CHAPTER 1

The Islamic Banking and Finance Industry

1.1 Introduction

The year ending December 2012 has proven to be a sukuk-dominating period for Islamic banking and finance. With a total value of USD144 billion of sukuk issued, 2012 proved to be a record-breaking year for the issuance of sukuk. Governments and government-linked entities along with large corporates from different countries issued sukuk during 2012, making sukuk look like an elitist phenomenon. Not to say that Islamic banking itself has emerged as a practice catering for the middle and upper middle classes of the societies it operates in. Observing the shareholders' pursuit of achieving a high street status, large consulting firms are advising such banks to increase their market share by effectively competing with their conventional counterparts. Exploring how to tap the segments of the society being underserved or completely ignored is not on the priority list of Islamic banks and financial institutions. Hence, while there is a lot being spent on marketing and advertisement, there is no Islamic bank in the whole world with any significant budget for research and development.

Undoubtedly an interesting year for sukuk, but it appears as if Islamic banking and finance as a whole is fast losing its traction in conventional banking and finance. The perceived role of Islamic banking and finance as a bridge between Islamic communities and the rest of the world is fast evolving to bring it out as a regional phenomenon rather than a global practice attractive for both Muslims and non-Muslims. This is a message that should be taken seriously by Islamic bankers – that Islamic banking is "Islamic" because it is for Muslims. Those who advocate Islamic banking as a form of "just" banking must understand that it is always safe to play on a home ground in home colours. Any attempt to play "away" and that even not in one's own colour is likely to bring defeat, which certainly will not be supported by the home crowd.

There are about 1.8 billion Muslims in the world (see Chapter 11 for further demographic analysis of the Muslim world), and it is this segment of the global population Islamic banks should attempt to win. Those who argue for making Islamic banking attractive for all –- Muslims and non-Muslims alike –- must keep in mind that Islamic banking is not the choice of majority even in a single Muslim country,[1] which offers a window of opportunity for Islamic banks. While conventional banks have only limited interest in converting their conventional customers into Islamic –- because of fear of cannibalisation –- fully-fledged Islamic banks can take the lead by offering financial products that are customer-oriented in nature and scope.

[1] Apart from the countries that have outlawed conventional banking and operate fully-fledged Islamic banking system, namely, Iran and Sudan.

1.2 Leadership in Islamic banking and finance

While the GCC remains a hub of Islamic banking and finance, newly emerging markets in Africa (Morocco, Tunisia, Libya and Egypt) will bring a new growth dimension to the Islamic financial services industry. In the last 10-15 years, leadership of Islamic finance has tilted away from the well-established players like Dar al Maal al Islami (DMI) Trust and Dalla Al Baraka Group, in favour of some new players from Qatar (e.g., Masraf Al Rayan and Qatar Islamic Bank) and the UAE (e.g., Abu Dhabi Islamic Bank and Dubai Islamic Bank). Saudi Arabia is still the largest market for Islamic banking and finance, but Qatari institutions are now playing a role in internationalising Islamic banking and finance. Qatar Islamic Bank (QIB) has already expanded its presence to other countries like UK, where it owns QIB-UK, a fully-fledged Islamic investment bank in the country. Masraf Al Rayan is now in the process of acquiring majority shareholding in Islamic Bank of Britain, which already has significant Qatari shareholding. After the fall of Mubarak regime in Egypt, Abu Dhabi Islamic Bank (ADIB) has acquired National Bank for Development in Egypt to start Islamic retail banking in the country that pioneered modern Islamic banking in the 1960s. This is certainly a significant development, and the industry observers are expecting that the developments in Egypt will give a significant boost to assets under management (AUM) of Islamic financial institutions.

The likes of Dubai Islamic Bank (UAE), Kuwait Finance House (Kuwait) and Al Rajhi Bank (Saudi Arabia) are playing an increasingly stimulating role in internationalising of Islamic financial services – a role that was played by DMI and Dalla Baraka Group in the first phase of internationalisation of Islamic banking and finance. With its presence in Pakistan, Sudan, and Jordan, Dubai Islamic Bank is very aggressively pursuing its goal of becoming a pan-Islamic banking institution. Kuwait Finance House is already present in Bahrain, Turkey and Malaysia, and through its shareholdings in a number of other Islamic financial institutions, it has emerged as a global player in the Islamic financial services industry.

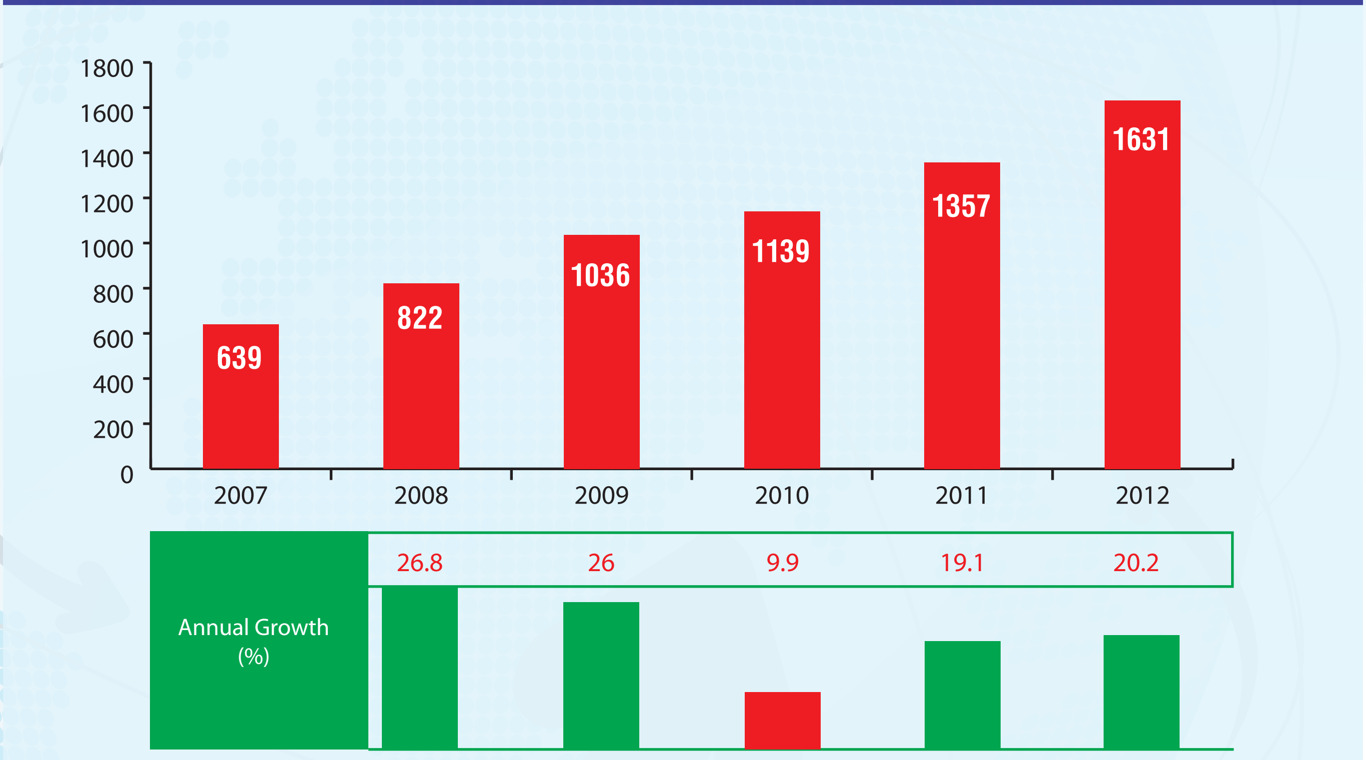
With the exit of the likes of HSBC from Islamic retail banking in a number of countries and the very slow start of Islamic Bank of Britain in UK, there is no doubt that Islamic banking and finance has very limited scope in the Western hemisphere. The European continent, although developed economically, does not offer future prospects for the global Islamic financial services industry. The financial centres like Luxembourg and Dublin are trying their best to lure Islamic asset and wealth management business by bringing changes in regulation and taxation to provide a level playing field to Islamic financial institutions. While this will certainly help in bringing some limited Islamic business to these financial centres, it is equally true that the new financial centres being developed in the Islamic world will become the prime beneficiaries of growth in Islamic banking and finance.

The likes of Dubai International Financial Centre (DIFC), Qatar Financial Centre (QFC) and Malaysia International Islamic Financial Centre (MIFC) will dominate the cross-border transactions in Islamic banking and finance. Malaysian government has been aggressively pursuing to develop Labuan as a clean and transparent financial centre for promoting the kind of offshore business that other more recognised offshore jurisdictions of the world have offered for decades.

1.3 Size of the global Islamic financial services industry

GIFR's authentic estimate for the size of the global Islamic financial services industry is USD1.632, which includes Islamic financial assets with Islamic banks, conventional banks' Islamic operations (windows and branches), investment banks and investment companies (e.g., mudaraba companies in Pakistan), Islamic funds, and takaful companies (fully-fledged or Islamic operations of conventional insurance companies). This figure also includes the amount of sukuk outstanding at the end of 2012. The GIFR methodology also takes into account double counting to ensure that the size of the Islamic financial services industry is not exaggerated. For example, it is likely that those assets under management of Islamic banks, which have been invested in sukuk and other investments are counted twice if we separately add all the components of the industry. Although detailed data on breakdowns of Islamic investments on a transaction and product level remains a challenge, but GIFR's analysis remains the most comprehensive and authentic. Figure 1 presents the size and growth of the Islamic financial services industry in last five years. It is clear that despite a slow down in 2010, Islamic banking and finance has consistently grown to remain relevant o the global financial services industry.

Figure 1: Size and Growth of Global Islamic Financial Assets (USD billion)



Country	2007	2008	2009	2010	2011	2012
Iran	235	293	369	406	413	416
Saudi Arabia	92	128	161	177	205	215
Malaysia	67	87	109	120	131	155
UAE	49	84	106	116	118	120
Kuwait	63	68	85	94	95	103
Bahrain	37	46	58	64	65	71
Qatar	21	28	35	38	47	68
UK	18	19	24	27	33	37
Turkey	16	18	22	25	35	41
Bangladesh	6	8	9	10	13	17
Sudan	5	7	9	10	11	14
Egypt	6	6	8	9	12	19
Pakistan	6	5	6	7	12	13
Jordan	3	5	6	6	11	13
Syria	1	4	5	5	5	4
Iraq	---	4	5	5	9	12
Indonesia	3	3	4	5	9	22
Brunei	3	3	4	4	8	10
Other countries	7	7	9	10	125	281
Total	**639**	**822**	**1,036**	**1,139**	**1,357**	**1,631**

Table 1: Size of the Global Islamic Financial Services Industry (AUM USD Bn)

Table 1 presents the breakdown of Islamic financial assets in a selected number of countries. It is interesting to note that the size of the informal Islamic financial assets is on a rise (USD199.51 billion[2]), despite obvious institutionalisation of Islamic banking and finance. With the rapid growth of Islamic banking and finance, it was expected that size of the informal Islamic financial sector would decrease but obviously this has been the case. It is primarily because a number of strict families, especially in the GCC region (but also in other countries like Pakistan, Bangladesh and other countries), are not sufficiently convinced with the Shari'a authenticity of Islamic banking and finance. There is a definite need to bring such families by bringing these families into the Islamic banking and financial net.

[2] It is estimated that 71% of USD281 billion dispersed in a number of countries is the Shari'a compliant businesses that are still outside the formal Islamic financial sector. We call them informal Islamic financial assets.

1.4 The halal industry and Islamic finance

It is surprising that although halal sector and Islamic banking and finance both draw their legitimacy from Islam, yet they have developed very independent of each other. The GIFR 2013, therefore focuses on the global halal industry to bring it close to the practice of Islamic banking and finance. If the two industries are integrated, there is no doubt that the combined size of the industry will be many-fold of their present individual sizes.

CHAPTER 2

Islamic Finance Country Index 2013

2.1 Introduction

In 2012, sukuk issuance reached a record USD144 billion[1], a 64% increase from 2011. Total Islamic bank assets in the GCC increased to USD445 billion, an over 14% increase from 2011[2] while conventional assets grew by only 8.1% during this period. 2012 also witnessed the introduction of Islamic finance in a number of new territories. Following the overthrow of governments in Tunisia, Egypt and Libya, all three nations are looking to incorporate Islamic finance into their economic systems. The government of Egypt is working actively to issue a sukuk in order to relieve its debt burden. In Oman, the Central Bank has come up with detailed regulations upon the provision of Islamic banking services in the country. In addition two Islamic banks and a number of windows have commenced operations. Strong growth in a number of African nations such as Tanzania and Nigeria, as well as other emerging markets adds to this growing industry. There have been many positives in the industries; at the same time, other events have dampened optimism for the growth of Islamic banking and finance. As mentioned in Chapter 1, HSBC have desisted their Amanah window in a number of countries, although their focus is now on Saudi Arabia and Malaysia – two of the biggest players in the Islamic finance industry.

GIFR initiated the Islamic Finance Country Index (IFCI) in 2011 with the aim to capture the growth of the industry, and to provide an immediate assessment of the state of the Islamic banking and finance industry in each country. It has since then emerged as the most comprehensive and, to date, the only globally accepted means to compare countries in this sector. The Index provides a benchmark for nations to track their progress against other nations. The IFCI is a composite ranking that reflects the state of the Islamic banking and finance industry in different countries. More importantly, it highlights the leaders in the industry. The IFCI shows the growth of Islamic banking in an objective manner making it a useful tool for industry analysis and comparative assessments. It is the first, and only, index of its kind in the Islamic banking and finance industry, and has proven to be very popular amongst regulators, analysts, researchers and industry players all over the world.

IFCI ranks countries based on available information for different variables across each country in a manner that avoids any bias affecting the outcome.

2.2 Methodology

The IFCI is based on a proprietary methodology developed by Edbiz Consulting. It is based on a multivariate analysis the details of which are given below.

2.2.1 Data

There are over 70 countries involved in Islamic finance in some capacity. However, due to limitations related to the authenticity and availability of the data, we have only been able to rank 36 countries in the year 2011, 42 in the year 2012 and 43 for the year 2013. In all cases, the data has been collected from various secondary sources, including central banks websites, individual Islamic financial institution's published accounts, various agencies and national newspapers, and information portals like IFIS, Bloomberg and Thomson Reuters. Exhibits 1 and 2 evidences the 8 variables used for IFCI 2012 together with their weights.

2.2.2 Weights

As per IFCI 2013, we collected data on 8 variables for 43 countries for the year 2012. The data was then suitably organised, coded to enable multivariate analysis and construction of IFCI using SPSS. The data was then tested to see if it contained any meaningful information to draw conclusions from. In order for factor analysis to be applicable, it is important that the data fits a specification test for such an analysis. The Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy is used to compare the magnitudes of the observed correlation coefficients in relation to the magnitudes and partial correlation coefficients. Large values (between 0.5 and 1.0) indicate factor analysis may be useful with the

[1] Zawya 2013, IFIS and other sources.

[2] http://www.zawya.com/story/Islamic_banking_assets_in_GCC_jump_to_USD445bn_in_2012-ZAWYA20130321034237/

data. If the value is less than that, then the results of the factor analysis might not be very useful. For the data we used, we found the measure to be 0.85, which made it reasonable for us to carry out the factor analysis. Bartlett's test of sphericity is another specification test which tests the hypothesis that the correlation matrix is an identity matrix indicating that given variables are unrelated and therefore unsuitable for structure design. Smaller values (less than 0.05) of the significance level indicate that factor analysis may be useful with the data. For the purpose of IFCI 2013, this value was found to be significant (0.00 level) which means that data was fit for factor analysis. Factor analysis was run to compute initial communalities to measure the proportion of variance accounted for in each variable by the rest of the variables. In this manner we were able to assign weights to all 8 variables in an objective manner.

By following the above method, we have been able to remove the subjectivity factor in the index as now the data speaks for itself, and the statistical method comes up with the weights. The weights used in IFCI 2013 are similar to IFCI 2011. These weights points to the relative importance of each constituent variable of the index in determining the rank of an individual country. Hence, it is natural to assume that countries which have a large number of Islamic banks, a central Shari'a supervisory authority, and a number of institutions involved in Islamic finance will rank high because they have a high weightage in the index compared to other variables.

Variables	Description
Muslim population	Represents the absolute number of Muslims living in a country
Number of Institutions involved in Islamic finance Industry	Represents both banking and non-banking institutions involved in Islamic finance in a country
Number of Islamic banks	Represents fully fledged Islamic banks (either stand alone or subsidiaries of conventional banking groups) in a country of both local and foreign origins
Size of Islamic financial assets	Represents all assets relating to the industry in a country
Size of sukuk	Represents total outstanding sukuk in the country
Regulatory and legal infrastructure	Represents the presence of regulatory and legal environment enabling IFI to op¬erate in the country on a level playing (e.g., Islamic banking act, Islamic capital markets act, takaful act etc.)
Central Shari'a Supervisory Regime	Represents the presence of a state-representative body to look after the Shari'a-compliancy process across the IFI in a country
Education and Culture	Represents the presence of an educational and cultural environment conducive to operations of the IFI (this could be formal Islamic finance qualifications, degree courses, diplomas, and dedicated training programmes)

Exhibit 1: Description of variables chosen

Variables	% Weights (2013)
Number of Islamic banks	21.8
Central Shari'a supervisory regime	19.7
Number of institutions involved in Islamic finance industry	20.3
Size of Islamic financial assets	13.9
Size of sukuk	6.6
Muslim population	7.2
Education and culture	5.7
Regulatory and legal infrastructure	4.9

Exhibit 2: Weights

One particular change this year in the collection of data is sukuk issuance, which will be the total amount of sukuk outstanding instead of total size of sukuk issued for the particular year. This is employed to standardise the data throughout the index as other values such as the values used for Islamic financial assets, and the number of Islamic banks are total values and not do not reflect any particular year.

2.2.3 The model

The model used for the IFCI index is as below:

IFCI (C_j) = $\sum_{i=1}^{i=8}$ Wi. Xi

Where

C= Country

j = 1, 2, …., 43

W= Weight for individual variable

X= Variable

With these minor changes in the data set, and resulting changes in the weights assigned to the variables used, the above model generated some interesting results. Exhibit 3 and 4 provide a comparison of the ranking of the countries for the years 2012 and 2013.

