew of enabling regulations for Islamic financial activities and transactions, legislating for a wide range of Islamic banking products such as Murabahah deposits and more complex Islamic financing structures such as Istisnah-based project financing. This was accompanied by amendments to tax regulations and the issuance of tax guides, to remove additional tax burdens that would arise from the more structured and asset-based nature of Islamic financial transactions. The most recent change to the tax framework came into effect on the 8th April 2015 through the Stamp Duties (Islamic Financial Arrangements) (Remission) Rules 2015, giving a provision for the remission of stamp duty to Islamic financial arrangements such as diminishing Musharakah, Istisnah and Ijarah Wa Iqtina, provided that the Islamic financial arrangements are endorsed by a Shariah council, body or committee formed for the purpose of providing guidance on compliance with Shariah law.

While industry players continue to lament Singapore's refusal to seriously tilt the playing field in favor of Islamic finance the way many other jurisdictions have been willing to, in order to get a leg up in the race to attract Islamic investors and Middle East funds, the reality could be that any such incentives may not help much. In 2013, the MAS allowed two tax incentives for Islamic finance to lapse after they were first introduced in 2008. The first incentive was the FSI-Islamic Finance award, introduced to encourage more prescribed Shariah compliant financial activities to be done out of Singapore by granting a 5% concessionary tax rate for income from qualifying activities endorsed by an approved Shariah board. The second incentive was for offshore Takaful and re-Takaful business, which offered a 5% concessionary tax rate to an approved Takaful insurer for income derived from writing offshore General Takaful and re-Takaful insurance. In both cases, reports indicated a very low take-up rate for the tax incentives.

In response to the fallout from the withdrawal of the two tax incentives, the assistant managing director of MAS, Ng Nam Sin,

explained at the Islamic Finance news Singapore Roadshow 2013 that the lapsing of the incentives was not a reflection of any reduced commitment to develop Islamic financial services in Singapore, and he tellingly remarked that Singapore's proposition for Islamic finance must be broader than just tax advantage. The two points made by Ng quite aptly underscore Singapore's long-term strategy for Islamic finance, and also explain the position Singapore is in today with respect to Islamic finance. While there exists a relatively good spread of Islamic financial products and instruments on the menu in Singapore, the reality is that such products and instruments are generally characterized by greater complexity, additional work, a longer time to market and ultimately higher costs, in comparison to conventional financial products, thereby making them a perennially weaker alternative.

It also means that the playing field is not really as level as it seems, due to the inherent characteristics of Islamic finance and more could be done. In order to remove these hurdles, the MAS and IRSA will need to start looking at ways to simplify the approval process for the clearance of tax issues for innovative or new Islamic financing structures, or those that do not fit squarely within the pre-defined list of approved or qualifying Islamic financing structures. Some form of grant to offset the additional legal and ratings costs associated with Sukuk offerings would also go a long way toward incentivizing first-time Sukuk issuers, and ultimately boost the industry.

Singapore's Islamic financial market today reflects a relatively shallow Islamic capital market with sporadic Sukuk issuances, and an Islamic wealth management industry which has simply not taken off, with little interest and much less activity in Shariah compliant funds. Since the Islamic capital markets and Islamic wealth management sectors are the two areas which have long been touted as areas with the greatest Islamic finance potential for Singapore, questions should now aptly be asked as to whether a new approach is required.

Singapore's torchbearer in Islamic finance remains Singapore-listed Sabana Shariah Compliant Industrial Real Estate Investment Trust (Sabana REIT), still to date the largest Shariah compliant REIT in the world by assets under management. Sabana REIT continued to tap into the Islamic debt markets in 2015 through a three-year secured commodity Murabahah facility of up to SG\$50 million (US\$35.65 million) from CIMB Bank (Singapore branch). It also entered into a SG\$243 million (US\$173.26 million) secured commodity Murabahah facility with HSBC, Malayan Banking (Singapore branch) and United Overseas Bank, as participants. It holds a diversified portfolio of 23 industrial properties in Singapore with total assets currently valued at approximately SG\$1.3 billion (US\$926.92 million), and has been assigned a 'BBB-' long-term corporate credit rating from S&P.

New players and new niches

Maybank and CIMB together offer the widest range of Islamic products in Singapore, including a mix of Islamic property financing for industrial and commercial properties, and residential properties in Malaysia, Islamic trade finance facilities, innovative upfront-paying fixed deposit products and structured deposit products, and Islamic automobile hire-purchase schemes.

Maybank remains the biggest player in the Islamic financial sector in Singapore, with 22 branches island-wide. It continues to see commendable growth in the Islamic banking segment in Singapore, with their financing and deposit portfolios reaping a compound annual growth rate of 71% and 43% respectively over the last five years.

CIMB Islamic has also experienced tremendous growth in the last few years and now boasts close to SG\$3 billion (US\$2.14 billion) in combined Islamic deposits and Islamic financing assets, resulting from a 30% year-on-year growth for Islamic deposits and a 80% year-on-year growth in Islamic financing assets.

The general consensus remains that Shariah compliant deposit and investment offerings have yet to gain much traction in the domestic retail banking market, largely as a result of low awareness of Islamic finance value propositions. Due to the small percentage of Muslims in the country, most of whom are relatively very well-banked and financially served, it is difficult to expect the level of growth in demand from the retail base which is necessary for the Islamic retail banking segment to reach a critical mass. Despite these challenges, the performance of Maybank Islamic and CIMB Islamic in Singapore seem to suggest reasons to be optimistic. Their dominance will now be tested with the emergence of news of RHB Islamic Bank's intention to launch an Islamic window in Singapore by year-end.

In addition, a number of smaller players have emerged and taken up the baton by targeting small niches within the market. The Singapore Islamic Scholars and Religious Teachers Association (Persatuan Ulama dan Guru-Guru Islam (Singapore)), has announced its intention to take a leadership role in Islamic finance in Singapore, by offering a number of services to consumers and players in the Islamic finance space. Its Financial Syariah Advisory and Consultancy Unit now offers services to Muslims to help improve the Shariah compliance of their insurance/Takaful portfolios, their investment activities and their other financial arrangements (including the treatment of their Central Provident Fund monies). Their advisory work also includes helping businesses and investment firms structure their operations and investment structures/documentation in a Shariah compliant manner, and issuing Shariah pronouncements and certifications. Their two-pronged approach of providing Shariah advisory services to both product providers and consumers should lead to an increased understanding and appreciation for Islamic finance products and services over time, and simultaneously spur the demand and supply for Islamic financial products.

