Developing Islamic Finance Strategies in the OIC Member Countries

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Executive Summary

- Islamic Finance has become a global industry, providing services throughout the world in both emerging and established markets.
- The industry has progressed in terms of development through an increase in market share and an increase in the amount of institutions and the initiatives on the industry-level.
- Continuous expansion and profitability through the global financial crises reflects the resiliency of the industry.

Executive Summary

- The essential feature of Islamic Finance is to achieve the objectives set forth in Shariah law, which is to:

  Maintain high ethical values

  Create wealth to be equally distributed in the community,

  Protect religion, life, lineage, intellect, and wealth.

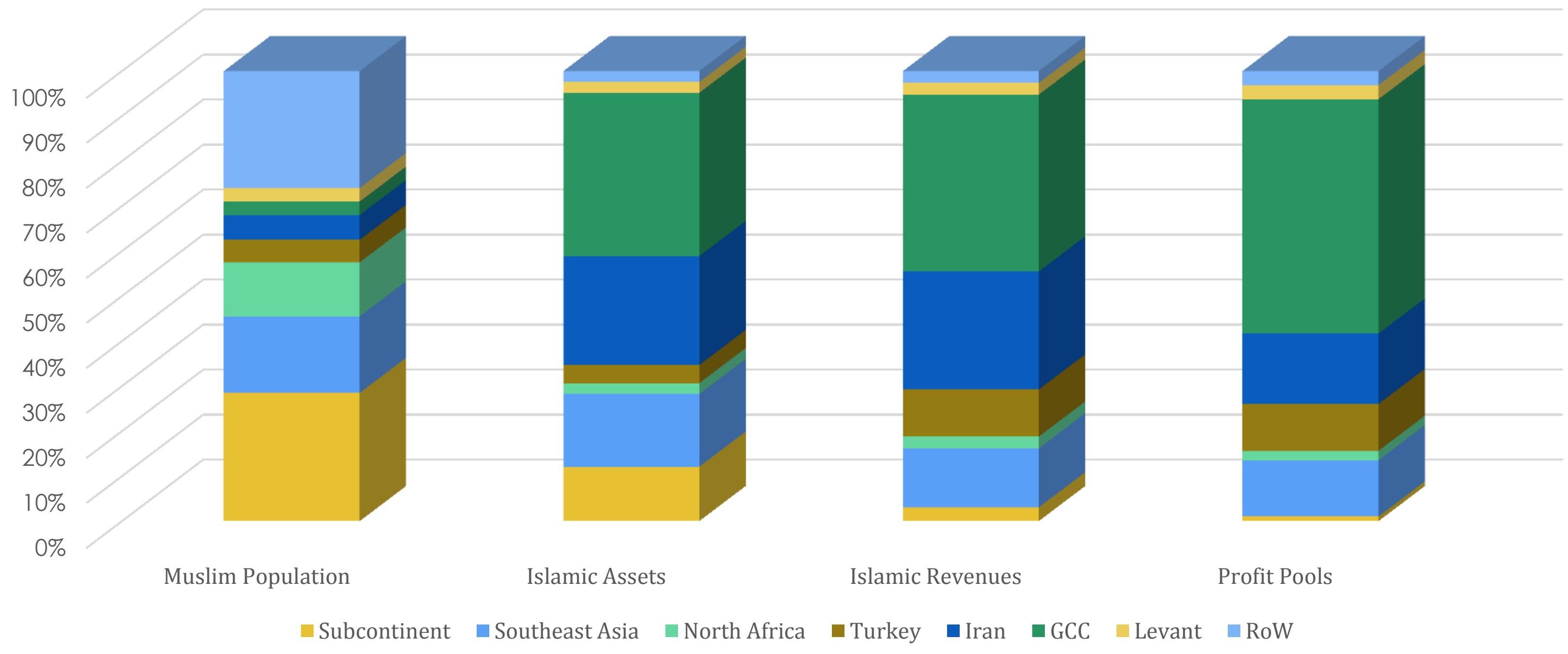
- This is in contrast to conventional finance, which focuses purely on profit maximization. Usury (riba), gambling (maisir), and ambiguity (gharar) are prohibited by Shariah law.