2.2.4 Analysis

It is the third consecutive year that the top three countries have remained unchanged, with Iran number one, Malaysia number two and Saudi Arabia at number three. Iran has an index value of 73, remaining the leading country across all the variables as its entire banking and finance sector is operating under Shari'a law. Total Islamic financial assets in Iran reached USD416 billion, the highest for any country. Malaysia is seen as a leader in the Islamic banking and finance industry. It is interesting to note how a country of less than 30 million people has led the Islamic banking and finance industry, and assisted a number of other countries in their own development of Islamic finance. Malaysia is the largest sukuk issuer for the second year in a row: approximately 70% of total global sukuk issuance (USD144 billion) originated from Malaysia. In addition, Malaysia has passed a new comprehensive law, the Islamic Financial Services Act Malaysia 2013, which is coming into force in May 2013. Saudi Arabia, with Islamic financial assets of USD215 billion, the second largest in the world, and an index value of 44, is closing the gap on Malaysia, which has an index value of 46. Saudi Arabia is also the second largest issuer of sukuk in 2012. UAE, ranked fifth in the IFCI 2012, has moved up the ranking. It was the third largest issuer of sukuk for 2012. H.E. Sheikh Rashid Al Maktoum, the Ruler of Dubai and Vice President of the UAE, has shown interest in making UAE the regional hub for Islamic banking and finance.

Indonesia, a country with the largest Muslim population, is working hard to attract the attention of the global Islamic banking and finance industry, and is trying to become a hub. It is a country with high potential, especially as only 14 million out of a population of 215 million are using Islamic finance.[3] Indonesia was the fourth[4] largest sukuk issuer in 2012. Out of the total sukuk issuance (USD9.3 billion), USD5.8 billion was issued by the government. Regulators are working on improving the legal and regulatory system in the country to accommodate Islamic finance.

[3] http://dawn.com/2013/01/21/indonesian-focus-on-islamic-financing/

[4] http://www.ameinfo.com/kfh-research-131bn-total-issuance-sukuk-2012-325296

Bahrain has the most mature regulatory system for Islamic finance in the Middle East, and is home to a number of multilateral organisations that support the industry. It has remained at number 6 for the second year according to IFCI ranking. The International rating agency, Standards & Poor's, declared the Bahraini economy stable following political unrest in 2011. Market share of Islamic banking is currently at 13.3 percent as of August 2012. Bahrain Central Bank remains strong in its sukuk programme.

In terms of Islamic financial assets, Kuwait is the fourth largest, but has moved from 4th to 7th in the ranking. One reason for the drop in ranking is due to reduced sukuk issuance in the country as compared to other countries.

The growth rate of Islamic finance in Pakistan is increasing yearly, but the country remains at number 8. Total Islamic financial assets in the country have reached USD8.5billion. With 5 Islamic banks and 13 windows, the total number of Islamic banking branches in the country reached 1097 in 2012. In the last quarter of 2012, one conventional bank commenced its Islamic operations. Total Islamic deposits accounts for 9.7% of the total deposits in the country. Net financing and investments accounts for 8.1% of the total investments and financing in the country.

Qatar, the richest country based on per capita GDP, and with the fourth largest sukuk issuance (USD25 billion) for 2012, moved down 2 ranks to number 11. One would expect that after the strong performance for the year, Qatar would have improved its ranking. However, according to IFCI 2013 it certainly did not. This is perhaps due to the closing of conventional banking windows in the country following the government pronouncement to this effect in 2011. Its effect on IFCI 2012 was negligible due to the lag, which is being felt now.

Bangladesh and Sudan have both improved their IFCI ranking. The United Kingdom was ranked number 11 according to IFCI 2012 and has moved one place down to number 12. While one major UAE bank, Abu Dhabi Islamic Bank, has opened its offices in London, HSBC Amanah has decided to close its business from a number of geographical locations including UK.

The most surprising result is the movement of the United States of America in the ranking from 41 to 15. However, this is explained by the inclusion of more data to compose the variables. This year we have included all forms of Islamic finance institutions including credit unions, housing firms and other Islamic financial services firm. It is interesting to note that some of the countries which are new to Islamic banking and finance have also been ranked. These include Oman and Egypt. It is expected that with the growth of Islamic finance in these countries, the overall Islamic banking and finance industry will improve and grow.

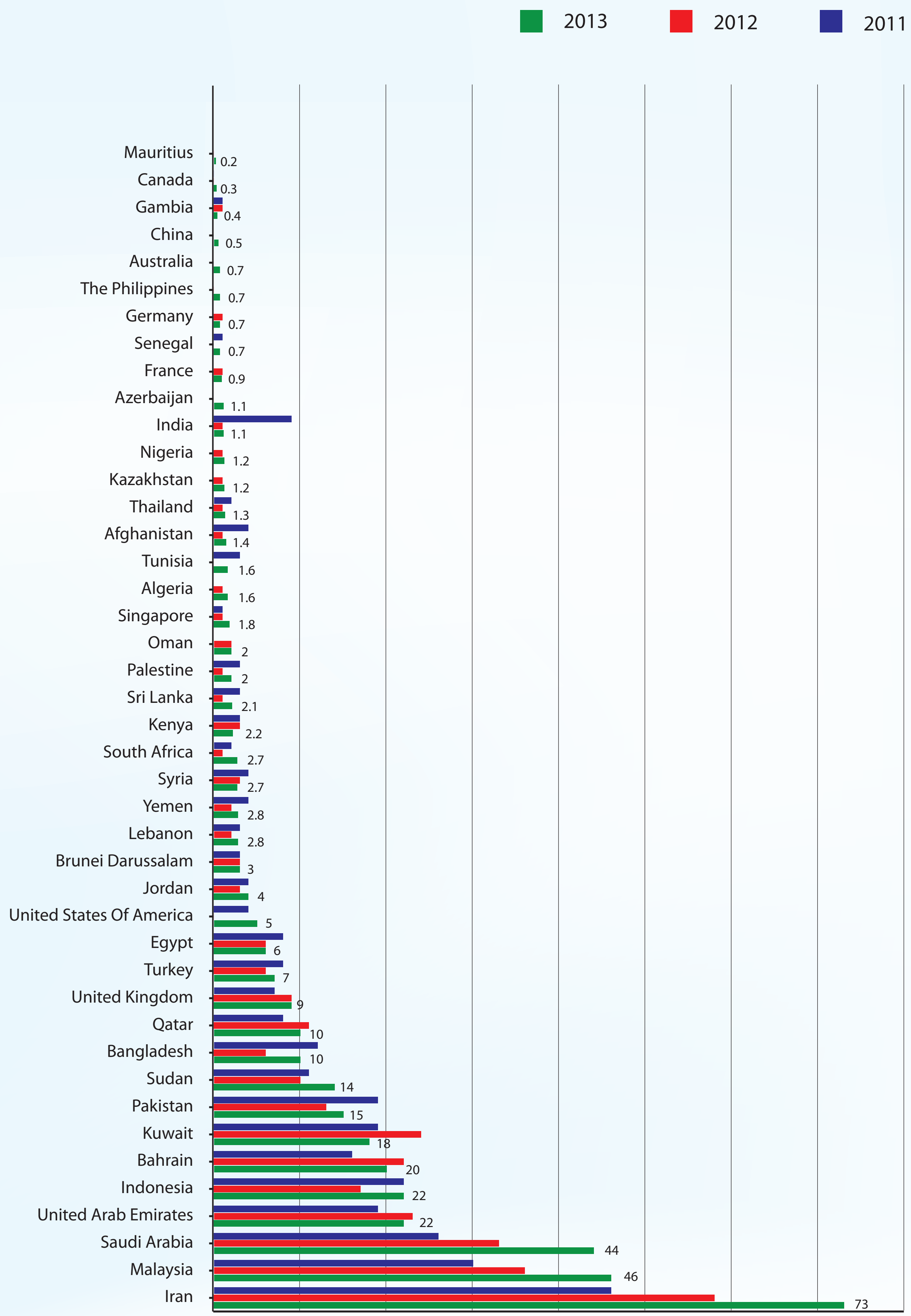


Exhibit 3: Index value

Country	2013	2012	Change
Iran	1	1	-
Malaysia	2	2	-
Saudi Arabia	3	3	-
United Arab Emirates	4	5	+1
Indonesia	5	7	+2
Bahrain	6	6	-
Kuwait	7	4	-3
Pakistan	8	8	-
Sudan	9	10	+1
Bangladesh	10	12	+2
Qatar	11	9	-2
United Kingdom	12	11	-1
Turkey	13	14	+1
Egypt	14	13	-1
United States Of America	15	41	+26
Jordan	16	16	-
Brunei Darussalam	17	15	-2
Lebanon	18	29	+10
Yemen	19	19	-
Syria	20	18	-2
South Africa	21	26	+5
Kenya	22	17	-5
Sri Lanka	23	22	-1
Palestine	24	28	+4
Oman	25	21	-4
Singapore	26	23	-3
Algeria	27	24	-3
Tunisia	28	20	-8
Afghanistan	29	25	-4
Thailand	30	27	-3
Kazakhstan	31	35	+4
Nigeria	32	31	-1
India	33	30	-3
Azerbaijan	34	N/A	-
France	35	34	-1
Senegal	36	32	-4
Germany	37	37	-
Philippines	38	40	+2
Australia	39	N/A	-
China	40	N/A	-
Gambia	41	33	-8
Canada	42	39	-3
Mauritius	43	42	-1

Exhibit 4: Changes in index value

Islamic Finance Review

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CHAPTER 3

Country sketches

Afghanistan

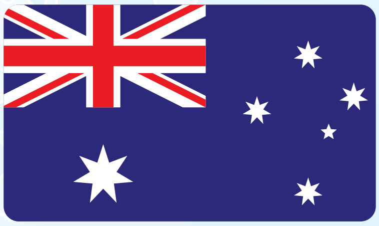
IFCI Ranking **29**

Afghanistan, where 99% of its 29 million people are Muslims, is attempting to expand Islamic financial services and lure international investors to help reduce the nation's reliance on overseas aid for reconstruction after more than three decades of war. Islamic banking will help attract cash from Afghans, who refuse to use non-Shari'a compliant institutions

Economic instability and legal obstacles have slowed the introduction of modern forms of Islamic finance in Afghanistan. But Shari'a-compliant instruments are playing a role in the farm sector through a US-funded aid programme. Afghanistan plans to sell Islamic bills for the first time following the withdrawal of foreign troops in 2014. The Afghan government is using Islamic financial contracts to extend credit to farmers in areas where conventional banking has not fully satisfied demand for funds. The Agricultural Development Fund (ADF), set up in 2010 through a USD100 million grant from the U.S. Agency for International Development (USAID), offers both conventional credit and Islamic financing. In December, the Asian Development Bank (ADB) provided a USD750,000 grant to promote Islamic banking in Indonesia, Pakistan, Bangladesh and Afghanistan. The money will be shared between those countries' governments to help their banking systems to meet regulatory standards set by the Islamic Financial Services Board.

As many as 18 banks are working in Afghanistan. Out of these, Kabul Bank, Ghazanfer Bank, Alfalah Bank, Azizi bank and Bank-e-Milli Afghan are providing Islamic banking in the country. Bank-e-Millie Afghan, which started operations in 1933, forecasts the number of its Shari'a-compliant customers will increase 50% over one year from 15,000 after legislation on Islamic banking is passed. After the success of Islamic banking in Pakistan, local banks want to steer towards Afghanistan which has a rapidly emerging market for the financial industry. Several local banks are eyeing Afghanistan to expand themselves.

Australia



IFCI Ranking **39**

Sukuk is being promoted as ideal for Australia's capital-intensive industries such as construction or mining, but tax rules and pricing are still limiting access. Some also see sukuk as a way to help meet the huge shortfall in infrastructure funding Australia is facing. In December, Melbourne-based venture capital adviser Yanese Chellapen began offering Australian companies access to the Malaysian sukuk market. In the same month, Australian fund manager Crescent Wealth launched the country's first Islamic pension fund, through a deal with the Association of Independently Owned Financial Professionals (AIOFP). The Islamic pension option will be offered through AOIFP's Personal Choice Private eWrap - an account that provides investors access to a wide range of investments, superannuation, pension, insurance, managed funds, cash and term deposits and ASX-listed securities. The agreement will allow retail investors in Australia to transfer all or part of their superannuation savings to Shari'a-compliant investment options offered by Australia's first Islamic wealth manager, Crescent Wealth.

Firstmac, a non-Bank lender, has offered Shari'a-compliant finance via several providers, including Melbourne mortgage provider MCCA for over a decade. But it wants to securitise that through a sukuk. They would have become the first organisation in Australia to issue sukuk. However, the Solar Guys, a solar panel and heating installer, will issue a USD100 million sukuk via a joint venture, SGI-Mitabu, early in 2013, as a part of a USD500 million raising to build a 250MW solar power plant in Indonesia. It is doing it through the International Business and Financial Centre in Labuan, one of three tax-free Malaysian islands.

Azerbaijan

IFCI Ranking **34**

Previously, the government's fear of political Islam forced banks to conduct clandestine Islamic finance operations in which Shari'a-compliant deals were hidden under the veneer of conventional banking. Now several banks in Azerbaijan openly offer a limited range of services based on Islamic principles. The International Bank of Azerbaijan (IBA), the country's largest lender, opened an Islamic window providing finance to small companies. In September, IBA signed a commodity murabaha agreement to obtain USD20 million of financing from the Islamic Corporation for the Development of the Private Sector (ICDPS), to offer Islamic trade financing to private sector companies in Azerbaijan. The IBA had planned to offer a USD150 million Islamic loan, a one-year private syndication that would have been the first of its kind in Azerbaijan. The bank is in talks with a number of Gulf-based lenders to manage the syndication. IBA plans to increase its Islamic banking assets to USD120 million by the end of 2013 from

USD60 million currently.

The government is clearly interested in the Gulf's huge pool of investment funds. In July, IBA said it aimed to establish an Islamic banking subsidiary in Qatar by the end of 2012. But with no legislative framework, Islamic finance is estimated at a small fraction of Azerbaijan's banking assets, which totalled 14.8 billion manats (USD19 billion) in July. Ansar Leasing, which was established in 2008 by the ICDPS is considering the issue of the country's first sukuk, which would pay no coupon and be issued at a discount from par value. The issue would be very small, perhaps USD1 million with a three-year tenor. But in the absence of legislation, the issue would require a government decree to exempt it from taxes.

IFCI Ranking 06

Bahrain

Islamic finance in Bahrain is booming. As of March 2012, the total assets of Islamic banks in Bahrain have increased 13 per cent. According to Ernst and Young's World Islamic Banking Competitiveness Report 2013 the Kingdom's Islamic asset market share amounted to 26.9 per cent with USD13 billion assets. Building on this growth, Thomson Reuters established a global Islamic finance hub in September. The Islamic finance hub will provide institutions focused on the sector with vital quality and breadth of timely information, with up-to-the-minute data and categorised content for each financial instrument, as well as in-depth analysis of markets and assets classes. Coverage of all information and transaction requirements will be provided through dedicated communication, knowledge and transaction systems. This will allow the sharing of content and transactions with counterparties in addition to displaying prices and covering recent trends, coverage and analysis.The hub will initially employ 21 Bahrainis, and is expected to grow over time. A two year training period will also be provided to equip staff with the knowledge and skills required to become Islamic finance specialists, through a combination of in-class training and intensive mentoring.

Standard Chartered, which makes most of its revenue from Asia, is expanding Saadiq in the UAE and Bahrain, two markets HSBC Holdings is withdrawing from. Standard Chartered Saadiq now offers Shari'a-compliant financing to small and medium-sized companies in Bahrain.In January 2013, three Bahrain-based banks became the first Islamic banks to merge, creating a financial institution with total assets in excess of USD400 million, spanning the MENA region, Europe and Asia. The merger is between Elaf Bank, Capital Management House and Capivest. With a larger capital base, the newly created institution will be better positioned to participate in larger investments and projects and capitalise on a broader set of available opportunities both across the MENA region and globally. The proposed merger was announced in September 2012. On the other side, in February, Bahrain Islamic Bank ended talks with Al Salam Bank over plans to merge to create a new USD4.5 billion entity.

The Central Bank of Bahrain (CBB) is rolling out draft rules to enhance the operational model for the takaful industry. The CBB has earmarked the following areas in takaful business where it intends to issue new, enhanced and updated rules and requirements in 2013: solvency and corporate governance. Actuarial reporting requirements for the overall insurance business are another area which will see new rules in the year ahead. The objective of modifying the existing takaful rules was to facilitate a faster growth of the takaful business in Bahrain while protecting the interest of all stakeholders, vis-à-vis participants, shareholders and takaful operators.

The desire to improve takaful is in part due to figures which show that the growth of Bahrain's takaful sector dipped to single digits in 2011 for the first time in a decade, although it still outpaced growth in conventional insurance. Takaful gross contributions grew by 4.25% to 40.2 million dinars (USD107 million) in 2011. This compares to 18% growth in 2010, with double-digit growth registered in all of the previous 10 years. Gross premiums for both Islamic and conventional insurance combined increased by 2.12% to 214.9 million dinars in 2011 down from 4.95% a year earlier.

Bangladesh

IFCI Ranking 10

Bangladesh has launched an Islamic interbank money market, aiming to help Shari'a-compliant banks manage their short-term funding. The new market is based upon the experiences of money market solutions from Indonesia, Malaysia and Saudi Arabia which were studied while developing the Bangladeshi platform. The central bank will act as a custodian. Interbank transactions, limited to overnight tenors, will be based on a pre-determined profit-share ratio that will be decided by a central bank committee using Islamic banks' deposit rates as a starting reference. The country's Islamic banks maintain liquid assets above statutory requirements and well above levels held by conventional banks, but limited money market tools have made it difficult to manage this excess liquidity.

Brunei

IFCI Ranking 17

It is expected that market share held by Shari'a-compliant banking in Brunei will increase to 60% from its current levels of 40-55% over the next five years. However, it is feared that Brunei is not pacing fast enough compared to regional players. The Sultanate is working to address challenges in developing Islamic finance in the country, with a particular emphasis on improving staff training. In mid-April, th Universiti Brunei Darussalam (UBD) announced it would be reviewing its curriculum for its Islamic finance courses to ensure their content was relevant to the sector, a process that would also include seeking input from the industry itself.

In September, the Islamic Bank of Brunei was launched. This replaced the International Bank of Brunei as the sole domestically owned bank operating in the country. In mid-October, Standard Chartered Bank Brunei (SCB) said it was mulling plans to introduce Islamic banking products this year to meet increased demand for Shari'a-compliant banking services in the Sultanate. In November, the Autoriti Monetari Brunei Darussalam (AMBD), which is acting as the central bank, announced the successful pricing of its 82nd issuance of sukuk, which was worth BND100 million (USD122.5 million) at a rental rate of 0.16%. The move followed a USD100 million, 90-day issuance.

