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EXECUTIVE EDITOR
Mohammad Ali Qayyum,
Director General, IIBI

EDITOR
Tanya Andreasyan

CONTRIBUTING EDITORS
Tom Alford
Don Brownlow
James Ling

IIBI EDITOR
Mohammad Shafique

IIBI EDITORIAL PANEL
Mohammad Amin
Stella Cox
Dr Humayon Dar
Iqbal Khan
Richard Thomas
Dr Imran Ashraf Usmani

DESIGN CONSULTANT
Becky Ellison

PUBLISHED BY
IBS Publishing Ltd
8 Stade Street
Hythe, Kent, CT21 5DT
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Tel: +44 (0) 1303 262 636
Fax: +44 (0) 1303 262 646
Email: newhorizon@ibspublishing.com
Web: www.ibspublishing.com

CONTACT
Advertising
IBS Publishing Ltd
Paul Minister
Advertising Manager
Tel: +44 (0) 1303 262 636
Fax: +44 (0) 1303 262 646
Email: newhorizon@ibspublishing.com

SUBSCRIPTION
Institute of Islamic
Banking & Insurance (IIBI)
12–14 Barkat House
116–118 Finchley Road
London NW3 5HT
United Kingdom
Tel: +44 (0) 207 245 0404
Fax: +44 (0) 207 245 9769
Email: iibi@islamic-banking.com
Web: www.islamic-banking.com

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Editor's Note





Some previous NewHorizon issues

NewHorizon is possibly the oldest magazine published in English on Islamic banking and insurance. It has been in publication for over 15 years, and is the official journal of the Institute of Islamic Banking and Insurance (IIBI), an independent not-for-profit organisation. Founded in London back in 1991, it is now one of the world's leading independent education, training and research organisations dedicated solely to the promotion and implementation of Islamic finance in the UK and globally.

NewHorizon publishes in-depth articles on various aspects of Islamic banking and insurance and also reports on events and developments from around the world. The magazine enjoys a wide readership in around 105 countries.

Over the years the look and contents of NewHorizon have evolved to reflect the times. IIBI is now working with IBS Publishing, a UK-based company, to produce the magazine, with the first issue of this quarterly journal covering the period from January to March 2007.

NewHorizon embraces challenges facing the Islamic financial sector right across the globe, from the developments in the well-established Islamic banking markets in the Middle East, through the growing markets of Pakistan, UAE and the UK, to the attempts to introduce this industry in Russia. African developments continue at pace with Kenya becoming one of the latest countries to provide its citizens with Islamic financial services.

The range of such services continues to expand. Shari'ah-compliant credit cards and personal loans are amongst the newcomers. Sukuk (government bonds) are becoming more prominent in the Islamic banking market. This issue of NewHorizon also tackles the subject of takaful (Islamic insurance) with further in-depth analysis of this matter to come in our future publications.

Whether you are already an Islamic finance specialist, about to enter the world of Islamic banking and insurance or just interested in this subject, we hope you find the magazine interesting, cognitive and educational.



Mohammad Ali Qayyum
Director General IIBI

Bank and real-estate developer sign Memorandum of Understanding

Islamic bank, Masraf Al Rayan, and real-estate developer, Qatari Diar, have signed a Memorandum of Understanding worth $2.25 billion for the development of the Lusail Corniche Project in Qatar. Under the terms of the agreement, Masraf Al Rayan will take the primary role in arranging and managing the mobilisation of funds to finance the project. However, the bank is not only limited to a financial role within the project, it will also be working with Qatari Diar to develop the project through an investment fund.

The agreement was signed by Dr Hussain Al-Abdulla, chairman and managing director of Masraf Al Rayan, and Nasser Al-Ansari, CEO of Qatari Diar



(above). Both men were happy with the agreement and saw it as a step forward for their relative institutions. Al-Abdulla described the agreement as one that will 'strengthen our position in the local market and help us to achieve our goals of being a truly progressive force in the banking world'. Al-Ansari saw the deal as 'part of our strategy in developing projects in partnership with and support of local financial institutions'.

Masraf Al Rayan is the only fully-fledged Islamic commercial and investment bank in Qatar, and has an entirely Shari'ah-compliant portfolio of products. This deal will come as no surprise; the bank has been heavily involved with the financing of new real estate developments in Qatar since its inception in October last year.

The Lusail Corniche Project is part of the waterfront district of the Lusail development. Consisting of two small islands, the Corniche district will have around two and a half kilometres of waterfront promenade made up of retail and restaurant outlets. Qatari Diar, a real-estate company wholly owned by the Qatar Investment Authority, is the company behind the Lusail development. The waterfront district looks to be a popular area for the developers; recently all 46 plots within the district were sold to investors within hours of going on sale. Development of the Corniche Project is planned to start by the end of this year, with a completion date set for the end of 2009.

Maybank tops The Asian Banker survey

Maybank has been ranked as the largest Islamic banking service provider in the Asia Pacific region by The Asian Banker Islamic Bank 40 survey. The annual study identifies the 40 key players in the Asia Pacific banking sector, and ranks them according to the size of their Shari'ah-compliant products.

The inaugural study has revealed that Maybank, which is not a standalone Islamic bank, currently holds over $6.4 billion in assets through its Islamic banking window. The largest standalone Islamic bank was Bank Islam Malaysia; this had about half as many Shari'ah-compliant assets as Maybank and was ranked number two in the region.

The study also revealed that Malaysia was leading the way for Islamic financial services industry in the region. It showed the country to have 17 institutions which hold 73 per cent of the top 40's total assets.

Government of Abu Dhabi sets up Al Hilal Bank

The government of Abu Dhabi is setting up an Islamic bank with $1.1 billion in authorised capital. The new bank, called Al Hilal Bank, will operate under the provisions of Islamic Shari'ah while rendering all modern services required for the business sector, as well as investment in the industrial, agricultural and real estate sectors.

The bank will be aimed at the private sector. The Founders' Committee says, 'the bank has been designed to cater to project-related requirements and provide credit facilities for the private sector, which will be the backbone of the economic development of the country'.

The bank will deal with corporate and retail banking, consultancy services, funds management and will invest customer funds in Shari'ah-compliant financial instruments.

UK to become global centre for Islamic finance

Plans to establish the UK as a leading global centre for Islamic finance have been announced by economic secretary, Ed Balls *(below)*. In his speech to the Euromoney Annual Islamic Finance summit, Balls announced plans for new legislation to facilitate the issuance and trading of sukuk, and guidance on diminishing musharakah and takaful.

The market for Islamic finance products in the UK has shown strong growth since the government started shaping the tax and regulatory framework, and it hopes that these new measures will help to make Britain the financial partner of choice for Muslim countries all over the world. Balls said, 'As Islamic finance grows in importance, we want to see more of this business coming to the UK.'

In his speech, Balls announced that the Treasury will set out in the Budget what the tax framework for sukuk will look like, and that detailed legislation will follow in the Finance Bill. He also indicated that guidance on how diminishing musharakah products will be treated for capital gains and capital allowances will be published, to provide certainty of interpretation. In his speech, Balls also announced the plans to publish guidance on how takaful products will be taxed within current rules; it is hoped that this guidance will clarify the uncertainty in the market over treatment of these products.

The government hopes that these new measures will ensure that the tax and regulatory system will encourage the development of Shari'ah-compliant products, and will cement Britain's role as a global centre for Islamic finance and trade.



Three banks in dual tranche deal

Asya Katilim Bankasi of Turkey has mandated three banks to arrange a $50 million murabaha financing facility. The mandated banks are ABC Islamic Bank, Standard Chartered Bank and Unicredit Markets & Investment Banking. It has been structured as a one- and two-year dual tranche facility, with the proceeds being used to finance the Turkish bank's Shari'ah-compliant trade finance activities.

Global House to establish Islamic bank in Syria

The Bahrain-based investment banking group Global House is to launch a new Islamic bank in Syria. The new bank will be set up with an initial capital of $500 million; so far half of this figure has been put up by the banking group. Dr Ahmed Bin Hussein Al-Dawsary, chairman of Global House, says the group 'will be a partner in the new bank' with the initial contribution that it makes dependent on other key shareholders.

The group has been studying the Syrian market for well over a year, since the country became more open to international investors. It concluded that it would be feasible for Global House to invest in more than one Syrian city. Al-Dawsary says, 'The creation of an Islamic bank in Syria had for a long time been on the cards for the group, as the country itself is yet to benefit from Islamic finance'.

The group plans that preliminary operations for the bank will begin in the next few months, depending on completion of the required paperwork.

Emirates Global Islamic Bank launched in Pakistan

A new six-branched Islamic bank has been set up in Pakistan. Emirates Global Islamic Bank Ltd (EGIBL) is a dedicated commercial Islamic bank and, according to president and CEO Syed Tariq Husain, it plans to become 'a leading Islamic commercial bank in Pakistan'.

The bank aims to capture market share by offering Shari'ah-compliant competitive banking products. EGIBL will offer Shari'ah-compliant savings and current accounts, as well as term deposit schemes, and trade, ijara, murabaha, and consumer financing.

The bank, which is sponsored by leading investors from the UAE and Saudi Arabia, has opened with five branches in Karachi and one in Lahore. However, it is looking to extend its branch network to gain access to more people. EGIBL chairman, Sheikh Tariq Bin Faisal Al-Qassimi says, 'The Pakistani market offers tremendous potential and the finance sector has been doing exceptionally well. We are confident we can build upon the work already being done here to develop the sector even further.'

The bank has big plans for the future. It plans to establish an asset management company and launch Shari'ah-compliant funds this year. It is also looking to be listed on the stock exchange through an IPO (Initial Public Offering) in 2008.

RHB takeover rumbles on

March has been an interesting month in the ongoing takeover of Malaysia's fourth largest lender Rashid Hussain Behad (RHB). It was originally thought that the Kuwait Finance House (KFH) would be successful with its bid for the debt-ridden institution, and that it would go on to form the world's largest Islamic bank.

This plan was shattered when Malaysia's state pension fund company, the Employees Provident Fund (EPF), outbid KFH to buy the Utama Banking Group's (UBG) 32 per cent stake in RHB, taking its overall stake in the banking group to about 64 per cent. The deal was initially welcomed by KFH – in a statement to Bernama (Malaysian National News Agency) it said it was confident the consortium it led would have a role to play in the new development to create the world's largest Islamic bank. EPF seemed to confirm this; the pension fund plans to cut its stake in the bank to around 35–40 per cent and is looking for two or three strategic partners in order to achieve this. In an interview with Bernama, EPF's CEO Datuk Azlan Zainol said that it would consider KHF as a strategic partner in RHB due to its extensive expertise in Islamic banking. Speaking about KHF as a potential partner, Zainol said 'it will augur well in helping Malaysia become an Islamic finance hub'.

There seems to have been no progress on a deal between the two companies since this point. Speaking at the Invest Malaysia 2007 conference, managing director of KFH (Malaysia) Bhd, K. Salman Younis told reporters that the bank would be 'interested' in taking a 49 per cent stake in RHB Islamic Bhd, but as yet had not been offered the opportunity.

EPF is looking to cut costs at RHB in order to clear some of the banks debts. It has decided to sell the bank's non-core assets, such as Vision City, and even hinted that the RHB head office could be sold off. The IT systems at the bank will be looked at. Zainol told Bernama that improvements here would 'bring down the cost of doing business and increase market share'. The branch network is also under consideration; the bank currently has around 200 branches in Malaysia, which will be restructured to better position the firm in the banking business.

Securing future of Islamic finance market

A landmark agreement has been reached between the International Capital Market Association (ICMA) and the International Islamic Financial Market (IIFM) to sign a Memorandum of Understanding that it is hoped will help secure the long-term future of the Islamic finance market.

The agreement, signed on 30th January at the Annual Islamic Finance Summit in London, is a significant step in the development of a key section of the global Islamic financial services industry. It will allow focused work on the sukuk market, now worth over $40 billion, which is increasingly attracting non-Islamic financial institutions and firms. Khalid Hamad, vice chairman of the IIFM *(below)*, said that the agreement will 'enable the IIFM and ICMA to address critical market issues, through shared expertise and through consultation with industry'.



The Memorandum of Understanding will establish a joint working group between the ICMA and the IIFM. This group will develop standardised contracts, language and practices for secondary market transactions and will also develop standardised practices for the trading of sukuk and other Islamic financial instruments.

CIMB goes global



CIMB Islamic Bank plans to take its Shari'ah-compliant finance products into the global market. Executive director Badlisyah Abdul Ghani *(above)* explains, 'We have various financing products available for local and foreign players in the halal industry'.

Speaking at the World Halal Forum in Kuala Lumpur, Ghani told reporters that the global halal and Islamic finance industry is estimated to be worth $1.5 trillion, which means there is enormous potential for partnerships. 'Players should consider using Islamic financing as an option to raise funds as the cost is lower compared with conventional banking,' he said.

Ghani also announced the bank's plans to expand its Malaysian operations. The bank plans to open 320 branches across Malaysia by June this year, says Ghani. 'These branches will contribute toward making our products and services more accessible to the market.'

Dubai Bank launches new Shari'ah-compliant finance products

Dubai Bank has launched a new Islamic finance product range. The bank started its Shari'ah-compliant operations in January, and a series of announcements in March has seen four new products become available in the UAE. The first new offerings were launched in the first week of March. The most interesting of these new lines were a mulki property financing product designed to facilitate the purchase of properties in the UAE, and a sanad personal finance product. The mulki product has a financing structure based on those of murabaha or ijara, and is available to UAE nationals and expatriates living in the UAE.

The sanad was designed to help customers meet their personal finance needs or transfer their existing liabilities from other banks. In an attempt to boost the uptake of the offering, the bank promised a gift voucher worth between $136 (AED500) and $1089 (AED4000), which could be redeemed for electronics or air tickets to every customer.

The next wave of the new product range was released in mid-March. The bank launched its markaba auto finance and souk goods finance products. These products have been designed to aid the purchase of cars and goods within the UAE. With both new products, the bank will purchase the goods requested by the customer and then sell them on to the customer at an agreed profit.

The product launches have been a success for the bank. Head of distribution, Mohammad Al-Nahdi, said the products had received 'a tremendous response' and had 'increased the inflow of traffic at our branches'. The bank has also increased its branch footprint, opening five new branches across the UAE on 1st April. It has also opened three new branches in Dubai, as well as one in Ras Al Kaimah and one in Al Ain, in an attempt to enhance its customer reach.

Credit Suisse expands its Islamic banking product range

Credit Suisse is set to expand its Shari'ah-compliant range of banking products. The bank entered the market in March this year with a Shari'ah-compliant fund, and has quickly decided to expand its offering. There was no specified amount that the Swiss bank planned to raise with the initial fund, but it did announce that up to 20 per cent of the amount raised will be invested in emerging economies.



The bank is expecting to see a continued demand for investments that conform to Islamic principles in the global market. 'I have not witnessed a banking activity that has shown such sustained growth for two decades,' global head of Credit Suisse Islamic investments, Fares Murad *(above)*, told Gulf News.

There is currently an increasing demand from Arab investors in the Gulf for opportunities that do not involve profiting from investments in interest-based assets, or in businesses involved with alcohol, gambling, weapons, entertainment or non-halal meat. Murad believes that this will mean that, in terms of assets, the Islamic banking sector could overtake the conventional banks. 'The possibility is there. Islamic banks in the region are very active and innovative and they are eager to grow,' explained Murad.

The Islamic banking sector in the Gulf is believed to hold around half of the assets of the entire Islamic financial sector. This works out to about $200 billion and is still growing. Murad does not believe that the reasons for this are entirely to do with oil. 'There are many socio-political factors that are driving this growth. To say that Islamic finance is growing because of petro-dollars is simplistic.'

First Islamic bank to open in Kenya

A consortium of investors is set to open Kenya's first Shari'ah-compliant bank, Gulf Africa Bank. The setting up of the bank is good news for Kenya's Muslim community. Around 26 per cent of the Kenyan population are followers of Islam, but until now they have not had a dedicated Islamic financial service.

The consortium is made up of a collection of investors from around the financial industry. They include BankMuscat International, the Dubai government investment agency Isithmar and The World Bank Group International Finance Corporation. The bank will start with $25 million in capital and aims to become a domestic bank with a regional presence.


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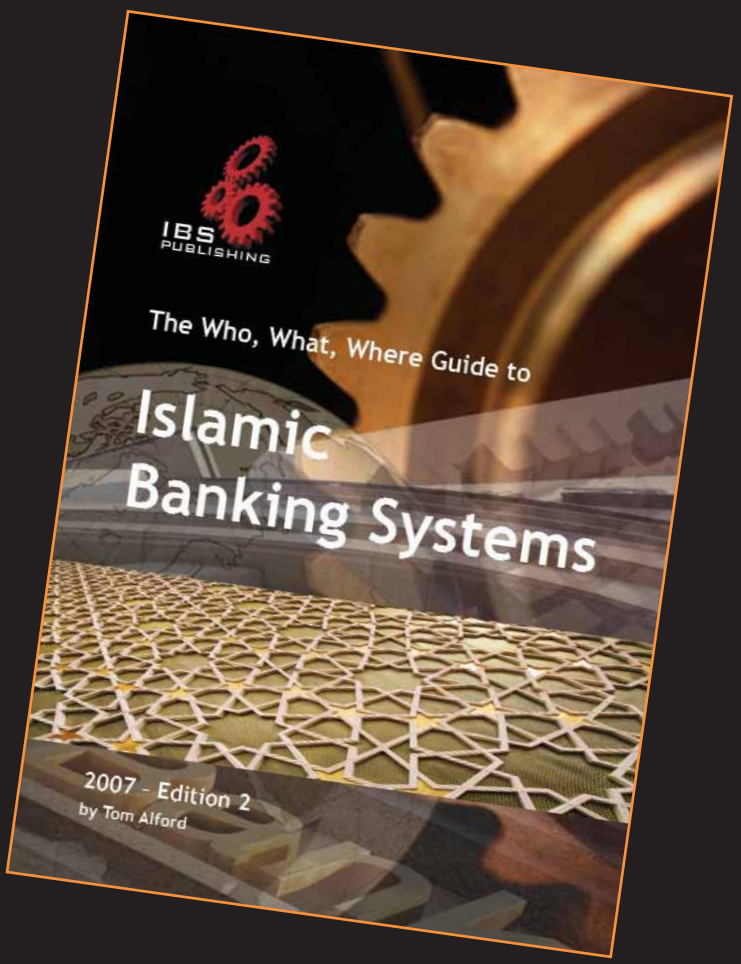
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IBS Publishing Limited, 8 Stade Street, Hythe, Kent, CT21 6BE, UK
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Islamic home finance products in Egypt

Amlak Finance and Real Estate Investment, a company offering Islamic home finance products, has been launched in Egypt. It is the first to offer Islamic home finance products to the local market.

'With growth of over 1.5 per cent annually, and a current shortfall of approximately 145,000 houses per year, the real-estate industry has been highlighted by the current government as an area for development in 2007,' says Shahil Akram Juma, CEO of Amlak Finance and Real Estate Investment in Egypt. Added to this, the government has introduced the mortgage finance law, enabling individuals across the country to own a home within a well regulated system headed up by the Mortgage Finance Authority (MFA). Chairman of the MFA, Osama Saleh, says 'As we work to provide physical housing for all sectors of society, it is right that people should have the ability to choose a financing solution that is in line with their beliefs'.

When this backdrop is combined with Egypt's largely Muslim population, it is no wonder that the parent company Amlak Finance has decided the time is right to enter the Egyptian market. Initially, customers will be able to purchase any completed property, with long-term tenures of up to 20 years.

Islamic banks growing rapidly

Islamic banks are growing at more than twice the rate of conventional banks according to Ahmed Darweesh Bin Dagher Al Marar, managing director of Abu Dhabi Islamic Bank (ADIB). Globally the growth rate of Islamic banks is 23 per cent, more than double the ten per cent growth rate of conventional banks. Islamic deposits in Gulf investment accounts have more than doubled in the last five years, and Al Marar believes that Islamic banks will attract half of the world's Islamic funds in as little as a decade.