Introduction

- Because of these standards of business practice, the market share of the Islamic Finance industry has grown substantially in a short amount of time.
- Despite this, it has mostly grown in a limited amount of regions.
- There is a great amount of opportunity for the industry to grow further by increasing public awareness of the Islamic Finance industry as well as building a stronger financial infrastructure and means of enforcement of transparency and adherence to Shariah law.

Introduction

Figure 1.1 Muslim population, Islamic Assets, revenues, and profit pool breakdown by region, 2007



Introduction

- The great amount of development in the segments of the Islamic industry brings opportunities to further develop the industry in regards to human capital, infrastructure, regulation, and market expansion.
- These topics have been explored in the OIC Report SWOT analysis and the OIC Report Survey.
- The SWOT analysis goes through the strengths, weaknesses, opportunities, and threats that the Islamic finance industry is facing.

Introduction

- The OIC Report Survey looks at what can be improved from the perspectives of Islamic Finance industry members and researchers with responses from a sample of over 100 people, comprised of academics, scholars, researchers, and industry professionals involved in the Islamic Finance industry throughout the world.
- The results from this survey bring insight as to what improvements should be undertaken to further develop and grow the industry.

Introduction

A set of 6 recommendations are included that were compiled from the data collected through the OIC Survey as well as analyzing an extensive amount of research publications and economic reports.

The main topics of focus in the recommendations determined from this research study are:

- Regulatory
- Shariah
- Infrastructure
- Products and Services
- Initiatives
- Talent Development

Islamic Financial Products

Islamic Finance has several financial products that are utilized in the industry. Some of the products are used in both Islamic and conventional Islamic windows.

The Key Islamic Finance products are:

- Islamic Banking
- Sukuk
- Zakah
- Awqaf
- Takaful
- ReTakaful
- Mudarabah
- Musharakah
- Istisna
- Islamic Equities
- Islamic funds
- Islamic Microfinance

OIC Member Report Survey

- In order to further explore the current status and sentiment of the Islamic finance industry, this survey was developed and administered to obtain additional data.
- This survey was distributed to academics, scholars, researchers, and industry professionals involved in the Islamic Finance industry throughout the world in order to explore Islamic Finance strategies in the OIC member countries.
- The sample contains a total of 164 respondents from 42 countries, with respondents having multiple field specializations that totaled to 265 responses.

Roadmap to Develop Islamic Finance Strategy

- The majority of countries do not have national Islamic Finance Strategies.
- Malaysia and Pakistan are the two main countries utilizing a national Islamic Finance strategy.

The recommended framework for a national Islamic Finance Strategy contains 6 components, which are:

- Regulatory
- Shariah
- Infrastructure
- Product and Services
- Initiatives
- Talent Development

Time Scope for IFS

Term	Objective	Stakeholder
Short-term		

	• Increase access to technology
	  ○ Increase the use of mobile banking
	  ○ Using technology, increase communication channels between regulatory bodies and Islamic finance providers.
	  ○ Increase transparency with this use of technology. This will give more people access to daily activities.
		• Islamic Financial Institutions
		• Islamic Finance Industry Organizations

	• Cultivate human capital by developing and implementing training programs and industry-specific certifications
	  ○ Industry partners should create a certification program to familiarize human resources with the Islamic Financial industry's best practices.
	    ▪ Programs should further specialize in :
	      • Islamic financial services
	      • Islamic financial products
	      • Microfinance
	    ▪ University should create new programs with Islamic finance specializations.
		• Islamic Financial Institutions
		• Islamic Finance Industry Organizations
		• Governments
		• Central Banks
		• Research Institutions
		• Islamic Non-financial Institutions