Brunei is one of the leading markets for the halal industry. Having launched the Brunei Halal brand in 2010, the Sultanate has since strengthened its reputation by becoming one of the few countries outside of the Middle East to establish an internationally recognised certifying body for the industry. The Sultanate's halal brand now looks to be generating significant interest among emerging players, including non-Muslim countries, who are keen to gain a share of market growth. Firms from the Philippines and Thailand are looking to develop partnerships and the setting up of joint ventures in halal food production initiatives. South Korea and Mexico have also expressed interest. Brunei Halal is looking to expand its operations by setting up new production centres to run alongside its manufacturing bases in Malaysia, Spain and the UK. The Brunei Agro-Technology Park (BATP) is likely to be instrumental in driving industry growth by providing local manufacturers with modern facilities they need to stay globally competitive. The park will cover 50 hectares with the first phase earmarked for completion in 2015. The facility is expected to help small and medium-sized enterprises (SMEs) tackle a range of challenges, from developing and exporting products to obtaining halal certification. The BATP will also have a strong focus on research and development, which could prove key to the Sultanate's plans to diversify away from a reliance on oil and gas revenues, particularly in newly emerging segments such as halal pharmaceuticals.

Egypt

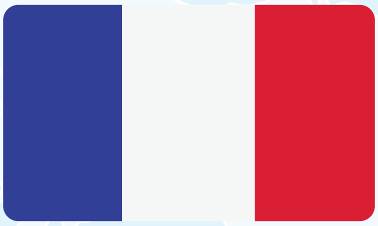
IFCI Ranking 14

The leader of Egypt, Mohammed Morsi, has spoken on encouraging Islamic finance and banking in Egypt. However, he is facing challenges in adopting Islamic economic principles to run the economy. In December, the Islamist led government issued a draft for a new sukuk law. A sukuk law has been mooted for several years but only taken more seriously after the revolution. The draft sukuk law, however, was roundly condemned by scholars from Al-Azhar University, and other religious scholars for failing to adhere to Islamic laws. It is now under review again, with amendments forthcoming. According to the finance minister, El-Morsi Hegazy, the sukuk law is expected to generate USD10 billion for the Egyptian government.

Egypt's economy is currently suffering from a lack of investment, and has had to go to the IMF for a loan to shore up finances. Egypt is facing the Middle East's widest budget deficit, an unemployment rate of almost 13 per cent and dwindling foreign reserves that are down to just USD15 billion, half the level they were before the uprising. The Islamist government has had to reconcile the need for the law with the outward prohibition of interest. Gehad Al Haddad, senior advisor to the Muslim Brotherhood, said the group views the loan's interest rate as a "loan processing fee" making it permissible under Islamic law.

In October, Dana Gas, the United Arab Emirates' largest listed natural gas firm, reported that it will not repay a USD920 million convertible sukuk, primarily because it has been hit by payment delays from Egypt and Iraq's Kurdistan region. Dana Gas has been unfortunate enough to be one of a long list of companies to have problems getting paid for exploration in Egypt from the state-run oil company.

There is a growing diversity of Islamic economic ideas in Egypt, although analysts argue that there is no real, practical platform, simply vague slogans to stir up the demand for Islamic economic ideas. In consequence, with the establishment of the pro-labor and borderline socialist al-Sha'ab Party, the Islamist political scene appears to be polarising into two camps: proponents of free market reforms, and supporters of redistributive welfare measures aimed at improving conditions for workers, farmers and other disadvantaged constituencies.



IFCI Ranking 35

France

According to KFH research, published in April 2012, there are 1.5 million clients willing to use Islamic banking tools and products in France, which equals USD18.2 billion. Three are large players which have a presence in France, namely National Bank of Kuwait (NBK), Tejerat Bank (TB) and Qatar National Bank. Credit Agricole also offers some Islamic products and services. In 2011, Chaabi Bank, through its 17 branches across France, launched Islamic deposit accounts for its customers. The bank plans to open its Shari'a-compliant deposit account to small- and medium-sized enterprises (SMEs), thus addressing a latent need of small businesses for Islamic banking products. Chaabi also aims to offer corporate finance and mortgage products. Bahraini-based Al Baraka Bank plans to launch to cater to the retail banking requirements of the Muslims in the country. The group also plans to launch five branches which will be opened as subsidiaries in the form of joint ventures with selected French investors.

France is working to make numerous legal and organisational reformations to facilitate the offering of Islamic financial services and products. In November 2011, Paris Europlace launched the French Sukuk Guidebook to assist those parties interested in learning about the possibility to issue or list sukuk in France whether using International Law or French Law. However, France had its top AAA credit rating cut by Standard & Poor's in January 2012 due to concerns that the country is failing to adequately address their debt burden. This has created a drag on the issuance of sukuk.

IFCI Ranking 37

Germany

Germany remains laxadaisical in building an Islamic finance industry in the country. Part of the reason is the majority of Muslims in Germany are of Turkish origin and relatively secular in outlook. The biggest hurdle in Germany is the low income of Muslims. A study published in 2012 by the Stresemann Institute found that Islamic finance had failed in the Eurozone as the majority of Muslim customers had lower income levels and thus little investment potential. Moreover, Germany's tax system makes certain forms of Islamic finance unattractive. Under German law, there are still multiple taxes on the purchase of a property, making it far more expensive than a conventional mortgage. The government has not remedied this, even after much lobbying. However, Kuwait Finance House's Turkish operation, Kuveyt Turk, has applied for a German banking licence and aims to become the first Islamic bank. Kuveyt Turk planned to invest initial capital of 45 million euros (USD 58 million) in its planned German unit. In May, CIMB Principal became the only registered Islamic fund in the country.

India

India is reticent to incorporate Islamic finance into the economic system. In a statement, the Reserve Bank of India (RBI) Governor, Dr. Duwuri Subbarao ruled out introduction of Islamic banking in the country but did say that channelling funds through other means using Islamic finance instruments is possible. This latter comment was considered positive for the industry, given the RBI's historic reticence to bring in Islamic banking in to the country. Industry actors will have to look at more innovative ways to create Islamic banking products, but the retail banking side is likely to remain absent for the foreseeable future.

One of the major concerns is who would regulate the Islamic financial system. The provision of credit is of significant concern as the Banking Regulation Act of India does not consider Islamic banking, allowing banks to borrow from, and deposit money with, the RBI on interest. Moreover, according to Subbarao, no organisation has proposed a robust model that would account for Indian laws making it difficult for the government to fully support wholesale changes. Nevertheless, a handful of politicians have been lobbying for years to start Islamic banking in India. Politicians from the south-western state of Kerala, where there is a large Muslim population, have raised the issue in parliament. Rising demand has compelled the government to look at tweaking certain laws to accommodate the nuances of Islamic financial products.

Some capital market products, regulated by the Securities and Exchange Board of India (SEBI), are already based on Islamic equity indexes, such as one launched in 2010 by TASIS and the Bombay Stock Exchange. Infinity Consultants and Amana Group have developed savings schemes known as chit funds that comply with Islamic finance principles. In chit funds, subscribers pool their money, from which members can then obtain temporary use of the funds through a bidding process. In May, SEBI introduced guidelines for alternative investment funds (AIF) which allow the pooling of capital from local and foreign investors.

IFCI Ranking 33

Indonesia

Hope prevails for the Islamic banking industry in Indonesia. HSBC have scaled back their global Islamic finance business in less-profitable markets, including the U.K. and Singapore, to concentrate on Malaysia, Saudi Arabia and, to some extent, Indonesia. However, the market, as compared to the former two, is smaller. Indonesia allows 16 Islamic-banking products, compared with 59 in Malaysia. Regulations also require amending. Indonesia's tax framework is incomplete, leaving potential sukuk issuers uncertain on tax payments although Bank Indonesia have stated that Islamic products will receive tax exemptions in order to place them on equal footing with conventional bonds. It is expected that once the regulatory framework is improved, Indonesia will outpace Malaysia as a destination of choice for Islamic finance. Indonesia will require non-Islamic banks operating Islamic- banking windows in their branches to set up independent units by 2015 to prompt them to inject more capital into the business.

Islamic lenders in Indonesia including Bank Muamalat, the PT BNI Syariah unit of PT Bank Negara Indonesia and CIMB Islamic, have said they want to provide fixed-rate deposits to consumers so they can compete directly with non-Islamic banks. In order to improve Islamic banking liquidity, since July, Shari'a-compliant banks in Indonesia have been allowed to lend to each other at fixed rates to manage excess cash, paving the way for savings accounts with a stable return similar to what non-Islamic banks pay for deposits.

There are increasing signs that the Islamic finance market is contributing more to the nation's economy. Indonesia recorded an increase in foreign exchange (forex) reserves on strong inflows of foreign direct investment (FDI), portfolio investments and government dollar-denominated Islamic bond issues. In December, USD1 billion of foreign flows came into the country from sukuk. The Indonesian government announced in the same month that they will issue rupiah-denominated sukuk Islamic bonds to finance state projects in 2013. This has been widely praised and is seen as a breakthrough in the development of the sector. Moreover, with Indonesia's progress in building infrastructure remaining sluggish, sukuk provides an alternative way of raising funds. Currently, very little from Indonesia's sukuk are specifically earmarked for infrastructure projects.

IFCI Ranking 05

IFCI Ranking **16**

Jordan

Currently, there are four Islamic banks operating in the country. Annual growth is currently at 13 per cent, with Islamic banks surpassing traditional banks in the growth of deposits and financing. The banks hold approximately 4.85% of the total banking sector.

Takaful companies are still performing poorly. According to Swiss Re's World Insurance Report, insurance penetration in Jordan was only 2.3 per cent while the global average was 7.0 per cent as of 2009. In order to improve the insurance penetration as well as to meet the citizen's difference insurance needs, the Insurance Commission of Jordan has issued orders which regulate the takaful industry in the country. In October 2012, the Jordanian government approved the Sukuk law. According to this law, sukuk shall be tradable at the stock exchange. The law provided a number of contract forms which can be used for sukuk issuances.

The Jordanian government hopes to establish a leading regional center for Islamic finance. In August, it assisted in the organisation of the first International Forum of Islamic Banks and Financial Institutions attended by Islamic financial practitioners from across the globe.

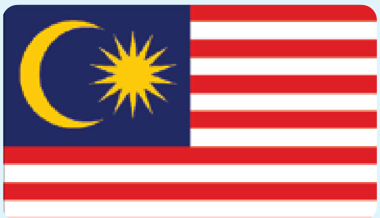
IFCI Ranking **31**

Kazakhstan

Kazakhstan intends to become the regional Islamic centre by 2020. The country is awaiting the opening of its second Islamic bank and is continuing to develop legal conditions to permit Islamic finance. In March, it formed a road map to develop the Islamic financial system in the country.
There are currently only a few Islamic banking institutions in the country. Al-Hilal Bank is the only Islamic bank in the country, and comprises less than one % of the total banking assets in the country. There is also Fattah Finance, and the Association for the Development of Islamic Finance is advancing the ideas of Shari'a financing. Takaful, the first Islamic insurance company, is also present. However, the legal framework on Islamic banking remains weak. For many, Islamic banking remains incomprehensible and complex.

But Kazakhstan holds a lot of potential in terms of investment in its natural resources. The Islamic Development Bank launched a USD50 million renewable energy fund and has further plans to finance agricultural projects. The Islamic Corporation for the Development of the Private Sector (ICDPS) said it was considering financing farming projects in Kazakhstan from its USD600 million agribusiness fund.

In October, the Development Bank of Kazakhstan issued a five-year 240 million MYR (USD75.5 million) sukuk, the first to be issued in the former USSR. It is expected to spur more issues in the country. The issue is part of the bank's 1.5 billion MYR Islamic note programme, approved this year by the Malaysian central bank and the Shari'a Advisory Council of the Securities Commission of Malaysia. Fitch Ratings has assigned the Development Bank of Kazakhstan's (DBK) programme and sukuk a rating of 'BBB-'. Malaysian investors took up 62 per cent of the Development Bank's debut issue, and it is expected that the inflow will contribute to the development of the economy.



IFCI Ranking **02**

Malaysia

According to the Malaysian Ministry of Finance Economic Report 2012/2013, Islamic banking assets increased 20.6 per cent to MYR 469.5 billion, representing 24.2 per cent of the country's banking system's assets. The contribution of Islamic finance to the Malaysian economy had also been growing signifi cantly, accounting for 2.1% of GDP in 2009. It is anticipated that there will be the enactment of further laws for the Islamic finance industry, making the country a leader, if not the leader, Islamic banking and finance. The new legal framework is expected to streamline the legal requirements across sectors and ensure that law was reflective of Shari'a contract nuances. The degree of regulation is anticipated to be commensurate with level of risks associated with Islamic financial services and products.

The government is also planning reforms to the pension system, which will allow Malaysians to allocate a part of their retirement contributions to Islamic investments. At present, the Employees Provident Fund (EPF) receives public pension contributions and invests the money, some in Shari'a compliant products, but there is no choice on behalf of the investor. Under the new, voluntary Private Retirement Scheme (PRS), it will allow contributors to invest in Shari'a compliant instruments. The Employees Provident Fund (EPF) plans to increase holdings of global Islamic bonds to USD3 billion by 2013 from USD1.7 billion. Shari'a-compliant funds have on average held 10.6 % of total assets under management in Malaysian retail products over the last two years, according to Reuters. If this ratio is maintained under the PRS scheme, Islamic funds could theoretically see inflows of 3.3 billion to 7.7 billion MYR.

Bank Negara Malaysia (BNM) data suggests that Islamic banking and finance constitutes 19.6% of total banking share. Islamic banks have added 111.6 billion MYR in assets over the past two years. Malaysia is offering tax breaks to issuers in an effort to secure its global dominance of Islamic finance. Malaysian tax breaks on sukuk are luring companies from Germany, France and Turkey to tap into the market as Europe's debt crisis continues.

KFH research reports that Malaysia and the ringgit continue to dominate the market of sovereign sukuk issuance, where governmental and sovereign issuances increased by 70 %. Malaysia was domicile to 74% of all primary market issuances. Saudi Arabia, the second highest, was domicile for a far smaller amount of 8%.

In October, the FTSE Group and Bursa Malaysia launched the FTSE Bursa Malaysia Small Cap Shari'ah Index to complement the existing FTSE Bursa Malaysia Shari'a indices. The FTSE Bursa Malaysia Small Cap Shari'ah Index was developed to provide a a benchmark to track the performance of Shari'a-compliant small cap companies.

The International Centre for Education in Islamic Finance (INCEIF) has signed MoUs with the World Bank and the Islamic Financial Services Board in efforts to enhance collaboration on sharing of knowledge, undertaking research, development, training, and education in the Islamic financial services industry. Industry experts expect that over the next 20 years, the need for Islamic financial practitioners will increase significantly, and therefore training is an important aspect in developing the necessary talent. Malaysia continues to develop its research capabilities by the inauguration of the Centre for Islamic Wealth Management. The research centre will concentrate on Islamic wealth management, asset management and capital markets, and looks to increase knowledge and develop a wider and diversified range of financial products and solutions.

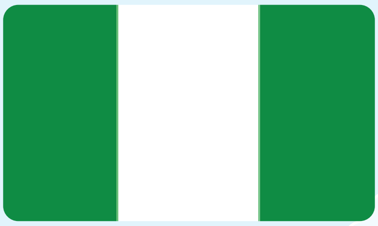
The relationship between Malaysia and GCC countries is strengthening. In July, the National Bank of Abu Dhabi (NBAD) secured its licence to operate in Malaysia in July and set up a wholly-owned local subsidiary National Bank of Abu Dhabi Malaysia Bhd. While NBAD is a conventional financial bank, with the focus on offering conventional banking products, it is expected that NBAD will develop its Islamic banking capabilities through working with local Islamic financial experts. Malaysia's Securities Commission is revising its guidelines for equities which qualify for Islamic investment. By doing so, it is hoped that it will increase the appeal of the country's Shari'a-compliant funds industry to Gulf investors. In June, Bank Negara introduced an Islamic overnight funding facility encouraging commercial banks from the Gulf to trade more in the country's Shari'a-compliant money market. The new facility would allow Islamic banks to obtain funds from the central bank by pledging high investment grade sukuk as collateral. As the facility is based on the murabaha, it is likely to be more acceptable to Gulf banks.

Yet it is not only institutions that are interested in learning from Malaysia. Sudan is looking to Malaysia for assistance in the setting up of Islamic banks in the African country in a move that officials believe will go a long way in facilitating trade and investment financing between both countries. Malaysian regulators and banks such as CIMB have also been invited to Pakistan. Bank Muamalat Malaysia Bhd has teamed up with Bank of Shi Zui Shan of China to set up its first Islamic bank in China in Ningxia Province, in two years, and develop and promote Islamic banking there.

During the first seven months of 2012, two Islamic fund management licences were approved, bringing the number of full-fledged Islamic fund management companies to 18. During the same period, an additional Islamic unit trust fund and four Islamic unit trust and four Islamic wholesale funds were launched. Islamic financing accounted for 26.6 % of total loans at the end of July, compared with 25.9 % at the end of last year. The household sector accounted for over two-thirds of loans made through Islamic financing. The Islamic capital market, consisting of Shari'a compliant equities improved its share of total trade volume to 66.8 % from 59.1 % last year.

On a retail level, Islamic mortgages in Malaysia grew at three times the rate of conventional mortgages. This is largely due to tax incentives and flexible payments. Malaysia's government is providing a 20 per cent discount on stamp duty for Islamic mortgages. Flexibility on the loans arise as monthly payments rise and fall to reflect changes in the benchmark interest rate.

Malaysia is also strengthening its halal industry. As of February, a total of 1,420 applications for the halal certificate had been received. Entrepreneurs who fail to display the halal certificate and logo issued by the Malaysian Islamic Development Department (Jakim) and the State Islamic Religious Departments (JAIN) will face a fine and imprisonment. This came into effect from July 1st.



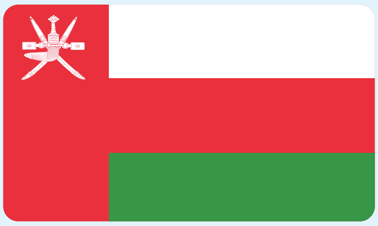
IFCI Ranking **32**

Nigeria

In August, the Nigerian Stock Exchange (NSE) opened an Islamic window on its trading floor. The objective, of the index is to monitor stocks and ensure they comply with Shari'a rulings. Lotus Capital, a halal investment boutique, manages the window. In July, Lotus Capital and Nigeria's bourse (NSE) launched a debut index of Nigerian Stock Exchange-listed companies that comply with Islamic investment principles. The NSE Lotus Islamic index, covers 15 equities with combined market capitalisation of around 2.87 billion naira (USD18 million). It is designed to attract investors from the Middle East, and beyond.