The research that led to these results has been carried out by ADIB for the Oxford Business Group (OBG), a UK-based publishing, research and consultancy conglomerate. OBG is preparing its new guide to doing business in Abu Dhabi and this research will go into a chapter dedicated to the Islamic financial services industry. The guide will be available in the second quarter of this year.

Two deals for the European Islamic Investment Bank

The European Islamic Investment Bank (EIIB), the first Shari'ah-compliant Islamic investment bank to be authorised and regulated by the Financial Services Authority in the UK, has announced the completion of two deals.

The first is a structured trade finance facility with trade finance group CCH International (CCH). Under the deal, EIIB has signed an agreement with CCH and its subsidiaries for a sterling-denominated revolving financing facility. The proceeds of the facility will be used according to the principles of Shari'ah to finance UK-based supplier of steel products, Alphasteel. This deal is the sixth structured trade finance transaction to be signed by EIIB and the first in the UK for CCH. Managing director of CCH, Eren Nil *(right)*, said that the deal was 'a key addition to our funding base which has traditionally been provided by Middle Eastern institutions'.

In the second deal, EIIB has signed a committed standby facility with the Islamic Bank of Britain (IBB). The facility is structured as an undrawn revolving commodity murabaha and is designed to assist IBB in managing its liquidity profile.



ICCI to set up 200 companies in ten years

The Islamic Chamber of Commerce and Industry (ICCI) has announced that, through its subsidiary the Foras Investment Company, it will help to set up 200 companies in the next five years in the 57 member countries of the Organisation of the Islamic Conference (OIC). The announcement is part of a ten-year development plan and, according to Foras CEO Hatim Jamil Mukhtar, it has been set up 'to accelerate the process of economic development across the Muslim Ummah'. Mukhtar made this announcement to a select gathering of businessmen in Lahore.

Foras currently has a paid up capital of $100 million and it is hoped that this will soon double. The company will set up five sub-holding entities in Pakistan, Malaysia, Turkey, Egypt and Senegal, which it is hoped will help speed up the process of company formation across the Muslim world. According to Mukhtar, the companies will be set up 'for the promotion of diverse fields ranging from bio-technology to IT and infrastructure'.

Foras has already begun its work with the preparation of investment road maps for ten Muslim countries, such as Pakistan. It is hoped that these steps will lead to the formation of an economic consortium of the Islamic world.

Islamic business banking on the UK high street

Lloyds TSB *(below)* has launched the first high-street Islamic business accounts in the UK. The Shari'ah-compliant accounts have been split into two categories. If the turnover of a business is under £2 million ($3.9 million) it will be eligible for the Islamic Business account. If a business has a turnover greater than this it will be eligible for the Islamic Corporate account. Both accounts comply with Shari'ah law and, as such, offer no credit interest and no overdraft facility, but still offer all the other services available to traditional business and corporate account holders.



The launch of these new accounts establishes Lloyds TSB as the largest provider of Islamic banking across the UK. Truett Tate, group executive director for wholesale and international banking, says: 'We're consolidating our position as the UK's leading provider of Islamic financial services and making it possible for Britain's Muslim businesses and aspiring entrepreneurs to bank according to their principles'.

This is the latest addition to the bank's Islamic finance range. The range was developed after a survey last year revealed that three quarters of the UK's Muslim population were interested in Islamic finance. The new business accounts are available across the bank's 2000 strong branch network, and the bank is hoping that it will mean that Muslims will not have to compromise their principles when it comes to their business finance.

New Islamic investment fund launched in Saudi Arabia

Saudi Arabia's National Commercial Bank (NCB) has launched a new investment fund for individuals to invest in international corporations. The Al-Ahli Ma'moun Fund for International Stock Trade D will allow investors to invest in international corporations that are leaders in their field. The two-year fund will also protect the investor's capital by investing in an international stock folder that is compliant with Islamic principles. Sami Abdo, head of NCB's Investment Services Division, said, 'The new fund will provide alternative investment channels compliant with Islamic principles and invest in large international corporations that enjoy strong and stable growth averages'.

Islamic banks support Sharjah Electricity and Water Authority

Sharjah Electricity and Water Authority (SEWA) has successfully closed its $350 million sukuk al ijara facility. It received strong interest from regional banks in the general syndication, and was over-subscribed. SEWA, the monopoly supplier of electricity, water and gas to the Emirate of Sharjah, is the first entity owned by the government of Sharjah to approach the syndication market for a long-term Islamic financing facility. The financing was provided by a total of twelve banks including ABC Islamic Bank, Gulf International Bank, Kuwait Finance House and Sharjah Islamic Bank.

Malaysia International Islamic Financial Centre initiatives strengthened with MOU

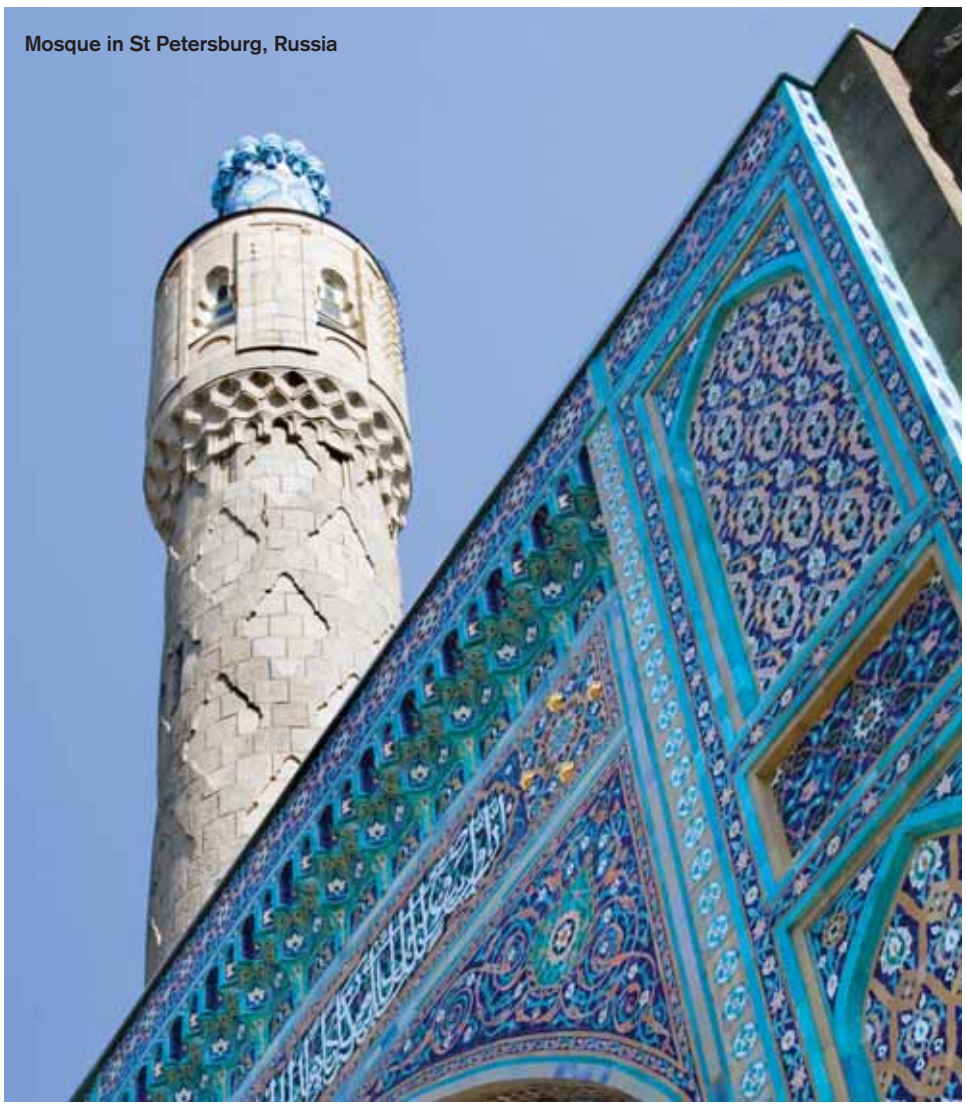
A Memorandum of Understanding (MOU) has been signed between Bank Negara Malaysia, Qatar Financial Centre Regulatory Authority and Dubai Financial Services Authority. The deal has been signed as part of the Malaysia International Islamic Financial Centre initiatives.

The initiatives aim to establish collaborative relationships with strategic partners towards the development of Islamic finance, and are based around three themes. The first is co-operation on capacity building and human capital development in Islamic finance. The second is a mutual co-operation on the development of international Islamic finance, and the third includes Shari'ah harmonisation and strategic promotion initiatives.

It is hoped that this MOU, signed between East and West Asia, will mutually strengthen the inter-linkages amongst the Islamic financial centres, and reinforce trade and investment flows between the regions.

Islamic banking and takaful in Russia: What the future holds

With over 15 million Muslims living in Russia today, the domestic introduction of Islamic financial services has been discussed and attempted by both businessmen and scholars. But is the country ready for it? Renat Bekkin, Moscow State Institute of International Relations lecturer, talks to Tanya Andreasyan about the challenges facing Islamic banking and insurance in Russia.



Mosque in St Petersburg, Russia

In recent years, the Russian banking market has been developing at a rapid pace. As the country's economy is stabilising and taking a definitive shape, so is its financial services industry.

In typically dramatic Russian style, recent events within the Russian banking sector have attracted attention on a worldwide scale, not always in a positive way. The murder of the Central Bank's vice chairman, Andrei Kozlov; the revoking of banking licences; the control of many domestic banks by foreign investors; and the upcoming changes connected with the Russian Federation joining the World Trade Organisation (WTO) are contributing to the shape of the Russian banking sector today.

Currently, there are around 1200 banks operating in Russia, with Sberbank (Savings Bank of the Russian Federation) having the largest share and the widest spread over all eleven time zones of the country. The rest are a pretty mixed bunch, but there are some strong and growing players. Regional expansion is high on the banks' agenda and retail banking services are of the utmost importance in capturing the largest market share.

However, having suffered a number of situations in which people's savings were lost in the recent past, the Russian population is being cautious and somewhat sceptical of the current developments. There is still an estimated $1.5 billion in so-called 'mattress' money held by the public. Nevertheless, the

banks hope to introduce the financial services to as many of the 145 million Russian citizens as possible.

An estimated 15–20 million of them are Muslims. And while the country's population is largely diminishing, Russia's Muslim population is on the increase. It has grown by around 40 per cent since 1989, due to high birth rates in the Muslim community and continued immigration from the Caucasus and Central Asia. Some analysts project Muslims to become one-fifth of the country's overall population by 2020.

Today, Russia has about 8,000 mosques compared to 300 mosques 15 years ago. Statistics predict that by the end of 2015, the number of mosques in the country will exceed 25,000.

One would expect that, with such a growth in the Islamic population in the region, there would be increasing demand for Islamic financial services. However, this is not quite the case. As mentioned earlier, the confidence of Russia's population in the country's banking system is still low. And it's not only the confidence problem; it is the general knowledge about banking. Russia's President, Vladimir Putin, once mentioned that 'the majority of Russian citizens are still avoiding banks, just don't understand how they work and consider them to be too complicated and requiring professional knowledge'. According to Putin, only one quarter of Russian citizens have bank accounts and less than ten per cent of the population uses plastic cards.

And if conventional banking, which has existed for a long time, is still a mystery for a large number of people in Russia, what can one say about the Islamic financial institutions, which have emerged only recently? The situation is much the same in other countries comprising the Commonwealth of Independent States (CIS), the successor to the USSR. Depending on the geographical location and ethnic population, some of these countries are more advanced in their knowledge of Islam and Islamic banking than others. The countries situated in Central Asia – for example Kyrgyzstan and Tajikistan – are predominantly Muslim, as so are some countries in the Caucasus such as Azerbaijan.

One of Russia's specialists in Islamic finance, who has contributed to its promotion across the territory of the former USSR, is Renat Bekkin, international law lecturer at one of the most prestigious universities in Russia, the Moscow State Institute of International Relations (MGIMO-University). The university functions under the auspices of the Ministry of Foreign Affairs of the Russian Federation.

Bekkin studied at MGIMO and graduated from it with a Master of Law degree in 2000. A few years later, he received a PhD in Law, having written a dissertation 'Insurance in Islamic Law: Theory and Practice'. Today, he is a professor at the UNESCO (United Nations Educational, Scientific and Cultural Organization) department in MGIMO.

Bekkin is originally from St Petersburg but moved to Moscow to attend the university and continues to live there today. He speaks three foreign languages – English, Arabic and Chinese. Literature is one of Bekkin's passions, so much so that he writes himself and has also established an open literary prize called 'Islamic Breakthrough'.

Bekkin's interest in Islamic finance has developed gradually. Originally, international law was his subject of specialisation but then, in the course of research, he came across the legal issues of Islamic insurance (takaful) which later became the topic of his thesis. Eventually, Bekkin's area of interest broadened to other aspects of Islamic law and finance including: retakaful; Islamic law in non-Muslim countries; Islamic economics; Islamic law of banking, securities and business transactions; and the philosophy of Islamic law.

So what is his opinion on the situation with Islamic financial institutions in Russia?

'There is still a lot of scepticism over the idea of Islamic banks among Russia's Muslims,' says Bekkin. 'Actually, a number of Muslims around the world do not support Islamic banking and consider it to be unacceptable, the same as Islamic whisky. Some people in Russia also support this theory, even if they don't know much about Islamic finance to begin with.'

Although the Arab world considers Russia a potentially emerging market with regard to Islamic finance, there is still a lot of apprehension when it comes to investing capital in it. 'There are many hitches and complications.'

Bekkin explains: 'Generally, the attitude of Muslims in Russia towards Islamic finance can be divided into four main categories. The first one is that it is not vital to use Islamic banking services. These people consider that observing other rites, for example, praying and fasting, is sufficient. The second category consists of those who do not practise any rites at all or are not even aware of them. This category often includes ethnic Muslims. And there is a third small category of people who think that practising all principles of Islam, including in the financial sphere, is essential.' He goes on: 'So, these Muslims have to somehow find a way of minimising the risks of using non-Islamic banking products. The solution of banking abroad is, unfortunately, not affordable for the majority of them.'

'There is also a fourth category of intellectuals who are very enthusiastic about Islamic finance. These Muslims, generally ethnic, may not be as strict in following other Islamic rites but are very interested in Islamic finance and the concept of ethical banking.' The latter category includes Muslims who have tried to establish Islamic financial institutions in Russia since the early

The secret of success is to introduce the economic aspects of Islam before any penalising sanctions. It is necessary to begin with economics rather than with scaring. This is a much more effective way to familiarise and attract people to Shari'ah law.



Renat Bekkin, MGIMO-University

1990s. Regrettably, none of these undertakings seems to have resulted in anything long-lasting.

Back in 1992, an Islamic Cultural Centre in Moscow and the All-Russia Tatar Cultural and Educational Centre, together with a number of Russia's large machinery and metallurgical plants, announced the establishment of the United Islamic Commercial Bank Inc. It was going to be located in the Kemerovo Region, an industrial district in the north-east of Russia. The reasons behind this collaboration were more practical than religious; the bank was set up to develop the industry in the region and to attract foreign investors primarily from Muslim states. 'The regional government knew next to nothing about Islamic finance at the time, they just wanted to create a financial structure to attract capital from the Arab world,' says Bekkin. However, this project was never completed.

Another unrealised project, which directly involved Bekkin, was the launch in 2005 of an Islamic insurance company in the republic of Tatarstan (a federal subject of Russia) called 'Itil'. It was supposed to be a joint venture between local entrepreneurs and foreign investors from the Arab world. 'There were no obstacles from the legislative or political point of view,' says Bekkin. He was appointed director of the company. 'We drew up a business plan and presented it to the foreign investors. The problem turned out to be quite worldly – apathy from both sides to actually press on with the project. So, it didn't end with anything.'

Indeed, although the Arab world considers Russia a potentially emerging market with regard to Islamic finance, there is still a lot of apprehension when it comes to investing capital in it. 'There are many hitches and complications,' admits Bekkin. 'One of the potential investors [from UAE] in the takaful company, Itil, once said that Sudan interested him more than Russia from the point of view of the Islamic financial services market.'

And it's not just the Middle East countries that are contemplating introducing Islamic banking in Russia. Not long ago, Bekkin



Kul Sharif Mosque, Kazan, Republic of Tatarstan, Russia

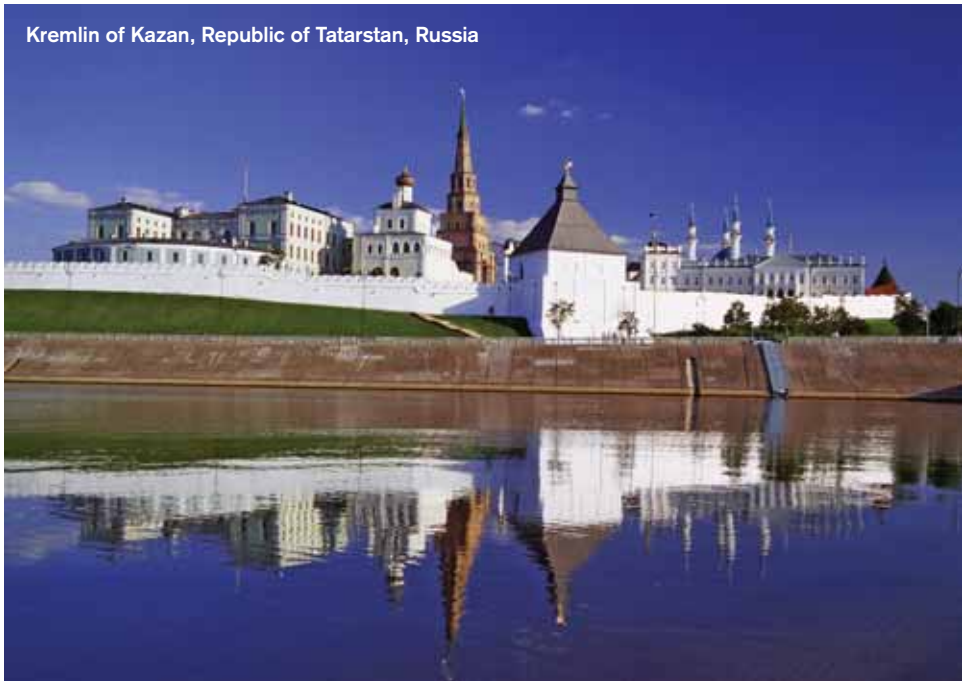


held some talks 'on a consulting level' with the Swiss bank Fortis, which was pondering a move into the Russian banking market with its Islamic offering. The idea was to develop tailored financial products and services using the Islamic model, yet without calling them Islamic. However, the bank's initial analysis was not satisfactory and so far Fortis has not taken any further steps.

Bekkin thinks that chances of success in this field would be higher if large international conglomerates like HSBC or Citibank opened their Islamic subsidiaries in Russia, as opposed to purely Arab banks doing the same thing. 'It is more likely to have a positive reaction,' he says. However, to date, neither western nor Middle Eastern investors have carried out such a project from start to finish.

The only undertaking that actually moved further than 'half a step' (although today it is also history) was Badr-Forte Bank. This bank was set up in Moscow back in 1991, and operated according to Shari'ah law from 1997. Officially it was not called Islamic, but its charter stated that the bank had the right 'to act according to Russian and international laws by applying Islamic economic technologies which do not contradict the banking laws of Russia'. Badr-Forte was also a member of the General Council of Islamic Banks under the IDB (Islamic Development Bank).