	• Increase presence of Shariah Boards in monitoring Shariah compliant business practices ○ Increase communication between national and local Shariah boards.	• Islamic Financial Institutions • Islamic Finance Industry Organizations • Governments
	• Increase stability of regulatory bodies. Review of existing laws are regulations should create more stability and further define roles.	• Islamic Financial Institutions • Governments • Central Banks

Time Scope for IFS

Term	Objective	Stakeholder
Medium-term		
	• Improve legal and regulatory framework ○ All countries should create and implement a national strategy that includes plans for the improvement of legal and regulatory frameworks.	• Islamic Financial Institutions • Governments • Central Banks
	• Increase awareness and education of Islamic Finance ○ Launch national campaigns to increase the awareness or Islamic finance.	• Islamic Finance Industry Organizations
	• Create additional Islamic Capital Markets Indices	• Governments • Central Banks
	• Increase data collection from Islamic financial markets ○ Partner with Universities for the collection and storage of Islamic financial data.	• Islamic Financial Institutions • Islamic Finance Industry Organizations • Governments • Central Banks • Research Institutions • Islamic Non-financial Institutions

Time Scope for IFS

Term	Objective	Stakeholder
Long-term		
	• Expand market share beyond the present concentrated regions	• Islamic Financial Institutions • Islamic Finance Industry Organizations
	• Access new markets in both Muslim and secular countries	• Islamic Financial Institutions • Islamic Non-financial Institutions
	• Increase transparency in all markets ○ Use more technology to increase transparency.	• Islamic Financial Institutions • Islamic Finance Industry Organizations • Governments • Central Banks • Research Institutions • Islamic Non-financial Institutions
	• Develop Shariah compliant accounting standards for all countries	• Islamic Finance Industry Organizations

Main Challenges and Obstacles in initial steps and implementation of IFS

Limited clarity and transparency of Islamic microfinance

- Countries such as Pakistan have included the objective of utilizing Islamic microfinance in their action plan.
- This was included in order to help increase demand and innovation.
- Islamic microfinance has the potential to become a main driver of the demand for Islamic finance as well as innovation.
- In order for this to occur, Islamic microfinance needs to have an increased level of transparency and clarity to be effective.
- This can be done through efficient and clear regulation that ensures that Islamic microfinance business practices are focused on providing transparency.

Main Challenges and Obstacles in initial steps and implementation of IFS

Limited clarity and transparency of Islamic microfinance

- Adhering to international standards will also increase transparency of Islamic microfinance.
- OIC Report Survey respondents have stated that there is a shortage of supporting infrastructures for implementing the standards, inadequate knowledge and understanding on implementing the standards, and no enforcement present from an international standard setting entity.
- These issues need to be addressed in order to strengthen adherence to international standards and in turn increase transparency.

Main Challenges and Obstacles in initial steps and implementation of IFS

Need for expanding into non-Muslim markets

- There is a growing demand for Islamic financial products in secular countries, such as the United Kingdom, Germany and the United States.
- The United Kingdom is home to the first wholly Shariah compliant retail bank in the west and London has become one of the most important financial centers in the world.
- Just in 2014, the United Kingdom had 9 Islamic financial institutions and 6.35 Billion USD in Total Islamic Banking assets.

Main Challenges and Obstacles in initial steps and implementation of IFS

Need for expanding into non-Muslim markets

- This market shows that there is great potential for Islamic finance to expand into non-Muslim markets.
- Training programs in the UK specializing in Islamic finance are also quite substantial with 16 programs being offered in universities and academic and industry institutions that specialize in Islamic banking.
- This investment in Human capital also offers the needed resources for growth in Islamic finance in the United Kingdom.

Main Challenges and Obstacles in initial steps and implementation of IFS

Need for expanding into non-Muslim markets

- OIC Member countries should include participating in non-Muslim markets in their national Islamic Finance strategy.
- The demand Islamic financial products in these markets is evident.
- Partnerships between non-Muslim and OC Member academic institutions will further develop human capital, research interest, and public interest in the Islamic finance industry.