Singapore's Club Ethis and KapitalBoost have also been making waves through their Islamic crowdfunding projects. They have arranged financing for some 13 projects to date, with crowd-sourced capital totaling approximately SG\$2.7 million (US\$1.93 million), largely from Singaporeans. The two crowdfunding setups rely on traditional asset-procurement Murabahah techniques to fund expanding businesses in need of working capital, and traditional profit-and-loss sharing Mudarabah contracts to fund contract-based construction projects. Apart from the attraction of utilizing relatively simple Islamic financial structures and documentation, Ethis, in particular, has been able to attract investors through their focus on socially impactful affordable housing projects which resonate well with the tenets of Islamic finance.

Looking ahead

In 2010, back when there was considerably more optimism and excitement about the prospects for Islamic finance in Singapore, Haszeri Hussin, the Islamic treasury head at Oversea-Chinese Banking Corporation, said that: "Islamic finance will take off in Singapore but it's going to be quite slow." For the time being, Islamic finance players in Singapore remain confident that the predicted 'take-off' will come at some point, even though the Islamic capital market and wealth management sectors in Singapore may not have developed as quickly as planned.

Singapore's approach of non-preferentialism in effect challenges Islamic financial players to find, create and sell real value propositions through Islamic finance, in order to draw issuers, borrowers, investors and retail consumers to Islamic finance. This approach eschews short-term artificial incentives in exchange for what should arguably be a more sustainable and competitive model of Islamic finance in general. Notwithstanding this, one cannot help but wish for the government to throw in some 'booster shots' every now and then, even if temporary, along the way. ☺

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A fertile environment for Islamic finance in South Africa

By Amman Muhammad

The South African minister of finance Nhlamhla Musa Nene noted in his medium-term budget speech that tough times are indeed ahead but a better future can be created; however, Nene punctuated his policy statement speech with one exhortation: “Without economic growth, there is no revenue growth, and without revenue growth, expenditure cannot increase and the nation cannot develop and succeed.”

This maxim holds true in all facets of business life and in this context, the Islamic finance industry is no different and is also subject to the same rules. However, with the increasing consideration in the use of Islamic banking and finance structures for both micro and macro requirements, we believe that these Islamic underlying structures will inspire growth in not just South Africa, but sub-Saharan Africa as well.

“ Sukuk remains a buzzword that corporate, merchant and Islamic bankers propose in discussions with typical customers looking to raise funding ”

Review of 2015

2015 in South Africa will be remembered as a year of anticipation. Roughly translated, it equated to a wait-and-see game as to who in the South African market would next issue Sukuk following the successful sovereign issuance in 2014.

2015 saw the return of the dreaded, electricity supply load-shedding return, which drove incentives and increased pressure on authorities to stabilize the South African electricity grid and to ease electricity cuts. These electricity cuts proved to be detrimental to output production in the country and adversely affected the country's business sector. Eskom, the country's major electricity public utility firm desperately sought funding and thoroughly investigated Sukuk-funding options.

Briefly moving away from Sukuk, the country's Islamic banking operations appeared to have showed resilient growth with all indicating decent growth. The same was noted of the Islamic asset management industry, where Shariah compliant mutual funds and exchange-traded funds appear to be performing relatively well in challenging and volatile market conditions. It is encouraging to note that the South African Islamic asset management industry through some of its niche, boutique operators deployed innovative techniques in utilizing foreign exchange control-approved annual allowances in allowing Muslim investors access to offshore Shariah compliant investments. This diversification in the investment platform has allowed for greater risk diversification and has also allowed its customers exposure seldom experienced.

In addition, during 2015, ‘tax-free’ investment structures that were introduced by the government have seen Islamic financial institutions adapt products and offer such tax-free Shariah compliant

investments to Muslim customers. The products essentially were designed to inculcate a culture of savings and legislation around the product exempts customers from paying tax on earnings made from these specific products.

2015 also saw one of South Africa's largest financial services providers suspend the sale of its short-term Takaful product through its Takaful window. The said provider is the only Takaful provider in South Africa. It is understood that they are exiting the short-term insurance business in its entirety and as such the Takaful window will also fall away. However, in the interim, it is understood that another insurance company has stepped up to service the South African Takaful market.

Preview of 2016

Having discussed the attention that Sukuk has generated in the South African market, the consideration of Sukuk as a different funding mechanism has once again captured public interest in this minority Muslim country and it remains a buzzword that corporate, merchant and Islamic bankers propose in discussions with typical customers looking to raise funding. The key element that Sukuk has taught even the staunchest of conventional bankers is that Sukuk provides for an alternate funding source that an investor has not considered before.

South Africa as an emerging economy with a growing population and large infrastructure requirements sets itself up as a fertile environment for Sukuk issuance of all types, servicing government and corporate development alike. Over and above Eskom, a number of the country's other state-owned entities, local municipal governments and certain listed entities are also looking to issue Sukuk to fund projects that they are working on. Sukuk issuances are anticipated from South African entities during 2016 and by doing so, South Africa will steadily entrench itself as the Islamic finance hub for sub-Saharan Africa.

Furthermore, new entrants to the South African Islamic banking market are also expected and this would come in the form of large established banks and smaller niche players opening Islamic windows to serve an ever-growing list of discerning customers looking for Shariah banking options. Competition in this market will undoubtedly benefit the customer who for a long time had few choices in a small market. This move would also accelerate other financial institutions to enter the Islamic market with alternative improved offerings like Shariah compliant pension and provident funds, retirement annuity products and competitive Takaful services. 2016 will also be the year of consolidation of the African continent and will showcase the collective importance of Africa as a serious player in the Islamic finance markets.

Conclusion

While the South African Islamic finance industry continues to report growth, further advancement and investment in awareness and education programs will be required to develop the skills and capabilities of Islamic financial services practitioners and also to capture the imagination of the Muslim customer.