The bank managed to adapt successfully to the Russian legislation and economy whilst following the Islamic principles of banking although, according to Bekkin, 'due to the specifics of Russian laws Badr-Forte had to compromise more in some respects than its foreign counterparts'. The piece of legislation that became a stumbling-block for Badr-Forte and Russia's Central Bank was the deposit insurance scheme, which the Central Bank made mandatory. Badr-Forte tried to explain that the essence of an obligatory deposit insurance scheme contravened the very principles of Islamic banking, but the Central Bank stood firm. In the end, Badr-Forte's licence was revoked on the grounds of money-laundering activity plus the gross violation of order and period when reporting suspicious transactions.


Kremlin of Kazan, Republic of Tatarstan, Russia

The bank had focused on foreign trade operations, such as cross-border transfers, guarantees and letters of credit. Unfortunately, its retail Islamic offering was limited to deposits, money transfers and mortgages, with the latter being launched shortly before the bank's closure. Furthermore, the bank had no branches and was not widely known to the general Muslim public even in Moscow (the city which hosted the bank's headquarters), let alone regionally. Badr-Forte, however, tried to compensate for its absence of outlets by actively promoting both internet and mobile phone banking.

Bekkin is very familiar with the bank and its founder and chairman, Adalet Dzhabiev, as Bekkin worked on probation in the bank for a while during his university years. 'Actually, everyone who was studying Islamic finance at the time or was writing about it bore some relation to Badr-Forte,' he says. 'Everything concerning Islamic banking in Russia and everybody involved in it were revolving around this bank.'

However, in December 2006, the Central Bank of Russia revoked Badr-Forte's banking licence. There have been a few unsuccessful attempts to recover the licence, but it doesn't seem likely that Russia's only Islamic financial institution is going to be revived any time soon. Dzhabiev is not in a rush to open another Islamic bank in the country. As the proverb goes, 'Once bitten twice shy'.

Of course, Bekkin regrets that the idea of an Islamic bank in Russia still remains only theoretical, but he thinks that Badr-Forte had more than Russia's legislation and the current state of the Russian banking market to blame. The lack of the bank's activity in the social and educational spheres resulted in the absence of a wide-spread support for the bank among Russia's Muslims.

'One of the primary functions of any Islamic financial institution is a social one,' states Bekkin. 'Unfortunately, Badr-Forte did not really fulfill that.' He goes on to give an example: 'Dzhabiev and his right hand, Samira Karahanova, were the only Muslims working in the bank, and Dzhabiev was keen on recruiting qualified Muslim staff to work in Badr-Forte. Since such personnel were hard to come by, there was a suggestion to train the potential staff, provide them with the necessary literature and let them get a feel for Islamic banking in practice. Dzhabiev's position on this issue was far from supportive, as he suggested that those willing should research and learn Islamic banking themselves, without the bank's help. And this kind of attitude spread to other things too.'

However, in spite of Badr-Forte's fate, the idea of establishing an Islamic financial institution in Russia continues to hover in the air. So, if another Islamic bank were to open in the country, what would be the best geographical location for it? Bekkin thinks that 'Moscow is the city with the most potential of developing an Islamic finance service industry, as it has a large Muslim community, and quite a lot of well-off Muslims, both ethnic and newly converted'. Russia's capital is among the most expensive cities in the world, and the standard of living there (regardless of people's faith) is traditionally high compared to other parts of the country. Plus, Moscow has embraced the financial services industry with considerably more enthusiasm than the regions.

Another part of Russia that is also a potential Islamic banking and insurance hub is the republic of Tatarstan, situated in the central part of Russia. Tatarstan lies between the Volga River and the Kama River (a tributary of the Volga) and extends to the Ural Mountains. It is a predominantly Muslim republic, with a population of nearly four million people. 'It has a claim on being the leading Muslim community centre of Russia,' says Bekkin, 'so there is a potential interest in the Islamic financial structures there; however, it is more political than economic'.

Then, there is also the republic of Dagestan, situated on the Caspian Sea coast in the southern part of Russia, the North Caucasus. Over 90 per cent of this republic's population (2.3 million) is Muslim, with Islamic faith dating back centuries there. 'This region is exactly the case where people follow Shari'ah principles in various aspects of life except the financial one. There is a lack of understanding and support of this matter both from the local government and the local population,' says Bekkin. Even so, there has been sporadic talk of establishing an Islamic financial institution there, but this has turned out to be unsubstantiated.

Such empty promises are not an unusual thing for Russia. Once in a while, announcements of establishing an Islamic bank or a takaful company appear in the mass media. Bekkin thinks that most of the time 'it is merely a trick to attract attention and to occupy a niche in this market in advance'.

Nevertheless, the development of Islamic banking in Russia is by no means a lost cause. More widespread education about Islamic economics and finance is needed, as 'the lack of knowledge in this area is one of the main causes of low demand for Islamic financial products'. Even a basic thing, such as zakat (Islamic concept of tithing and alms), is a very unclear subject for a lot of Muslims in the country. 'Knowledge of zakat is a touchstone by which you can judge the people's attitude to Islamic finance,' says Bekkin. 'Here it is very often thought to be unnecessary, or many people think that giving alms to the paupers by the mosque is zakat.'

Also, creating favourable conditions for the development of Islamic financial services is essential. 'The secret of success is to introduce the economic aspects of Islam before any penalising sanctions. It is necessary to begin with economics rather than with scaring. This is a much more effective way to familiarise and attract people to Shari'ah law,' states Bekkin.

At the moment, Bekkin is involved in the project of creating an Islamic mutual fund, Gold Dinar, which is expected to commence operations later this year. 'The management company has already been registered, and now we are in the process of developing the products,' says Bekkin. Gold Dinar will be situated in Moscow, with the ambition of moving into Russia's regions in due course. At present, Bekkin's role in the project is purely consultative; however he is considering further involvement in this mutual fund. 'I am always interested in learning something new,' he says. 'Maybe I'll work in the company.' It all depends whether the company's investors stick to the project and go all the way. So far 'everything seems to be serious', but having encountered so many canards before, Bekkin is cautious in his prognosis.

Moscow is the city with the most potential for developing an Islamic finance service industry, as it has a large Muslim community and quite a lot of well-off Muslims, both ethnic and newly converted.

The 'initiative group' organising Gold Dinar consists of seven people. Most of the participants are originally from Dagestan, but they have been living and working in Moscow for a long time. Although the primary goal of establishing this company is to offer the public Shari'ah-compliant services, it is also seen as a 'promising business'. 'The investors are very experienced in this field – some of them have been dealing in securities for over a decade,' says Bekkin. 'So they clearly see the potential in the Islamic mutual fund and know that there is a demand for its products and services in Russia.'


Mosque in Norilsk, Siberia, Russia

The concept of mutual funds is relatively new to the Russian market and this niche has recently been developing rapidly, with plenty of coverage in the mass media and a mushroom growth of conventional mutual funds as an alternative way of depositing money. Muslims in Russia turn to mutual funds for financial services, as these organisations are regarded as more ethical and less contradictory of Shari'ah law than banks. Therefore, setting up a proper Shari'ah-compliant mutual fund in the country is indeed 'a hopeful activity'. And the successful completion of this project will surely be a step in the right direction towards further development of Russia's Islamic financial services market.

Meeting with Japanese delegation

Warren Edwardes, a member of the IIBI's informal Board of Governors, received a Japanese delegation visiting London for a research project 'The Emergence of Islamic Finance in the UK'. Professor Koji Muto, professor of Middle Eastern economic studies and Islamic finance, College of Asia Pacific Management; Katsura Daikuhara, principal economist (Middle Eastern economic development); and H. Hosoda, the latter two both from the Japan Centre for International Finance, acknowledged that London is seen as one of the key centres of growth in the Islamic finance sector today. They discussed London's prospects of becoming the centre of global Islamic finance transactions, such as sukuk, and the pros and cons of this scenario. The delegation also assessed the UK government's efforts to promote Islamic finance in the country and what remains to be done in this area.

The talks were not limited to the domestic issues of the industry, but embraced other topical subjects of Islamic finance on a worldwide scale. The Japanese delegation raised the very interesting question of the differences in Shari'ah interpretation between the Gulf countries and Malaysia, and whether such uncertainty causes problems, for instance, in damaging the stability of issuance or trading of sukuk.

Other global problems, such as a possible increase in the costs of Islamic products and services due to the conflict between strengthening competitiveness and Shari'ah compliance, as well as the negative effect that the petrodollar shrinkage might have on Islamic finance, were also discussed.

IIBI director general joins Muslim Power 100

Mohammad Ali Qayyum, director general of IIBI, has been included in the Muslim Power 100 list, an initiative set up by Carter Andersen, media and business consulting organisation. In the words of Khalid Darr, chairman of Carter Andersen, the Muslim Power 100 names 'Muslim men and women who contribute positively and often powerfully within all sectors of British life'.

The purpose of the nomination is to set out how the Islamic 'traditional core values of empathy, objectivity, integrity and impartiality drive the contribution to the social and cultural welfare of Britain'. Today, the Muslim population in the UK is estimated at 2.1 million with a contribution to the annual GDP (gross domestic product) of £51 billion.



Mohammad Ali Qayyum, IIBI

The country's Islamic finance services sector has grown considerably over the past few years and continues to increase steadily. Qayyum believes that unbiased education and training from independent organisations like the IIBI supported by professionals, the industry, regulators and government is the key to successful promotion and implementation of Islamic finance both within the UK and outside it.

In 2003, Qayyum became director general of the London-based Institute of Islamic Banking and Insurance (IIBI), bringing in-depth knowledge and practical experience gained from nearly three decades in the banking industry.

Until the sad demise in March 2005 of the IIBI's founder and chairman, Muazzam Ali, Qayyum assisted him in reviewing the Institute's short-term strategy. The late Ali, who established the IIBI as a non-profit organisation, was a pioneer and highly respected figure; he realised early on that the success of the Islamic banking movement would depend heavily on education, training and research.

Since taking on the position of director general, Qayyum has been working closely with members of the IIBI's informal Board of Governors on developing the short-term as well as long-term business plans to take the IIBI to a higher level. Together with his team and the Institute's 'friends', Qayyum is continuing the late Ali's legacy of promoting Shari'ah-compliant finance and of establishing the IIBI as a global centre of excellence in Islamic banking and insurance education, training and research based in the City of London.

Korea Economic Daily interviews IIBI

Due to the growing interest in Islamic banking in South Korea and in order to introduce it to South Korean national readers, Yong-Seok Ju, a journalist at the Korea Economic Daily (Han Kyung), one of the largest finance and business daily national newspapers in South Korea, along with his interpreter, Ms Hee Choo, visited IIBI and interviewed Mohammed A. Qayyum, the Institute's director general.

In the course of the discussion, Ju raised various questions on the history of Islamic finance, its present position in the mainstream financial system, the role of Middle Eastern economies in its development, and the future prospects of the industry. He also enquired about the Institute's objectives, activities and areas of support in promoting Islamic finance. Qayyum informed him that IIBI has been endorsing this sphere of finance for over a decade, providing training and education in the form of post-graduate diploma courses, monthly lectures in London, publication of reference books, and issuing NewHorizon, an official magazine of IIBI. Qayyum also stated that the Institute has further plans to expand its activity and upgrade its services, while continuing to offer assistance to all those willing to learn more about Islamic banking and insurance.

Promoting Islamic finance

January: What should be our vision and objectives in Islamic finance?

This was the theme addressed by Dr Muhammad Imran Ashraf Usmani for the IIBI monthly lecture on 30th January 2007.

Dr Imran is one of the leading Shari'ah advisors in the Islamic finance world and currently serves on the Shari'ah boards of many international financial institutions. He is also a member of the IIBI's Shari'ah Advisory Group.

The lecture was chaired by Iqbal Khan, former founding CEO, HSBC Amanah, and member of the IIBI Board of Governors.

Forty years ago, when the modern Islamic banking movement began to establish itself in the global financial system, pioneers of the movement saw it as a cure for the economic and social ills of society. According to them, these ills stemmed from unbridled capitalism. Islamic banking is now regarded as the defining characteristic of the Islamic economic system and, while many Islamic banks are now operating around the world, debate continues as to what constitutes success in relation to its potential to maximise social welfare. Meanwhile, the belief still lingers that profit and loss sharing banking is superior to interest-based banking.

Dr Imran pointed out that Islam is a complete religion and provides a comprehensive code of life, with guidance in every sphere including socioeconomic fields. If this guidance were followed by society, the welfare and well-being of mankind would benefit. He referred to specific instances: 'Allah (SWT) permitted trade and prohibited riba'; and Prophet Muhammad (SAW) encouraged shirkah (partnership) in various maxims and sayings. Islamic finance facilitates the equitable distribution of wealth by prohibiting riba (interest), maysir (gambling) and gharar (speculation). Some permissible Islamic financing modes were preferred and encouraged by the Islamic Shari'ah over others – the contract of equities, for example.

Dr Imran said that Islamic banking transactions should be based primarily on musharakah /mudarabah (profit and loss sharing models), so that capital would flow from the rich to the poor, while the ratio of equity based transactions should increase over non-participatory based transactions to achieve the real benefits of Islamic banking. Where profit and loss sharing contracts were not feasible, however, exchange contracts such as murabaha, ijara and salam, diminishing musharakah and istisna should be used. These are asset-backed transactions that would reduce the level of economic inflation.

Islamic financial institutions should evaluate the extent to which they fulfil the basic requirements of the community. If they were to increase their product range they would boost the confidence of the community and broaden the customer net. This would be key to the growth of the Islamic finance industry. 'Products should be Shari'ah compliant not only in form, but also in substance, in order to realise the true benefits of the Islamic financial system,' he concluded.


January lecture

February: How to create a Shari'ah-compliant, balanced investment portfolio

Sufyan Gulam Ismail, CEO and founder of 1st Ethical group, considered how to create a Shari'ah-compliant, balanced investment portfolio at the IIBI February lecture.

Ismail started his career with Deloitte & Touche, a firm of chartered accountants, which also offers advisory, financial, management and taxation services. In 2001, Ismail identified a gap in the marketplace for a specialist firm to provide bespoke tax solutions to owner-managed businesses. He filled that gap by starting up 1st Ethical in the same year.

The lecture was chaired by Sultan Choudhury, director of sales, Islamic Bank of Britain.

Social responsibility is gaining increasing popularity in the corporate world. It is perceived as a means of self-regulation to demystify stakeholders' concerns about the operations of a business and a way of highlighting the contribution to the community and environment in which the enterprise is operating. Shari'ah-compliant products, with their underlying principles of equity and social justice, embody the same values.

As the Islamic finance industry grows, Islamic financial institutions must disseminate information about the range of products available, along with their different risk profiles, and must commit to responsible business conduct, investment in people and in the community.

The basic principles of Shari'ah, as applicable to investments, include the prohibition of interest and the avoidance of unethical concerns and contractual deficiencies, such as uncertainty and 'risk and reward' consideration. There are other key factors, however, which must also be considered when screening for Shari'ah-compliant investments. The shares of gambling outlets and businesses, tobacco companies, pornographic concerns, banks and insurance firms dealing in interest, and manufacturers and distributors of alcohol must be filtered out. Add to this list organisations whose principal activity may not centre on the above but which derive more than ten per cent of their income from one or more of these activities; highly leveraged companies (with gearing in excess of 33 per cent); and companies involved in activities prejudicial in any other way to the interests of the Shari'ah.



Sufyan Gulam Ismail, 1st Ethical group

Ismail looked at the current retail products in the UK marketplace and segregated them according to their risk profile. He also discussed the tax efficiency of these investments. He cited low risk products, including the Islamic bank accounts presently offered by HSBC Amanah, LloydsTSB and Islamic Bank of Britain; and Shari'ah-compliant property investments. Medium risk products are the ethical unit trusts, which minimise the risk of investment by diversifying the portfolio, such as Friends Provident, musharakah funds and property share funds. High risk products include Middle East Islamic bank equity funds, Shari'ah-compliant UK equities and direct investment in the Dow Jones Islamic index.

March: Risk management in Islamic finance

For the IIBI March lecture, Professor Rodney Wilson, director of Postgraduate Studies at Durham University's School of Government and International Affairs, addressed some of the key issues faced by Islamic financial institutions in managing credit, operational, liquidity, Shari'ah, legal and regulatory risk.

The lecture was jointly chaired by Richard Thomas, the former managing director of Asset Management at Arab Banking Corporation, London, and Professor Mahmood Faruqui, honorary vice-chairman, IIBI.

With an increasing number of organisations operating across borders, facilitated by advances in information technology, executives are focusing increasingly on the management of the risk incurred by the various business operations.

As financial institutions are key players in each country's economic stability and growth, governments all over the world are developing regulations and monitoring mechanisms.

Such mechanisms are necessary in order to maintain and enhance public trust in their financial institutions, in this era of globalisation, where millions of funds can be transferred at the click of a mouse.

While the modern Islamic banking movement is still in its infancy, it must devote more resources, train more personnel and build a comprehensive strategy to manage risk and develop confidence in its operations and long-term sustainability.

The distinctive nature of Shari'ah-compliant financial liabilities and assets has implications for risk management.

Professor Wilson focused on credit risk initially – an area of great concern for all financial institutions, but more important in Islamic banking as Shari'ah ruling emphasises the need to take a lenient


March lecture

approach when borrowers are in genuine financial difficulty.

Investment mudarabah deposits cannot be guaranteed, a fact which conflicts potentially with deposit protection insurance requirements. In murabaha financing operations, and with ijara operating leases, Islamic banks take on ownership risks which conventional banks try to avoid.

Since Islamic banking is based on traditional principles of profit sharing, there are also potential asymmetric information problems that increase risk. Internal management processes and client screening criteria should be strong to minimise these risks.

Having an experienced management team and well-trained staff may curtail the operational risk for the banks. Liquidity risk can be managed by using murabaha inter-bank deposits, to utilise the surplus funds of one bank by another.

Professor Wilson also discussed ways to deal with unscrupulous defaulters. These included blacklisting a client, taking him/her to court and the confiscation of his/her passport. These penalties may vary from country to country, depending on the profile of the client and the national, legal and regulatory structures in place.

At the same time, those who had genuinely fallen into financial difficulty, as a result of changes in their circumstances, should be given more time and, if possible, their capital payments should be treated on the basis of quard hasanah (the extension of a loan without interest, where the borrower pays back the capital only).

This approach could enhance the reputation of Islamic banks, so improving client loyalty while helping to attract new clients, as the bank is partnering with the client to overcome a difficult financial situation.

Mudarabah and musharakah financing modes are used infrequently because these expose Islamic banks to maximum liability and it is also very costly to establish effective monitoring mechanisms – a prerequisite here. Therefore most Islamic banks tend towards non-participatory modes, where the risk is much lower compared to the mudarabah and musharakah.

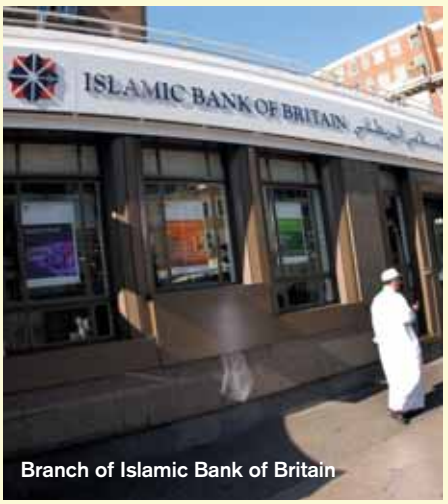
A more detailed article on credit risk from Professor Wilson can be found on page 36.

April lecture preview: Successful strategies for attracting Muslim customers by Islamic banks

This is the topic of the IIBI's April lecture, which will be presented by Sultan Choudhury, director of sales, Islamic Bank of Britain. Choudhury has plenty of knowledge and experience to share, as the customer base of this, the UK's first standalone Islamic bank, has trebled in the past two years reaching 51,000.