Main Challenges and Obstacles in initial steps and implementation of IFS

Strengthen support for regulatory systems

- Strong regulatory systems are needed in order to encourage the growth of Islamic finance.
- This especially important for Islamic banking and can be achieved by creating tax regulations that enhance Islamic financial infrastructure, value equity over debt, creating regulations that provide strong governance over Islamic banking practices.

Main Challenges and Obstacles in initial steps and implementation of IFS

Strengthen support for regulatory systems

- An example of this is the plan in Indonesia to introduce a new legal framework to integrate Islamic banks into the global finance system, which will revise capital market requirements to make Indonesia banks in line with international standards.
- Additionally, Qatar has developed Islamic finance regulations governed under the Islamic Finance Rulebook for Islamic Banking, the Prudential-Insurance Rulebook for Takaful and the Private Placement Scheme Rules 2010 for capital markets.

Main Challenges and Obstacles in initial steps and implementation of IFS

Limited consistent data on Islamic financial markets

- There is a limited amount of consistent data on Islamic financial markets.
- This can be remedied by increasing data collection from Islamic financial markets by partnering with universities and academic institutions for the collection and storage of Islamic financial data as well as creating government agencies that collect Islamic financial market data.
- An example is Indonesia's financial service authority, also known as Otoritas Jasa Keuangan (OJK), which collects Islamic banking asset data.

Main Challenges and Obstacles in initial steps and implementation of IFS

Lack of specialized Islamic finance training

- There is a limited amount of Islamic finance training that is currently available.
- This training is concentrated in certain Islamic finance hubs and not immediately available in the countries that greatly need personnel that are specifically trained in Islamic finance.
- This can be problematic when determining who will be responsible for creating and implementing components of the National Islamic Strategy to further industry growth.

Main Challenges and Obstacles in initial steps and implementation of IFS

Lack of specialized Islamic finance training

- It is essential for Islamic finance industry personnel to have the skills and knowledge needed in order to further grow the industry.
- This can be done through promoting and sponsoring academic research on Islamic finance and social finance, increasing training and academic programs specific to Islamic finance, and developing industry certifications for Islamic finance.

Main Challenges and Obstacles in initial steps and implementation of IFS

Lack of specialized Islamic finance training

- A good example of a country that has developed several training programs is Pakistan, which currently has several universities that offer training in Islamic Banking.
- Indonesia also promotes talent development in many different types of specializations in Islamic finance.
- There are Islamic finance research institutes located in the UAE and also universities that offer Islamic finance specializations.
- The universities in Indonesia that offer training in Islamic Banking are Airlangga University, LPPI Indonesian Banking Development Institute (Institute), and Paramadina Graduate School (Institute).

Source: Simply Sharia Human Capital, (Central Bank of Bahrain) All schools listed are Universities unless otherwise denoted.

Main Challenges and Obstacles in initial steps and implementation of IFS

Lack of Shariah and Islamic Financial rating agencies

- Sharia and Islamic Financial rating agencies are essential in providing needed information on Islamic financial products for current and potential investors in Islamic finance.
- Arno Meirbrugger from the Gulf Times states that, "In the wake of a globally growing Islamic finance sector, rating agencies specialized on Islamic financial products and Shariah compliance of financial instruments are seeing fast rising demand for their services.

Main Challenges and Obstacles in initial steps and implementation of IFS

Lack of Shariah and Islamic Financial rating agencies

- Although the “big three” agencies , Standard & Poor’s, Moody’s and Fitch Rating, are rating Islamic banks or Islamic financial vehicles such as sukuk, they are not differentiating them sufficiently enough form conventional banks requesting a global credit rating.” (Meirbrugger, 2015)
- This shows that there is an increase of demand for rating agencies, but rating agencies that can delve more into Shariah compliance and the facets of what is valued and assessed in an Islamic financial product.

Main Components of IFS

Regulatory

- A well-functioning regulatory system is vital to the growth of the Islamic financial services industry.
- The survey shows, a majority of respondents believe there is a regulatory infrastructure for Islamic finance.
- Several countries are taking bold actions to correct or improve upon their existing regulatory structures. Malaysia has been at the forefront of regulatory restructuring.