However, due to religious conflicts, many investors believe that such a move is to islamisise the economic system, and the country soon after. Perceptions with Islamic banking in Nigeria vary. While Jaiz International Bank became the first Islamic bank in Nigeria following the Central Bank of Nigeria (CBN) issuance of a license, it has not been met with complete satisfaction. In June, a Federal High Court sitting in Abuja declared the establishment of Jaiz Bank as illegal and unconstitutional. According to the Judge, no provisions are within the CBN Act (2007) and the Banks and other Financial Institutions Act (BOFIA) that empowers the CBN Governor to issue a license for an Islamic bank without approval of the government. If an Islamic bank is to be legal, then National Assembly has to amend the BOFIA. Currently, BOFIA contains provisions for the creations of a PLS bank, but not a "Malaysian" style Islamic bank. The judgement does not have any legal consequences, given the plaintiff was not in a position to carry out the revocation of the bank. The Judge's comments were therefore persuasive and not binding, but the case and the judgement shows tension on religious issues.

The government, on the hand, are positive about Islamic banking and anticipate that it will benefit the country's economic development. National Insurance Commission (NAICOM) developed guidelines on takaful insurance in order to increase insurance penetration, which will be released in 2013. Throughout the year a series of conferences and seminars have been organised to raise awareness of Islamic banking and finance. This has become increasingly important in a country where many are apprehensive of the intents and purposes of Islamic finance.



IFCI Ranking **25**

Oman

In January 2013, Bank Nizwa became Oman's first dedicated Islamic bank to open its doors to the public. The bank has spent the last year building its foundations. In December, it signed a Memorandum of Understanding (MoU) with Capitas Group International (CGI), a leading management firm specialising in Shari'a compliant finance. Under the MoU, both firms will collaborate to create specialised financial platforms in the Sultanate by tapping into their combined skills and resources. Jeddah based CGI was formed in partnership with the Islamic Development Bank's private sector arm, the Islamic Corporation for Development of the Private Sector (ICD). The company establishes financial services businesses to fill the unmet demand for Shari'a compliant finance in OIC member countries. The MOU between the two organisations is to create a housing development finance programme.

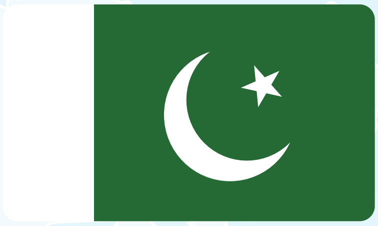
It has been two years since Sultan Qaboos decree, but in that time the Omani regulators have deliberated and endeavoured to create the necessary framework for the Islamic finance industry. In December, the Central Bank of Oman (CBO) released the Islamic Banking Regulatory Framework (IBRF). The 519-page document is considered to be comprehensive and sets higher standards for the industry than those in place in other countries. The CBO has proscribed the use of tawarruq, which will have an effect on how banks maintain liquidity. Many banks believe that some of the rules are too strict and may hinder the growth of Islamic banks.

The IBRF document has been categorised under different titles and covers all issues concerning Islamic banking such as the information on licensing requirements, general obligations and governance, accounting standards and auditor reports, supervision and control, capital adequacy, the credit risks, the market risks, the operational risks, the liquidity risks, etc. It also contains information about Shari'a advisory, and further stipulates that accounting standards for Islamic banks will follow AAOIFI. Tax legislation is also likely to change. The financial services firm, KPMG, are currently advising the government on how best to amend the tax legislation to ensure that Islamic financial institutions are not disadvantaged compared with their conventional peers.

These guidelines will undoubtedly assist and clarify Islamic banking issues for institutions that wish to offer Islamic banking services. Along with Bank Nizwa, Al Izz international bank will also offer Islamic banking services. Both banks undertook IPOs in 2013. Banks that plan to offer Shari'a-compliant products through Islamic windows include Bank Sohar, Bank Dhofar, Bank Muscat, Ahli Bank, National Bank of Oman (NBO), and Oman Arab Bank.

There is a buzz with the Omani Islamic finance industry. Omani institutions are planning to issue sukuk in 2013. The Capital Markets Authority (CMA) has finalised the initial draft for sukuk regulations. The draft is currently on the CMA website for public consultation. The CMA has already given approval to at least three companies to float sukuk. Also, the CMA has approved licenses to three takaful companies. The draft of the takaful law has also been finalised and is up for public consultations. Analysts believe that the takaful industry could reach RO50 million by 2015. After receiving feedback on both draft laws, it is expected to be enacted by Royal Decree.

Pakistan



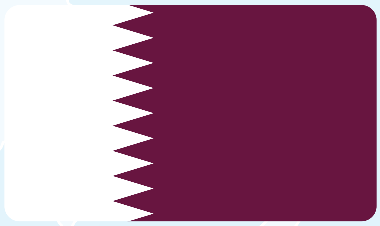
IFCI Ranking 08

At the end of 2012, the Islamic banking and finance industry represented approximately 8.5% of the total banking assets of the country. There are now 5 fully fledged Islamic banks and 13 conventional banks with Islamic banking branches. There are 1097 branches and over 500 windows in more than 70 districts across the country. According to State Bank of Pakistan (SBP) data, the total assets under management (AUM) of Islamic banks and financial institutions in Pakistan has reached Rs 837 billion in December 2012, compared to Rs6.97 billion in December 2002, a 119% growth. During this period the total assets witnessed an average annual growth of 69%. Total Islamic banking deposits have reached a total of Rs 706 billion in December 2012 as compared to 5 billion in 2002. These deposits now account for 9.70% of the total deposits of the banking sector in the country. The total size of net financing and investments has reached to 8.10% of the overall banking industry.

In July, the SBP introduced new takaful rules designed to boost competition and lift the sector's market share. Currently, there are 37 general insurance companies, 7 life insurance companies, 5 takaful and retakaful companies operating in Pakistan, with market share at 2-3%. The new rules are expected to increase the number of takaful operators as it allows the entry of conventional players with takaful windows. The rules make Pakistan the second country after Indonesia to officially allow takaful windows. However, there has been condemnation. Pakistan's five takaful operators filed a petition in a court in the Sindh province, the country's second-largest Islamic banking market, to challenge the new rules.

The SBP have been active in reforming the Islamic banking industry to ensure competitiveness on the global markets. The central bank is currently working on a 5 year strategic plan for the Islamic banking industry. It announced in September that it would develop rules defining the roles and responsibilities of all those involved in the Shari'a compliance process of Islamic banks, including scholars. Moreover, in November, SBP issued a comprehensive profit distribution and pool management framework in order to improve transparency and bring standardisation to profit distribution and pool management. The results have yet to be published.

Qatar



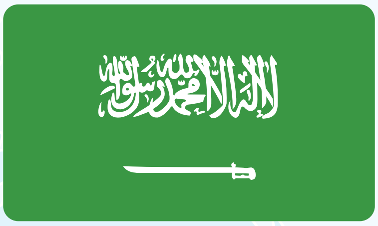
IFCI Ranking 11

Islamic banking assets accounts for an estimated 19.3% of total banking assets. Qatar has fiercely committed itself to creating an authentic Islamic banking industry, without foreign interference. Qatar central bank wishes to extend the ban on conventional banks offering Islamic banking services to those institutions within the Qatar Financial Centre. With different rule books, this may prove difficult; however, in December, the Emir of Qatar approved a law paving the way for a single regulator of all financial institutions.

In July, Qatar issued its first sovereign sukuk. It also happened to be the largest dollar denominated sukuk to be issued. It is a two-tranche sukuk and was priced at USD4 billion. The sukuk attracted an order book of more than USD24 billion. Qatar has benefited from high oil prices, solid economic growth and comfortable budget surpluses. Bond prices of GCC countries have risen strongly as well. Qatar took a step towards facilitating the use of sukuk for banks' liquidity management in March when it launched a regular programme of quarterly sukuk issuance.

The government have supported the Islamic finance industry greatly. The Islamic Development Bank, Dallah Albaraka Group and the Qatari government signed a memorandum of understanding to set up an Islamic megabank with a paid up capital of USD1 billion. The bank is expected to fund infrastructure projects.

Qatar Islamic bank (QIB) is also diversifying both in terms of sector and geography. Qatar Islamic Bank is launching Aamaly, a programme providing special services to the Qatari SMEs. For the first time in Qatar, QIB is introducing specific sectors' related packages to meet the different needs of SMEs starting with the key sectors of construction, trading and services. For each sector QIB is offering tailored package to SMEs. QIB's commitment to the local economy has been recognised. In December, QIB received two awards at the Global Entrepreneurship Week 2012 for its engagement with Qatar Development Bank's 'Al Dhameen' programme, which supports and encourages SMEs in their start up and early development phases.
Qatari institutions are also expanding internationally. Masraf al Rayan is looking to have a strategic stake in a Libyan bank. It has also sought to acquire the Islamic Bank of Britain in the UK. The bank wishes to own 70% of the bank, but will require approval from state regulators. Qatar International Islamic Bank (QIIB) has already injected £20 million of capital into IBB in 2010 after losses at the bank.



IFCI Ranking 03

Saudi Arabia

Saudi Arabia Islamic Finance Assets represent 8.2% out of total Global Islamic Finance assets. There are four Islamic commercial banks operating in the Kingom. They include: Al Rajhi Bank, which has USD58.8 billionn total assets; Bank Al Jazira, which has USD10.3 billion total assets; Alinma Bank which has USD9.8 billion total assets; and Bank Al Bilad with USD7.4billion total assets. Sukuk sales in Saudi Arabia have risen to a new record in 2012 of USD8 billion. It is the third largest issuer of sukuk in the world. Growth of takaful contributions in Saudi Arabia slowed to 12% in 2010 from a compound annual growth rate of 38% during 2005-2009 according to Ernst & Young.

The approval of the Saudi Mortgage Law by the Council of Ministers in July is expected to be pivotal for the housing finance and real estate development market in the industry. The law will help enhance their asset growth potential, strengthen the profitability of retail franchises and increase loan book diversification. The mortgage law is Shari'a-compliant, not only in terms of the mortgage finance contract, but also in terms of the rights of the mortgagee. A mortgage law has been under discussion for three decades but has not been approved until now because of resistance from religious scholars concerned about whether mortgages were compliant with Islamic law. The mechanisms of the law are still enveloped with uncertainty, especially with regards to foreclosure.

HSBC Group will focus its Islamic finance offering on customers in Malaysia and Saudi Arabia, and maintain a limited presence in Indonesia. Through its operations in Malaysia and Saudi Arabia, it will offer wholesale Islamic financing capacity to its global client base. In 2011, Saudi Arabia constituted the largest share of HSBC business. In October, the World Bank and Islamic Development Bank signed a Memorandum of Understanding (MoU) to set out a framework for collaboration between the two parties and lend support to global, regional and country efforts in the development of Islamic finance. The partnership will explore Islamic finance as a potential tool supporting the efforts of countries to reach their development goals.

Other partnerships include renewed efforts between Malaysian and Saudi Arabian Islamic scholars to create common regulations for scholars. The new rules being worked on between Malaysian based International Shariah Research Academy for Islamic Finance (ISRA) and Saudi Arabian Islamic Research & Training Institute (IRTI) will work on guidelines that will address, amongst other things, the number of boards on which scholars can sit to reduce conflicts of interest.

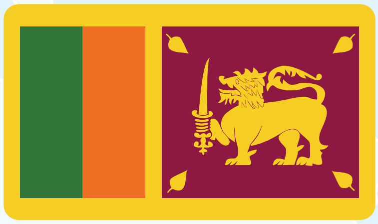
Aside from Islamic finance, Saudi Arabia is also contributing to growth of the halal industry. In February, it held the first ever international conference on halal food in the Middle East, a four day International Conference on Halal Food Control & Exhibition. It attracted over 500 delegates and representatives from more than 20 countries. More than 50 organisations and companies exhibited at the conference.

Singapore

IFCI Ranking 26

Islamic finance in Singapore appears to be slowly fading. While still host of the World Islamic Banking Conference Asia, there is less of a buzz about Islamic finance on the island. There a few notable highlights. MAS set up the Islamic bond programme in 2009, and its wholly owned unit issued USD80 million in March. In November, Singapore investors accounted for 18 per cent of Abu Dhabi Islamic Bank's USD1 billion Tier 1 perpetual sukuk, the world's first Shari'a-compliant Tier 1 perpetual sukuk. In January 2013, Malaysian conglomerate Sime Darby's first US-dollar sukuk was sold in Singapore, Hong Kong, London and Abu Dhabi to enthusiastic response. The USD800 million sukuk received orders of USD8 billion. So while there is an appetite for sukuk, there does not appear to be much else. That being said, according to Maybank Singapore, which offers a range of Islamic finance products in Singapore their customer base has grown more than 40 per cent. But OCSB Singapore and Islamic Bank of Asia appear to be less active in the Islamic banking field.

Sri Lanka



IFCI Ranking 23

There is an expectation that Islamic finance in Sri Lanka will grow exponentially over the coming years. Islamic finance total assets in Sri Lanka account for 3% of the total financial assets of the country. Demand from both Muslims and non-Muslims for Islamic financial services are increasing. Amana Bank, Sri Lanka's only full-fledged Islamic lender set up in 2011, plans to double its branches by expanding into rural areas. In December, Amana Bank introduced the ATM card for its customers. The card enables the customer to access their account from Amana Bank ATM machines at selected branches and over 500 Commercial Bank of Ceylon ATM machines. The Commercial Bank of Ceylon is interested in Islamic finance. The Islamic banking in January 2013 agreed to introduce Islamic microfinance, and will expand schemes island-wide depending on popularity.

In November, Heraymila Capital (Pvt) Ltd. (HCL) and Amana Capital Ltd. (ACL) jointly launched the Amana-Heraymila Shariah Fund, a balanced unit trust fund that will invest in Shari'a-compliant listed equity and income securities. In March, Sri Lankan stock broker Lanka Securities has introduced a Shari'a compliant share list to meet the requirements of both local and foreign Islamic investors on the Colombo Stock Exchange. Lanka Securities, a joint venture between Pakistan's First Capital Securities Corporation, Bank of Ceylon and Merchant Bank of Sri Lanka, said the list will be reviewed on a weekly basis to capture the impact of the price movements of the equities.

Amana Takaful, one of Sri Lanka's fastest growing composite insurers reported an impressive growth of 26% for the 9 months to September 2012, well above the industry's 12.2%. The insurance company has 21 outlets around the country. In addition to Amana Bank, five non-Islamic lenders are also offering Shari'a-compliant services through booths. Hatton National Bank started its Shari'a window in February.

Islamic finance is likely to grow in popularity. Indian based Oasis academy in association with South Eastern University of Sri Lanka (SESUL) is offering a special training program of one month for Students across India.It is a campus based programme in Sri Lanka's SESUL University. The Course will commence from January 2013. The special training programme in Islamic banking and finance is aimed mainly at students and professionals who are seeking to have more than a basic understanding of the concepts and operating principles that apply to different types of Islamic banking in comparison to conventional banking. In this one month's campus program the participant will learn about Fundamentals of Islamic Economics, Foundations of Islamic Banking and Finance, Islamic Commercial Law & Contracts, Islamic Modes of Finance, Islamic Treasury and Capital Market Operations, Takaful and Re Takaful: Principles and Operations. Currently, Pakistan's Meezan Bank is conducting training sessions with the staff of Amana Bank according to an agreement signed by the two organisations in 2011.

IFCI Ranking 21

South Africa

South Africa is preparing to launch sub-Saharan Africa's first Islamic bond. South Africa is leaning towards a dollar-denominated, five-year sukuk, using an ijara structure. The bond would be marketed to Middle Eastern countries. Muslims make up only 2% of the population of South Africa, which has a BBB+ foreign currency credit rating from Standard & Poor's. However, the government is seeking to diversify its investor base, and its Treasury is exploring new funding methods. South Africa's National Treasury appointed six companies, including Standard Bank Group Ltd., BNP Paribas and Albaraka Banking Group to advise it on its debut Islamic bond issue.

Absa is seeking to expand its operations in South African and the rest of Africa. It brought Takafol SA in 2011 as part of its plan to expand its offering of Islamic financial services and products. In December, Absa purchased the majority of Barclays Africa's portfolio in an all-share deal worth R18.3 billion. The deal was part of a strategy by Barclays and Absa to create a dominant retail bank in the region where it would have more than 14.4 million customers and over 1,300 branches. The bank wishes to launch Islamic banking services in certain African jurisdictions including Egypt, Tanzania, Uganda, Ghana and Zambia. Absa are currently the largest Islamic bank in South Africa and is witnessing growth in Tanzania.

While Absa is a leading Islamic bank in the country, and the region, other banks are taking notice of Islamic banking and finance in South Africa. South Africa's First National Bank (FNB) aims to appoint a new Shari'a board for its Islamic finance division by the end of 2012, after the previous board dealt a blow to the bank's effort in the sector by resigning. Its new Shari'a board will comprise of scholars from local and international Muslim communities. The bank is also looking to grow in the rest of Africa and India. While Islamic banking is not a material contributor to its business, FNB is seeking to expand further into this sector over the coming years.

There are no national rules for Islamic finance in South Africa so the Islamic operations of institutions such as FNB, Al Baraka and Absa are under pressure to demonstrate to the public that their Shari'a boards are effective in providing authentic Shari'a advice. FNB had the misfortune of having its previous Shari'a board resign over governance issues. New rules are likely to be in place to ensure greater clarity. Oasis Crescent, one of the world's largest Shari'a asset manager, opened an office in London in 2012 to attract European investors.

IFCI Ranking 09

Sudan

Following the independence of South Sudan in July 2011, North Sudan has been deprived of three-quarters of its oil production. Sudan is struggling with a severe downturn and annual inflation of over 40%. In September, the two countries agreed to restart oil exports from the South through northern pipelines and a Sudanese port, giving both ailing economies a much-needed shot in the arm. Bank of Khartoum plans to sell sukuk as the economic outlook for African country improves in the wake of an oil deal with South Sudan. Sudan already issues sukuk: it offers musharaka sukuk, known as "shahama", four times a year, usually yielding around 16 to 19%. Sudan were also looking to raise USD1.5 billion through sukuk, offering stakes in an oil pipeline, a move the African country hopes will draw more Gulf Arab investment. However, this move has yet to transpire. The Sudanese government are looking to build their Islamic financial capacity. The government has invited Malaysia to help set up Islamic banks in Sudan and boost trade and investment financing between both countries.

IFCI Ranking 13

Turkey

The Turkish Islamic finance sector commands a 5% to 6% of the nation's overall banking assets. Ernst & Young state that Turkish participation banks have expanded every year at an average of 19% and their commercial volume reached USD1.3 billion in 2011. E&Y expects Turkey will increase the size of its participation banks to over USD100 billion over the next few years. Currently only one Turkish participation bank, Bank Asya, is completely Turkish-capitalised. The majority stakes of the other three, Albaraka Türk, Kuveyt Türk and Türkiye Finans, are held by Middle Eastern capital owners.