The lecture will address the issues of understanding the increasing importance of the emerging Islamic financial services industry; benefiting from the new demographic and economic realities; learning how to identify and target potential customers with the right products and customised services; training the workforce to ensure that they genuinely believe in the products and services they are selling to the Muslim customers and that they are able to empathise with them.

To register, please visit: www.islamic-banking.com



Branch of Islamic Bank of Britain

The lecture will take place on 30th April 2007 at 5.30pm at:
British Bankers' Association
Pinners Hall
105–108 Old Broad Street
London
EC2N 1EX

The London Islamic Financial Services Summit

Investors, lawyers, accountants and bankers gathered at the Barbican Centre in London on 29th March 2007 to discuss developments in Islamic banking products and services. The summit was endorsed by the IIBI.

A key thrust of the conference was discussing London's role in the Islamic banking industry. Some of the City's heavyweight figures – including Ed Balls MP, economic secretary to the Treasury; Sir Michael Oliver, a former Lord Mayor of the City of London; Michael Ainley, the head of the UK's FSA (Financial Services Authority – the UK's financial market regulator); and wholesale banks and investment firms unit, all made enthusiastic addresses on the way the UK government has changed regulations to accommodate Islamic banking. There were several references to the way in which the UK has adopted a 'principles-based' approach rather than 'just ticked boxes' in a 'rules-based' approach.

To create a 'level playing field' between the conventional banking market and the rapidly developing Islamic market, the government has passed legislation specifically aimed at accommodating Islamic instruments and has adopted changes to its tax environment. In the March 2007 Budget, the Chancellor announced changes to accommodate 'alternative finance investment bonds' specifically intended for the sukuk. Currently, there are around 25–30 regulated firms in the UK that are authorised to offer Islamic products, with more applications from banks in the pipeline. A UK base enables firms to open in any EU country.

Some speakers felt that other worldwide regulations and accords are proving more problematic for Islamic banks to adopt. The Basel II Accord, for example, is more difficult to apply to an Islamic financial institution because the instruments it uses have different risk profiles from conventional ones. Basel II requires banks to allocate capital according to the perceived risk of each asset class. The IFSB (Islamic Financial Services Board) is attempting to create capital adequacy guidance standards for Islamic financial institutions, which will provide a standard platform to help these institutions make allocations against specific Basel II risk categories.

New structures of Islamic products are being developed and some were presented to the conference. The world of derivatives is now being made available to investors in a form that is acceptable to Islamic scholars. Traditionally, scholars saw these instruments as speculative and a form of gambling. They are now increasingly being accepted as a hedging tool. The lack of standardisation in Shari'ah products and differences between countries makes developing Shari'ah-compliant derivative products a more expensive process. The ISDA/IIFM (International Swaps and Derivatives Association/International Islamic Financial Market) are jointly discussing the principles of a Shari'ah-compliant 'master agreement'. The developed draft is being reviewed by a working group in conjunction with Islamic scholars. The agreement will make derivative products much easier to structure.

The conference was told that the most common Shari'ah derivative structures are the murabaha followed by the arboun (resembling a conventional call option) and then the salam (resembling a forward sale). The murabaha can be used to configure a profit rate swap which is a structure equivalent to an interest rate swap in the conventional market. The murabaha profit swap is often used in conjunction with a tawaruq. Also, Deutsche Bank has published a white paper on how it structured an innovative product using wa'ad (promise) features that allows Shari'ah-compliant investments to reference a wide range of asset classes, including indices.

There are over 260 Islamic scholars around the world involved with banking in some way, although there are only around 20 who are recognised globally. Of these, a dozen or so regularly deal with Western banks. The objective of having an Islamic scholar to review a structure is to obtain a fatwa regarding the Shari'ah compliance of the product. One respected scholar shared his viewpoint on the concept of Shari'ah compliance with the conference. He pointed out that Shari'ah consists of two parts: the practical; and the theoretical representing belief based on faith. When a product is accepted as being Shari'ah compliant it means that it is in-line with the practical aspects and therefore doesn't offend Islam. This is not the same as a product being Shari'ah based – one that incorporates a full partnership between the bank and the customer for their mutual benefit, including genuine assistance as well as sharing of the profits and risks. In this scholar's opinion, Islamic banking has grown from almost nothing 30 years ago to a significant business today. Currently, he feels, it is trying to copy the conventional banking products that have been developed over hundreds of years. He questions whether the aim should be to become Shari'ah based, rather than simply Shari'ah compliant.

Although the sukuk is regarded by some as a 'new' product, one speaker pointed out that it is, in fact, one of Islam's oldest instruments. There are references dating back to the Islamic Caliphates about the 'sakk' (whose plural is 'sukuk'). The word means 'note or certificate' and relates to ancient traders acquiring additional capital through mudarabah when setting off on trading missions to India and other places. Modern structures are more complex.

Islamic Banks, Financial Institutions & Financial Instruments

Below is a monthly list of the latest long- and short-term credit ratings for each Islamic financial institution and financial instruments monitored by Capital Intelligence (CI), an international credit rating agency. Detailed information on rating processes and definitions can be found on the CI's website www.ciratings.com

1st April 2007	CURRENT RATING					
	FOREIGN CURRENCY		FINANCIAL STRENGTH	SUPPORT	OUTLOOK	SINCE
ISLAMIC BANKS	LONG TERM	SHORT TERM				
Abu Dhabi Islamic Bank	A-	A2	A-	2	Positive	Feb 2006
Al Amin Bank	BB+	B	BB+	2	Positive	Oct 2006
Al-Baraka Islamic Bank (Bahrain)	BB+	A3	BB	2	Stable	Aug 2006
Al Rajhi Banking & Investment Corp.	A+	A1	A	2	Stable	Jul 2006
Arab Islamic Bank	NA	NA	B+	3	Stable	Oct 2005
Bahrain Islamic Bank	BBB	A3	BBB	3	Stable	Nov 2006
Bank Islam Malaysia	BBB-	A3	BB+	2	Stable	Oct 2006
Faysal Bank (Pakistan)	B+	B	BB	2	Stable	Aug 2006
Gulf Finance House	BBB	A2	BBB	3	Positive	Nov 2006
Jordan Islamic Bank for Finance & Investment	BB	B	BBB-	3	Stable	Oct 2006
Kuwait Finance House	A	A1	A	2	Stable	Oct 2006
Qatar International Islamic Bank	BBB	A2	BBB	3	Stable	Nov 2006
Qatar Islamic Bank	BBB+	A2	BBB+	3	Stable	Oct 2006
Sharjah Islamic Bank	BBB	A3	BBB	3	Positive	Jan 2006
Shamil Bank of Bahrain	BBB	A3	BBB	2	Stable	Nov 2006
The National Commercial Bank	A+	A1	A+	1	Stable	Jul 2006
Tadhamon International Islamic Bank	B-	B	BB-	2	Stable	Nov 2006

	CORPORATE RATING		OUTLOOK	SINCE
FINANCIAL INSTITUTIONS	LONG TERM	SHORT TERM		
Al Tawfeek Company for Investment Funds Limited	BBB	A2	Stable	Oct 2006
A'Ayan Leasing & Investment Co	BBB-	A3	Stable	Feb 2006
Grand Real Estate Projects Co	BB	B	Stable	Nov 2006
Investment Dar Company	BBB	A3	Stable	Jul 2006
Khaleej Finance & Investment Company	BB+	A3	Stable	Jan 2007

	BOND RATING		OUTLOOK	SINCE
FINANCIAL INSTRUMENTS	LONG TERM	SHORT TERM		
Commercial Real Estate Sukuk Company	A-	A2	Stable	Oct 2006
KCMCC Sukuk Company	BBB	A3	Stable	Jul 2006



Bahrain Fort: The old and the new

Bahrain: Middle Eastern promise

As the world's Islamic finance industry continues to grow and mature, striving for more transparency and a wider range of products and services, so does the banking market of Bahrain. Innovation, modernisation and regulation are the three cornerstones of the country's main regulator, the Central Bank of Bahrain.

Although the practice of Islamic finance in the Muslim world dates back to the Middle Ages, it's only the last few decades that have seen the globalisation of Islamic banking. Islamic financial institutions are now rightfully recognised as fully-functional counterparts of conventional ones. Today, the market size of this industry is estimated at $250–300 billion spread over around 75 countries.

The Kingdom of Bahrain is traditionally considered to be the hub of Islamic banking and, according to the Central Bank of Bahrain (formerly the Bahrain Monetary Agency or BMA), 'is proud to play host to the largest concentration of Islamic financial institutions in the Middle East region'. Indeed, a country with an area of only 665 square kilometres (253 square miles) has become one of the leading Islamic financial centres in the region having licensed 33 financial institutions of this type, including 26 banks and seven investment business firms and financing companies.

The history of Islamic banking in the country dates back to 1978, when the first Islamic bank, Bahrain Islamic Bank, was licensed. The industry's growth in the years following the bank's establishment was slow. One of the triggers which prompted a rapid development of Islamic finance was the Gulf war, which broke out in the early 1990s. It stimulated the Islamic finance market by pushing up oil prices and boosting revenues, thus increasing the demand for Islamic tailored investments. Since then, the world in general and Bahrain in particular has witnessed a mushroom growth and rapid development of Islamic financial institutions.

Pakistan has adopted a Shari'ah-compliant banking system alongside its conventional counterpart. The entire banking system of Sudan has made its practices Shari'ah-compliant. A number of conventional banks in the Muslim world have converted to Islamic banking, with Sharjah Islamic Bank being one example. In 2005, the former Sharjah National Bank announced its 'new vision and commitment', becoming the first and only bank in Sharjah offering Islamic banking products and services to the public.

Adopting such practices has not been confined to the Muslim countries and has spread to the Western world. In mid-2004, the first UK-based entirely Shari'ah-compliant bank, Islamic Bank of Britain, was established, followed by the European Islamic Investment Bank in 2005. A similar project is now in the pipeline in France. Large conventional banking conglomerates, including Lloyds TSB, have capitalised on this niche by establishing Islamic departments. And global financial institutions such as Citigroup and HSBC have created fully-fledged Islamic subsidiaries operating in various parts of the world, including the Kingdom of Bahrain. 'They have recognised the importance of Islamic banking,' says Abdulrahman Abdulla Al-Sayed, director of Islamic Financial Institutions, Central Bank. 'And although the number of Islamic banks has increased significantly, there is still a very good potential for them to grow further in the region and worldwide.'

However, Bahrain is not focusing solely on Islamic banking. It also encourages the presence of conventional banks by pursuing a dual banking system. 'There is no reason

Central Bank is very potent in imposing and supervising banking activities. That is why Shamil Bank chose to be headquartered here.

Abdulnasser Ali Bukamal, Shamil Bank



We have a number of prominent Shari'ah scholars. But we need a new generation of specialists who, in addition to knowledge of the Shari'ah law, also have a background in banking, especially practical banking.

Abdulrahman Abdulla Al-Sayed, Central Bank of Bahrain

why both types of banks cannot co-exist successfully in the Kingdom of Bahrain' states Al-Sayed. 'We offer them equal opportunities and provide equal treatment.' According to him, there has been an increase in conventional banks in the country, but this increase 'hasn't been as significant as that of their Islamic counterparts'.

There is a lot of interaction going on between Islamic and conventional banks in Bahrain. A large number of specialists from the latter move to work at Islamic financial institutions. 'There is no Shari'ah law that says that Islamic banks should only recruit Muslims,' states Al-Sayed. The staff is hired according to the universal rule of judging potential employees by their knowledge and abilities, not by their faith. Conventional bankers can 'provide skills and experience', given the fact that conventional banking is much older than Islamic banking. 'Islamic banking, not Islamic transactions,' emphasises Al-Sayed. 'Islamic transactions have existed for over a thousand years, but they were done on an individual basis between individuals. So, the concept is there to take and develop into products.' In the course of this development (in addition to traditional Islamic products) the conventional banking specialists use some conventional products as a basis and then 'modify them in order to make them Shari'ah-compliant'. Al-Sayed goes on to give an example: 'Let's take a credit card. Ten years ago, everybody would say there was no way it could be Shari'ah-compliant, as it involves 'selling' cash and there is a prohibition of direct cash financing in Islamic banking. But Islamic banks are very innovative and today, there is a range of Shari'ah-compliant credit cards, based on murabaha [the bank buys and sells the items required by the customer], ijara [leasing] and so on.'

Needless to say, the Bahraini Islamic banking system is 'booming'. In 2006, its total assets reached $20 billion compared to just over $10 billion two years ago. In 2006 alone, three new Islamic banks were granted banking licences (Al Salam Bank and United International Bank (UIB) are amongst the newcomers), with another two a year earlier. 'There are more banks in the queue waiting for the Central Bank's approval,' says Abdulnasser Ali Bukamal, senior manager, banking operations, and money laundering reporting officer (MLRO), at Bahrain-based Shamil Bank.

Shamil Bank of Bahrain is one of the oldest Islamic banks in the country. It launched Shari'ah-compliant operations back in 1982, when it was established as an offshore banking unit, only a few years after Bahrain Islamic Bank was licensed. In 1994, it obtained a commercial banking licence and became a fully-fledged Islamic financial institution. Today, Shamil Bank has a shareholding equity of $353.4 million (as of 31st December 2006), seven branches and 14 ATMs in the country, and the holders of the bank's cards can use ATM facilities in any of the GCC (Gulf Cooperation Council) countries. It also maintains a presence overseas (including China and Saudi Arabia) through its associated and affiliated companies.

The bank provides financial and investment services for both corporate and retail customers. Facing the competition from its counterparts, it has expanded the range of standard products offered by the majority of the Islamic financial institutions. In addition to such services as murabaha, mudarabah (profit loss sharing), musharakah (joint venture), ijara and istisna (contractual agreement for manufacturing goods and commodities), Shamil Bank has introduced al-ruban (credit card), commodity murabaha (personal loan, cash money) and tawaruq (personal loan). To date, it is the only bank in Bahrain offering al-ruban services, with around 2000 takers so far. As for tawaruq, it is 'a newly developed product' not just for the bank, but for the Bahrain's Islamic financial market as a whole. 'Now we can fully compete with conventional banks,' states Bukamal.

Shamil Bank's database consists of both Muslim and non-Muslim customers, and Islamic banking is proving to be more and more popular among people of non-Islamic faith. But what is the secret of its success? Bukamal gives his outlook: 'When some people approach a certain bank, it is not done only from a religious point of view.

The costs are also considered, and the customer will go where the costs are lower.' In times of intense competition in the country's banking market today, it is logical for a bank to offer favourable conditions.

Al-Sayed expounds his opinion: 'Some people deal with Islamic banks simply because they are Muslim and they wish to transact in accordance with their faith. Others are looking for investment opportunities. And that's where non-Muslims come in. Islamic banks are innovative and they introduce products that offer an attractive return to customers. So, innovation together with the yield that the banks are offering has contributed positively towards attracting non-Muslims.'

Encouraging innovations is one of the keystones of the Central Bank's policy. Every Islamic bank based in the country has its own Shari'ah board – a mandatory authority which consists of a minimum of three people. It is up to the board to advise the bank on various aspects of Islamic finance and to decide which products and services are Shari'ah-compliant. The Central Bank, in its turn, also has a supervisory Shari'ah board, but this has a different role. It deals with the issue of sukuk (government bonds). The Central Bank does not centralise the decision-making processes concerning Shari'ah compliance issues of individual banks, and it does not interfere in these processes.

Such practice is different in some other Islamic financial centres, such as Malaysia, where the Central Bank (Bank Negara Malaysia) – or to be more precise its Shari'ah board, has to approve any innovations in Islamic finance before they are introduced to the market. In addition, Shari'ah boards of all of the banks in the country are 'to some extent subject to review by the Central Bank'. 'This does not seem practical for Bahrain,' says Al-Sayed. In his view, Bahrain's approach 'does not hinder innovation or delay the process of transactions'.

Creating a favourable environment for the innovations has proved to be worthwhile. The product range of Islamic finance is expanding rapidly. The Bahraini banking market has witnessed the emergence of the aforementioned Shari'ah-compliant credit cards and a recent introduction (although, as with many other Islamic products, its roots go back centuries), the tawaruq or personal loan service referred to earlier by Bukamal.

However, this policy is not the only factor attracting financial institutions to the Kingdom of Bahrain. Al-Sayed thinks there are several reasons for such recognition. 'First of all, it is human resources,' he says. 'Bahrain has individuals who are very experienced in banking in general and have extensive knowledge of it. And I am comparing Bahrain not to the GCC only, but to the whole region.'

Due to the country's long tradition in finance, the Central Bank offers its expertise to specialists both within the country and outside it. The Bahrain Institute of Banking and Finance (BIBF) was set up under the auspices of the Central Bank back in 1981 to provide training and education in various aspects of finance, such as conventional and Islamic banking, IT, accounting and regulation. Central Bank has advised a number of countries on regulation matters, including the USA, UK, Sudan and Malaysia. Such international acknowledgement makes Al-Sayed very proud of Central Bank's achievements. 'They approached us because they knew that Bahrain's banking regulation was in compliance with the best international practices.'

And on the ground the banks are contributing to this educational process too. Shamil Bank, for example, is known as 'a training bank' both in Bahrain and outside it. As one of the oldest and most well-established Islamic financial institutions in the country, it offers its expertise to banking specialists and graduates. 'Providing sufficient training has always been our policy,' states Bukamal. With such a rapid growth of Islamic banks, there has to be enough trained personnel to work in them. 'Handling of Islamic transactions and documentation is not easy, and far from the straightforward practices at the conventional banks,' says Bukamal.

Having worked at the Shamil Bank for 21 years, Bukamal himself has plenty of knowledge and experience to share. He is a private instructor at the BIBF in addition to his main job at Shamil Bank, lecturing in Islamic international trade finance, documentation structure for financing facilities and teaching the advanced Islamic Banking Diploma Programme at evening classes.

However, there is still room for improvement in Islamic finance education and training, thinks Al-Sayed. Shortage of Shari'ah scholars remains a challenge for the country. 'We have a number of prominent Shari'ah scholars,' he says. 'But we need a new generation of specialists who, in addition to knowledge of the Shari'ah law, also have a background in banking, especially practical banking.' The Central Bank encourages such 'skilled talent development' in every way possible.

A strong regulatory framework is another cornerstone of the Central Bank's policy. 'Central Bank is very potent in imposing and supervising banking activities,' says Bukamal. 'That is why Shamil Bank chose to be headquartered here. Bahrain is a good base for a bank's head office, and its branches can be located in any of the GCC countries or outside.'



Abdulnasser Ali Bukamal, Shamil Bank

'Our regulations are of the highest standards of the best international practices,' assures Al-Sayed. 'But at the same time they are flexible.' He explains: 'We are in constant ongoing consultation with the industry.

Central Bank does not introduce any local or international regulations without consulting the financial services industry first.

Abdulrahman Abdulla Al-Sayed, Central Bank of Bahrain

Central Bank does not introduce any local or international regulations without consulting the financial services industry first.'

This proved to be very topical when introducing Basel II requirements (the international agreement on the amount of capital needed by a bank; a refined version of Basel I). At the moment, Bahrain is in full compliance with Basel I, with the implementation work of Basel II in progress. It is expected to come into effect in January 2008. 'Both conventional and Islamic banks have been involved in the process for the last 12 months,' says Al-Sayed. Recently, the Central Bank has sent out the consultation papers on the introduction of Basel II to all the banks in the country, and is now 'waiting for their comments'. And with the Central Bank leading the way, the banks on the ground are striving to meet all the necessary Basel II requirements. Shamil Bank, for example, is seeking help in this matter from its auditor, PricewaterhouseCoopers, who, according to Bukamal, 'is working closely with the risk managers on this issue'.