Main Components of IFS

Regulatory Opportunities:

- Some countries still have the absence of a suitable regulatory structure to foster growth of the Islamic financial services industry. The survey indicates that a majority of countries have a suitable regulatory system for Islamic banking, however, all countries need a suitable plan.
- Respondents indicate weaknesses in regulatory infrastructure. This indicates that a comprehensive review of regulation is needed. Several countries are already in process of review existing regulations.
- A majority of respondents indicate there is no arbitration process for resolving Islamic financial disputes. This is a key component of a suitable regulatory infrastructure.

Main Components of IFS

Regulatory Opportunities:

- This component, combined with deposit insurance, is key for the public confidence in Islamic finance.
- In most countries regulatory structures are stronger for financial services compared to capital markets.
- The survey shows a suitable regulatory structure for Islamic capital markets is desired. Respective capital market authorities would benefit from more strategic planning for Islamic finance.

Main Components of IFS

Shariah

- Like regulatory infrastructure, Shariah infrastructure is more prevalent in financial services than in capital markets.
- Respondents indicate a majority of Shariah guidance only for the issuance of Sukuk.
- A more standardized Shariah infrastructure across Islamic finance countries could provide stronger guidance for capital markets, financial services, and microfinance.

Main Components of IFS

Shariah

Opportunities:

- Only 37% of respondents indicated the presence of a Shariah governance infrastructure.
- By creating a national Shariah board, subject countries would immediately benefit of from Shariah infrastructure and guidance.
- Increased communication through the use of technology is important for the effectiveness of any form of Shariah board.
- Countries that already have a national Shariah board would benefit from increased communication and transparency through the use of technology.

Main Components of IFS

Infrastructure

- Survey respondents are mixed on the development of infrastructure.
- This is an opportunity for growth and should play an important role in all countries strategic plan.
- A main focus should be the development of Islamic capital markets across countries.

Opportunities:

- There is an opportunity for growth through the development of Islamic capital markets.

Main Components of IFS

Products and Services

- Product development is greatly needed in Islamic financial sectors in order to satisfy the needs of the client as well as adhere to international standards and Shariah laws.

Opportunities:

- 28% of Islamic capital market respondents stated that that there is a high capacity of product development in their region, while 44% stated that their region is at medium capacity, and 28% stated their region was at a low capacity. This indicates the need for greater product creation and innovation
- In the Takaful sector, 50% stated that their region was at a high capacity for product development, while 50% stated that their region was at low capacity. This indicates the need for more product development in multiple branches Islamic finance.

Main Components of IFS

Products and Services

Product Standardization

For product standardization, respondents proposed several ways to ensure the standardization of zakatable assets:

- Create a special expert committee
- Utilize the assets to create jobs for the poor
- Follow the Malaysian or Pakistani model of zakat standardization
- Pursue the Standardization of zakatable assets in light of The Holy Qur'an and The Sunnah of The Holy Prophet Muhammad (Peace Be Upon Him)
- Utilize Net savings and value of commercial assets net of running liabilities
- Independent management of the zakatable assets. These funds should be treated in a special budget independent of the government budget.
- Fatwa ulama emphasizes with government regulation
- Good laws and governance

Main Components of IFS

Initiatives

- For Islamic finance to grow strategic plans should include initiatives.
- Below are several initiatives that have been identified to provide stable growth.

Initiative Opportunities:

- Develop Human Capital
- Increase cost efficiency of operations
- Increase data collection
- Increase collaboration
- Strengthen Regulation
- Ensure Tax Neutrality
- Promote research and innovation
- Educate people on Islamic Finance

Main Components of IFS

Talent Development

- 83 % of the OIC survey respondents state that their region has developed training programs on Islamic banking for institution staff and Islamic banks, with 4 % planning to in the future.
- The widespread adoption of research on Islamic finance is important for its growth.
- 89 % of respondents state that there are workshop training, seminars, and conferences present for training Islamic banking staff.