While the conventional financial sector surpasses Islamic finance, one area where Islamic finance is experiencing growth and even edging conventional banks in Turkey is the provision of private pension via the Asya Pension Fund and in Islamic equity. The bank has opened over 39,000 private retirement accounts so far since the pension fund was created in mid-May 2012.

One of the reasons for the popularity of these funds is that the Turkish government is giving incentives to encourage long-term deposit of the pension funds, offering 25% profit for funds stocked for at least 10 years.

In September, Liquidity Management House (LMH) arranged an ijara sukuk for the Turkish Treasury amounting to USD1.5 billion in cooperation with Citigroup and HSBC. The assets underlying the lease are state-owned buildings and land in Turkey. Currently, the Turkish government exempts ijara sukuk from multiple taxation. Other structures do not have this benefit. This issuance is the first of its kind for the Turkish government. 250 investors have requested to participate in the issuance totalling USD7.1 billion (i.e. 5 times oversubscription coverage). As for the geographical participation, the largest share is coming from the Middle East with 58%, followed by Europe (13%), then Asia (12%), Turkey (9%) and USA (8%). The sukuk is expected to be a benchmark for future issuances from the government and the private sector. Current market conditions for Turkish sukuk issuance appear excellent. Because of unsatisfied investor demand for sukuk, many borrowers have been able to issue Islamic bonds more cheaply than conventional bonds. Turkey's Islamic banks have been depending largely on retail deposits and short-term syndicated loans for funding, and have had limited access to international markets. Sukuks may help Turkish banks to access international markets, as well as help banks reach minimum capital standards. Surprisingly, Turkey’s staunchly secular media argued for the merits of raising funds through sukuk as a means to attract Middle East and Asian investors to the country.

In the same month, Albaraka Turk successfully concluded a murabaha syndication facility in dual currencies with a breakdown of USD293.2 m and EUR124.5 m for a total dollar equivalent of USD450 m with the participation of 32 banks from 16 countries. This facility will be used for diversifying funding sources.

UAE

IFCI Ranking 04

The UAE has what it takes to become a hub for Islamic finance according to Sheikh Mohammed bin Rashid Al Maktoum, the country's vice president and prime minister. In comments made in February, 2013, Sheikh Mohammed stated that the government has a clear vision to build an Islamic financial sector in the country, Sheikh Hamdan Bin Mohammad Bin Rashid Al Maktoum, Dubai Crown Prince and Chairman of the Dubai Executive Council attended the first meeting of the Higher Committee for developing the Islamic-compliant economic sector in Dubai in January 2013. The Dubai government hopes to set up a comprehensive platform for Islamic financial products and services. Commentators are also predicting that Islamic finance will contribute much to the development of infrastructure in the country. Already, the consortium financing the development of Abu Dhabi airport has predominately used Shari’a compliant financing. In June, USD1.25 billion was raised through a sukuk to fund the expansion of the Dubai airport.

Currently, UAE has total assets of USD75 billion and represents 17% of the total banking sector. It has issued approximately USD10 billion worth of sukuk. UAE are keen to amplify the industry in the country. HSBC have left the country, but Standard Chartered, through their Saadiq unit, are hoping to offer Islamic banking services in the country. Islamic banks in the country are growing, and are playing an active role in the development of the industry. According to the National Bonds Corporation, Shari’a compliance is the key factor driving savings decisions among Emiratis and Arab expats. Encouraging a savings culture in the UAE is important given the culture of consumerism. With a growing population, there is a need to ensure the elderly have sound savings.

Al Hilal Bank has teamed up with Emirates National Schools, a series of campuses in the UAE, to offer special Islamic banking and economics courses on the school curriculum, as part of a push by the Ministry of Presidential Affairs to promote financial literacy. Emirates National Schools plans to offer these courses to students up to the age 12 at its three campuses.

In December, Dubai held the Halal Middle East Congress. The two-day event discussed and reviewed halal practices and procedures as well as new opportunities in the global halal industry. Delegates from 37 countries attended the congress, which was organised by the Halal Development Council (HDC) Pakistan with Expo Centre Sharjah.

CHAPTER 4

Dynamic Markets

It is widely agreed among the world's Islamic finance community that Islamic finance is a global phenomenon. Not just in Muslim countries, but non-Muslim countries also find benefits of introducing Islamic finance into their financial markets. UK and Singapore are major examples. These countries mainly focus on their wholesale banking industry, to strengthen its global competitiveness and to better-function as a hub for international finance.

Islamic finance is universal, with products and services intended to meet the needs of diverse communities. Having originated in Muslim countries, it spread quickly throughout the world, and institutions in most countries, have utilised Islamic finance products. Much more needs to be done, but there is no doubt that the spread of Islamic finance will continue.

In this chapter, we explore Islamic finance in Latin America, Russia, Bahrain, India and Indonesia: a cross section of the industry, not only in terms of geography, but also in terms of activity. Latin America remains an unchartered market, but has much potential in adopting Islamic finance, both from a demand and supply side. The market in Russia has seen a little more activity especially in federal subjects such as Tatarstan. The state remains cautious about all things Islamic, but with growing demand – and the strengthening Islamic financial markets in the GCC and the Far East – interest is likely to increase. The government in India, it appears, is far more ambivalent about Islamic finance in the country even through there are over 175 million Muslims (The Economist). India's example shows that even with a large Muslim population, there is no guarantee that Islamic finance will prosper. A lot has to do with government support. In this regard, Bahrain has been at the forefront of developing the global Islamic finance industry, but has recently taken something of a backseat as countries like Malaysia and Saudi Arabia build their Islamic finance capacity. Indonesia, on the hand, is a growing Islamic financial market. With government support strong, and containing the highest number of Muslims, Indonesia is likely to be a foremost player in the global Islamic financial market. These five markets are in different stages, but they are all dynamic markets, and offer lessons to other nations seeking to build their own Islamic financial capacity.

LATIN AMERICA

Introduction

Latin America tends to be regarded as an outsider to the global Islamic financial markets. The Muslim population in this region is a minority as seen in Table 1, making the continent a virtual blank canvass for Islamic finance.

However, there is growing belief that many Latin American countries provide the perfect market for Islamic finance. Many industry observerse believe Latin American countries have the essentials to issue sukuk. Best RE, a retakaful subsidiary of Salama, a Dubai-based Takaful conglomerate, expressed its interest to step into the Latin America in next few years. The general manager feels Brazil would be one of the major targets. Finally a number of training providers in islamic finance have shown interest in launching training services in the region. These examples show that there is an interest to expand Islamic financial services into Latin America.

Table 1: Muslim population in major Latin American states

Country	Estimated Muslim ('000)	% of the total
Argentina	784	1.9
Brazil	191	0.1
Mexico	110	0.1
Venezuela	94	0.3
Suriname	83	15.9
Trinidad & Tobago	78	5.8
Guyana	55	7.2
Panama	24	0.7
USA	2,454	0.8
Canada	657	2.0
Total of Americas	**4,596**	**0.5**

Source: Pew Research Center

Brazil's experience and potential

On the demand side, there is also interest. In 2000, Chase Manhattan Bank and Saudi National Commercial Bank arranged a one year USD50 million Islamic syndicated financing facility. This was intended to finance the import of oil from the Gulf region, mainly the Kingdom of Saudi Arabia. A subsidiary, Petrobras International Finance Company, used an Islamic note programme for their funding in the same year.

One of the most apparent and promising fields on the Islamic finance landscape in Latin America is financing related to the halal food industry, especially poultry exporters in the region (Table 2). Brazil exports a tremendous amount of chicken to the rest of the world, part of which are produced as halal. Producers of halal foods export products to overseas Muslim buyers using Shari'a-compliant financing, typically a murabaha. The local financier has an incentive to provide finance in a faith-based way to attract its Muslim customer base abroad.

Table 2: Brazil's positioning as the leader of chicken exporter

('000 ton)	2007	2008	2009	2010	2011
Brazil	2,992	3,242	2,992	3,181	3,310
USA	2,678	3,157	3,093	3,072	2,971
EU	635	742	783	992	940
Thailand	296	383	379	432	475
China	358	285	291	379	440
Argentina	125	164	178	214	250
Canada	139	152	147	147	155
Chili	39	63	87	79	80
Kuwait	60	70	70	70	70
Ukraine	6	8	19	33	35
Australia	25	27	30	26	30
Others	98	120	144	168	157
Total	**7,381**	**8,413**	**8,213**	**8,793**	**8,913**

Source: USDA

Introducing the Latin America model

Latin American countries can create a new model of Islamic finance development in non-Muslim countries. To date, most non-Muslim countries that have adopted Islamic finance have concentrated on the financial markets: create Islamic financial products to bring in the Shari'a sensitive investor. However, given the importance of exporting halal meat in Brazil, this new model can tie trade with finance. Hence, there is almost a blank canvass from which Islamic financial players can formulate a more trade-based model.

The push for Islamic finance in Latin America has to be investor-led. In February 2012, Almarai Company, the Saudi dairy corporation, acquired stakes of Fondomente Argentina SA, with Islamic and conventional financing. Apparently, the Shari'a compliant portion was due to the investor, as there was no reason for the Argentinean entity to go Islamic. Latin America is also one of the most active destinations for microfinance. According to data by the Microfinance Information Exchange (MIX), the region accounts for 39% of the world's microfinance assets, and ranked at the top, followed by Eastern Europe, East Asia, South Asia, Africa and MENA. As a matter of course, the call for being Shari'a compliant should come from the side of Muslim investors to local microfinance companies, not from that of the local borrowers given that the continent does not have substantial Muslim population as shown in Table1.

Implications of the Latin American model

If we take a more careful look at financial demands in the region, the Latin American model, or more specifically Brazil, is characterised by huge financial demands for (1) export of agricultural products, (2) export of natural recourses such as gold, iron, copper, rubber, timber and coffee beans, and (3) investment in infrastructure projects on the continent.

The Latin American model has analogues elsewhere. The above three aspects can be applied to Australia. It too is a major exporter of agricultural products, rich in natural resources and has huge infrastructure demands. In this sense, building up a classification of the Latin America model, as a sub-set of the non-Muslim model, has a precedent. Australia, with a Muslim population ratio of less than 2% of the total, is already active in incorporating Islamic finance into its system. There are several Islamic financial institutions, including local community banks, offering services. Kuwait Finance House has an Australian subsidiary as an investment arm for local projects. The local banking giant Westpac includes Shari'a compliant services in their product suites. Not only the private sector, but the government is positive. AUSTRADE, the government arm of promoting cross-border trades and investment, published an official report on Islamic finance. The report picks up some promising areas for Islamic finance in the country: agriculture, mineral resources (iron ore, uranium, nickel, etc) and infrastructure. They are exactly same as that of Latin America.

Given this similarity, Latin American countries can learn from Australia's policy measures if they intend to introduce Islamic finance into their jurisdictions. For instance, in Australia, a group of local finance experts, the Australian Financial Center Forum, under the government's initiative published a report titled "Australia as a Financial Centre – Building on Our Strengths". They proposed in the report that taxation and regulatory frameworks should be amended, if necessary, to accommodate Islamic finance transactions. Governments of Latin American nations can follow these steps, given that economic conditions are similar.

Closer ties between Latin America and the Gulf

With globalisation of economic and financial activities reducing communication barriers, Latin American countries are getting closer to Islamic countries. The recently-signed economic agreement between Peru and the GCC countries on economic, commercial, investment and technical cooperation is a very good example. It was developed by the bi-regional cooperation mechanism called ASPA, the Summit of South American and Arab countries (in Spanish, umbre América del Sur-Países Árabes, and in Portuguese, Cúpula América do Sul-Países Árabes). The conflation of food security issues in GCC and conditions for agriculture in Latin America is one of the big reasons for this mechanism. The initiation of comprehensive cooperation is likely to result in a more diversified outcome, including collaboration in Islamic finance.

Outlook

Looking ahead, Islamic finance is likely to develop differently in each Latin American nation. Typically, corporate financing, such as trade finance (mainly for agricultural and resource products) and infrastructure and other investments from Islamic countries are possibilities. Some countries may issue sukuk to attract Muslim investors. Others may want to welcome Islamic microfinance companies to alleviate poverty using Islamic funds. Furthermore, even retail products can be sold in a country like Suriname, the only Islamic country and member of the Organisation for Islamic Cooperation (OIC) on the Latin American continent. If there are signs of growth, ancillary services for Islamic finance, such as education, law and tax, can also be expected. The region can never be a virtually blank area as described in the beginning of this paper.

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BAHRAIN

Bahrain has an established reputation as one of the global hubs for Islamic finance and has played a key role in its development. Although the initial development of Shari'a-compliant finance in the 1960s took place outside of the Gulf region, the subsequent oil boom in the 1970s quickly began to change this. Following the establishment of the Jeddah-based multilateral organisation, the Islamic Development Bank in 1975, Bahrain Islamic Bank, set up in 1978-9, became the second commercial institution in the region providing Islamic finance (after Dubai Islamic Bank which began operations in 1975).

The further expansion of the sector capitalised on Bahrain's position as a leading regional financial hub. Faisal Islamic Bank, subsequently renamed Shamil Bank (and eventually absorbed by Ithmaar Bank in 2010) was set up in 1982. Faisal Bank was, among other things, a pioneer of Islamic syndicated finance which it first introduced in 1987. Al Baraka Islamic Bank began operations in 1983 and has been instrumental in fostering the spread of Islamic finance to other jurisdictions through its subsidiaries in Turkey and Egypt. By 1994, Bahrain was home to five Islamic banks and one off-shore entity. Renewed growth followed during the past decade thanks to the liquidity boom created by rising oil prices. By 2007, Bahrain hosted 27 Islamic banks and 13 takaful companies.

The growth of Islamic finance in Bahrain has benefited from the proactive role of the Central Bank of Bahrain (CBB) (known in 1973-2006 as the Bahrain Monetary Agency), and the existence of multilateral Islamic infrastructure institutions, including the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), The International Islamic Financial Market (IIFM) and the Liquidity Management Center (LMC) as well as a wider array of ancillary financial services.

Industry landscape

Bahrain has historically been the dominant hub of Shari'a-compliant finance in the Gulf region and the number of GCC Islamic financial institutions domiciled in the Kingdom peaked at as much as two-thirds of the regional total. This erstwhile dominance has been challenged somewhat by the growing maturity of Shari'a-compliant finance elsewhere in the region due to new investments and regulatory initiatives. For instance, Oman in 2011 became the last GCC member state to formally authorise Islamic banking.

In spite of the more contested landscape, however, Bahraini Islamic financial institutions have continued to perform well, both in relation to their conventional counterparts and in absolute terms. As of December 2012, Bahrain had 26 Islamic bank licenses, seven takaful companies, and two re-takaful firms. Industry consolidation is clearly underway as the sector evolves and develops, especially in the area of banking where some of the smaller players are joining forces or merging with bigger institutions. Ithmaar Bank last year announced its merger with First Leasing Bank. January 2012 saw the announcement of a three-way merger between Elaf Bank, Capital Management House, and Capinvest to create an international group with assets in excess of USD400 million.

Apart from purely Islamic banks, a number of conventional banks offer Shari'a-compliant products through Islamic windows. Some international banking groups have used Bahrain as the main hub for developing their Islamic product offering. The CBB was the first regulator globally to permit Islamic windows by conventional institutions. As a result of industry consolidation, the number of Shari'a-compliant banks as of January 2013 was 24: six retail banks and 18 wholesale banks.

Islamic finance remains one of the most dynamic areas in the Bahraini financial services sector, reflecting both the growing maturity of the sector in terms of its product offerings as well as the increasing popularity of Shari'a-compliant financial solutions. The consolidated assets of Bahrain-domiciled Islamic banks rose from USD1.9 billion in 2000 to USD25.5 billion in October 2012. As a result of this rapid growth, their share of total banking assets increased from 1.8% to 13.5% over the same time period.

The growth of Islamic banking assets has fairly consistently outpaced conventional bank asset growth, a discrepancy that was particularly pronounced in connection with the onset of the global financial crisis in 2008. Before the global crisis, Islamic banks exhibited extremely high growth rates of around 30%-50% between 2004 and 2008. Since 2010, however, Islamic banks have felt the effects of the regional housing and equity market corrections, reflecting the challenges they still often face in terms of diversifying their asset portfolios. Nonetheless, Islamic institutions have been far more resilient than their conventional counterparts, partly due to their lower leverage levels and lesser reliance on complex products.

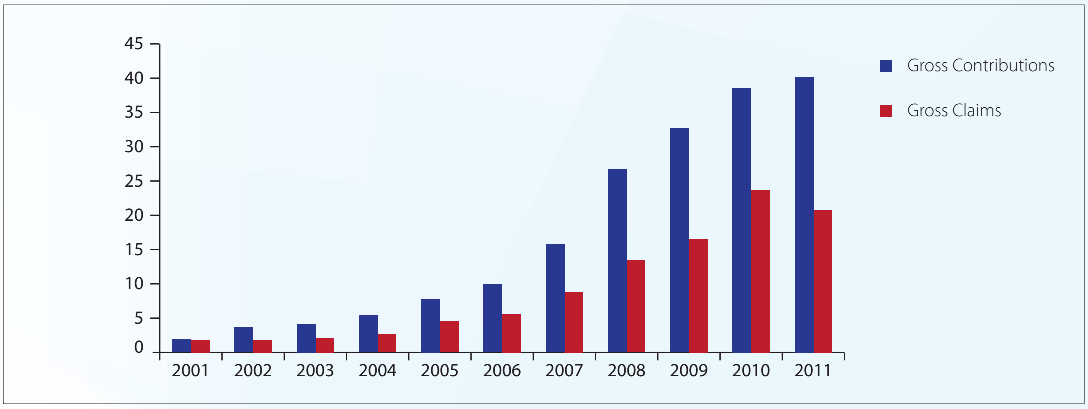
In contrast to conventional banks, most liabilities of Bahraini Islamic banks are domestic (Figure 1).

Alongside Islamic banks, cooperative takaful providers play an important role in the financial sector due to their growing importance in insurance provision, something that reflects Bahrain's broader stature as a regional insurance center. The average annual growth rate of the local takaful sector over the past decade was 35.7%, with gross contributions standing at BHD40.2 million in 2011, compared to BHD1.9 million in 2001. Takaful's share of total gross written premiums/contributions has expanded more than six-fold from 3% in 2001 to 19% in 2011 (Figure 2).