Both conventional and Islamic banks are subject to the same supervisory regulations, including those of the Basel requirements. However, Islamic banking has 'unique characteristics' that make it somewhat problematical to be compliant with exactly the same regulations when it comes to Basel. Islamic transactions are dissimilar to conventional ones. 'And it's not just the transactions,' states Al-Sayed, 'it's the whole relationship between the customer and the bank that is different.' He gives an example based on a mudarabah contract: 'When a customer brings money to a conventional bank, he/she is generally guaranteed a return. But in an Islamic bank when a mudarib (manager) and a customer, who is a fund provider, draw up a mudarabah contract, there is no guarantee on return. If the investment is successful, a bank and a customer share the return; if not, a customer bears losses. An Islamic bank is not liable for the losses, except in the case of misconduct or negligence.' This aspect changes an asset–liability mix which, in its turn, impacts the capital adequacy requirements. Therefore, 'the capital adequacy is treated differently in Islamic banking'.



Central Bank, Bahrain

In order to cater for these differences, the Prudential Information and Regulatory Framework (PIRI) was devised. The Islamic Financial Services Board (IFSB) – of which Bahrain is a member – has issued standards in a number of areas, including capital adequacy, corporate governance and asset management. And there are two more standards to come which will cover Pillar II and Pillar III requirements (market difference and supervisory review). 'IFSB used the fundamental principles of Basel II, and modified them to be suitable for the Islamic banking market', says Al Sayed.

So, whilst the conventional banks operating in Bahrain must fully comply with Basel II, their Islamic counterparts must comply with 'the combination of IFSB standards and Basel II'. 'This is not a deviation from Basel requirements,' emphasises Al-Sayed, 'but rather an enhancement and addition to them to reflect the nature of the unique characteristics of Islamic transactions and the bank–customer relationship.'

Bahrain was the first country to introduce the regulatory framework specifically for Islamic banks in 2001. But even prior to this, according to Al-Sayed, it was 'the first country in the world to request the Bahrain-based Islamic banks to comply with AAOIFI [Accounting and Auditing Organisation for Islamic Financial Institutions]'. This organisation was founded in 1990 in Algiers, with its main purpose being 'to issue accounting and auditing standards' and governance norms within the Islamic finance sector. Al-Sayed thinks that compliance with AAOIFI 'gives the local market more disclosure, makes the financial statements more transparent and reflects the actual transaction'. Bahrain's example was followed by Sudan, Jordan and Qatar, who also adopted the standards for their banking markets.

As a matter of fact, Bahrain has been the pioneer in a number of Islamic-related activities. The country's government was at the forefront in issuing sukuk through the Central Bank. It was the first to release Islamic securities, and to date it has issued over $1 billion worth of ijara sukuk (Islamic leasing bonds). This initiative has proved to be successful and has resulted in other GCC countries turning to Bahrain to manage their sukuk programmes.

The Kingdom of Bahrain hosts a number of supporting organisations for Islamic financial institutions. In 2001, the General Council for Islamic Banks and Financial Institutions (GCIBFI) was founded in the country. One of its major purposes is to gather accurate information and data on the Islamic finance industry.

A year later, the Liquidity Management Centre (LMC) was established. This seeks


Manama, Bahrain

to develop an active secondary market for short-term Shari'ah-compliant treasury products and to create additional investment opportunities for financial institutions and investors. This centre, 'the first of its kind', in the words of Central Bank, commenced its operations in 2003.

Also, in 2002, the International Islamic Financial Market (IIFM) launched its operations. This non-profit organisation was a result of an agreement between the Central Banks of Bahrain, Indonesia and Sudan, the Islamic Development Bank, the Labuan Offshore Financial Services Authority (representing Malaysia) and the Ministry of Finance of Brunei Darussalam. The main aim of IIFM is to ensure further growth and development of the Islamic financial market in compliance with Shari'ah law.

As mentioned above, Bahrain is a member of IFSB. The initiative to establish this organisation was originally proposed in 2000, at the Regulation of Islamic Banking conference held in Bahrain. Governors of the Central Banks and senior officials from various countries, including Bahrain, Iran, Pakistan, Sudan, Egypt, Jordan and Malaysia, put forward the idea of creating a supervisory board for supporting and adapting the international standards for Islamic financial products and different aspects of Islamic finance.

One of the most recent supporting organisations to be based in the Kingdom of Bahrain is the International Islamic Rating Agency (IIRA). This is an independent group that, according to the country's Central Bank, 'will help to increase transparency and accordingly provide more confidence to investors, regulators and to the public at large'.

All in all, recent years have seen a lot of changes on the Bahraini financial market front. 2006 was proclaimed a 'milestone year' by the country's Central Bank. That year, it took over 'the role of a central bank and a single regulator for the country's financial industry' from the BMA. This means that the Central Bank's policies cover Bahrain's banking, insurance and


Shamil Bank of Bahrain, Manama, Bahrain

investment business and also the capital markets. Since its activity instigation, Central Bank has carried out a number of reforms in these sectors. It has introduced 'a new, modernised licensing framework for financial institutions' which became effective in October 2006. There are five licensee categories that comprise the new framework: conventional banking, Islamic banking, insurance, investment business and specialised licensees. The sub-categories have also undergone changes, and there are now two sub-categories instead of three: 'retail bank' (instead of 'full commercial bank') and 'wholesale bank' (instead of 'offshore banking unit' and 'investment banking licence'). According to Al-Sayed, one of the main reasons for this is 'lifting the restrictions on dealing with residents and non-residents'.

The country's payment system, 'the lifeline of the national economy', as it has been described by the Central Bank, is also being modernised. The implementation of the Real Time Gross Settlement (RTGS) system which 'facilitates inter-bank payments and settlements in real-time online mode' is a vital component of this project. According to the Central Bank, in addition to its main purpose, RTGS will also 'take care of retail fund transfers on behalf of banks' customers'. In the course of the project, the system will be seamlessly integrated with the Securities Settlement Systems (SSS). The latter will assist in the 'real-time online settlement of all government securities'. Both RTGS and SSS are expected to go live in the first half of 2007. To ensure that all banks in the country are ready for these innovations, the Central Bank is providing education and training for the users, with the second phase of this task currently underway. Dr Abdul Rahman Saif, executive director, banking operations, at the Central Bank, is reported as saying: 'We are very pleased with the progress made by the banks. We welcome the support from the industry in implementing such a project of national importance.'

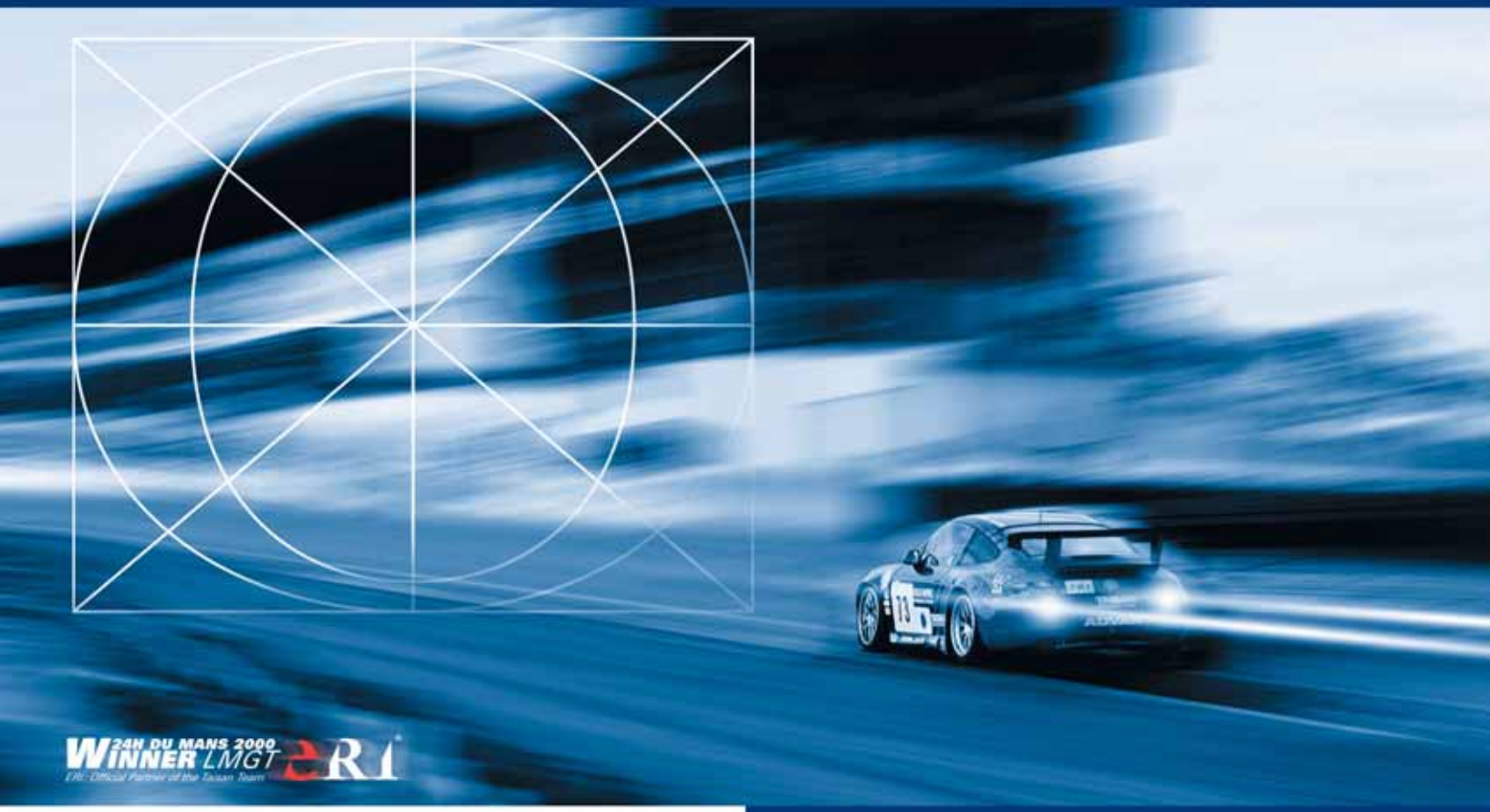
Anti-money laundering legislation is also high on the Central Bank's agenda. 'The anti-money laundering laws are getting tougher and tougher,' says Bukamal. Indeed, the Central Bank is tightening its grip on AML by imposing stricter regulations on banking activities, especially international payment transactions. Middle East and North Africa (MENA) countries, including Bahrain, adopted FATF (Financial Action Task Force on Money Laundering) recommendations concerning AML and KYC (Know Your Customer) so that they could continue dealing and competing in the global market. Furthermore, a MENA-FATF centre was created in 2005 with headquarters in Bahrain. The centre claims a 90 per cent decline in illegal money laundering activity in the region since it came into existence.

Being true to its policy, the Central Bank confers on the subject of AML with representatives from the banks operating in the country. Bukamal and other MLROs from all Bahrain-based banks attend regular meetings held by the executive director of the compliance unit at the Central Bank. 'We discuss relevant issues and consider various suggestions on how to improve things and avoid any concealing of dirty money in the country's banking system,' says Bukamal.

As Bahrain's banking system continues to surge ahead, with year-on-year growth of an average of 18 per cent for the past two years, so does the country's capital, Manama. Cranes are dominating the horizon wherever you look, erecting more ultra-modern buildings for banks, hotels and business centres. Manama is without doubt one of the leading financial centres in the Middle East and it seems it has ambitious plans to go even further and become number one. A grand project of building Bahrain Financial Harbour on 380,000 square metres of reclaimed land aims to create a complete financial city, a self-contained community, in the centre of Manama.

With the continuing transformation and development of the geographical and financial landscapes of the Kingdom of Bahrain, the strategy of encouraging innovations while sustaining a strong regulatory framework, and its extensive tradition in finance, the country is bound to retain the title of one of the foremost financial centres in the region.

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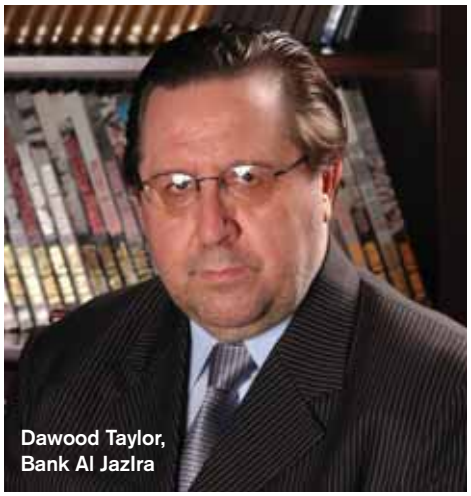
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First line of protection

Bank Al Jazira's Takaful Ta'awuni programme is the first and only Shari'ah-compliant protection savings plan located in Saudi Arabia. Tom Alford spoke to divisional head, Dawood Taylor.


Dawood Taylor, Bank Al Jazira

'We are the market,' says the head of Bank Al Jazira's (BAJ) Takaful Ta'awuni programme. It's not an idle boast, but a fact; it is the only organisation offering Shari'ah-compliant protection savings plans for the people of Saudi Arabia. But new laws coming on stream from the country's banking and insurance regulator, the Saudi Arabia Monetary Authority (SAMA), may see competition hotting up in this already lively global market. Bank Al Jazira is prepared.

Since the Islamic Insurance Company of Sudan was established in Sudan in 1979 as the first formalised takaful provider, the concept of Islamic insurance has expanded to fill an evermore appreciative market. To date, around 85 providers, covering 26 countries from the Bahamas to Yemen, offer takaful products. In doing so, they provide an ethical financial service free from the concepts of riba, maisir and gharar.

The desire for Muslims, and indeed an increasing number of non-Muslims, to engage with financial products affording such benefits is becoming increasingly evident. Commercially, world takaful contributions are estimated to be on the rise in no uncertain terms. Dubai-based Salama, the largest Islamic insurance operator for takaful and re-takaful (Shari'ah-compliant reinsurance) in the world, expects substantial growth during the next five years in the global market. It currently values this market at $1.7 billion and fully anticipates this figure to grow to between $7.5 billion and $10 billion, with sustainable growth looking likely to hit an average 20 per cent per year over the next five to ten years, particularly in the major markets which fall in Malaysia, Indonesia, the GCC and other Arab countries.

The needs are very much the same, whether you're a Muslim or non-Muslim.

The upsurge of customer interest in a hitherto sparsely populated takaful provider market has created a rush of interest from the big international insurance players such as Allianz, AIG, Prudential and Axa. And based on a Shari'ah dispensation, there is now a corresponding uptake of interest in providing re-takaful for life policies, something which BAJ is in the process of switching to. 'We've gone from not enough suppliers, to too many,' Taylor jokes.

Already, major international players have emerged in the general takaful reinsurance field, with Tunis-based Best Re emerging as the world's largest re-takaful company; the Salam-owned business operates in more than 60 countries.

But as a player in the Middle East, a region accounting for around 36 per cent of the global takaful market, BAJ's unique life-based offering is still something of a national treasure.

The bank and its insurance offering operate totally on a Shari'ah-compliant basis – there is no conventional aspect whatsoever. As a fully Islamic insurance offering, it engages in Takaful Ta'awuni, a system based on mutual co-operation for financial assistance and protection. Naturally it is informed by the Quranic principles of Ta'awuni, or mutual assistance. Takaful Ta'awuni is therefore BAJ's response to what the Holy Quran asks Muslims to do on a co-operative basis to achieve the interests of the ummah (the diaspora of Islam), avoiding forbidden practices. Although the BAJ approach does not yet cross international boundaries, it is locally inclusive, encouraging membership of its schemes from all elements of the community in Saudi Arabia, whether local or expatriate, individuals or families, businesses or groups.

BAJ's Takaful Ta'awuni began life in 1999. Although SAMA rules on entry to the market have recently become more unified, at that point any insurance provider offering a long-term investment element had to be managed by a bank. According to Taylor, a period of 'significant research and development', and the co-creation (with a Malaysian vendor) of a bespoke IT system to match, allowed the first products to be brought to market by the bank in 2001.

The provision of this product-set follows the Islamic wakala model, in which the customer effectively appoints the insurance provider as a representative to undertake transactions on his or her behalf – it is similar to granting power of attorney.



There is a good reason for adopting this model, notes Taylor. It revolves around 'a clear separation or segregation' between the client and the service provider so all business expenses are handled by the operator. This, he says, 'overcomes the [very topical] issue of the operator participating in surplus', a problem inherent in mudarabah, the former model of choice for takaful providers (mudarabah is a kind of profit and loss sharing venture between the insurance company and the investor). 'It's a much more transparent contract,' he observes.

Much to its credit, BAJ was 'at the forefront' of the development of the wakala approach to takaful. And it has proven most popular. In double-quick time, it has spread far and wide. 'Just about every other takaful operator that has come into business throughout the world has followed our lead,' Taylor remarks. Of course, the bank does not stake a claim to being the originator of wakala –it is an ancient Islamic contract system – but it has clearly played a vital role in changing the shape of the market, something of which it is justly proud.

As an Islamic financial advisory company selling individuals and corporates products for protection, savings and investment, BAJ's current range of Takaful Ta'awuni products looks remarkably similar to those of conventional insurance providers. And why shouldn't it, asks Taylor? 'The needs are very much the same, whether you're a Muslim or non-Muslim.' The conventional market, having enjoyed a 300-year or so head start on takaful, has obviously used the time to great advantage. It knows what people want and need. As a result, Taylor says the products on offer in the takaful industry do not 'vary significantly' from the products in the conventional industry. Indeed, apart from being Shari'ah-compliant, he asks 'what would you come up with as being unique?' It's a fair point.

However, there are a few culturally-informed products amongst the usual health, motor and pension-style general takaful offerings, and BAJ knows its market well; one of its biggest sellers is a marriage plan to help offset the vast expense of a typical Saudi wedding. But even here, Taylor is aware that, 'at the end of the day, it is still a savings plan'.

In understanding that there is little room or need to go beyond the product-set of the conventional market, BAJ currently offers an education plan, a retirement plan, group protection for employees (covering death and disability), savings and investment plans, protection plans, a capital plan, a group retirement plan, a loan repayment credit plan, and a waqf plan (waqf is similar to an endowment or trust as defined in common law). And through the concept of tabarru (which means to give away) customers are able to donate sums as they wish.

Despite not breaking any serious boundaries within the panoply of general insurance offerings, BAJ effectively stole a march on the competition by virtue of being the only bank offering an investment-based Islamic insurance product in Saudi. Since inception, BAJ has moved forward quickly in terms of customer numbers. It now claims to protect around 16,000 individual and 25,000 group customers, the latter drawn from around 40 corporate clients. Even so, Taylor admits that, with a Saudi population of around 26 million, 'we're only just scratching the surface'. It's the same for everyone though. Indeed, Saudi penetration for life insurance by Swiss Re, the world's largest life and health reinsurer, stands at just one tenth of one per cent.

But Taylor notes that BAJ's efforts have been 'very successful' on a small business model. In 2006 it scooped the Euromoney Life Takaful Award for its efforts. The bank hopes to expand this success in a number of ways. It currently operates through five offices, distributed evenly across the major Saudi cities. Another eight will be opened this year, with staff already being recruited. It also hopes to 'significantly extend' its agency network. Some 400 staff work from these outlets, around 320 of whom are sales people.

Overall, Taylor predicts that volumes of life assurance and savings will increase substantially over the next three to five years in the local market, as will the numbers of market players. This, in part, will be driven by the new licensing laws which have already seen three new Saudi takaful

operations licensed in as many months. However, these recent changes in the legal environment have not changed any of BAJ's development plans in terms of how it wants to progress its business. Taylor is adamant that the bank would be aiming for much the same rate of development regardless of whether the revised insurance business

Takaful is still in its infancy so it's difficult to say when cross-border selling will happen.

structure had been implemented or not – although as part of the new requirements, BAJ's Takaful Ta'awuni business is now on target to spin off from its banking parent. Come that day, it will transform into a fully-fledged IPO, creating a separately capitalised, but still totally Islamic-focused, legal entity. With its new-found agility, it should then be in a position to meet head-on the anticipated growth in the number of market players.