This industry is complex and delicate and the appropriate development of all its role players is paramount, not forgetting those of the Islamic scholars that sustain the underlying structure. (F)

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Islamic finance is a burgeoning industry in Sri Lanka

By Imruz Kamil

Islamic banking and finance, by and large, is a burgeoning industry in Sri Lanka. However, the key barrier to the industry's growth and development, similar to that of any other industry is a lack of standardization with regard to regulations governing Islamic financial products. Fully-fledged Islamic financial institutions and Islamic business units are facing issues with regard to investing their surplus funds and statutory reserves in non-Shariah compliant financial instruments (interest-bearing treasury bills/bonds) with Central Bank of Sri Lanka, which does not earn any income from the Islamic financial institutions.

A lack of standardization causes increased costs, increased barriers to entry into the market and reduced competitiveness in comparison to comparable products. Indeed, different jurisdictions took different approaches to the problems faced with the lack of standardization. In Pakistan, the State Bank of Pakistan issued a clear directive and rulings that segregated all processes and standardized the Islamic finance business operation. Similarly, Malaysia's central bank, Bank Negara Malaysia established a national Shariah council with vested power to oversee the industry while segregating its operation.

“ The objective of the AAFI is to create a forum for members to voice out and discuss issues pertaining to the Islamic banking industry ”

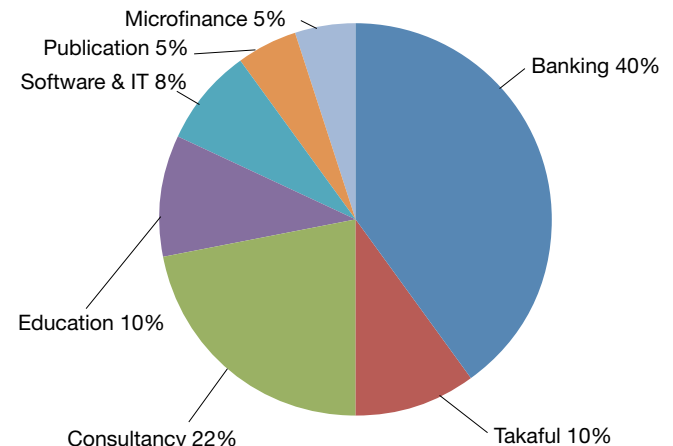
Review of 2015

The year 2015 brought a new era to the Islamic finance industry of Sri Lanka by focusing aggressively on market development and expanding the horizon of Islamic finance in Sri Lanka, putting the principles into practice without any presentiment. Identifying issues with Islamic finance as an alternative to regular finance such as the need to establish Islamic business values and change the process of meeting Shariah compliance is increasingly important and also a reflection of the increasing wealth and capacity of investors, both Muslim and non-Muslim, to seek and invest in new investment products that serve their needs.

Further political stability and good governance has increased the confidence of local and foreign investors. The Sri Lankan equity market has moved to a new growth phase, with a compound annual growth rate of 15.7% from the 30th September 2009 to the 30th September 2015. The economy is expected to grow in excess of 5% in the next two years. Although a new government came into power this year, the investors were cautious ahead of the government's policy statement to undertake any new investment projects in Sri Lanka.

Islamic finance industry practitioners are very positive and there have been some new investment products introduced to the market by a few Islamic financial institutions, for example, an Islamic money plus saving product, a unit trust investment to attract small-time investors. This investment is free from withholding tax and a unique feature of this product is that the investor can enter into this investment scheme with small units and he/she can exit from the

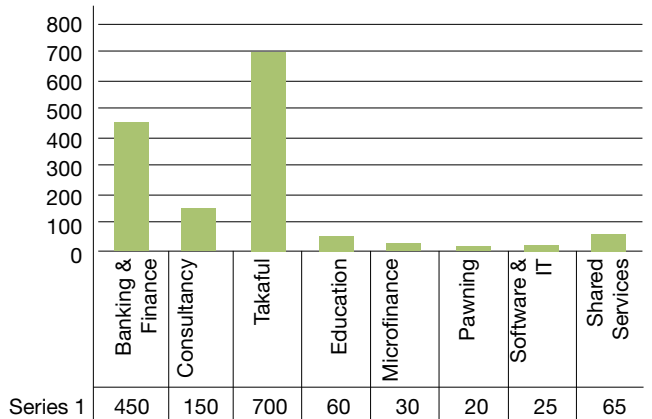
Chart 1: Number of players in the Islamic finance market in Sri Lanka



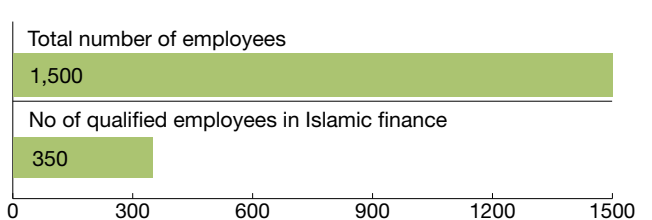
Source: Author's own

Chart 2: Islamic finance labor market statistics

Employment by sector



Islamic finance qualification levels



Source: Author's own

investment at any time. Another unit trust company is working on an Islamic cash fund to attract the big players.

There has been another interesting initiative this year, with two insurance companies, namely People's Insurance and LOLC Insurance, opening Takaful windows offering Shariah compliant insurance services to their customers, making the Takaful market more competitive in Sri Lanka. The monopoly status of Takaful operation has now become very challenging to pioneer operator Amana Takaful.



Two more financial service providers have joined the fold of Islamic finance in Sri Lanka: Commercial Leasing Finance and Adam Capital.

The total number of players in the Islamic finance industry in Sri Lanka currently stands at 44, of which 16 players are in the banking and finance sector, with four in the Takaful sector, nine in the consultancy and advisory sector, four in the education sector, three in the software and IT sector, two in the publishing sector and two in the microfinance sector. There are seven registered market intermediaries who act as investment managers for the Islamic capital market in Sri Lanka.