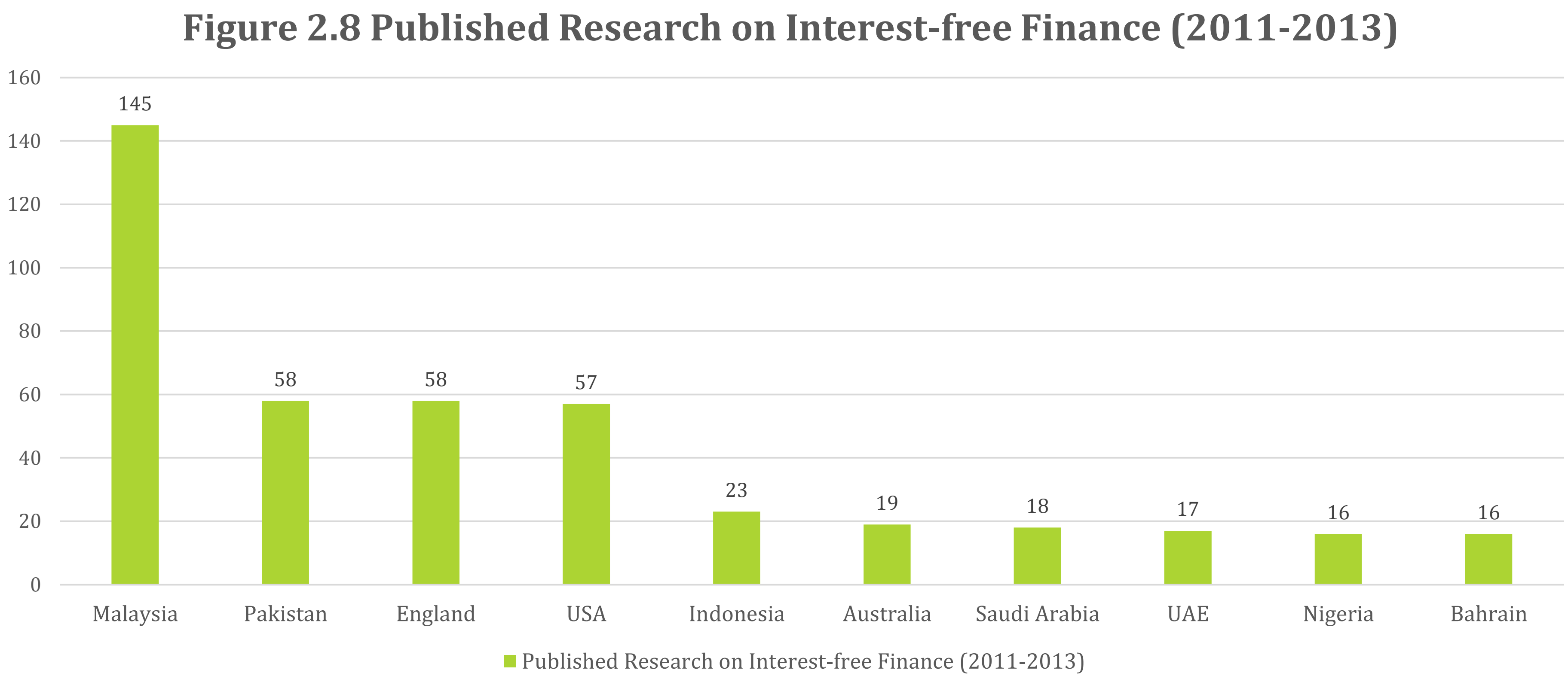
Main Components of IFS

Talent Development

Opportunities:

- The development of skills empowerment centers, the offering of additional training for clients before advancing financing to them, and the establishment of trade fairs were all cited as means of providing training for members of the Islamic finance industry.
- Increasing communication and the dissemination of information from research institutions to markets is an important component of strategic plans. By increasing communication, institutions and governments will see a greater return from research.

