

POLICY RECOMMENDATIONS
12TH MEETING OF THE COMCEC FINANCIAL COOPERATION
WORKING GROUP

The COMCEC Financial Cooperation Working Group (FCWG) has successfully held its 12th Meeting on March 28th, 2019, in Ankara, Turkey with the theme of “*Infrastructure Financing through Islamic Finance in the OIC Member Countries*”. During the Meeting, FCWG made deliberations on infrastructure financing through Islamic finance in the member countries. Accordingly, the participants have come up with some policy recommendations.

Policy Recommendation 1: Developing Legal and Regulatory Framework to Provide an Enabling Environment for Realizing Large Infrastructure Investments through Islamic Finance.

Rationale: Infrastructure projects are large and complex with long maturity periods. There is a need to mitigate the legal and regulatory risks arising from investments in these projects for encouraging the financial sector to invest in the infrastructure sector. This can be done by providing a sound PPP legal framework that would outline the key principles on how the infrastructure projects are procured and implemented. Given the uniqueness of various infrastructure sectors, sector-specific laws (e.g., energy, airports, railways, etc.) may be needed to cater to their individual features. Furthermore, financial laws and regulations for different Islamic financial sectors (i.e., banking, non-banking, and capital markets) are needed to provide an enabling environment for Islamic finance to grow and contribute to infrastructure development. Finally, the tax laws need to be adjusted to level the playing field of Islamic finance and conventional finance, where appropriate.

Policy Recommendation 2: Increasing the Number and Share of Islamic Nonbank Financial Institutions to Enhance the Contribution of Islamic Finance in Infrastructure Investments.

Rationale: The balance sheet features of nonbank financial institutions (constituting takaful operators, investment banks, pension funds, etc.) are more suitable for financing long-term infrastructure projects. However, Islamic nonbank financial institutions are relatively small and not contributing much to the investments in the infrastructure sector. There is a need to establish more Islamic nonbank financial institutions and increase their share in the overall nonbanking sector. In particular, enhancing the shares of Shariah compliant pension funds and sovereign wealth funds has the potential of increasing the size of contribution of infrastructure financing by the Islamic financial sector.

Policy Recommendation 3: Developing the Islamic Capital Markets Infrastructure to Facilitate the Issuance of Different Types of Project Sukuk and other Instruments as Appropriate for Infrastructure Projects.

Rationale: Capital markets facilitate raising funds for infrastructure projects from various types of investors. The investors can range from large institutional investors, to nonbank financial institutions and retail investors. Furthermore, financial institutions, such as Islamic banks, prefer to invest in tradable project sukuk rather than financing in infrastructure projects directly since they are illiquid. To encourage the development of Islamic capital markets and increase its role in infrastructure development would require a sound and enabling legal and regulatory

framework for sukuk issuance. In addition, since project sukuk structures are complex, provision of templates for various types of sukuk can further increase their issuances.

Policy Recommendation 4: Encouraging Innovative Models to use Islamic Social Sector (i.e., Zakat, Waqf and Sadaqah) to Provide Social Infrastructure Services (such as Education and Health) provided that they are Shariah-compliant.

Rationale: A key untapped source that has potential to provide social infrastructure services is the Islamic social sector such as Zakat, Waqf and Sadaqah. In some countries such as Malaysia and Indonesia innovative models of these institutions have been used to provide certain social infrastructure services to the poorer segments of the population. Since the size of zakat, waqf and Sadaqah is potentially large and many member countries face financing constraints to fund infrastructure projects, the Islamic social finance can be mobilized to provide some of the social infrastructure services such as education and health, provided that they are Shariah-compliant.

Policy Recommendation 5: Improving Capacity and human capital for increasing the use of Islamic Finance for infrastructure financing

Rationale: One of the key issues of involving Islamic finance in infrastructure projects is having appropriate Shariah-compliant products. Since the projects are large and involve complex contractual arrangements, there are many intricacies that need to be resolved from a Shariah point of view. However, there are a limited number of Islamic financial institutions that understand the complexities of project financing and Shariah advisory services on these can also be scant and costly. There is, thus, a need to reduce the knowledge gap and build capacity on the use of Islamic finance for PPP projects and enhance the awareness among stakeholders to increase the use of Islamic finance for infrastructure projects.

Instruments to Realize the Policy Advices:

COMCEC Financial Cooperation Working Group: In its subsequent meetings, the Working Group may elaborate on the above-mentioned policy areas in a more detailed manner.

COMCEC Project Funding: Under the COMCEC Project Funding, the COMCEC Coordination Office issues calls for project proposals each year. With the COMCEC Project Funding, the member countries participating in the Working Groups can submit multilateral cooperation projects to be financed through grants by the COMCEC Coordination Office. For realizing above-mentioned policy recommendations, the member countries can utilize the COMCEC Project Funding facility. These projects may include organization of seminars, training programs, study visits, exchange of experts, workshops and preparation of analytical studies, needs assessments and training materials/documents, etc.