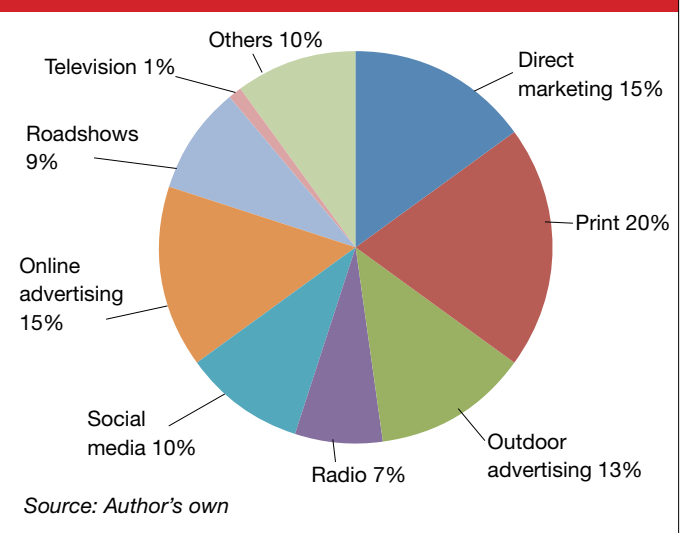
Preview of 2016

The Islamic finance industry in Sri Lanka is waiting for a government policy statement on new initiatives in 2016. Reports indicate that there may be a positive policy statement toward encouraging capital market operations for Sukuk and other new Islamic banking products. Sukuk are seen as well-suited for infrastructure financing for a developing economy. Sri Lanka is now on the verge of developing the infrastructure facilities. For example, Malaysia has used Sukuk to develop airports, marine ports and roads. Furthermore, Sukuk are listed debt instruments in many countries, such as Malaysia, Singapore, Luxembourg and the UK. A platform to list Sukuk on the Colombo Stock Exchange has been proposed in order to create a platform for secondary market trading and this would pave the way in attracting funds from the Middle East.

A new development was witnessed recently with the formation of the Association for Alternate Financial Institutions (AAFI). The objective of the AAFI is to create a forum for members to voice out and discuss issues pertaining to the Islamic banking industry.

The AAFI is now taking initiatives and lobbying the government to introduce alternative treasury bills/bonds for Islamic finance institutions to park their surplus funds and to generate income to

Chart 3: Advertising & promotion mix in Sri Lanka for Islamic finance sector



support banking activities and also to assist the government in raising funds for the treasury.

Conclusion

Islamic finance has been moving steadily and with a positive government policy statement on the horizon, the Islamic banking sector is expected to shift to a new epoch. The setting-up of the AAFI will make a difference in the Islamic banking sector in Sri Lanka by having a collective representation of the relevant policymakers and regulatory authorities to facilitate accounting, tax and legal changes.

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Islamic finance in Tunisia: What's next?

By *Rihab Grassa*

Considered one of the most promising new emerging markets of Africa, the Tunisian government has aligned its economic development strategy to include Islamic finance as it seeks to diversify its funding sources to rebuild its economy which was deeply injured during the long years of the old corrupted regime and shaken by the Arab Spring of 2011.

The change of the political landscape in Tunisia after the revolution has been a good restart for the development of a steady Islamic finance system in the country. The years 2013 and 2014 have definitely been the years of many important developments for the Islamic banking and finance industry, driven by structural changes within the Islamic finance sector.

Review of 2015

Undoubtedly, the year of 2015 was also marked by some important events in the Islamic finance sector. During the year, the draft law of banks and financial institutions has been issued. While the draft law specifies that both Islamic and conventional banks are subject to the same regulation, within this law, the first contracts with operations of Islamic finance have been defined. Moreover, banks' constitutions, operations, identification of a guarantee mechanism and depositor assets have also been discussed.

In November 2015, Amen Bank, the country's second-largest conventional private sector bank, asked for approval from the Central Bank of Tunisia to create an Islamic bank as a subsidiary or, where appropriate, an Islamic window. This will depend on the promulgation of the new banking law. Amen Bank also launched two Islamic mutual funds in December 2014 that were to be managed by Tunisia-based United Gulf Financial Services-North Africa.

Moreover, after more than two years from the date the Sukuk law was approved by the National Constituent Assembly, Tunisia is looking to issue a US\$500 million Sukuk by the beginning of 2016. The aim of the Tunisian sovereign Sukuk is to attract a new class of investors due to the political instability in Tunisia and beyond. The

issuance of the first Tunisian sovereign Sukuk was rescheduled first to 2014, then to 2015 and now to the beginning of 2016.

Preview of 2016

It seems that with the beginning of important changes last year, we will witness in 2016 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. On the heels of the successful steps toward the development of an effective and steady Islamic finance system during the past three years, we look forward to some important milestones in the Islamic finance industry in Tunisia in 2016.

Indeed, after the revolution, the Tunisian government has shown strong support toward the development of Islamic finance by making several initial steps to facilitate many Shariah compliant transactions like Sukuk, Shariah compliant funds and some Shariah compliant products.

However, it is still not enough. To promote the development of an effective Islamic financial market in Tunisia, the government needs to mobilize professionals and provide stronger political support.

A better regulatory framework for Islamic finance must also be developed by the regulatory and concerned authorities to cater to the demand for these alternative financial products. The government must also develop and promote new products to meet the needs of Tunisian customers and help to promote the economic development of the country.

Conclusion

The outlook for Islamic finance in Tunisia remains positive. The country has the opportunity to utilize Islamic finance for the good of its own economy and also to act as an Islamic hub for the French-speaking portion of Africa. ⁽²⁾

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Islamic finance continues rising in Turkey

By Ali Ceylan and Aytug Buyukatak

The Islamic finance sector continues to rise in Turkey. The industry has both domestic and global interest, with the Turkish people increasingly supporting Islamic banking services. Instead of Islamic banking, the term 'participation banking' is preferred; participation banks follow Shariah rules and allow customers to make transactions within an Islamic outline. The Turkish government had also announced plans to introduce three state-owned Islamic banks as affiliates of the state-run conventional banks: Ziraat Bank, Halkbank and VakıfBank, which means greater abundance will be added to the Islamic financial sector. However, there have been some changes at the end of the year. Halkbank announced that it has frozen its decision to establish a participation bank, at least for now. However, the Turkish market is still hungry for Islamic instruments such as Sukuk and Takaful.

Review of 2015

Banking sector

The Turkish government launched three state-owned Islamic banks namely, Ziraat Bank, Halkbank and VakıfBank. Turkey currently has five participation banks: Ziraat Katılım (the recently established affiliate of state-run Ziraat Bankası), Bank Asya, Türkiye Finans, Albaraka Türk and Kuveyt Türk and they comprise approximately 5.3% of the Turkish banking industry, according to data from the banking regulator. They have nearly 1,000 branches and employ more than 16,000 people, both more than twice their levels of 10 years ago. The sector goes on growing, with informed customers having conventional bank accounts looking likely to make the change and increase those numbers.