Figure 1: Liabilities

Source: CBB

Figure 2: Takaful insurance industry (2001-2011): gross contributions and gross claims (BHD millions)

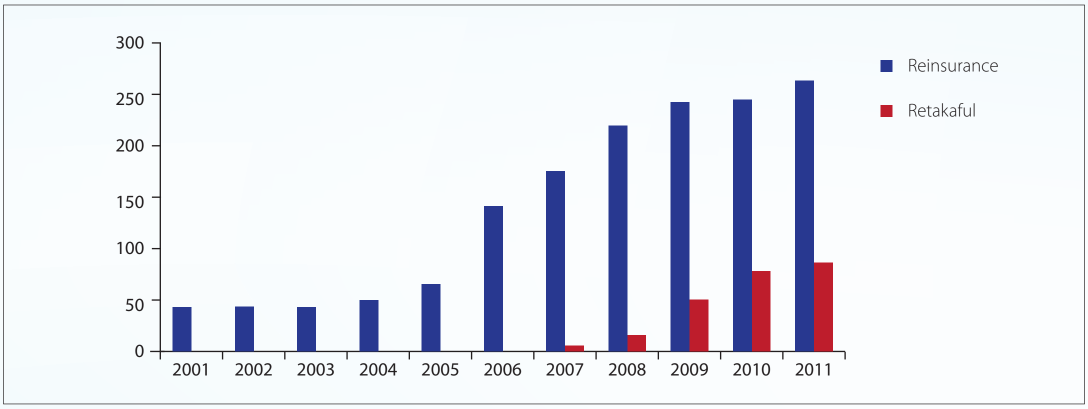


Source: CBB

Gross premiums of the reinsurance and retakaful industries in Bahrain increased from BHD181 million in 2007 (when the first takaful company was established) to BHD349.5 million in 2011, exhibiting a growth of 147% over the four-year period. The premiums of the country's two retakaful companies have increased 15-fold, from BHD5.7 million to BHD 86 million. The retakaful providers held some 25% of the total reinsurance and retakaful premiums in the last two years. Gross retakaful and reinsurance claims reached BHD272.8 million following 261% growth in 2001-2011 (Figure 3).

has been driven by the Bahrain Monetary Agency/ Central Bank of Bahrain which was a global pioneer in regularly issuing sukuk starting in 2001, primarily for the purpose of providing Islamic financial institutions with quality liquidity management tools. The first BMA sukuk al salam was issued in June 2001. It was a three-month bill initially issued with a monthly volume of USD25 million with the underlying al salam contracts based on aluminum. The first five-year USD100 million government sukuk al ijara was issued in August 2001, the first of its kind by any central bank in the world. In 2002,

Figure 3: Reinsurance and retakaful Firms, 2001-2011: gross premiums/contributions (BHD million)



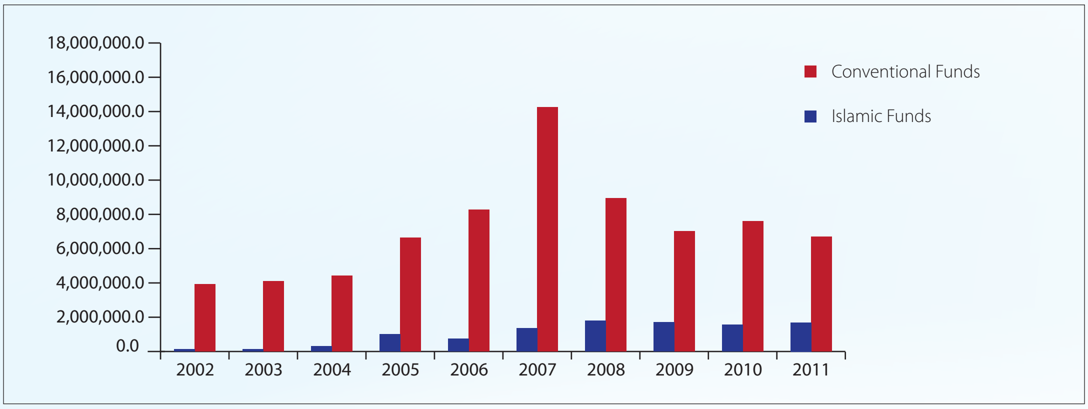
Source: CBB

Other Islamic financial institutions in the country include one rating agency, two financing companies, one microfinance bank, and one credit card company. In addition, Bahrain is home to Islamic investment firms and Islamic funds. Overall, Bahrain's mutual funds industry has more than USD9 billion in assets. Islamic funds domiciled in Bahrain numbered 101 of the total of 2,838 and had combined assets of USD1.7 billion as of 2011, which compared to just under USD1.6 billion in 2010. Shari'a-compliant vehicles accounted for around 20% of total fund investments in 2011, up sharply from a mere 3% in 2002 (Figure 4).

the government issued a USD70 million, three-year ijara sukuk. The CBB now issues sukuk al ijara regularly with a six-month tenor. The total new CBB sukuk issuance in 2011 reached BHD858 million (Figure 5).

The CBB also arranges sukuk issuances for the Government of Bahrain. The government most recently issued a seven-year USD750 million sukuk in November 2011. Much of the longer-term issuance over the years has also been listed on the Bahrain Stock Exchange (Bahrain Bourse).

Figure 4: Islamic funds vs. conventional funds



Source: CBB

Islamic capital markets

Bahrain has been a regional pioneer in developing Shari'a-compliant capital market products. The process

Central Bank of Bahrain

Since its establishment in 1973, the CBB has actively promoted Bahrain as an international financial center.

Figure 5: New sukuk issuance 2001 - 2011 (BHD million)

Source: CBB

It has, similarly, been a key enabler of Islamic finance through regulatory initiatives and the development of new products and market infrastructure. It provides guidance to the industry through ongoing consultations with various stakeholders and research. In many cases, its initiatives have marked world firsts. For instance in 2001, Bahrain became the first country in the world to develop and implement regulations specifically for Islamic banking through the CBB's comprehensive Prudential Information and Regulatory Framework for Islamic Banks. The implementation of this regulatory framework began in 2002 and it has been repeatedly updated. CBB regulation has sought to equalise the operating environment facing conventional and Islamic banks. Also the takaful/retakaful rulebooks, approved in 2005, provided the first comprehensive regulatory framework in the international Islamic finance industry. Bahrain's Collective Investment Undertakings regulations provide for the establishment of Shari'a-compliant funds. The CBB has actively supported the standardisation of products and practices in the industry by supporting and working with various standard-setting bodies in the sector (see below), in many cases formally mandating their recommendations.

Apart from its role as a proactive regulator, the CBB in 2006 established a dedicated fund – the Waqf Fund – to support research as well as education and training in Islamic finance. The fund was created with the participation of the leading Islamic banks in the Kingdom. The fund currently has 21 member institutions. The fund spends its returns on a number of training, education, and research initiatives. These include a Graduate Sponsorship Program established in 2011 which funds a six-month diploma program for 25 graduates every year. Training programs include a Shari'a Reviewer Development Program and an Advanced Diploma in Islamic Commercial Jurisprudence. In addition, an Islamic Banking Ethics for Bankers course is under preparation.

The Waqf Fund supports the Bahrain Institute of Banking and Finance in upgrading its programs for Shari'a financial professionals, arranges occasional roundtable discussions among industry participants and Shari'a scholars on topics of importance, and has also organised a number of corporate governance workshops for industry professionals. The CBB is also an active sponsor of industry events and conferences.

Infrastructure institutions

As mentioned above, Bahrain is home to a number of important multilateral institutions supporting the development of Shari'a-compliant finance globally. These entities typically came into being as a result of joint initiatives involving national regulators and the Islamic Development Bank. The first one of these was the **Accounting and Auditing Organisation for Islamic Financial Institutions** (AAOIFI) which was established in 1990 and began operations in Bahrain the following year. The main objective of the organisation was to establish accounting and Shari'a standards for Islamic institutions. The CBB was the first central bank to make the AAOIFI standards mandatory within its jurisdiction. At present, seven Middle Eastern jurisdictions have adopted the AAOIFI standards while six others, most of them outside of the region, have issued guidelines based on them. The organisation has prepared 26 accounting standards, five auditing standards, seven governance standards, two ethical standards, and 45 Shari'a standards. 18 new standards are currently under preparation.

The **International Islamic Financial Market** (IIFM) was established in November 2001 to create a structured global financial market and to foster cooperation among Islamic countries and financial institutions. Specifically, the IIFM has sought to foster the development and self-regulation of Islamic capital and money markets. It has been a key player in developing standardised structures and contracts for Islamic capital markets while improving products and market infrastructure. Current initiatives include further work to build on existing efforts to develop frameworks for Islamic hedging, master agreements for Islamic treasury murabaha contracts, and a framework for a secondary market for sukuk and other Islamic instruments. The IIFM works with market participants ranging from regulators to financial firms, lawyers, stock exchange, industry bodies, and other service provides through working groups and committees which are open to non-members as well.

Bahrain is further home to the **Liquidity Management Center** (LMC) which was set up in February 2002 with the objective of creating an active secondary market for the treasury management of Islamic banks. The center seeks to facilitate the creation of an Islamic interbank money market which can enable Islamic financial institutions to manage their liquidity with ease and efficiency. The initial objective was to cut the reliance of Shari'a-compliant institutions on commodity murabaha transactions by creating a pool of liquid assets for Islamic financial institutions to trade in so as to manage their asset-liability mismatches. In order to develop longer-term assets for the industry to investment, the LMC has operated as a sukuk arranger. It has further advised the CBB on the development of its sukuk program.

The **Islamic International Rating Agency** (IIRA) began operations in July 2005 following an IDB initiative. It is a leading provider of credit analysis and ratings on Shari'a-compliant products and institutions. The Fiduciary Rating System of the IIRA is based on recognising the mutual dependent nature of credit and fiduciary risks in Islamic financial institutions. It is composed of a Credit Rating and Fiduciary Score. The Fiduciary Score seeks to accommodate the specific qualities of Islamic institutions as well as jurisdiction-specific variation in Shari'a standards. The score is based on Corporate and Shari'a Governance, Shari'a Compliance, and Asset Manager Quality. IIRA ratings are recognised by the Central Bank of Bahrain and the Islamic Development Bank. IIRA is supported by multilateral development institutions, financial service providers, and other rating agencies. Its shareholders are financial institutions representing 11 countries which are the primary focus jurisdictions of the agency.

The **General Council for Islamic Banks and Financial Institutions** was established in May 2001 by the Islamic Development Bank and a number of Shari'a-compliant financial institutions with 39 members participating in its initial session. It serves as a coordinating body for Shari'a-compliant financial institutions. It disseminates information about the sector through events and publications. It supports its members through a range of training programs, typically provided jointly with external partners. An example is the globally recognised Certified Islamic Bankers qualification launched in 2010. The General Council currently has 114 members, 48 of whom are observers.

In the area of financial education and training, the **Bahrain Institute for Banking and Finance** (BIBIF) is recognised as one of the regional leaders. The BIBF was founded in 1981 and now provides more than 300 programs in different areas. More than 18,000 people participated in BIBF programs in 2011, up from just over 6,000 in 2000. The institute has, among other things, played a key role in providing training and education programs in the area of Islamic finance. The BIBF works closely with a number of international partners provided internationally recognized qualifications from DePaul University and the University of Cambridge. Apart from training programs, the BIBF operates a Center of Assessment and Development as well as a Center for Research. The BIBF has been repeatedly recognised as the leading global training provider for Islamic finance and has received a number of other international awards.

The **Shari'ah Review Bureau** is a leading Shari'a advisor active in a number of Middle Eastern, North African, and Asian countries. The Bureau provides access to Shari'a experts, produces fatwas and offer structuring solutions.

Outlook

Bahrain clearly enjoys an important position in the evolving landscape of global Islamic finance and is increasingly being joined by other players in the region as they develop their own Islamic finance industries. At the same time, Islamic financial services in Bahrain are going through a process of consolidation and refocusing reflecting the challenges and opportunities created by the global financial crisis and the industry's evolution. The end result of the process is likely to be a smaller number of more focused but stronger Shari'a-compliant service providers.

Bahrain will continue to play an important role as an innovator thanks to the concentration of a number of globally significant service providers and the growing global demand for better products and services. Innovation will continue to benefit from the presence of a proactive regulator committed to the development of the sector. Beyond this, the importance of Bahraini training and education institutions will likely remain particularly important at a time when Shari'a-compliance is taking shaping and experiencing the phase of rapid initial growth in a number of countries in North Africa, Asia, and elsewhere.

Introduction

Interest in procuring Islamic financial products in Russia is constantly increasing but the potential is still under-estimated. Given that many Muslims have no choice but to use the services of conventional banks, such potential has yet to be fully realised. Islamic finance attracts investors and businessmen, and while there is much discussion on the issue, development of the market remains slow. There might be two reasons explaining the situation: either demand has not matured - people are not interested in the products thus requiring more marketing efforts from service providers - or suppliers do not meet the expectations of the Muslim population. Reasons can also be found in legislation, which is shaped for the conventional banking system, thus, though unintentionally, putting obstacles for the smooth operation of Islamic finance instruments. On the other hand, market potential may in fact be very limited.

Despite the aforesaid, there were several highlights in 2012. In September 2011, AK BARS Bank executed the first USD60 million murabaha transaction, a syndication with foreign banks. In September 2012, the facility was successfully repaid. The bank is now aiming to renew and increase this facility.

The success of AK BARS illustrates that Islamic finance instruments have the capability of attracting funds for medium and large size projects. In this regard, there are real business opportunities within this sector that needs to be capitalised upon.

The retail market

Muslims in Russia are increasingly bringing Shari'a values to their day-to-day lives, although within parameters permitted by the Russian law. Bankers are acknowledging the importance of religion in determining choices, and are offering Shari'a compliant products to the retail market.

Ellips Bank, the regional bank with its head office located in Nizhny Novgorod, opened its Islamic branch, Vostok Capital in Ufa, another major Russian city recognised by Forbes as the second most attractive city for investment. Ufa is the capital of Bashkortostan, a major Muslim region in Russia, along with Dagestan and Tatarstan.

Vostok Capital offers its clients ijara, mudaraba and qard based products. The client base is growing, currently below a thousand customers, but the bank itself considers this positive given the general status of Islamic finance in Russia. The bank also provides clients with the standard number of banking services in Russia: money transfer, sale of precious metals and gold/silver coins, salary cards, etc.

The paucity of products on offer is in large part due to the fact that not all Shari'a contracts can be executed by commercial banks in Russia as certain requirements of these contracts come into collision with Russian banking legislation. For instance, musharaka contracts presume that the bank acts as the co-investor. The bank has to buy a part of the business. One of the most important characteristics for each bank is the size of the equity capital. According to the Regulations of the Bank of Russia No. 215: "About the Methodology for the Evaluation of the Equity Funds (capital) in Credit Companies", the equity capital of the bank is to be diminished by the amount of funds which have been invested by the bank in the equity capital of subsidiaries or affiliated companies (in case where the bank holds at least 20% of the equity capital of such a company). This means that it is not efficient, or cost effective, for banks to massively invest in the projects which lead to the diminishment of the equity capital of the bank itself. In Islamic finance institutions, most of the funds are deposited under mudaraba or wadia structures. Mudaraba cannot be classified as a deposit under Russian law and wadia-based agreements guarantees the refund of the deposit but it doesn't guarantee the interest. According to Russian banking rules, the deposit agreement is to guarantee the refund and the interest. The mudaraba agreement does not guarantee reimbursement. As Russian Muslim depositors have got used to the banking system with guaranteed principle and interest, they do not want to take this risk even in the case where the risk is justified by the Shari'a.

The ijara-based product, offered by Ellips Bank, attracted attention of borrowers looking to purchase vehicles. Here the bank has faced some difficulties related to central bank rules. Among them, a high number of movables (i.e. cars) itemized on accounts, a situation which is not standard for Russian banks. The bank will have to create an SPV to transfer the physical property in order to offer this product.

Notwithstanding these facts, the bank itself has an optimistic view on business growth. Knowledge of the bank is spreading throughout the city of Ufa with more Muslims showing interest in the bank's products and services. On the back of this, Vostok Capital plans to launch a murabaha based product soon. Moreover, the bank aims to open new offices in other cities of Russia including Moscow.

It is worth mentioning that the employees of the bank take part in advancing the idea of Islamic finance among students, workers and businessmen. They speak at seminars where Muslims can receive basic knowledge on the principals of Islamic finance. Chief executives of Vostok Capital also manage a popular on-line social network service in Russia in order to get feedback on the quality of services and inform (potential) clients on new offers and products.

In 2012, Lariba Finance ("Lariba") was incorporated in Dagestan. The limited partnership structure, which is analogous to the mudaraba, allows general partners to receive funds from limited partners and provide Muslims with halal funds. The project quickly gained credence in the community. One of the major factors for this is the fact that the monetary contribution of limited partners was guaranteed by the largest bank in the region, Express Bank, which itself had intended to open an Islamic window, but strict banking rules prevent attainment of this goal.

Lariba has been working without any external funding. With about 30 limited partners acting as depositors, Lariba has been able to provide nearly 200 clients with funds. The return on the capital invested by some major limited partners reached 18% for 2012.

The central product for Lariba is the mudaraba. Each client may become a limited partner and contribute to the capital of the partnership. Remuneration is paid on a monthly basis depending on Lariba investment activities, time of the deposit and the deposit amount. Earnings could reach 30%.

In a murabaha transaction, Lariba acquires the asset and sells it to the client at the initial price plus a margin. The company which acquires the asset becomes the legal owner of it. The amount stated in the contract cannot be changed upward (in case of the late debt repayment) or downward (in case of the early payment).

Solvency is secured by the assets which are received from the borrowers as pledge. According to Russian banking rules, individual savings in banks are insured by the Russian Federation subject to the depositor bank being a participant of the federal program on savings insurance. The amount of guaranteed savings to be refunded by the State cannot exceed RUB700,000 (USD23,400). By taking the borrowers property as pledge, limited partners have more security.

In addition to financial services, Lariba also provide their clients with accounting and consulting services. This is useful as limited partnerships, as a form of incorporation, are not that popular in Russia. General partners are held fully and jointly liable by their own property for all the debts of the limited partnership owed to the creditors, a feature that can be a burden for the business. Most businesses in Russia use another form of incorporation, limited liability company, which is flexible, simple and limits investor liability by the amount of their investment.

Lariba is a step in the right direction for Islamic finance in Russia, but there are several obstacles confronting the organisation. First, the absence of rules and regulations aimed specifically at Islamic finance. Secondly, there is an absence of qualified professionals who would be able to advise on complex transactions. Thirdly, there is a lack of knowledge on how the Islamic model of economics should work. Finally, there is still suspicion from state institutions on activities related to Islam.

The insurance market

In 2012, ISK Euro-Policy commenced the sale of Shari'a compliant insurance policies in Kazan, capital of Tatarstan, one of the brightest Islamic centers in Russia with a high ethnic Muslim population.

ISK Euro-Policy offers a limited number of products (in comparison with conventional insurance companies): comprehensive motor cover, world travelers insurance and property insurance (for both individuals and companies). The insurance company is expected to receive a license to provide obligatory motor insurance to customers soon. It has already insured the cathedral mosque of Kazan, Al-Marjani - the oldest mosque of Kazan built in circa 1770.