The natural rise of interest in Shari'ah-compliant financial products is not yet at its peak though. To overcome this, BAJ is engaged in a programme of customer education. 'We still see this as a major issue,' says Taylor, acknowledging that the insurance market has to all intents and purposes been non-existent in Saudi until now. 'Both the idea of protecting your family against any financial disaster in the event of death or disability, and savings beyond GOSI [the General Organisation of Social Insurance], are relatively new within an Islamic insurance wrapper,' he notes.

But BAJ's takaful offering tends to centre on more complex 'financial advisory products'. As such, having put sophisticated business intelligence tools and targeted advertising 'on the back seat' for the duration of the licensing transition ('we don't want to confuse the public'), it can only really educate as it sells. Through direct customer contact in an advisory role it is building long-term relationships and actually pursuing a sophisticated in-depth insurance lifecycle route. As a result, Taylor states that the products often tend to be 'bought not sold', the distinction being a real mark of sales success. Product complexity may demand a greater degree of underwriting for life cover but Taylor is convinced 'we are doing it the best way'.

And whilst the Takaful Ta'awuni programme is open to the two million strong Muslim and non-Muslim expatriate community in Saudi, Taylor is realistic in acknowledging that these people may be keen in theory, but they may harbour 'some hesitation' in buying a product that does not yet legally cross international borders. He is, however, totally convinced that takaful will be subject to cross-border selling at some point in the not too distant future. Of course, each operation will have to work within the regulatory framework of each country, the only bar perhaps being an individual country's acceptance of takaful in the first place. 'It took a long time for Europe to have its cross-border arrangement set up [for conventional insurance],' notes Taylor. 'Takaful is still in its infancy so it's difficult to say when cross-border selling will happen.'

One potential barrier to expansion for BAJ and the new Saudi providers is size. The two current methods of moving beyond a provider's natural reach, whether within or beyond the borders, are either through bancassurance, which delivers the benefit of a big bank network and corresponding client base, or through an agency distribution model. 'Because we are a small bank, we've adopted the latter to increase the size of our distribution capability,' says Taylor, mindful not to dismiss the former method as a possibility.

However the market moves forward over the next few years, BAJ's Takaful Ta'awuni division will always be the first of its kind in that country. 'We believe our success has shown our competitors that you can sell a Shari'ah-compliant life insurance savings product in Saudi Arabia where people have failed with conventional products,' states Taylor.

Indeed, most types of insurance are about trust, and trust only comes with time. As the established player in the region, on that basis alone, BAJ may well prove to be the first line of financial protection for many. But given that it is clearly open to taking on new challenges, this is unlikely to be the only reason for its progression.

Al Jazira scoops Middle East award

In the first week in April 2007, BAJ's Takaful Ta'awuni Division won the 2007 Middle East Insurance Award for Life Insurer of the Year. This is the only independent award in the region that recognises excellence in all sectors of the insurance industry, as voted on by peers from within the industry.

Life insurance companies, both conventional and takaful, were eligible for consideration in this category which covered the Gulf region, Yemen, Lebanon, Egypt, Syria, Jordan and Iran. Hosted by the Dubai-based Policy Magazine, the awards were held during 2007 Insurex Conference on 2nd April 2007, at the Grand Hyatt Hotel, Dubai.

This award follows BAJ's collection of the Euromoney 2006 award for Best Life Takaful Operator worldwide, and the Islamic Finance Weekly 2004 award for Best Takaful Operator.

Mishari Ibrahim Mishari, chief executive officer and general manager of the bank, comments: 'We see this development, inshallah, as only a beginning of better things to come'.

Institute *of* Islamic Banking *and* Insurance, London

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Mohammad Shafique
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Credit risk management in Islamic finance

Professor Rodney Wilson is director of Postgraduate Studies at Durham University's School of Government and International Affairs. He is a consultant to the Islamic Financial Services Board and also serves on the IIBI's academic committee.

Based on Professor Wilson's presentation at the IIBI's monthly lecture, London, March 2007.

Introduction

The central issue addressed here is the implications of Shari'ah compliance for credit risk management. This concerns not only Islamic banks, Shari'ah-compliant investment companies and takaful operators, but also conventional banks offering Islamic financial products. It also involves regulators since, if risks are not adequately identified and managed, resultant defaults could jeopardise institutional stability and lead to systemic failures in financial markets. Effective risk management is a core banking challenge, and any failure by Islamic banks could threaten not only their reputation, but also potentially that of the entire Shari'ah-compliant financial services sector. The distinctive nature of Shari'ah-compliant financial liabilities and assets has implications for risk management. Investment mudarabah deposits cannot be guaranteed, which potentially conflicts with deposit protection insurance requirements. In murabaha financing operations and with ijara operating leases, Islamic banks take on ownership risks which conventional banks seek to avoid. More fundamentally, as Quranic teaching stresses leniency towards debtors, what are the implications for credit risk?

The discussion here is confined to credit risk, notably payments defaults. There are of course other types of risk not covered here – such as liquidity risk – which arise when there is a mismatch between the maturity of assets and liabilities. The latter arises with virtually all banking operations, and Islamic banking is no different in this respect. Operational risk is also excluded although it can impact on credit risk as it involves inadequate management controls over employees and flawed internal reporting systems. Shari'ah risk has less impact on credit risk, as it arises from potential inadequacies in Shari'ah governance. It is best dealt with separately, as it links to legal risk, dispute settlement procedures and commercial arbitration, worthy topics for further research.

Types of credit risk and settlement of financial obligations

The two major types of credit risk are, firstly, the inability to make regular payments to service debt and, secondly, the failure to repay the principal advanced. The latter may be repaid through regular instalments, at the end of the contract period, or subsequent to a service payments default that involves a breach of contract, necessitating the financing being recalled. The obligations regarding repayment of principal will not be materially different in a Shari'ah-compliant contract, as it will usually be through deferred instalments in the case of murabaha, istisna or diminishing musharakah, and a lump sum final repayment in the case of an ijara wa iqtina hire purchase contract.

What is distinctive in Shari'ah-compliant contracts is that there should be no reference to riba or interest, but there will be reference to mark-up payments in the case of mudarabah, salam or istisna; sharing of profit in the case of mudarabah and musharakah; and rental obligations in the case of ijara – all of which should be honoured under the contract.

Although parties to financial contracts are liable to fulfil the terms and conditions they have signed for, exemptions can be made where the late settlement of obligations is due to genuine financial difficulties. The teaching of the Holy Quran is clear on this, and should be respected:

'If the debtor is in difficulty, grant him time till it is easy for him to repay. If ye remit by way of charity, that is best for you if ye only knew.' Sura 2:280

The first part of this injunction can be interpreted in the parlance of modern finance as justifying re-scheduling but keeping the same financing method and terms with no penalty to the borrower. The difficulty is of course to define what constitutes a 'genuine financial difficulty'. Where this is recognised, perhaps because of health problems, or unforeseen family circumstances, granting more time to honour financial obligations may be appropriate.

One way forward might be to provide the client with a qard hasan loan, the only loan permissible under Shari'ah, as no interest is involved, although there can be an arrangement fee and a recurrent charge to cover the administrative costs. The aim of this loan would be to enable the client to meet their existing contractual obligations. This would benefit the bank because no provision would then need to be made for non-performing debt. Qard hasan is of course unprofitable for Islamic banks, which

like conventional banks are not charities, as they have to provide dividends for their shareholders and returns to their depositors. However, although such interest-free lending only constitutes a small proportion of Islamic financing, it can serve to reduce losses and the write-down in asset values once provisions are made for impairments.

The second sentence of Sura 2:280 in the Holy Quran concerns debt remission, which in modern financial parlance means debt forgiveness. This is obviously more costly for an Islamic bank than rescheduling, as there is no longer the possibility of getting the principal returned or any further service payments on the bad debt. Assets will have to be written down and provisions made for their impairment so that overall asset quality can be maintained, otherwise the bank's own rating will be downgraded and the financial regulator will be concerned. Remission is therefore costly, but if the root cause of the failure of the client to meet their obligations reflects inadequate credit screening, or indeed negligence, by the bank, then it should share some of the responsibility for what has gone wrong rather than passing on all the blame to the client.

Furthermore, where clients get into additional unanticipated difficulties involving chronic health problems or terminal illness, then remission may be justified on grounds of humanity. Remission in these circumstances will bring goodwill from other clients and stakeholders in the Islamic bank, with depositors prepared to accept a lower return and investors a lesser dividend in such cases as long as the reasons are properly explained.

Default issues and payments safeguards

Leniency towards debtors can be abused and it is often difficult to distinguish between those who cannot meet their obligations through no fault of their own and unscrupulous defaulters who will not pay. There are potential moral hazard problems in Islamic finance, and those who would take advantage of any perceived leniency by Islamic banks. Shari'ah-compliant contracts assume a degree of trust between the parties, who should be governed by a higher moral authority. Peer pressure can make borrowers acknowledge their responsibilities, as with microfinance, and if all those involved in Islamic finance feel they are part of a community with shared religious values this should help ensure compliance with contractual obligations.

For Islamic financing based on traditional principles of profit sharing, such as mudarabah and musharakah, there are also potential asymmetric information problems that increase risk. The difficulty with profit-sharing arrangements is that there is always the possibility of the management of the company receiving the mudarabah and musharakah financing overstating or being lax with control over costs, including its wage costs, which will result in a lower profit being reported and shared with the financial institution. Rigorous auditing can alleviate the financial reporting problem, but not necessarily solve the conflict of interest over cost controls. With mudarabah the problem is compounded by only the financier, the rab-al-mal, bearing any losses, the argument being that the mudarib or entrepreneur has lost his or her time and should not be further penalised. Not surprisingly, this is a real deterrent to mudarabah and musharakah financing.

With murabaha, salam, istisna and ijara financing, there can be no additional financial charges levied in the event of late or non-payment since, if an Islamic bank benefited from such charges, this would represent an addition to the principal owed and therefore would amount to riba. However, the Shari'ah boards of most Islamic banks have approved a financial penalty being levied in the case of defaults, provided that the proceeds are given to a designated charity; a just solution especially in the case of unscrupulous defaulters where, arguably, immoral behaviour can be potentially cleansed through charity. An Islamic bank is also justified in levying additional charges to cover the costs associated with defaults.

There are, of course, a range of non-financial penalties that can be applied in the case of a payments default, notably the blacklisting of defaulters so that they will not have recourse to financing from any other bank, including conventional banks. In addition, it is possible to seek redress through the courts involving imprisonment or confiscation of passport, the latter being an especially effective deterrent in the Gulf. Payments safeguards can also be provided through the sequestration of assets, as murabaha and ijara involve financing real assets which can be seized if default occurs. This is very much a last resort, as an asset seized may not be worth much to the financier where it is a particular piece of equipment or commercial facility that was tailored to the client's need and may therefore be unattractive to other purchasers. For second-hand equipment the resale value will inevitably be limited.

Shari'ah restrictions apply to the type of assets which can be used as collateral, as they should have usufruct and be halal. Conventional financial assets such as bonds or other securities that pay interest cannot be used as collateral, as an Islamic bank cannot hold such assets, and conventional accounts receivable are also problematic since the current value of these is usually discounted by the interest rate and firms that rely heavily on income from supplier credits function like riba-based banks.

In the case of personal Shari'ah-compliant financing of a vehicle or home purchase, the amount provided is usually based on salary, with a requirement being that the income of the client is paid directly into an account with the Islamic bank making the advance. In the event of a default, the bank can impose limits on personal access to salary until its claims are met.

Conclusion

Under Shari'ah, those facing real problems in meeting financial obligations should be treated with leniency, but that does not imply that Islamic banks should be regarded as a 'soft touch'. Indeed, arguably, they need to be more rigorous in their credit appraisal systems than conventional institutions, and practices such as credit scoring to determine eligibility for financing are entirely legitimate under Shari'ah. Islamic banks are also quite justified in pursuing cases against unscrupulous debtors through the conventional courts and under English law Shari'ah-compliant financial contracts will be enforced as long as all the parties have signed to indicate their consent.

The role of the sukuk in managing liquidity issues

Managing liquidity is essential if banks are to maximise their earnings and control their risks. Conventional banks have the inter-bank market to help manage short- and medium-term liquidity, but what options are available to Islamic banks? Don Brownlow talks to Stella Cox, managing director at DDGI Ltd.



Stella Cox, DDGI Ltd

Liquidity management is the art of matching an organisation's incoming and outgoing cash-flows so that it can usefully invest any excess funds. Such investment needs to be made in a way that provides a return while still allowing the organisation quickly and easily to convert the investment back to cash. Conventional banks use the inter-bank market to buy and sell interest-bearing instruments amongst themselves to meet liquidity requirements.

This inter-bank market is termed a secondary market because the instruments that are traded are not bought directly from the issuers, as they are in primary markets, but are traded among participating banks. In this way Bank A, which has excess liquidity, may buy a 'Treasury 8%, maturity 2009 Gilt' from Bank B, which wishes to raise cash to meet outgoings. The Treasury Gilt was originally issued by the UK Government and bought by an investor bank in what is known as the primary market. That note is then traded – starting with the investor bank – and moves backwards and forwards between others as part of the secondary market.

Islamic banks wishing to remain Shari'ah compliant cannot utilise these interest-bearing inter-bank products. So Islamic banks have developed alternative Shari'ah-compliant instruments and products. The most popular have been those based around murabaha, where the financial contracts are supported by physical assets. The contracts can be structured to achieve a risk/yield profile comparable to an inter-bank deposit. However, murabaha products have a significant disadvantage in that many are not particularly liquid and are therefore more difficult to trade; others, because of Shari'ah stipulation, can not be traded at all.

Historical estimates indicate that up to 80 per cent of Islamic banking assets are held in murabaha and other similar products. The net effect is that Islamic banks can suffer from asset concentration and from large holdings of short-term, but illiquid, investments. As a result, Islamic banks need to maintain much higher levels of cash to meet their liquidity requirements than their conventional banking counterparts. This reduces their profitability. Of more concern is the future compliance of Islamic banks to the Basel II accord, which requires a bank to provide capital according to the risk weighting of its assets.

Most market participants believe that the sukuk is the long-term way forward to enable Islamic banks to manage liquidity through a range of maturity profiles while still remaining Shari'ah compliant. This versatile instrument first appeared in Malaysia around 2000. Despite some initial scepticism in the Middle East, many of the structures supporting sukuk issues have now been accepted in this region. Although some observers estimate that the total sukuk market is now worth around $54 billion, international users only account for around $25 billion. In both Malaysia and the Middle East, sovereign nations, banks and commercial businesses have brought to market sukuk issues. At sovereign level, the Government of Bahrain has led the way with its regular, consistent issues of sukuk into the market.

However, there needs to be a secondary market before the sukuk can become an instrument suitable for liquidity management. Such a secondary sukuk market will allow banks to buy and then readily sell sukuk for cash, depending on their liquidity needs. Once this market exists, Islamic banks will have a true liquidity management tool that they can

use to manage their short- and medium-term investments and to adjust their risk levels.

Traditionally (if this word can be used to describe such a new instrument), investors bought part of a sukuk issue with the intention of holding that investment to maturity. There are a number of reasons for this phenomenon, several of which are linked to the small size and number of sukuk issues. For example, there have been so few benchmark issues, that a significant investor could take part in each new one without having to liquidate any existing sukuk holding. Also, should that investor sell an existing holding, there are few viable alternative issues with which to replace it. With sovereign issues offering a premium return, there is little incentive to sell prior to maturity. Without investors selling prior to maturity, there can be no secondary market.

There are early signs that selling prior to maturity may be about to become more commonplace. In the last few months, several sizeable sukuk issues have attracted international attention. Abu Dhabi Islamic Bank's (ADIB) issue in November 2006 of $800 million sukuk bonds was rated A2 by Moody's and A by Fitch. That issue was originally planned as a $400–$500 million issue but was increased due to demand. In March of this year, Dubai Islamic Bank (DIB) came to market with its first US dollar denominated sukuk worth $750 million. That issue gained an A1 rating from Moody's. Both of these issues were listed on the Dubai International Financial Exchange and the London Stock Exchange.

No doubt fuelled by their international listings and investment grade ratings, these issues attracted investment, not only from Islamic investors but from conventional investors around the world. In the ADIB issue, for example, the Middle East accounted for 50 per cent, Europe accounted for 37 per cent, Asia accounted for twelve per cent, and the US one per cent. There were also different types of organisations that invested, with banks accounting for 58 per cent of the transaction, fund managers 31 per cent, corporates eight per cent and other investors (including individuals) three per cent. The presence of investors from areas other than the Middle East, as well as fund managers, suggests that those investments were made for strategic reasons and not simply to 'buy-and-hold'. That in turn suggests that the investments will be sold once their investment objectives are met. These sales will add to the size of the secondary market.

Other factors will need to be present before a secondary market can be considered to be efficient. These will include regulation, the presence of standard sized instruments, standard settlement procedures, and market-makers who are prepared to step in and provide liquidity to the market itself. Over the last 25 years or so, the Islamic banking community has built infrastructures when they have been needed and this is another such case in point.

Some Islamic banking centres, including Malaysia and Bahrain, already have much of the necessary infrastructure in place as a result of hosting parallel Islamic and conventional banking markets. Specifically, in the capital markets space, Dubai and London are keen to promote their depth of market expertise, regulators, ready-made pool of investors and market support professionals.

It will take time to build up a deep secondary sukuk market. More sukuk issues, made more frequently, would help that growth. Until now, many of the sukuk issues have been 'one-off' events, introduced to raise money for a specific purpose. Regular and frequent issues with different maturity dates – along the lines of Gilt issues in the UK or T-Bills in the US – would add depth to the market. That depth would facilitate banks buying and selling sukuk-based instruments 'on demand'. Once that is in place then Islamic banks will be able to use the sukuk to invest excess cash and manage liquidity to suit their needs.

How the Dubai Islamic Bank's March 2007 sukuk issue works

In March of 2007, Dubai Islamic Bank (DIB) issued a $750 million sukuk. DIB was founded in 1975 in Dubai and claims to be the world's first fully Islamic bank. For this sukuk issue, it was assisted by Barclays Capital, Citigroup and Standard Chartered Bank. The issue gained an A1 rating from Moody's.

The structure of the issue was based on two entities, DIB and a special-purpose company that was set up specifically for the issue, called DIB Sukuk Company Ltd. That company was the entity that actually issued the sukuk certificates to investors (the sukuk-holders). The funds raised are used to buy assets consisting of lease and musharakah assets (equity participations, profit and loss sharing) from DIB, with the two companies becoming co-owners in the co-ownership assets.

The day-to-day management of the assets will be performed by DIB, as managing agent. It will collect all rental and profit payments from the lease and musharakah contracts. It will pay DIB Sukuk Company an amount sufficient to fund the required periodic distribution amount to the sukuk-holders on each distribution date. Any excess payments from the co-ownership assets will be paid to DIB as an incentive fee, while any shortfalls will be covered by DIB to ensure that the required periodic distribution amount is paid.

DIB has also agreed to purchase the DIB Sukuk Company's interest in the co-ownership assets at a pre-agreed price on maturity. This will be the source of principal repayment.

Innovations in Islamic finance

The explosive growth in the Islamic banking sector over the last few years may soon be replicated in the insurance sector. NewHorizon talks to Dr Humayon Dar, CEO of Dar Al Istithmar, a subsidiary of Deutsche Bank group that provides Shari'ah consultancy services to the institutions offering Islamic finance.

The huge demand for Shari'ah-compliant financial services has created innovative service offerings from the Islamic banks. Nowadays, credit cards, car loans and mortgages are all available to private individuals while investment products, many based around the sukuk and investment funds of different types, are available to wealthy individuals and corporate bodies.