Halkbank

State-run Halkbank has revoked its application to set up an Islamic lender with the bank asking the Banking Regulation and Supervision Agency to cancel its previous application to establish a participation bank. They underlined that the bank may reconceive the plans in the future. The bank cited judicial reasons for the decision and also announced that they are working on material that does not require equity-raising.

Albaraka Turk

Albaraka Turk has secured a US\$450 million dual-tranche Murabahah loan, the proceeds of which will be used to expand its financing activities in the country. The Murabahah deal is a cost-plus-profit arrangement that is one of the most popular formats for structuring Islamic loans. Also, the bank has picked seven arrangers for a potential US dollar-denominated Sukuk. The lender is expected to raise around US\$250 million, with the Sukuk issue planned before the end of the year.

Stock market

Borsa Istanbul and Qatar Stock Exchange forge cooperation efforts. The Qatar Stock Exchange (QSE) and Borsa Istanbul signed an MoU at the QSE premises in Doha to establish and implement a procedure of mutual cooperation and agreement between the two exchanges, primarily for the purpose of facilitating the execution of functions assigned to them, the exchange of information, the proper dissemination of information and the promotion of the integrity of the markets.

The MoU provides a framework of cooperation which includes the existence of a channel of communication between the two

exchanges, the increasing mutual recognition and the exchange of legal and technical information. It also aims to develop opportunities to exchange information and expertise pertaining to their activities, markets and operations in order to establish a long-term relationship and contribute to the improvement of their countries' capital markets, as well as exploring the opportunities of the dual listing of securities to increase the competitiveness of both Borsa Istanbul and the QSE.

EBRD and Borsa Istanbul in exclusive talks over stake sale

The European Bank for Reconstruction and Development (EBRD) is entering exclusive negotiations to acquire a 10% stake in Borsa Istanbul, in a landmark deal which will support Turkey's efforts to reshape its capital markets.

Borsa Istanbul, majority-owned by the Turkish government, is the sole exchange entity in Turkey, created in 2013 by combining the Istanbul Stock Exchange, the Istanbul Gold Exchange and the Turkish Derivatives Exchange.

Borsa Istanbul and London Stock Exchange cooperate

The London Stock Exchange Group (LSEG) announced the launch of trading in Turkish equity index derivatives on the London Stock Exchange Derivatives Market, following a partnership agreement signed between LSEG and Borsa Istanbul in early 2015.

“ **Laws, particularly regarding taxation issues that prepare and define corporate Sukuk, remain less clear than those on Sukuk from banks** ”

Insurance

Takaful

The Islamic finance market also discovered that there is high potential in the Takaful insurance sector, and as a consequence, demands on Shariah compliant insurance instruments are rising. However, although Turkey has a high potential market for Islamic insurance in view of its large and young population, Takaful's supply-side constraints, as well as a limited legal infrastructure in the Islamic finance sector, are obstructing Takaful's market growth.

Turkey's Takaful market dynamics are, however, gaining attraction with the establishment of more participation banks since customers of participation banks are also considered as potential customers of Takaful and similar instruments which are not yet introduced to the market. Since no regulatory changes are needed to provide the market with Takaful products, the Takaful market may provide a totally new market to Turkish participation banks and their affiliates operating as insurance companies (if there are any) if accurate products are provided to customers.

Doga Group

The Doga Group had planned to join the Islamic insurance market (Takaful) in 2015 with what would be the country's first such product. The Doga Sigorta insurance unit announced that it is close to signing a cooperation deal with reinsurance companies. The company wants to take advantage of the growing interest for Islamic finance products in the largely Muslim nation. It is expected that at least three to four other firms are planning to enter the Takaful insurance market by 2018.

Real estate

The Turkish real estate sector had a boost after the reciprocity rule was adopted which allowed foreigners to more easily invest in the Turkish market. The increase of the market has slowed down a little

bit starting from the beginning of 2015; however, the market is still expanding and a significant increase in real estate market prices has been seen in 2015.

Government-backed projects are also continuing to be developed in 2015. The Istanbul Grand Airport consortium, which won a tender in 2013 to build Istanbul's new airport, signed a loan agreement in October 2015 with six banks, namely state-run Halkbank, Ziraat Bankasi and Vakifbank as well as foreign-financed Turkish banks DenizBank, Garanti Bankasi and Finansbank, to provide a sum of EUR4.5 billion (US\$4.83 billion) for the first phase of the project which is projected to be completed in 2018. According to the agreement, the loan maturity date has been set at 16 years. The consortium includes Turkish companies Cengiz, Mapa, Limak, Kolin and Kalyon.

The third Bosphorus Bridge – controversially named after 16th century Ottoman Sultan Selim I – and its connecting highways are expected to cost Turkey around US\$3 billion. The construction began in 2013 and both towers have already been completed. As of May, the Asian tower had reached 318 meters high from the ground, while the European one had risen to 322 meters. The bridge was projected to be completed in October 2015 but is now expected to be finished in early 2016.

Preview of 2016

Although a decrease is expected in the Islamic finance market globally, the number of participation banks, the insurance sector especially Takaful, and Sukuk will be increasing in significance in Turkey. Turkey's Treasury Department plans to issue Sukuk worth TRY1.5 billion (US\$517.74 million). The government also aims to present Istanbul first as a regional financial center and then as a global financial center by 2023. It is also expected to open 20 branches with a total of 400 employees at the end of this year. In the upcoming years, the bank aims to have 170 branches with 2,200 personnel. The number should reach 500 branches in 2023.

A large amount of funding for the government could come via Sukuk. Turkey's government is also planning debt issuances this year denominated in the euro and, possibly, the Japanese yen. Investors are unlikely to see in the near term the country's first corporate Sukuk. Laws, particularly regarding taxation issues that prepare and define corporate Sukuk, remain less clear than those on Sukuk from banks. In general, the legislative regulations need to be completed and be clearer for the activity in this market to pick up.