ISK Euro-Policy plans to sell at least 150 insurance policies in a city with over a million inhabitants. This is quite a low amount, but with a lack of insurance products on offer, choice is limited. Nevertheless, the company does have an optimistic view on the future of takaful in Russia, although insurance rules and standards impose limitations on the use of insurance funds for investment. In some circumstances, insurance funds may be invested in non-Shari'a compliant activities. Shari'a also limits the use of takaful fund resources.

The incentives of local authorities

A proposal for SmartCity, a large, ambitious project to develop a business suburb in Kazan, Tatartsan, was presented to the President of Tatarstan in July 2012, and upon approval has been successfully promoted among investors. SmartCity is aimed at the creation of a regional and international business hub in Tatarstan, as well as a major exhibition and conference center. Islamic financial instruments are going to be one of major sources of financing of this project. The project has significant Malaysian participation: AJM Planning and Urban Design Group and Amanah Capital Group have been involved. The project is supported by governmental bodies, Tatarstan Investment Development Agency and JSC Tatarstan Development Corporation.

Outlook

As demonstrated by developments in 2012, Russian financial institutions, businesses, government agencies and the general population have become more involved in Islamic finance projects. Major restrictions in the development of Islamic finance are to be found in banking and insurance rules and standards. However, these restrictions are justified by the intention of the authorities to minimise possible fraud in the conventional banking system of Russia. The system itself was established only in 1990s so it has not had enough time to fully develop.

Further progress of the Islamic finance industry in Russia requires a) assistance and advise to businesses willing to be involved in Shari'a compliant activities; b) knowledge dissemination; c) efficient cooperation with investment banks and funds prepared to invest in projects; and d) choice of efficient instruments for attractive investment projects, ready to structure in a Shari'a compliant way. In any case, Islamic finance sector can grow from stand alone deals into a niche market, potentially available to a larger number of domestic businesses.

Following success of Islamic windows in Kazan and Ufa, it is expected that in 2013 we will see opening of Islamic windows in Moscow. Within Russia, it is reasonable to expect that not only Tatarstan and Bashkortostan, but other Russian regions, including non-Muslim parts of Russia, will become more involved in Islamic finance projects.

Two local banks in Tatarstan, among which is Tatagroprombank, announced Islamic finance programs. Tatagroprombank is implementing trade finance products. Another Tatartain bank intends to execute an Islamic finance program worth USD 100 million. The program is focused on financing local Shari'a compliant projects with the use of Islamic finance instruments.

Following Russia's accession in 2012 into the WTO, the Russian market will become more open for foreign products and services, so more halal products and services may be imported. Banking restrictions is expected to be changed. Overall, the Russian business community and retail customers will receive access to a larger volume of products and services, while foreign players will become more active in the Russian market. This bodes well for Islamic finance in the country.

INDIA

Introduction

In recent years, India has emerged as a prominent economy. At present it is the 10th largest economy in terms of size, and in terms of purchasing power parity (PPP) India has become the 3rd largest economy after the USA and China. A BRIC Report has projected India to become the world's largest economy by first half of this century. Since launch of full-fledged economic reforms in the early 1990s, there has been enormous change in the Indian financial market, and it has now become more transparent and investor friendly. Regulators of the financial market - the Reserve Bank of India (RBI), Security Exchange Board of India (SEBI), Insurance Regulatory and Development Authority (IRDA) - have worked in tandem to bring discipline and transparency in working of Indian financial institutions and products. The country's legal system has proven robust in checking any aberrations. The financial market has deepened and foreign investors have shown confidence in the Indian market.

However, one area where India is still considered laggard - and not without reason- is the area of Islamic banking and finance. Many believe India to be the birth place of modern day Islamic economic thinking, and considering the huge numbers of Muslim citizens, India should have been a leading destination for Islamic finance. But owing to rigid banking laws in the country, Islamic banking and finance has not really picked up pace. Among the three major regulators, mentioned above, only SEBI (the capital markets regulator) has shown commitment and resilience to allow Shari'a compliant products in the country. There are some other positive developments which are covered in this brief report.

Notwithstanding this, the future of Islamic finance in India is highly promising primarily owing to the direction in which the Indian economy is heading and the growing number of Muslim youngsters who have been asserting their preference for Shari'a compliant products. Today we see many Shari'a compliant products in the Indian market although the quality and quantity requires improvement.

Islamic mutual funds

A mutual fund is a capital market product, and provides retail investors avenues to deploy their funds in an interest free manner. Under this category, the fund is invested in Shari'a compliant equities. This provides an alternative to retail investors who do not wish to save their money with a conventional bank. At present, there are two Shari'a compliant investment schemes launched by mainstream capital market players. Both are hundred per cent equity based investment schemes.

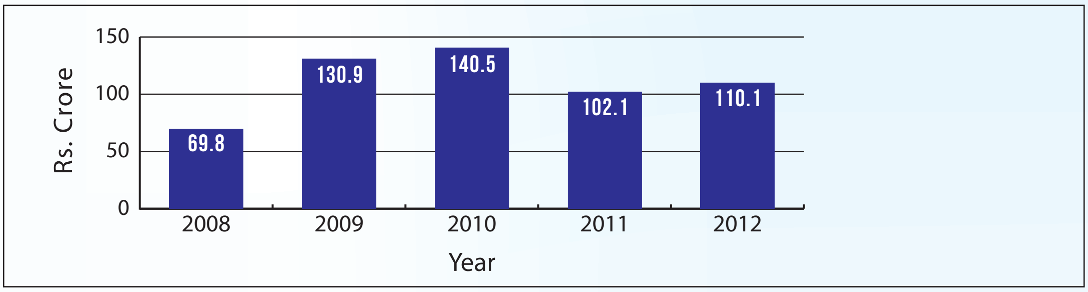
1. Tata Ethical Fund

TATA Ethical fund is India's first Shari'a compliant mutual fund scheme launched in 1996. The scheme is an open ended equity fund with a mandate to invest only in Shari'a compliant stocks. The scheme has two variants (growth and dividend); presently the size of the fund is Rs110 crore (USD23 million) which has grown with a CAGR of 9.54% over a period of five years 2008 to 2012 (Figures 6 and 7).

2. Taurus Ethical Fund

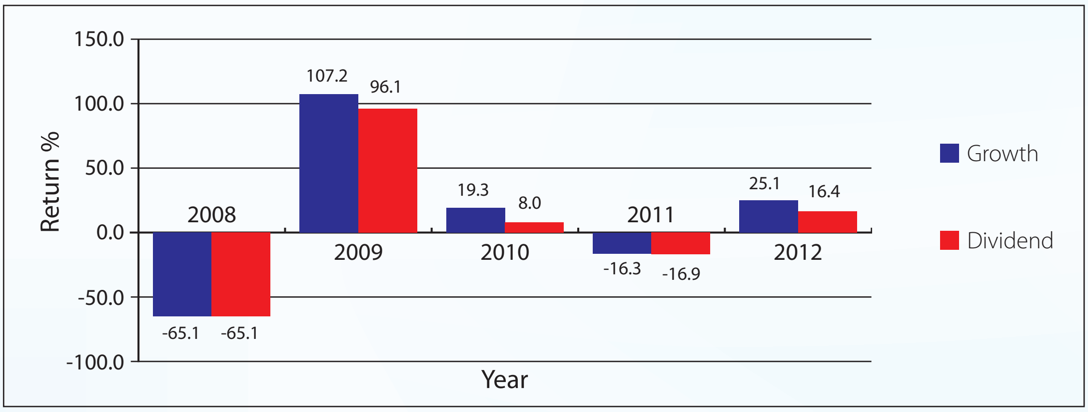
This is India's second Shari'a compliant mutual fund scheme launched in April 2009. The scheme has three variants: Growth, Bonus and Dividend. This is also an open ended equity oriented scheme which invests only in Shari'a compliant stocks. The present size of the asset under management is Rs25 crore (USD4.6 million). The AUM from 2009 to 2012 has grown with a CAGR of 20.63%. The scheme offered return of approximately 99% in the year 2009 which declined to approximately 12% in the year 2012 (Figures 8 and 9).

Figure 6: Tata Ethical Fund AUM



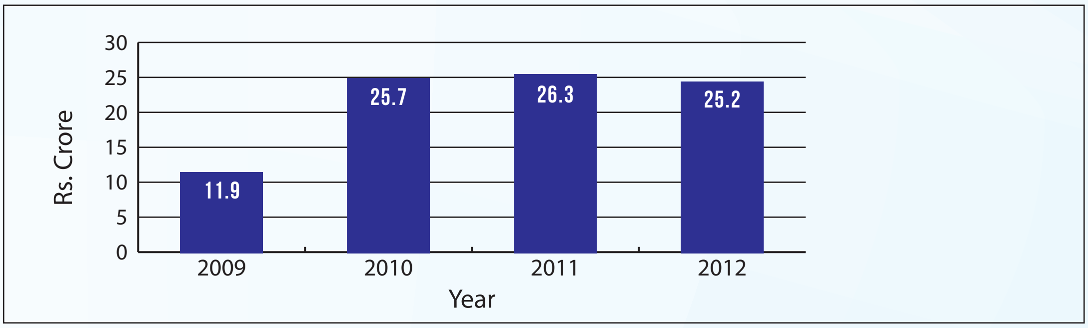
Source: moneycontrol.com

Figure 7: Tata Ethical Fund Absolute Annual Return (AAR)



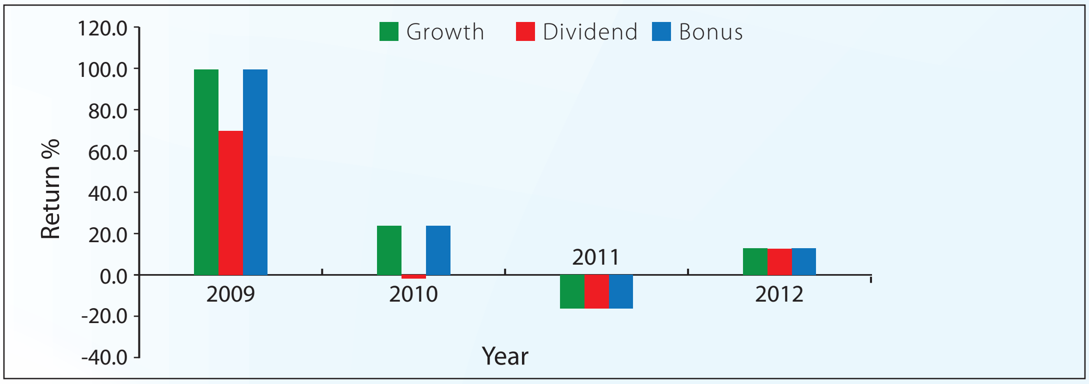
Source: moneycontrol.com

Figure 8: Taurus Ethical Fund AUM



Source: moneycontrol.com

Figure 9: Taurus Ethical Fund AAR (%)



Source: moneycontrol.com

Takaful and retakaful

Formally, the Islamic insurance market is not open in India as yet. According to IRDA regulation, an insurance scheme must offer insurance cover (Shari'a non-compliant at the moment) and also offer guaranteed return. This is a recent change in regulation after a spat between the two regulators (SEBI and IRDA) over regulating certain types of products. The new changes were brought to distinguish insurance activities from purely an investment activity. The new IRDA regulation to offer guaranteed returns to the insured makes it compulsory to invest (at least a portion) in fixed income securities.

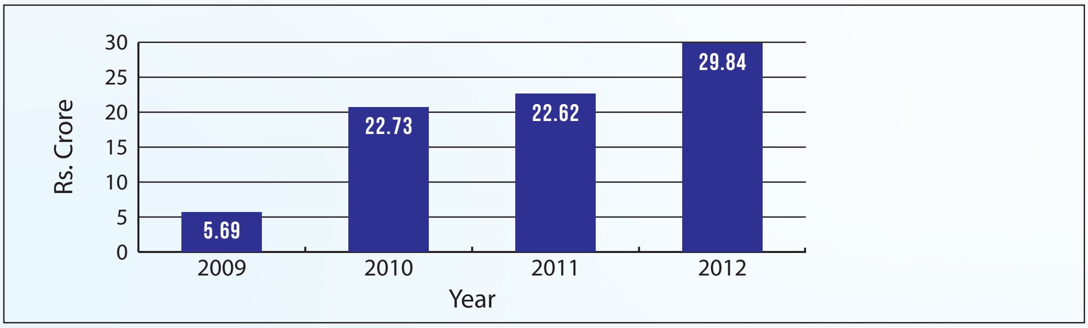
1. Pure Stock Pension Plan (PSPEN)

This was India's first Shari'a compliant pension scheme launched by Bajaj Allianz in 2009. The scheme was launched a year before new IRDA regulation came into force. Since the new regulation was not implemented retrospectively, the scheme continued after the regulation for existing investors. However, the scheme cannot invite new customers without compromising on Shari'a compliance (since premiums collected from new customers were required to be invested in debt securities). Though Bajaj Allianz under PSPEN scheme cannot add new customers, they have efficiently managed the funds of existing customers. The AUM of PSPEN in 2009 was Rs5.69 crore (USD1.04 million), and in 2010 it reached to Rs20.73 crore (USD3.81 million), an increase of 264%. After the new IRDA regulation, the fund only managed to grow to Rs22.62 crore (USD4.17 million)in 2011. Since the launch in 2009, and over the period of four years, AUM has grown with a CAGR of 51.33%. (Figure 10 and 11)

2. GIC Retakaful

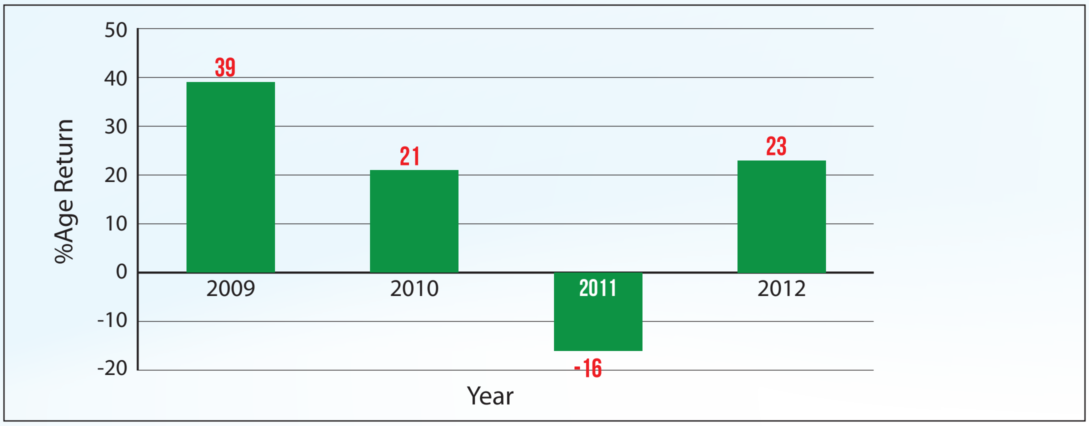
The General Insurance Corporation of India (GIC) is an Indian government owned reinsurance company. To capture the takaful market in the Middle East, GIC introduced a retakaful scheme. The scheme was launched in the 2009 and since then it has achieved decent growth. GIC Retakaful has been extended to South East Asian countries. Contribution collected from the UAE forms the major portion of the total premium collected. The average percentage of contribution collected from the UAE to total contribution is 87.8%. Data shows that GIC's market base is strongly growing in Malaysia. Contribution collected from Malaysia in 2011 was Rs0.11 crore (USD20,200) which increased to Rs6.5 crore (USD1.2 million) in 2012. The net takaful fund (after meeting claims) increased 5.4 times from 2010 to 2011. In 2011, claims were high which led to reductions in the fund (Figures 12 and 13).

Figure 10: PSPEN AUM



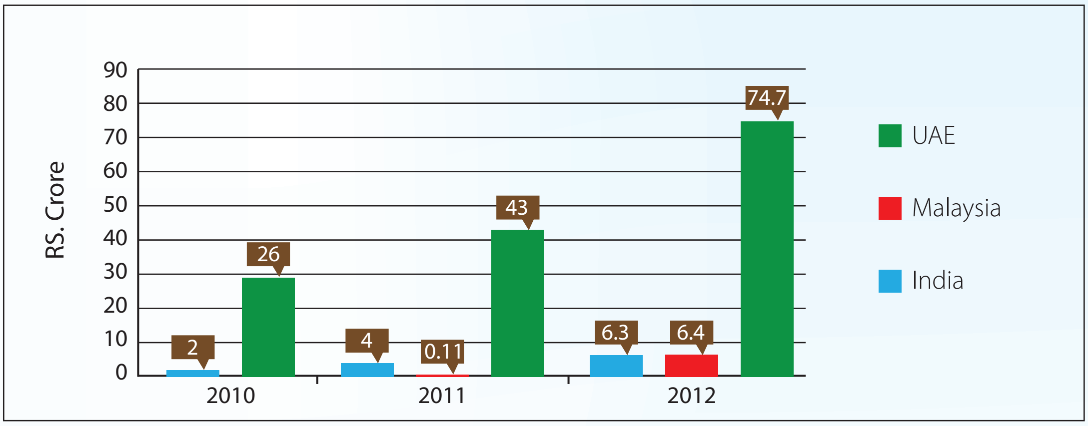
Source: Bajaj Allianz

Figure 11: PSPEN AAR (%)



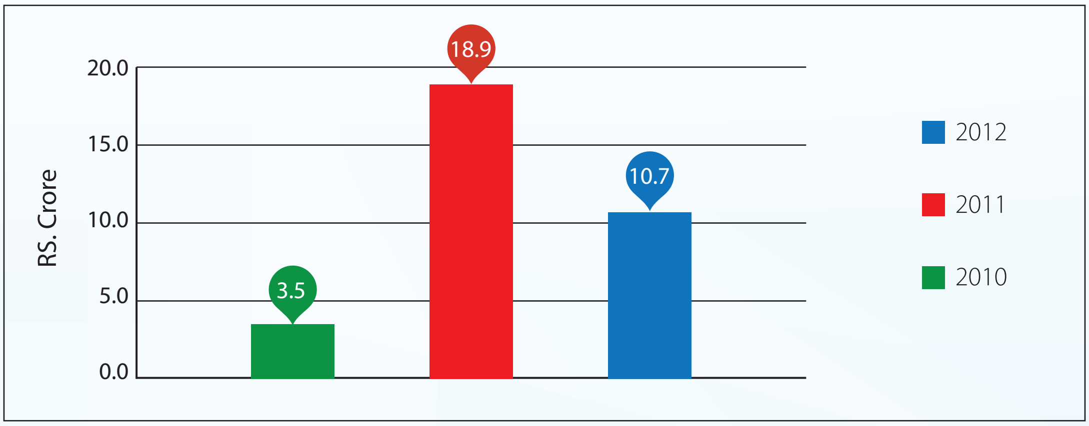
Source: Bajaj Allianz

Figure 12: GIC Retakaful gross takaful contribution



Source: GIC

Figure 13: GIC Retakaful net takaful fund



Source: GIC

Commodity markets

The National Spot Exchange Ltd (NSEL) is a commodity exchange for spot trading of bullion and agricultural commodities. In 2010, they introduced a series of innovative products called E-series. The first products launched under the E-series categories were E-Gold, E-Silver and E-Copper. Later, E-Zinc, E-Lead, E-Nickel and, recently, E-platinum were added. These E-series products are certified by the Indian-based Shari'a advisory firm, TASIS. These E-series products enable even small investors to invest and keep their holding in demat form. The equivalent amount of each E-series product's unit (traded in market) is stored in the vault of NSEL in physical form. The vault is regularly inspected by TASIS to assure Shari'a compliance. Investors are also provided the option to take physical delivery of the E-series products.