The housing market, in particular, has seen tremendous growth according to Dr Dar. Until recently, banks did not offer mortgages to individuals but the liberalisation of the financial market has meant that these products are now available and Islamic mortgages are becoming very popular. Housing markets across the world have expanded but the demand for Islamic home finance has been even further fuelled by the growth in the emerging Muslim economies, particularly those of the Gulf Cooperation Council (GCC) countries.

Dr Dar thinks the positive image that the availability of Islamic financial services sends to the rest of the financial world is enhanced by Islamic scholars working closely with Western bankers in London, New York and elsewhere. There is evidence that wealthy Muslims tend to invest in Shari'ah-compliant financial products when investing locally, although they may be prepared to invest in conventional banking products when investing overseas.

There is nothing religious about Islamic banking – it is a structure that is used to differentiate between halal and haram products

Some of the devices used to support Islamic products differ from country to country. In response to the rise in demand for credit cards, Islamic banks in different countries have created different models to replicate the economic effects of conventional credit cards. In Malaysia, for example, Islamic credit cards can be supported by the bai al-ina or buyback sale. In this the bank and the client buy and sell a piece of land between them with the difference in the buying and selling prices being used to provide the credit limit on the credit card.

This is the model used by Bank Islam Malaysia Berhard, the largest Islamic bank in that country. In the Middle East the more popular contract is the tawaruq which is similar to the bai al-ina but there are three parties involved in the buying and selling of the underlying asset: the bank, the client and a third party often found through the general marketplace.

In the UAE, credit cards are often provided as a fee-paying service with no underlying transaction. Banks provide different classes of card – gold, platinum, etc. – based on the client's income with different fee brackets based on the type of card.

The explosive growth in demand, and the fledging nature of the Islamic financial market means that, as yet, not all business areas are fully serviced. An example of a relatively difficult area is the Treasury Operations function within a bank or large corporation. According to Dr Dar these money market operations are an 'Achilles' heel' of Islamic banking and are a rather more complex area in which to achieve compliance.

In conventional banking circles a bank with excess liquidity will lend to another bank through inter-bank loans. To achieve the same function while still being Shari'ah-compliant, most Islamic banks will use a

commodity murabaha. In this both banks instruct a commodity broker – bank A will instruct the broker to buy, say, $100 million of commodity and sell it to bank B on a deferred payment basis. Bank B retains the funds obtained from instructing the broker to sell the commodity for cash on the open market. Repayment occurs at a predetermined frequency agreed by both banks. The sukuk is becoming more prominent in this market, particularly those issued in Malaysia and Bahrain, and this area may present future innovations.

Dr Dar feels that the real growth area is occurring in Islamic insurance or takaful which until recently has been a relatively untapped market. Some analysts think that this sector may prove to be bigger than Islamic banking.

Part of the demand for these products is in response to directives from financial institutions. If an individual obtains financing from a bank for a car or a home, the bank makes it compulsory to obtain insurance. Some of the large Western banks are aggressively entering this market. For example, HSBC Bank Malaysia Bhd has announced that in the next two years it aims to at least double the amount of insurance products used by its existing customers. Currently, around 30 per cent of its customers use insurance products.

ethical banking though, explains Dr Dar. There is not much similarity between Islamic finance and ethical investments or socially responsible investing. Ethical banking has more of a Western influence. As an example, the Dow Jones screening for Shari'ah-compliant companies includes companies that are doing prohibited business, such as making or distributing alcohol, or casinos. But there are others which are strange from an Islamic point of view such as tobacco or the defence industry. 'There is no consensus in Islam about tobacco,' says Dr Dar 'but Islamic funds will not invest in tobacco because it is considered unethical – an inference that has come from Western influence'.

Dr Dar feels that the next big event in Islamic banking may be what some people refer to as 'real' Islamic banking. The existing attempts to conduct business in a Shari'ah-compliant way could be called 'halal' banking rather than Islamic banking. There is nothing inherently Islamic about the operations of Islamic banks. They are simply doing business in compliance with Islamic law. Islamic banking to some people implies a social responsibility. 'Islamic banking so far has not shown an explicit responsibility towards the community in which it serves so possibly this will be the next step – the emergence of banks that are genuinely socially responsible,' says Dr Dar. 'Co-operatives and mutuality have gone out of fashion in the UK but it is something that is needed in some countries.' Dr Dar goes on to say that 'there is nothing religious about Islamic banking – it is a structure that is used to differentiate between halal and haram products'.


Dr Humayon Dar, Dar Al Istithmar

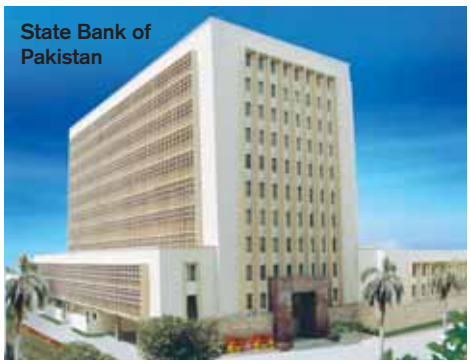
Islamic banking so far has not shown an explicit responsibility towards the community in which it serves so possibly this will be the next step – the emergence of banks that are genuinely socially responsible.

The reinsurance market, where insurance companies spread the risk among specialist underwriters, may also present a growth area. Although there are four or five small Islamic reinsurance companies, it is still largely dominated by conventional insurance organisations.

The emphasis in Islamic banking up until now has been on the Shari'ah compliance aspects and whether the underlying contract complies with the law. This is not necessarily

After such an explosive growth period in Islamic banking, it may be time to pause for reflection while the insurance sector takes up the financial expansion.

Healthy Islamic banking sector reaches new heights in Pakistan


State Bank of Pakistan

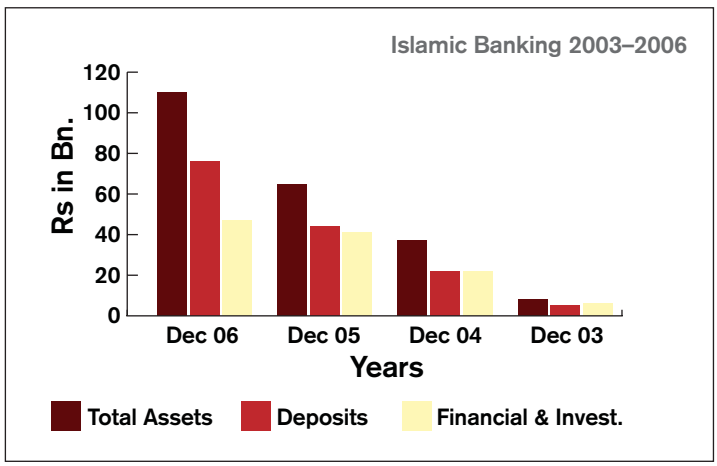
The Islamic banking industry is healthy and continues to grow in Pakistan. This is the finding that comes out of a report published by the State Bank of Pakistan (SBP). Set up as Pakistan's central bank following independence in 1948, the SBP is the organisation responsible for running the country's economy. In its most recent Islamic banking bulletin, SBP has published the figures for the last quarter of 2006, and announced continuing growth for the Islamic banking sector.

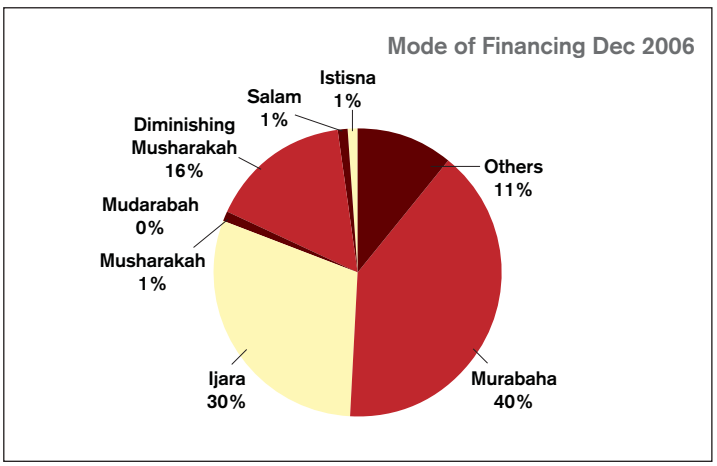
Around 90 per cent of the Pakistani population is Muslim, and the provision of Shari'ah-compliant banking products is an important area to help people comply with their faith. The provision of Islamic banking has in turn led to an increase in the branch network for Islamic banks. There are currently five exclusively Islamic banks in Pakistan with a sixth due to start operations later this year; between them they have 99 branches. Add to this 13 other banks which offer Islamic banking services and their 58 branches, and a healthy backdrop for the industry with good access to the general population can be seen.

The last quarter of 2006 was a very good one for the Islamic banking industry. Figures from the SBP show that the total assets portfolio within the sector expanded by 24 per cent to just under $2 billion (Rs118.183 billion). The cash held by Islamic banks also increased by a quarter to around $250 million (Rs15.266 billion). These figures show that the growth in the Islamic sector is not matched by Shari'ah-compliant money market instruments, and hence there are excess liquid funds that can not be properly utilised.

The increase for the last quarter of 2006 is part of a growing trend. Comparing the Islamic banking assets, deposits, and financing and investment over the same last quarter period for the previous three years shows that all areas of Islamic finance are increasing at an ever improved rate. In the last year, total assets have increased by $758 million (Rs46 billion), deposits have increased by $544 million (Rs30 billion), and financing and investment by $395 million (Rs24 billion). These are all good improvements for one year, but when comparing them back as far as 2003, the amount of money as assets and deposits is around ten times higher, and the financing and investment money is now seven times the size it was in December 2003.

The most favoured form of Islamic financing in Pakistan is murabaha. This mirrors a global trend where murabaha leads the field with the majority of Islamic banks. In Pakistan it accounts for almost 40 per cent of the total financing done by Islamic banking institutions. The second most widely used form of financing is ijara. With this accounting for 30 per cent, these two financing models represent nearly three-quarters of the financing from Islamic banks in Pakistan.





Graphs adapted from SBP Islamic Banking Bulletin, February 2007

On the move



Islamic finance specialist, **Oliver Agha** *(left)*, has been appointed a partner of law firm **DLA Piper** based in its Dubai office. Prior to this appointment, Agha was head of projects at Clifford Chance's Saudi Arabian law firm affiliate Al-Jadaan. In his time there, he worked on some of the most complex Islamic finance projects in the Kingdom of Saudi Arabia, such as the Rabigh project financing of a petrochemical refinery, and restructuring the first conventional loan transaction into an ijara Islamic finance transaction.

Bank Islam Malaysia Berhad has appointed three new directors and one alternative director, who are all representatives of the Dubai Group. The three new directors are **Salaam Said Al-Shaksy**, managing director of Dubai Group, **Fadel Al-Ali**, COO and CFO of Dubai Holding LLC and **Hashim Al-Dabal**, executive chairman, Dubai Properties. **Marwan Al-Khatib**, director at Dubai Islamic Investment Group, is an alternative director to Hashim Al-Dabal.

Al-Shaksy has over 20 years' experience in finance and investments. He is the vice chairman of board – Muscat Securities Market, vice chairman of board – Shell Marketing, and a board member of the College of Banking and Financial Studies, Oman. Prior to joining the Dubai Group, he was deputy chief executive for Bank Dhofar, and head of business planning and analysis for Citibank Global Consumer Business in the UAE.

Al-Ali joined Dubai Holding in 2004 as CFO, and was promoted to COO in 2005. Prior to this, he worked for 16 years at Citigroup in various roles, such as head of UAE distribution for Citibank.

Al-Dabal is the executive chairman of Dubai Properties and a board member of Dubai Holding. He has served on the boards of many of Dubai Holding's entities, such as Empower, Dubai International Capital and Noor Islamic Bank. Prior to joining Dubai Properties, he was the executive director of Dubai Islamic Bank, and also has ten years' experience within Citibank.

Alternative director, **Al-Khatib**, is the director of Islamic banking at Dubai Islamic Investment Group. He has over 15 years of finance experience working for Al-Futtaim Group, Mashreq Bank, Dubai Chamber of Commerce and Deloitte Touche Tohmatsu.

Bank Negara Malaysia Governor, **Tan Sri Dr Zeti Akhtar Aziz**, has been appointed as the fourth chairperson of the **Islamic Financial Services Board Council**. The role is on a one-year rotation amongst full members, and Dr Zeti will be in the role for the 2007 calendar year. The deputy chairperson for the year will be **Dr Shamshad Akhtar**, who is the governor of the State Bank of Pakistan.

Richard Thomas has been appointed as managing director of **GSH UK**. The new UK subsidiary of GSH has been set up in order to take advantage of the rapid developments in the UK in all spheres of international Islamic financial services. Thomas has over 28 years of experience from companies such as Saudi International Bank and the United Bank of Kuwait. Prior to his appointment at GSH UK, Thomas was the head of Islamic financial services, and CEO of Islamic asset management and alburaq at the Arab Banking Corporation in London. In addition to his new position, Thomas is also a member of the UKTI Financial Services Sector Advisory Board; in this capacity he chairs the Sub-Committee on Islamic Financial Services, and advises on Corporate Governance oversight for the Institute of Islamic Banking and Insurance (IIBI), London.

Tejoori, the Shari'ah-compliant investment company, has made two new senior appointments. **Yaqub Yousuf** has been appointed as non-executive director to the board. Yousuf has been an advisor to the company since its inception in 2005 and now acts as chairman of the executive committee to oversee the company's operations.

The second appointment is **Ilke Toklu** as general manager. Most recently she was director of business development at International Holdings group. Toklu joins the board with experience on a global level in management consultancy, business development and board direction in North America, Asia Pacific and the Middle East at companies such as Citibank, Dubai Holding and Prudential Securities.

Faiz Azmi, a partner at Pricewaterhouse Coopers (PWC) Malaysia, has been appointed as the inaugural Islamic finance leader of **PWC** worldwide. Azmi will be responsible for leading PWC's Islamic finance initiatives worldwide. In addition, he serves as a member of the Malaysian Accounting Standards Board's committee on Islamic Accounting Standards.



The time value of money in Islamic banking

The use of the Karachi Interbank Offered Rate (KIBOR) as a benchmark by Islamic banks in calculating the selling price of their commodities in murabaha sale transactions is not only justified, but also necessary, to remain competitive given the current banking industry dynamics in which Islamic banks have a pretty low share. However, it is not permissible under Shari'ah to price loans using KIBOR, as many conventional banks do. Najmul Hassan, general manager for coprorate and business development, Meezan Bank, explains the underlying differences in approach.

Unlike conventional banking based on interest-bearing loans, funds invested in an Islamic bank are used essentially for trade. The Quran clearly mentions riba in a number of places (Surah Ar-Rum, Al-Imran, An-Nisa, and Al-Baqra), with a very strong view against such people who indulge in it. The authentic definition from Hadith (with the chain of transmission being Hazrat Ali) leaves no room for ambiguity: 'every loan that draws a gain is riba'.

Many people question whether Islamic finance differs meaningfully from conventional finance. Outwardly in form, many structures do bear a similarity in a number of respects. The present day operating environment is a conventional one, from market structuring and dynamics, to rate benchmarks and circulation of money, then on to regulatory controls. However, the way these two financial systems function with respect to core defining parameters is very different. Many things look the same but are, in essence, fundamentally different.

We begin with basic principles. The one is interest-based money lending while the other operates like a trading house. Where does this difference originate? Two core principles lie at the centre – elimination of riba and gharar. Any Islamic transaction needs to assess these two things first and foremost.

Bearing in mind the definition given in Hadith, as mentioned above, we can discuss the time value of money and the workings of present day Islamic banks. For this, we have to look at the differences between the ways in which modern capitalist theory (the basis of interest-based banking) views 'money' and 'commodity' and the principles defined by Islam.

According to capitalist theory, there is no difference between money and commodity in so far as commercial transactions are concerned. Accordingly, both are treated at par and can be sold at whatever price parties agree upon. With this theory, selling Rs100 for Rs110 or renting Rs100 for a monthly rental of Rs10 is the same as selling a bag of rice costing Rs100 for Rs110 or renting a fixed asset costing Rs100 for a monthly rental of Rs10.

According to capitalist theory, there is no difference between money and commodity in so far as commercial transactions are concerned. Islamic principles differ from this concept because money and commodity have different characteristics.

Islamic principles differ from this concept because money and commodity have different characteristics. For instance, money has no intrinsic value but is rather a measure of value or a medium of exchange. It cannot fulfil human needs by itself, but needs to be converted into a commodity. On the other hand, a commodity can fulfil human needs directly. Furthermore, commodities can differ in quality while money has no differential quality, in the sense that a new note of Rs1000 is exactly equal in value and quality to an old note of Rs1000. Similarly, commodities are transacted or sold by pinpointing the item in question or at least by giving certain specifications. Money, however, cannot be pinpointed in a transaction of exchange. Even if it could be, it would be of no use to do this since the different denominations of money making up an equal amount have the same ultimate value.

With these differences in mind, to exchange Rs1000 for Rs1100 in a spot transaction would make no sense since the money in itself has no intrinsic utility or specified quality. So, the excess amount on either


Mosque in Karachi, Pakistan

side is without consideration and hence not allowed under Shari'ah. The same would hold true if we were to exchange these Rs1000 for Rs1100, to be delivered after a period of one month, since the excess of Rs100 would be without consideration of either utility or quality but would only be related to time.

The same is not true when commodities are involved. Since a commodity is known to possess an intrinsic value and quality, the owner of such a commodity is allowed to sell it at whatever price is mutually agreed with the buyer, provided that, in selling, he does not commit a fraud but is subjected to the forces of supply and demand. This would hold true even if the price that is mutually agreed upon is higher than the prevailing market price.

In conclusion, any excess amount charged against deferred payment is riba only when money is exchanged for money, since the excess is charged only against time. The proof lies in the fact that, if the debtor fails to repay at the stipulated time, he is charged extra money. In contrast, where a commodity is being exchanged for money, the seller may take into consideration various factors (like the supply and demand situation, quality, utility, special features and so on) as well as the time of deferred payment.

It is true that the seller may take account of the time factor in increasing the price of his commodity in a credit sale, but the increased price is being fixed for the commodity and not exclusively for the time element.

Time is not the exclusive consideration in fixing the price; therefore once the price is fixed it relates to the commodity and not to the time. For the same reason, if the purchaser fails to pay at the agreed time, the price would remain the same and under no circumstances would the seller be allowed to charge more than is actually owed.

Keeping in mind the above discussion, the use of KIBOR as a benchmark by Islamic banks in calculating the selling price of their commodities in murabaha sale transactions is not only justified, but also necessary, to remain competitive given the current situation in which Islamic banks have a pretty low share in the banking industry.

We must understand that the use of KIBOR as a benchmark to determine the profit is for indicative purposes only and this does not make the transaction impermissible if all of the other conditions of a valid sale are fulfilled. It is often the case that a trader, whether a large multinational trading corporation or a roadside store, will arrive at a decision on profit or margin rates, having taken into account a number of factors. A major variable of which is the competitive environment in which the trader is operating his business.

If a rice trader or a cloth merchant uses KIBOR as the basis for adding profit margins to the cost of his commodities to arrive at the price, this would not amount to interest or riba and it would not make the transaction impermissible. The principle is similar for Islamic banks using the KIBOR to arrive at the selling price of their commodities.

In contrast, conventional banks price their loans based on KIBOR, which does result in riba since it is an exchange between money and money and not a sale transaction in which commodities are exchanged with money.

It is being questioned in some circles whether Islamic banks could price their commodities by applying some other benchmark rate. The rationale behind using KIBOR is the banking environment is dominated by conventional banks, which discourages the development of an Islamic benchmark rate.

In the light of this situation, Islamic banks are compelled to use an interest-based benchmark to price their products. This not only ensures stable returns in line with the industry but also assures competitively priced products for the customers.

As more and more Islamic banks begin to operate, an inter-bank market between Islamic banks will be created and a new benchmark for the Islamic banking industry will then be able to be developed.