Conclusion

According to the Participation Banks Association of Turkey (TKBB), the legal outline of Islamic finance in Turkey is almost complete with awareness of Islamic finance in Turkey growing and the share of participation banks expected to reach 20% by 2023. The future of participation banks in Turkey will be brighter in the coming years. TKBB expects demand for Islamic finance products to come more from the corporate sector. Due to Shariah, legal and political issues, Turkey spent many years working on the Sukuk and Takaful sectors in the country. There is a big demand for Takaful in Turkey; however, there are no options for potential customers who are interested in Takaful. It is hoped that there will be companies/banks who will at least take steps to introduce Takaful products to the market. The banking sector is generally stable and powerful in Turkey. It would not be a surprise if new participation banks enter the market as it is already projected that some foreign banks will enter the Turkish conventional banking system via share purchases. The real estate market is one of the leading sectors of the Turkish economy. Despite being a little sluggish in 2015, the market is still growing and we expect the slight growth in the market will continue. (F)

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Growth of the Islamic banking sector in the UAE on track

By Rima Mrad

The Islamic finance sector in the UAE during 2015 featured a substantial expansion. The nature of growth witnessed throughout the first and second quarter of 2015 was mainly seen in the banking, finance and insurance sectors. There has also been a growing interest in the Shariah compliant structures and products from a number of conventional SMEs and small and specialized government organizations. This is a clear indication as to the expanding path of the Islamic industry as a whole in the GCC and more particularly as a key sector in the UAE economy.

During this year, the UAE government worked on the introduction of a number of regulatory policies aimed at regulating and organizing the sector and implementing international standards with the purpose of putting Dubai among the international Islamic capital markets such as London and Malaysia.

Earlier this year, the Central Bank of the UAE worked closely with industry players on a number of initiatives to strengthen the regulation and supervision of Islamic banking. It has also been announced that the Central Bank will work on new regulatory standards in line with international guidelines, namely standards set by the Basel Committee on Banking Supervision and the IFSB.

In line with this, the Central Bank proposed in June 2015 the creation of a higher Shariah authority to complement and oversee Shariah boards of individual Islamic banks. This will secure the creation of one main and synchronized reference for all institutions offering Islamic financial services. This will also eventually reinforce the public's confidence in the sector and will apply a minimum level of regulation and supervision over the industry.

Further, a new family business legal framework in line with Shariah was submitted to the GCC governments this year as part of the different measures being taken by different GCC countries with respect to the transition of power and control within large family businesses. The purpose of these regulations is to streamline the transition of power and business to the next generations smoothly. The new laws will be presented under the umbrella of the Family Business Network, a GCC-focused non-profit organization. This is supported by a new trend within the main local and regional family businesses to reshuffle and restructure their operational models based on Sharia compliant models.

On another front, a significant number of Shariah compliant transactions have been announced and completed in the UAE in the past year. The main ones are:

- Emirates Airline announced that it will be purchasing four new A380 aircraft, via a US\$913 million Sukuk issuance, which will be guaranteed by the UK's export credit agency, UK Export Finance (UKEF). This has captured a lot of international interest, as this will be the first time that UKEF has guaranteed a Sukuk issuance.
- Shopping mall operator Majid Al Futtaim (MAF) on the 3rd November completed the issuance of its US\$500 million 4.5% trust certificates due in 2025. This was issued through MAF Sukuk under the firm's US\$1.5 billion hybrid (Mudarabah and Wakalah) trust certificate issuance program. They have been admitted to trading on the Irish Stock Exchange and NASDAQ Dubai.



- The Hong Kong Monetary Authority (HKMA) announced the issuance of US\$1 billion-worth of Sukuk on NASDAQ Dubai in September. The HKMA stated that the issuance was oversubscribed by 4.7 times.
- Dubai real estate firm SKAI has secured US\$300 million in new funding from a range of local and international lenders. The syndicated finance package included a dual Islamic and conventional facility and is backed by seven financial institutions from the UAE and China.

The performance of the Islamic economy is still below expectations this year but this was partially attributed to the decline in oil prices. The growth of the Islamic banking sector in the UAE is, however, on track.

At this stage and to ensure the continued growth of the sector, the UAE government has been urged to consider the introduction of new material resolutions especially to address the following:

- Creation of a national Shariah board: this board will harmonize the principles and views of Shariah scholars on controversial structures. It will also ensure that there is one regulatory body overlooking the activities of the sector and enhancing the compliance culture among the relevant parties.
- Training centers for industry experts: there is a need for qualified experts in the Islamic fields and this should be supported by the creation of education and training centers.
- Introduction of policies to control monopoly: this will fight the monopoly of larger organizations and will give support to other smaller players to introduce new and diversified products. This is a key element to ensure the future growth of the sector and its sustainability.
- Enhancing the level of interaction with industry players: By issuing guidelines and papers with respect to the main risks faced by this industry and increasing the level of interaction with main players in the markets to further understand the challenges they face and how to address competition with conventional institutions. ☺

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The UK well positioned as primary western hub for Islamic finance industry development

By Fara Mohammad

Last year, Britain became the first country outside the Muslim world to issue Sukuk which attracted investor interest. It was another step in encouraging wider investment from the global Islamic finance industry to the City of London. As a consequence, the UK continues to secure its position as the leading Western center for Islamic finance.

Review of 2015

London remains a safe haven for property investors because of the strong support from its supply and demand characteristics and this looks set to continue. There are an increasing number of major projects that have been announced this year in London, the UK and Europe which are backed by Middle Eastern and Islamic investors. There is also a clear increase in the number of conventional and non-Muslim clients utilizing Islamic finance. Conventional borrowers are seen to be more readily considering Shariah compliant financing structures and this is driven by the need to widen their financing sources as well as the need of investors.

The UK government and the UK Export Finance had underwritten its first Islamic bond, a further sign of London's growing role in the global market for Shariah compliant debt. The government-backed export credit agency (ECA) provides cover for a GBP617 million (US\$936.95 million) Islamic bond issued by Dubai's Emirates Airline to purchase aircraft including the Airbus A380. This marks the first example of a Sukuk sold in the debt capital markets to be backed by an export credit agency. It is also the first time a Sukuk has been used to pre-fund the sale of aircraft, and the largest capital market offering of any kind for aviation to carry an ECA guarantee. This has widened options for buyers of UK exports and boosted the UK's aspiration to become the leading Western hub for Islamic finance.

The first Shariah compliant pre-delivery payment (PDP) helicopter financing deal was concluded by the Bank of London and the Middle East (BLME) who participated as the Islamic financing party. The deal allows LCI Helicopters to complete the world's first secured helicopter PDP funding under an Islamic finance structure. The innovative multi-year financing arrangement covers approximately US\$250 million worth of Airbus helicopter assets.