If we analyse the performance of the bullion (E-Gold, E-Silver), they have provided healthy returns to their investors over a period of time. E-Gold, over the period of three years, has given an average return of 17.8% per annum, whereas E-Silver has given an average return of 20.05% per annum over the same period. (Figure 14 and 15).

Venture capital

1. Secura India Real Estate Fund Domestic Scheme 1

Secura India Real Estate Fund (Domestic Scheme 1) is the first Shari'a compliant real estate scheme in India which is approved by SEBI as a venture capital fund. The funds raised have been invested in potential real estate projects and now the scheme has matured with 18% return to its investors. Immediately upon successful completion of Scheme 1, Secura announced the launch of Scheme 2.

2. Cheraman Premium Fund 1

This is India's second Shari'a compliant venture capital fund launched by the Kerala government, and promoted by Al-Barakah Financial Services Ltd (a subsidiary company of Kerala State Industrial Development Corporation, KSIDC). The fund is initially targeting Rs250 crore (USD46 million) with green shoe option of another Rs50 crore(USD 9.21 million). Another unique feature of this fund is that it will develop idle waqf properties in the state on the basis of musharaka.

Figure 14: E-Gold and E-Silver price performance

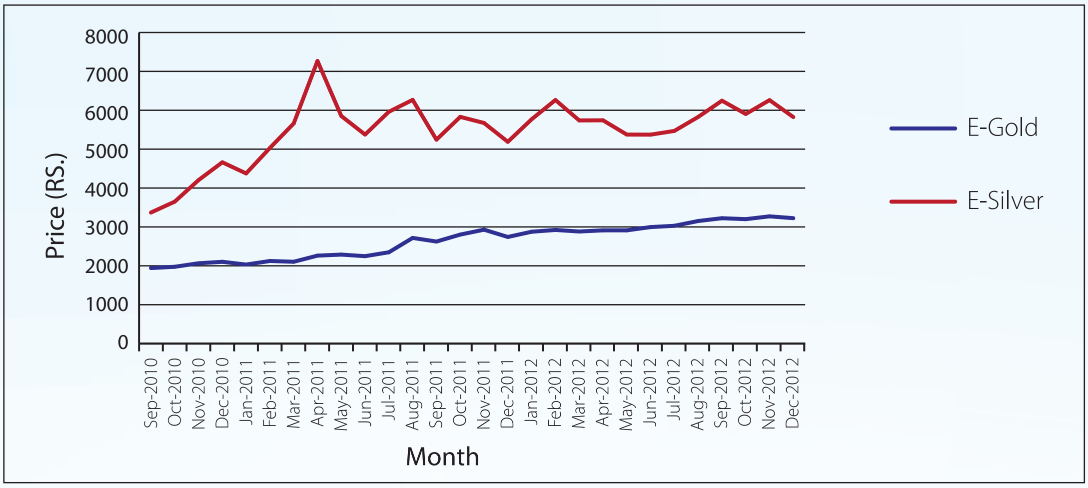


Figure 15: E-Series absolute annual return

PRODUCTS	ABSOLUTE ANNUAL RETURN (%)			RETURN SINCE LAUNCH
	2010	2011	2012	
E-Gold	8.30	30.36	14.76	65.62
E-Silver	38.34	11.30	10.51	72.06
E-Platinum			5.50	5.50
E-Copper	18.17	-9.33	5.37	13.22
E-Zinc		-9.48	8.89	-1.43
E-Nickel			-14.23	-14.23
E-Lead		-11.62	14.33	1.04

Source: NSEL

Conclusion

In this brief exposition of the Indian Islamic finance market, one can see that there is activity in the market, in a number of different sectors. We have concentrated primarily on commercial markets, leaving aside the retail sector which has yet to experience a significant boost. However, just as in the UK, by focusing on high-end investors, there is potential for a trickle down effect, especially in a country that contains 177 million Muslims (To compare, Pakistan has 178 million, while Bangladesh has 149 million). India proves that it is not the size of the Muslim population, but the willingness of the government to promote and push forward Islamic finance. Undoubtedly, with the growing interest in this sector, it is likely that the government will be more proactive in developing the market.

INDONESIA

In 2012, Indonesian Islamic banking experienced a slowdown in growth due to the impact of the global economic crisis on the country's economic growth. Additional factors such as the decline of deposits, partly because of the withdrawal of hajj pilgrimage funds from Islamic banks, contributed to the slowdown in the growth of Islamic assets, compared to the previous year.

Statistics on Islamic banking development up to October 2012 show that Islamic banking services are increasingly widely spread throughout the archipelago with as many as 11 Islamic commercial banks (BUS), 24 Islamic Business Units (UUS) and 156 Islamic Rural Banks (BPRS). Total Islamic banking assets reached Rp1,741 trillion; a 36.9% year on year (yoy) growth. Its market share is 4.3% of total national banking assets. Financing also grew by 40.1% which amounted to Rp135.6 trillion. The expansion of Islamic banking branch network and services increased the number of Islamic bank customers as reflected by the increase in the total number of financing and third party deposit accounts by 3.4 million accounts - from 9 million accounts to 12.4 million accounts.

In line with the achievements of the previous year, Islamic banking remains committed to optimising the real sector. As much as 80.8% of total Islamic banking funds or Rp135.6 trillion has been invested in financing activities, followed by placements at Bank Indonesia in the form of Bank Indonesia Shari'a Securities (SBIS), Giro and Bank Indonesia Facilities (FASBI) amounting to Rp. 18.5 trillion (11.0%), placement of securities amounting to Rp7.8 trillion (4.7%), and placement with other banks amounting to Rp5.2 trillion (3.1%).

The intermediary function of banks can be relatively subdued as reflected in Islamic bank FDR (Financing to Deposit Ratio) aggregates recording high increases of 100.8%, higher than the previous year which stood at 95.1%. In addition to the intermediary function and in an effort to provide services to a wider range of the community, access to office networks increased to 2188 (29.3%) from 1692 offices the previous year. This expansion of branch networks has enabled an increase in Islamic banking customers.

Although the number of BUS (11) and UUS (24) did not change in 2012, the availability of Islamic banking services has become more widespread as reflected by the increase in the number of branch offices, from 452 to 508 offices, while the sub-branch offices (KCP) and cash offices (KK) increased by 440 offices in the same period (October 2012).

Increase in funding of Islamic banking arose while maintaining regard to the precautionary principle that Non-Performing Financing (NPF) can be maintained within a stable range. On average, gross NPF decreased from 3.11% in 2011 to 2.58% in 2012. Increase in funding and improved quality of financing has driven profitability and cost efficiency, so that profitability can be maintained and even increased, which in turn would increase the accumulated earnings to strengthen capital.

Profitability of Islamic banks with respect to its assets were favorable as reflected in ROA and ROE ratios of 2.1% and 25.5% respectively, better than the previous year's ratios of 1.8% and 17.4%. Increasing funding coupled with improved performance has lowered the ratio of operating expenses to operating income from 79.2% last year to 75% this year.

The Micro, Small and Medium Enterprises (MSME) sector is an important sector in driving the national economy reflected by its contribution to the national GDP reaching 56.5%. The advantage of MSMEs as a domestic sector that is able to drive the national economy is due to its strong dependence on local forces. As a financial institution that has great concern over the development of the real sector, Islamic banking has been able to capitalise on the opportunities of the financial needs of the MSME sector. As many as 61.3% or Rp83.1 trillion of total financing of Islamic banks (BUS + UUS) is channeled to the MSME sector.

Based on Bank Indonesia Act No. 21 of 2008 on Islamic Banking, Islamic banks can carry out charitable and BUS -UUS linkage functions through fund collection from zakat, infaq, alms and other charity funds to be distributed to zakat fund organisations. As many as 8 BUS and 4 UUS reported carrying out charitable and linkage functions. This charity function reflects the role of Islamic banks in the equitable distribution of the economic welfare of the community.

Bank Indonesia Act No. 3 of 2004 states that the task of banking supervision oversight will be carried out by an independent financial services supervision body. In accordance to Financial Services Authority (OJK) Act of 2011, Bank Indonesia's microprudential banking supervision will be reassigned to the OJK. The OJK's new assignment will come into effect on January 1, 2014.

Bank Indonesia (BI), as the central bank, is optimistic that the era of high growth of Islamic banking will continue even as the global economy today, particularly in Europe and the United States, is still overshadowed by the crisis and decelerating economic growth. The growth of Islamic banking will not be affected much by the global crisis as asset portfolio exposure in foreign currency and foreign exposure is very small. Slowing global economic growth is going to decrease demand for Indonesia's export commodities, but the current portion of Islamic bank financing directly related to foreign trade is relatively small.

BI has a strong commitment to continue to facilitate the development of Islamic economics and finance, particularly Islamic banking, because BI is certain of its benefits to the national economy. BI will also continue to work closely with stakeholders, such as the National Shari'a Board (DSN), Indonesian Accountants Association (IAI) and the Government (specifically the Ministry of Finance), and especially with the Financial Services Authority (OJK) in developing the Islamic banking industry at this crucial period of transition.

In order to continue to promote and maintain the sustainable development of Islamic banking, Bank Indonesia sees the need to focus on development and policy measures of Islamic banking in the following:

1. Islamic banking financing geared to a more productive economic sector and broader community

Indonesia's demographic advantage is a huge opportunity for the growth of the national economy. Financing of the productive sector increases the market share of Islamic banking and supports a more self-sufficient national economy. Some of the breakthroughs that can be taken are to enter a number of priority projects including construction, electricity and gas, agriculture and creative industries, the productive sector for business start-ups and SMEs as well as projects included in the MP3EI initiative (Master Plan for the Acceleration and Expansion of Indonesian Economic Development).

The challenges for the Islamic banking industry in the financing of productive economy are capital and infrastructure aspects including office networks, information technology and human capital (HC). Several attempts to reduce the HC gap can be achieved through training, workshops, seminars, as well as communities within Islamic banking. All the challenges of financing productive sectors would assuredly require a strong commitment from the Islamic banking industry itself and the readiness of risk management associated to its business concentration, among others, through the preparation of risk management products.

This policy direction to the productive sector must be balanced with the spirit of inclusiveness of Islamic banking services to all communities across borders and economic power. This inclusivity is demonstrated by the availability of Islamic banking services across 33 provinces and by Islamic banks' availability and sociological proximity to Islamic Financial Cooperatives (KJKS) particularly Baitul Maal wa Tamwil (BMT) institutions. The total number of BMT / KJKS per April 2012 amounted to approximately 4,117 with a total membership of about 762 thousand people and total assets reaching Rp5 to Rp8 trillion. This provides a great potential for financial inclusion. KJKS / BMT linkage strategy is worthy of consideration as a strategic partner for disbursement of Islamic banking financing through channeling and executing schemes, lending of last resort (APEX bank) and technical assistance.

In order to ensure its inclusive financial intermediary role and to focus more on the productive sector and financing to the broader community, Islamic banking and MSME productive financing targets will therefore be set at a minimum of 20% corresponding to its conventional banking counterparts.

2. Product development to better meet the needs of society and the productive sector

Bank Indonesia will prioritise support for product development related to the productive sector and to better meet the needs of the wider society. Support is provided among others, through improved regulation, the product licensing process, product assessment and dissemination of knowledge and skills for financial/productive sector analysts through activities such as workshops and seminars. The improvement of regulations related to Islamic banking products will continue to be improved through the Islamic Banking Working Group cooperation forum as a tripartite with the National Shari'a Board and the Indonesian Accountants Association which assuredly would continue to involve industry players in order to accelerate product development tailored to the needs of banks and the public.

3. Transition of oversight whilst maintaining continuity of Islamic banking development

2013 is a very crucial year in preparing the transfer of regulation and supervision function of Islamic banking from BI to the OJK which will come into effect on January 1, 2014. The establishment of the OJK, has divided the two authorities of banking regulation and supervision, namely microprudential of OJK and macroprudential of BI. In practice, there is a possibility of overlapping between the macroprudential and microprudential policy; therefore during the transition period it is expected that the supervision will not interfere with the development and growth process of Islamic banking itself.

Macroprudential policy among others is outlined in the Islamic banking provisions of Financing to Value (FTV) and Down Payment (DP) and capital requirement that can accommodate changes in the business cycle and the economy. Along with macrosurveillance, and as a liquidity provider for banks, the function of Lender of Last Resort (LOLR) remains a function that will be executed by Bank Indonesia.

A number of infrastructures prepared by BI include Islamic Banking Information Systems (SIP) that implement a new concept of Islamic Banking Soundness (Islamic RBBR) by adding two risks associated with Shari'a aspects (Risk of Return and Investment Risk) and is also equipped with statistical information and efforts to complete the LBUS plan reporting system using XBRL. Other infrastructures include the preparation of Islamic banking regulations related to the management of risk concentration and governance such as Islamic banking capital as well as guidance for new products and activities. Additionally, BI will consider the following items to be put in the 2013 agenda: the process of revising the Blueprint of Islamic Banking and taking part in formulating the Indonesian Islamic Finance Architecture that will be required by OJK, BI and other agencies for the development of Islamic banking and finance.

4. Revitalisation on increasing synergies with parent banks

Strategies of expansion and increasing Islamic banking assets remain centered on synergistic strategic partnerships between conventional parent banks and Islamic banks. The strategy is aimed to optimise the utilisation of technological facilities, office networks and human capital for funding services and financing analysis.

BI wishes to encourage regulatory incentive based policies with regard to institutions, and improving Islamic banking services availability within the parent bank network. This is to support more progressive innovation including support for capital and business expansion on a regular basis. Thus, the development of cross-selling and product equivalency with the support of network infrastructure such as office network and IT along with human capital policies can be better integrated in enhancing the growth of Islamic banking including employee job assessment (key performance indicator) on Islamic banking service activities by the parent bank. In addition, the sharing of competence in designing and selling products on the one hand, and Shari'a contract comprehension on the other, will increase Shari'a service products outreach to diverse customer segments, whether micro, retail or commercial / corporate.

Policies on the utilisation and expansion of networks and services through the parent bank, and/or banks under one group (leveraging) should not create a disincentive for expansion of Islamic bank branch networks. It can be anticipated through measures such as: (i) an increase in productivity or cost efficiency, but within the limits of acceptable risk, (ii) clarity of responsibility and fulfillment of compliance and supervisory access, (iii) maintaining continuity of service, reputation and ability of banks to meet its obligations, and (iv) obligations for opening an Islamic bank branch by meeting certain requirements upon opening Islamic banking services in offices of the network of the parent bank/banks under one group.

5. Increasing education and communication to continue promoting Islamic banking capacity in productive sectors and communication of the "parity" and "distinctiveness" of Islamic banking products

In order to increase the number of people who use Islamic banking products and services through educational activities/dissemination, BI hopes to optimise its strategic cooperation with the Communication Center for Islamic Economics (PKES), Islamic Banking Committee and the National Shari'a Board. The alliance will be focused on increasing the capacity of Islamic banking in productive sectors, and communicate the benefits of diversified Islamic banking products advancing aspects of parity and the trademark differences that define Islamic banking products. This will be effectively implemented through various relevant media and forums.

As a mandate of the National Convention of PKES Members of July 13 2012, in order to optimise the target achievement of communication and dissemination of Islamic finance/economics, the Forum on Communication and Advocacy of Islamic Economics (ForKAES) was established. This forum is a medium of communication for associations formed both by practitioners of Islamic finance and related professions, as well as observers of Islamic economics. ForKAES aims to coordinate and synchronise programs and dissemination activities, publications and communications made by associations such as Islamic Economic Society (MES), Indonesian Islamic Bank Association (ASBISINDO), Islamic Economic Experts Association (IAEI), Indonesian BMT Association (ABSINDO), Indonesian Islamic Insurance Association (AASI) and Communication Center for Islamic Economics (PKES).

In an effort to improve the competence of human capital in Islamic banking, Bank Indonesia is expected to continue its cooperation with the International Center for Development in Islamic Finance of the Indonesian Banking Development Institute (ICDIF-LPPI) through the support of training and education programs vital to enhancing the skills / operational technical competence and analytical skills of Islamic banking human capital in marketing prudential-based and Shari'a-compliant Islamic products.

Outlook

For 2013, three scenarios are possible for the Islamic banking sector, namely (i) a pessimistic scenario, (ii) moderate scenario and (iii) optimistic scenario. The pessimistic scenario will occur if the expansion of Islamic banking comes under pressure from both internal and external factors. Pressure from internal sources originate from the limited funding that has been collected from the public, especially given the ability of a number of banks which have declined in raising deposits. Pressure from external factors comes from the declining performance of the national economy. The Euro economic crisis has an impact on the national economy even as Indonesia's economy remains growing positively, but at a slower pace.

The moderate scenario is when the acceleration of the current Islamic banking continues and does not experience any pressure, or continues to be supported by organic factors. Financing continues to expand, and deposits continue to increase to offset the asset side. The optimistic scenario is where non-organic factors coincide together with organic factors (moderate scenario) as displayed in the opening of new Islamic banks, spin off from UUS to BUS, conversion of conventional banks into Islamic banks including increased placement of government funds in Islamic banks (hajj pilgrimage fund, sukuk, etc).

Through these scenarios, the projected total assets in 2013 is Rp255 trillion (pessimistic scenario), Rp269 trillion (moderate scenario) and Rp296 trillion (optimistic scenario). Islamic Banking market share of 5% is expected to be reached between April 2013 - May 2013, and by the end of 2013, it is estimated to have a market share of 6.5%. Total deposits at the end of 2013 are estimated to be Rp168 trillion (pessimistic), Rp177 trillion (moderate), and Rp186 trillion (optimistic). Total financing in 2013 is estimated at Rp200 trillion (pessimistic), Rp211 trillion (moderate) and to Rp222 trillion (optimistic).