Any excess amount charged against deferred payment is riba only when money is exchanged for money, since the excess is charged only against time.

THE **POST GRADUATE DIPLOMA COURSE**

In a short period of some 20 years, Islamic banking and insurance has made an impressive progress. Today, a large number of Islamic financial institutions are functioning in many countries around the world, managing huge funds and employing thousands of people.

Indications are that the coming years will see a big increase in the number, size and sophistication of Islamic financial institutions all over the world. Two factors support this view. First, after a great deal of research and development the groundwork for the establishment of Islamic financial institutions has been laid and their viability in the modern world firmly established. Second, the demand for interest-free ethical banking and insurance is growing strongly.

The rapid growth of Islamic financial institutions during the last 20 years has created good job opportunities for people well-versed in the philosophy and concepts of Islamic banking and Insurance. The demand is expected to receive a big boost in the coming years. Unless met in time, the increasing shortage of qualified personnel would retard the growth of Islamic financial institutions, frustrating the aspirations of the Muslim people.

Responding to this important need, the Institute of Islamic Banking and Insurance, London developed a post graduate diploma course in Islamic banking and insurance with the help of a team of experts, based on the "distance learning" method. The Institute believes that job opportunities for suitably qualified people in Islamic financial institutions are quite bright and will be even better in the coming years with the establishment of more and more institutions.



Al-Saffah (749-54 AD)
Al-Kufa mint, 135 AH
Dirham, silver, 25 mm.

The course aims to equip personnel with the knowledge and understanding of the principles and practice of Islamic banking and insurance to meet the present and future needs of the Islamic banking and insurance industry for qualified personnel.

Since its launch eight years ago, 468 students from 48 countries have enrolled on the course. Among them are bankers, fund managers, academics, accountants, businessmen and students.

Experience shows that more and more conventional banks, which are introducing Islamic Banking windows show their interest in our post graduate diploma course. The post graduate diploma course, which has a separate lesson on the subject of how to convert a conventional bank into an Islamic bank is invaluable for conventional bankers who want to understand the concept and procedures of Islamic banking.

The Lessons for the course were written by an international team of eminent scholars in the field of Islamic banking and finance. These were then checked for technical accuracy and compliance with the Shariah by experts of the highest standing and finally submitted to the Institute in London.

The University of Durham, UK has accorded recognition to the Institute's post graduate diploma course as an entry qualification to the University's MA programme in Islamic political economy and MBA by distance learning. Informing the Institute of the recognition, Prof. Rodney Wilson, Head of the University's centre for Middle East and Islamic Studies, commended the Institute's post graduate diploma course and described it as "well prepared, clearly set up and invaluable to students."

The Institute of Islamic Banking and Insurance, London is an independent, non-profit organisation. Its aims and objectives include :

Promotion of knowledge and understanding of Islamic banking and insurance.

Education of personnel in Islamic banking and insurance and conducting research and development to develop new Islamic financial instruments and to tackle issues and problems relating to Islamic banking and insurance.

The Institute publishes a monthly magazine - The New Horizon - devoted to Islamic banking and insurance.

The Institute's standing programes include holding of meetings of professionals using Islamic financial instruments, organising International Conference, Seminars and workshops to address various issues concerning Islamic banking and insurance.

The Institute offers its membership to organisations and individuals who satisfy prescribed conditions.



"I am sure most of us in London who deal with clients from the Islamic world welcome the initiative which your Institute has taken in trying to spread a wider understanding of the principles and the methodologies adopted by Islamic financial institutions"

Terry Stone
Ernst & Young, London

"I have learnt a lot from this post graduate diploma course, it has given a comprehensive knowledge of fundamental concepts governing the working of Islamic banking. I am sure that it has provide a sound foundation for successful development of banking career and will be helpful for further growth."

Mr. Ch. Tariq Waseem,
Assistant Vice President,
Faysal Bank Ltd. Pakistan



Al-Rashid (786-809 AD)
Madina al-Salam mint, 193 AH
(Baghdad, Iraq)
Dirham, silver, 21 mm

Institute of Islamic Banking & Insurance (IIBI)
12–14 Barkat House
116–118 Finchley Road
London NW3 5HT
United Kingdom
Tel: +44 (0) 207 245 0404
Fax: +44 (0) 207 245 9769
Email: iibi@islamic-banking.com
Web: www.islamic-banking.com

Diary of Events

April

15–19: Corporate Governance Forum, Dubai
Conference to move corporate governance thinking and practice forward in the Middle East.
Tel: +97 143 352 437
Email: register@iirme.com
www.iirme.com/cg

24–25: Annual Islamic Wealth Management Event, Geneva
Conference focusing on wealth management for the Muslim investor.
Tel: +44 (0) 20 7868 1717
Email: gassner@islamicfinance.de
www.islamicwealthmanagement.com

25: Sukuk: Exploring the Phenomena, Dubai
Conference focusing on the sukuk mode of Shari'ah-compliant financing.
Tel: +44 (0) 20 7286 6523
Email:
contact@middleeastbusinessforum.com
www.middleeastbusinessforum.com/sukuk


Dubai

May

7–10: Risk Management in Islamic Banking, Kuala Lumpur
Four-day training course for risk management within Islamic banking.
Tel: +60 321 438 100
www.islamicfinancetraining.com/rmib.php

8–9: 4th Annual Middle East Insurance Forum, Bahrain
The region's largest platform for the international and regional insurance industry to assess the new growth opportunities in the market.
Contact: Welma Williams
Tel: +97 143 431 200
Email: welma@megaevents.net

13–15: Islamic Treasury Simulation, Dubai
Course to help understand key characteristics in Islamic banking, and how to develop and implement treasury strategies.
Tel: +60 321 438 100
www.islamicfinancetraining.com/IslamicTreasurySimulation.php

15–16: Islamic Finance & Capital Market Conference, Kuala Lumpur
Conference to provide insight into the modus operandi and related issues of Islamic finance and Islamic capital market instruments.
Tel: +60 321 636 990
Email: info@globalpro.com.my
www.globalpro.com.my

15–16: 4th Islamic Financial Services Board Summit, Dubai
Summit looking at the need for a cross-sector approach to the supervision of Islamic financial services.
Contact: Ms Farrah Aris
Tel: +60 326 984 248
Email: farrah@ifsb.org
www.ifsbdubai2007.com


Ottawa

17–18: 3rd International Islamic Banking, Finance & Insurance (Takaful) Conference, Ottawa
Conference to educate and introduce Shari'ah concepts and rules about Islamic banking.
Email: conference@ansargroup.com
www.ansargroup.com/conference

22–24: 1st Islamic Banking, Finance and Insurance Awareness Conference and Exhibition Pakistan, Lahore
Conference to educate and introduce various groups to Shari'ah concepts, rules about Islamic banking, financing and insurance and highlighting successful applications worldwide.
Tel: +92 042 504 8213
Email: mevent@gmail.com

22–24: Islamic Finance World North America 2007, Toronto
Conference focused on the key business drivers of the Islamic finance business in North America.
Tel: +1 212 379 6322
Email: enquiry.us@terrapinn.com
www.terrapinn.com/2007/ifwna

27–28: Middle East Islamic Capital Market, Dubai
Forum to equip delegates with the strategic information to deal with the complexities of Islamic finance.
Contact: Bernadine Michael
Tel: +60 327 236 604
Email: bernardinem@marcusevanskl.com
www.marcusevans.com/events/cfeventinfo.asp?eventid=12131

27–29: 2nd Annual Bank Marketing and Management Forum, Jordan
Forum from the Arab Academy for Banking and Financial Sciences to deliver big-picture strategies and practical solutions to address marketing challenges in the banking industry.
Contact: Amal Mishlawi
Tel: +96 265 502 900
Email: forums@aabfs.org
www.aabfs.org/bmmf2.asp

June


Singapore

18–19: International Islamic Banking & Finance Forum 2007, Singapore
Conference to address the trends, opportunities and challenges facing Islamic banking.
Contact: Bernadine Michael
Tel: +60 327 236 604
Email: bernardinem@marcusevanskl.com
www.marcusevans.com/events/cfeventinfo.asp?eventid=11883

20–21: The Sukuk Summit 2007, London
Summit to provide a platform for issuers and end users to engage with investors, arrangers, listing and rating agencies, and community organisations.
Tel: +44 (0) 20 8209 1751
Email: info@icg-events.com
www.sukuksummit.com

25–26: Successful Strategies in Planning, Negotiating & Managing Mergers & Acquisitions, Kuala Lumpur
Conference to address the key steps of pre-M&A stages, from planning and negotiating, to structuring, financing and due diligence; and post-M&A issues including HR, change management and communications strategies.
Tel: +60 320 703 299
Email: sangeeta.t@abf.com.sg
www.abf-sia.com/project/9436MC_EM.pdf

25–27: 2nd Islamic Finance Summit 2007, Kuala Lumpur
Summit to explore Islamic investment opportunities and meet product operators.
Contact: Alison McInerney
Tel: +65 6514 3173
Email: Alison.mcinerney@ibcasia.com.sg

July

4: Islamic Finance Conference, London
A one-day introduction to Islamic finance.
Tel: +44 (0) 1354 695 599
Email: louise@marchpublishing.co.uk
www.marchpublishing.co.uk/ifc.html

9–12: Structuring Islamic Financial Products, Zurich
Course designed to give an all round understanding of the most important and widely offered Islamic financial products.
Tel: +60 321 438 100
www.islamicfinancetraining.com/sifp2007.php

August

10–12: Structuring Innovative Islamic Financial Products Workshop, Cambridge
A three-day residential workshop to focus on new developments in Islamic structured products, funds, capital market structures and retail, corporate and investment banking products.
Contact: Mohammad Shafique
Tel: +44 (0) 207 245 0404
Email: iibi@islamic-banking.com

20–23: Structuring Islamic Financial Products, Johannesburg
Course designed to give an all round understanding of the most important and widely offered Islamic financial products.
Tel: +60 321 438 100
www.islamicfinancetraining.com/sifp2007.php

November

26–29: B-Tech Libya: 1st International Banking, Financial Sector & Investment Exhibition 2007, Tripoli
Exhibition offering the full range of products and services offered by banking sectors, financial and investment institutions and insurance companies.
www.atex.com.ly/b-techlibya/index.html


Zurich

Events endorsed by the IIBI

arboun
An Islamic version of option, a deposit for the delivery of a specified quantity of a commodity on a predetermined date.

bai al-ina
This refers to the selling of an asset by the bank to the customer on a deferred payments basis, then buying back the asset at a lower price, and paying the customer in cash terms.

commodity murabaha
A murabaha contract using certain specified commodities, through a metal exchange.

fatwa
A ruling made by a competent Shari'ah scholar on a particular issue, where fiqh (Islamic jurisprudence) is unclear. It is an opinion, and is not legally binding.

gharar
Lit: uncertainty, hazard, chance or risk. Technically, sale of a thing which is not present at hand; or the sale of a thing whose consequence or outcome is not known; or a sale involving risk or hazard in which one does not know whether it will come to be or not.

Hadith
A record of the sayings, deeds or tacit approval of the Prophet Muhammad (PBUH).

halal
Activities which are permissible according to Shari'ah.

haram
Activities which are prohibited according to Shari'ah.

ijara
A leasing contract under which a bank purchases and leases out a building or equipment or any other facility required by its client for a rental fee. The duration of the lease and rental fees are agreed in advance. Ownership of the equipment remains in the hands of the bank.

ijara sukuk
A sukuk having ijara as an underlying structure.

ijara wa iqtina
The same as ijara except the business owner is committed to buying the building or equipment or facility at the end of the lease period. Fees previously paid constitute part of the purchase price. It is commonly used for home and commercial equipment financing.

istisna
A contract of acquisition of goods by specification or order, where the price is fixed in advance, but the goods are manufactured and delivered at a later date. Normally, the price is paid progressively in accordance with the progress of the job.

maysir
Gambling – a prohibited activity, as it is a zero-sum game just transferring the wealth not creating new wealth.

mudarabah
A form of business contract in which one party brings capital and the other personal effort. The proportionate share in profit is determined by mutual agreement at the start. But the loss, if any, is borne only by the owner of the capital, in which case the entrepreneur gets nothing for his labour.

mudarib
In a mudarabah contract, the person or party who acts as entrepreneur.

murabaha
A contract of sale between the bank and its client for the sale of goods at a price plus an agreed profit margin for the bank. The contract involves the purchase of goods by the bank which then sells them to the client at an agreed mark-up. Repayment is usually in instalments.

musharakah
An agreement under which the Islamic bank provides funds which are mingled with the funds of the business enterprise and others. All providers of capital are entitled to participate in the management but not necessarily required to do so. The profit is distributed among the partners in predetermined ratios, while the loss is borne by each partner in proportion to his contribution.

musharakah, diminishing
An agreement which allows equity participation and sharing of profit on a pro rata basis, but also provides a method through which the bank keeps on reducing its equity in the project and ultimately transfers the ownership of the asset to the participants.

qard hasan
An interest-free loan given for either welfare purposes or for fulfilling short-term funding requirements. The borrower is only obligated to pay back the principal amount of the loan.

rab-al-maal
In a mudarabah contract the person who invests the capital.

retakaful
Reinsurance based on Islamic principles. It is a mechanism used by direct insurance companies to protect their retained business by achieving geographic spread and obtaining protection, above certain threshold values, from larger, specialist reinsurance companies and pools.

riba
Lit: increase or addition. Technically it denotes any increase or addition to capital obtained by the lender as a condition of the loan. Any risk-free or 'guaranteed' rate of return on a loan or investment is riba. Riba, in all forms, is prohibited in Islam. Usually, riba and interest are used interchangeably.

salam
Salam means a contract in which advance payment is made for goods to be delivered later on.

Shari'ah
Refers to the laws contained in or derived from the Quran and the Sunnah (practice and traditions of the Prophet Muhammad (PBUH).

Shari'ah board
An authority appointed by an Islamic financial institution, which supervises and ensures the Shari'ah compliance of new product development as well as existing operations.

shirkah
A contract between two or more persons who launch a business or financial enterprise to make profit.

sukuk
Similar characteristics to that of a conventional bond with the key difference being that they are asset backed; a sukuk represents proportionate beneficial ownership in the underlying asset. The asset will be leased to the client to yield the return on the sukuk.

ta'awuni
A principle of mutual assistance.

tabarru
A donation covenant in which the participants agree to mutually help each other by contributing financially.

takaful
A form of Islamic insurance based on the Quranic principle of mutual assistance (ta'awuni). It provides mutual protection of assets and property and offers joint risk sharing in the event of a loss by one of its members.

tawaruq
A sale of a commodity to the customer by a bank on deferred payment at cost plus profit. The customer then sells the commodities to a third party on a spot basis and gets instant cash.

ummah
The diaspora or 'Community of the Believers' (ummat al-mu'minin), the world-wide community of Muslims.

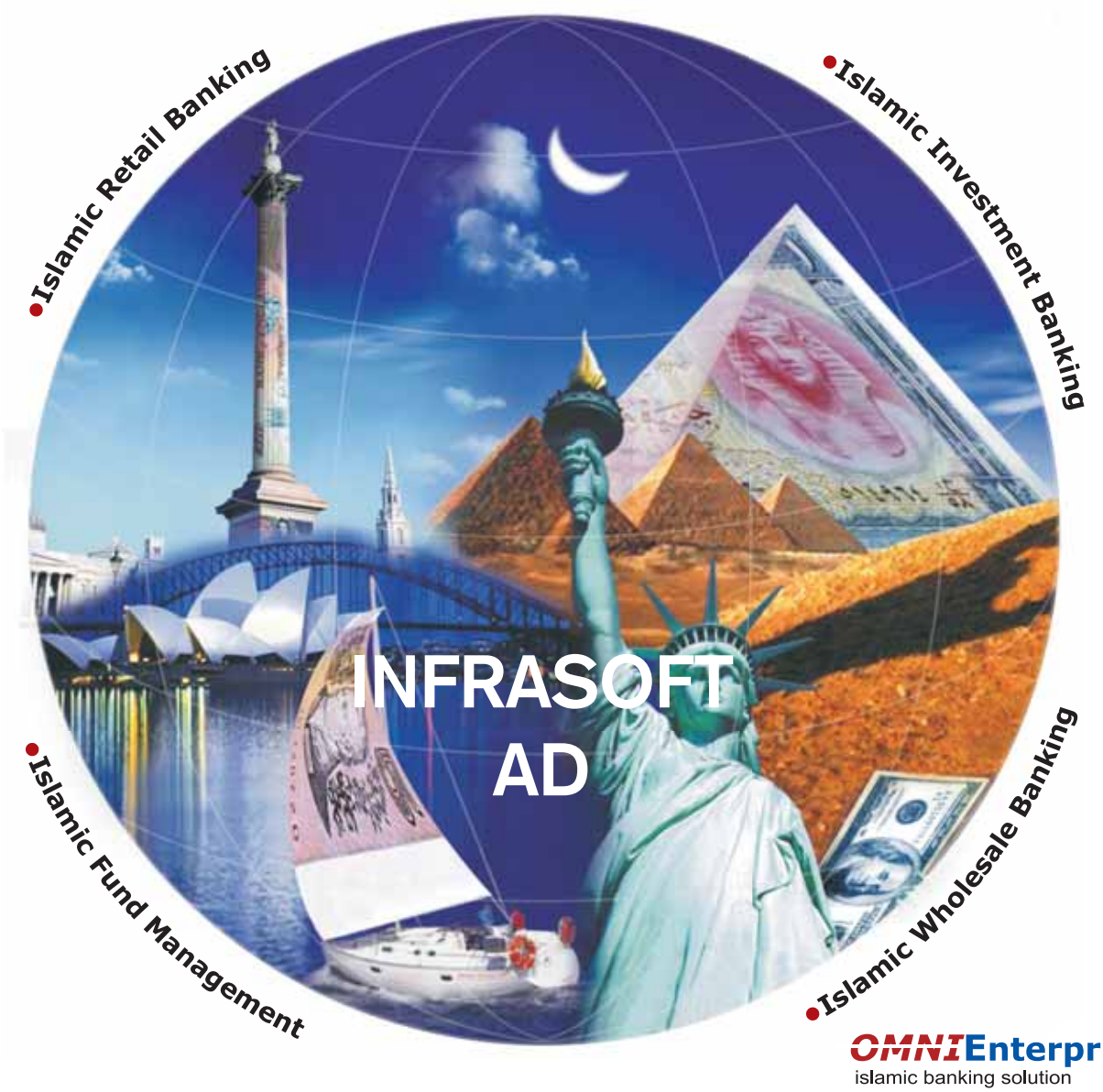
wa'ad
A promise to buy or sell certain goods in a certain quantity at a certain time in future at a certain price. It is not a legally binding agreement.

wakala
A contract of agency in which one person appoints someone else to perform a certain task on his behalf, usually against a certain fee.

waqf
An appropriation or tying-up of a property in perpetuity so that no propriety rights can be exercised over the usufruct. The waqf property can neither be sold nor inherited nor donated to anyone.

zakat
An obligation on Muslims to pay a prescribed percentage of their wealth to specified categories in their society, when their wealth exceeds a certain limit. Zakat purifies wealth. The objective is to take away a part of the wealth of the well-to-do and to distribute it among the poor and the needy.

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Middle East Operations
Dubai : Infrasoft Technologies FZ-LLC, 207 Bldg 12, Dubai Internet City, Dubai, UAE Ph : + 97 14 369 4278 /79
Bahrain : Infrasoft Technologies Limited, Gulf Business Center, PO Box No. 3282, 11th Floor, Al Salam Tower, Diplomatic Area, Manama, Kingdom of Bahrain, Tel : + 973-530 913, Email : me@infrasofttech.com
Global Offices: London, New York, Mumbai, Bahrain, Dubai, Singapore, Kuala Lumpur
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