The Islamic Insurance Association of London was launched to support and develop the UK insurance and reinsurance markets that conduct business in the Islamic finance industry. The intention is to drive and develop principles for the Shariah compliant commercial insurance and reinsurance business and this is part of the broader aim to become the hub for Islamic insurance in the west. This year also saw XL Group and Cobalt Underwriting launching their first Shariah compliant product which is available through Lloyd's of London. The demand for Shariah compliant options when it comes to insurance is expected to grow and it is believed that the London market has a major opportunity to deliver real value to Islamic investors and insurance clients.

The UK Trade & Investment Department continues to develop initiatives to increase new opportunities in the Islamic finance space and there is a focus on Shariah compliant UK regeneration project developments. The developments selected contribute to the regeneration and renewal of properties in towns and cities in the UK. This has been supported by the UK Regeneration Investment



Organization to include developments where the project and finance structure can be raised through Shariah compliant options.

Preview of 2016

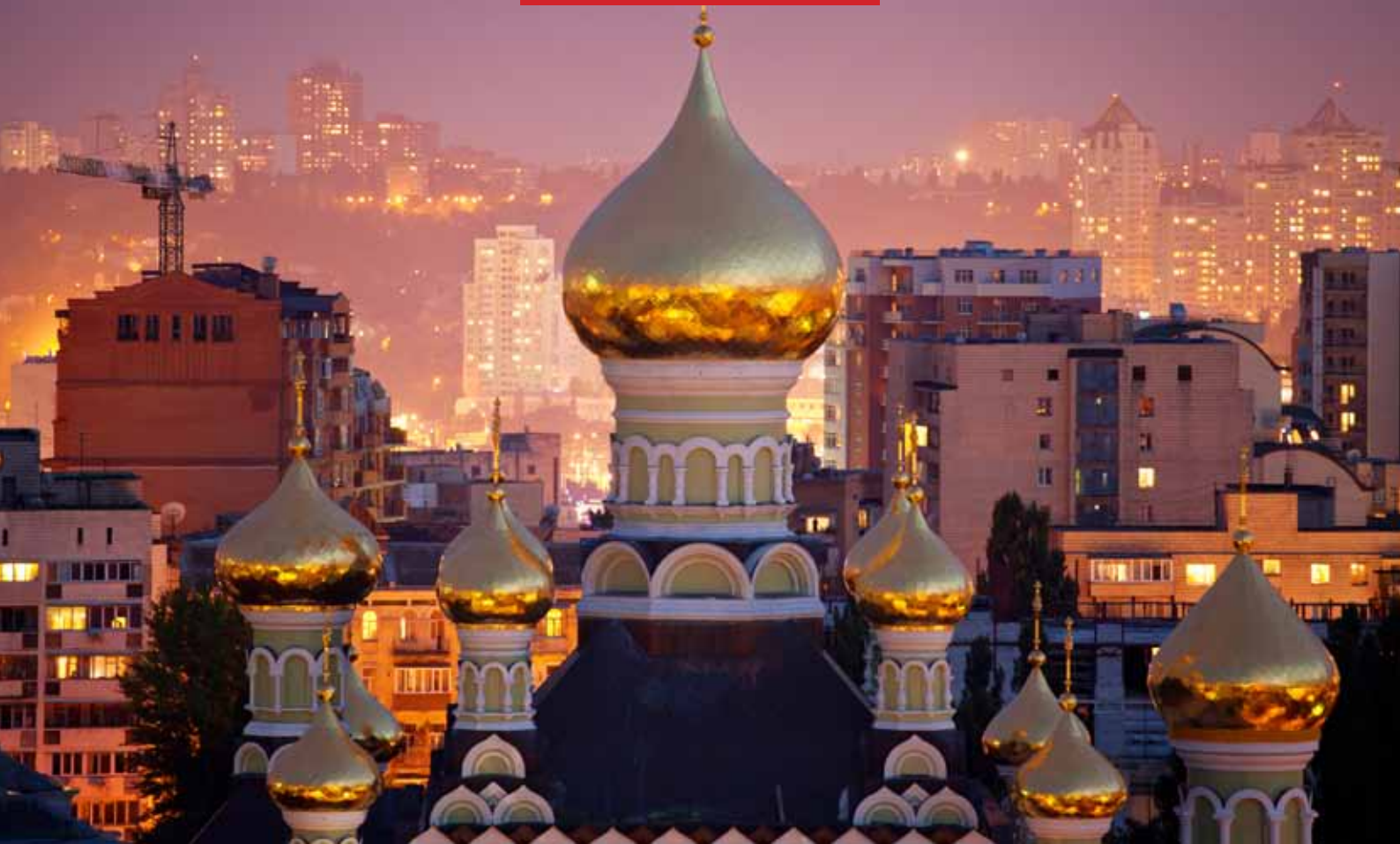
Private banking and wealth management is an area that is set to expand in the UK. Several Islamic banks in the UK have played a role in developing this area and these initiatives tend to focus on the real estate sector. BLME in partnership with Bank Muamalat in Malaysia have plans to further develop their private banking services. Al Rayan Bank has also announced the intention to enhance its services in private banking for its clients. Several residential property funds have also been established which represent a pioneering step forward for the Islamic wealth management sector in the UK.

It is expected that there will be changes in the residential property market based on proposed changes in the UK budget to the treatment of non-domiciled residents. Although it is still unclear what the implications would be, it is anticipated that this may have an impact on the property market and might encourage investors to consider more commercial assets, given the tax attraction.

Conclusion

With the Islamic finance industry poised for continued growth, the UK is well positioned as the primary western hub for its development. The ethically based foundations of Islamic finance appeal to both Muslims wishing to adhere to their faith and conventional/non-Muslims drawn to the underlying benefits. The UK's involvement in developing this niche sector can certainly spur economic growth and key financial prospects in the future. This past year has seen an increase in the participation of the UK in Islamic financial services and this trend is set to continue in the years ahead. (2)

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Islamic finance in Ukraine: A new reality

By Roustam Vakhitov and Nariman Kimsanov

Review of 2015

In 2015, Ukraine increased its trade turnover with the Islamic world. The military-industrial complex received orders worth billions of dollars. The country has also intensified international trade in agriculture, in particular with Egypt.

Nevertheless, bilateral cooperation between Ukraine and the countries of the Muslim world is mainly the initiative of individual businesses, without significant state support or governmental business development programs.

Ukraine is currently home to hundreds of thousands of Muslims, both of indigenous origin (Volga and Crimean Tatars), as well as students and immigrants from Muslim countries. They consume a significant amount of Halal products: food, clothing, etc. But many services and goods are still inaccessible to the Ukrainian Muslim population, such as Halal financial services including: financial leasing, money transfers, retail deposit and credit products and corporate finance.

In 2015, Ukraine saw a few events fully or partially focused on Islamic finance, in particular, the Islamic finance seminar conducted at the Central Ukrainian Trade Chamber in February 2015 and the Islamic trade finance session during the Ukraine: Trade Finance 2015 conference. A non-governmental working group has been established to develop and implement the first Ukrainian Shariah compliant microfinance establishment. Several new Halal restaurants also opened in 2015 in the capital, Kiev.

Preview of 2016

While Islamic investment considerations are not fundamentally

different from general fundamental investment principles, it is for the Ukrainian government to demonstrate to Islamic investors that the legal, tax and investment environment is stable and attractive.

From an economic perspective, investment in Ukraine may be attractive, especially considering the four to five times depreciation of the local currency against the euro/US dollar over the year, making local assets much cheaper for foreign investors.

Ukraine has activated an interstate dialog with several Arabic countries like the UAE, Saudi Arabia, Algeria and others. The Ministry of Foreign Affairs of Ukraine is constantly contacting the diplomatic services of these states. According to the minister of foreign affairs Pavel Klimkin, Ukraine is now considering an opportunity of the simplification of the visa regime with some Arabic countries. This will stimulate the free movement of people and labor.

There are proactive Muslim NGOs in Ukraine like the Islamic Culture Center, Alraid and many others, encouraging large local Halal producers such as Kozyatin Meat Processing Plant and Nasha Ryaba to enter new markets with Halal goods and services.

It is expected that the creation of the first Ukrainian Halal microfinance establishment in 2016 will speed up and consolidate the Halal industry with the possible development of this institution into an Islamic bank, contributing further to the development of the Ukrainian Halal industry. (2)

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Islamic finance slowly building in the US

By David Loundy

This has been a quiet year for Islamic finance in the US, but energy is building. Transactions are being done at the larger end of the spectrum as overseas funds still seek solid assets, and more discussions are being carried out about promoting more large Sukuk transactions.

At the retail level, after last year's shot to the chest from the Assembly of Muslim Jurists of America (AMJA) Fatwa in which a group of scholars declared pretty much every product in the country unacceptable, the retail mortgage providers have all re-grouped, tended their wounds, and begun to move forward again. Commercial SME financing continues plodding along at a liquidity-constrained pace. The few public investment funds continue to grow having reached the coveted 'crossover' status of appealing to non-Muslim investors. A proto-Islamic 'bank' was launched in September, but likely won't develop quickly until various issues on securities laws can be clarified. The Malaysia/US Chamber of Commerce even had a conference on the Islamic capital markets in the US, which was a surprisingly decent conference considering the nearly complete lack of an Islamic capital market in the US.

The real estate firm 90 North has made a substantial commitment to developing real estate projects in the US on behalf of its clients and has been repositioning a third of a million square feet of office space in the Chicago suburbs. Other large projects include the financing of Islamic community centers and New York real estate, all using overseas money. These larger financing projects are often occurring in the US, but are not in the spotlight as there is no requirement that they be reported and the participants are often not interested in publicity.

One area where there has been publicity is with the AMJA October 2014 Fatwa that found the retail provision of home financing in the US universally flawed. The industry response was predictably strongly critical of this Fatwa, and much of the year has focused on 'spin control' explaining the flaws of this Fatwa, rather than driving product change as perhaps the AMJA may have wished. Production volumes at the major providers were briefly affected, but have returned to normal and appear to be growing across the board. Conditions remain favorable for buying homes in the US, and this is reflected in the Islamic financing volume.

With the improving US economy, small enterprise financing is also increasing; however, such financing is still constrained by the size and number of institutions that provide such financing. Most of the

financing is still tied to real estate assets, though there has been more activity in financing heavy equipment as well as companies in the Halal food segment provided both at the bank-level and by private fund capital. This is a trend that will likely continue as the demand for Halal food in more mainstream stores, such as Walmart, is increasing in excess of the ability of Halal food companies to meet the demand. This year has also seen growth in syndicated SME financing, as some of the providers have worked with other institutions to handle larger transactions on a shared basis.

On the investment fund level, there are now more than half a dozen Shariah compliant funds publicly traded in the US. As of the end of 2014, there is now a second attempt (after the failed Javelin JETS Islamic ETF) to launch another Islamic exchange-traded fund. The Falah Capital ETF is the 'Falah Russel-IdealRatings US Large Cap ETF (NYSE: FIA); however, as of this writing, it has only attracted US\$1.3 million in assets. Saturna Capital has a new entrant in the fund universe with the end of September 2015 launch of the Amana Participation Fund, which has attracted just under US\$6 million in assets, as of this writing. The Azzad Funds have also gained some good visibility as a result of the completion of an external Shariah audit performed by the Islamic Finance Advisory and Assurance Services auditors in the UK.

On the 15th September 2015, Abraham's River commenced preliminary operations, structured as a financial institution for non-interest-based finance, modeled after an Islamic bank. Its management is working to clear securities hurdles before investment becomes available to the public, however, and it is currently building its portfolio of assets with a small investor group.

The Malaysia/US Chamber of Commerce held its second Islamic finance conference in Washington, DC in October titled 'Islamic Capital Market: Inroads into the US' in the hopes of expanding asset generation and securitization by US issuers. This is in part an outgrowth of Islamic finance and Islamic capital markets seminars being held at Drake University in Iowa thanks to Noripah Kamso acting as a visiting scholar in residence. She has been an advisor for CIMB Islamic and CEO of CIMB Principal Islamic Asset Management in Malaysia. The Principal Financial Group is headquartered near Drake. As much as various Asian and Gulf countries fight with each other to be the hub of Islamic finance, I bet none of them thought of Des Moines as being a threat – until now! Or, maybe not. ☺

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