Main Components of IFS



Source: ICD Thomson Reuters Islamic Financne Development Report 2014

Suggested Stakeholders for IFS and Recommendations

- Suggested examples of responsible stakeholder for the implementation of IFS and Recommendations are listed in this report.
- These lists give the reader an idea of what kinds of government agencies, Islamic Finance industry organizations, research institutions, Islamic financial institutions and non-financial institutions are most suitable for implementing these actions.

Suggested Stakeholders for IFS and Recommendations

- The listings have been broken down by country.
- Some of these agencies are already included in the National Islamic Finance strategies for certain countries, such as the Islamic Finance Strategy for Turkey.
- The majority of the OIC member countries do not have an Islamic Finance strategy set forth, so this list proves extensively useful to give stakeholders an idea of an existing entity to take on a given IFS objective, or to create a new entity to take on an IFS objective specifically.

Suggested Stakeholders for IFS and Recommendations

Table 4.4: Suggested Stakeholders for IFS and Recommendations

Stakeholder Type	Stakeholders by Selected Country
Governments/ Government Agencies	**Turkey:** Ministry of Development, Undersecretariat of Treasury, Ministry of Finance, Banking Regulation and Supervision Agency (BRSA), Capital Markets Board of Turkey (CMB), Borsa Istanbul (BIST) **Pakistan**: Securities and Exchange Commission of Pakistan, Shariah Board **Malaysia**: Securities Commission Malaysia (SC) **Sudan**: Khartoum (Sudan Stock Exchange) **Saudi Arabia:** Saudi Arabian General Investment Authority (SAIGIA)
Central Banks	**Turkey:** Central Bank of Turkey (TCMB) **Pakistan**: State Bank of Pakistan **Malaysia**: Bank Negara Malaysia (the Central Bank of Malaysia) **Sudan**: Central Bank of Sudan
Islamic Financial Institutions	**International:** AAOIFI **Turkey:** Al Baraka, Ziraat Bank **Pakistan:** Islamic Banking and Finance Consultive Group **Malaysia:** Bursa Malaysia, Kuwait Finance House (Malaysia) Bd, AmInvestment Group Bd **United Kingdom:** HSBC Amanah, European Islamic Investment Bank **Saudi Arabia**: Al Rajhi Bank **Iran:** Bank Melli Iran, Bank Saderat Iran **Qatar:** Qatar Islamic Bank, Qatar International Islamic Bank, Masraf Al Rayan, Qatar Reasl Estate Investment Co. **Kuwait:** Investment Dar, Aayan Leasing and Investment Co., AREF Investment Group, First Investment Company, Gulf Investment House **Bahrain:** ABC Islamic Bank, Ithmaar Bank BSC, Arcapita Bank, Shamil Bank, Gulf Finance House BSC, Al Salam Bank, Khaleej Finance and Investment Co., Al Amin Bank **Pakistan**: National Investment Trust Karachi

Suggested Stakeholders for IFS and Recommendations

Table 4.4 cont.: Suggested Stakeholders for IFS and Recommendations cont.	
Stakeholder Type	**Stakeholders by Selected Country**
Research Institutions	**Turkey:** International Research Center for Islamic Economics and Finance at İstanbul Sabahattin Zaim University, Higher Education System in Turkey (Yok), **Pakistan:** Al-Huda CIBE, Iqra University, Institute of Business Management (IOBM) (Institute), International Islamic University, National University of Science & Technology (NUST) **Malaysia:** International Centre for Education in Islamic Finance (INCEIF), Islamic Research Training Institute, International Shariah Academy of Islamic Finance (ISRA), Malaysia International Islamic Finance Center (MIFC) **Saudi Arabia**: IRTI from The Islamic Development Bank Group, Islamic Economics Research Center at King Abdul Aziz University **Sudan:** Cambridge International Training Center **UAE:** Islamic Banking and Finance Center at Al Ghurair University
Islamic Non-financial Institutions	**Brunei:** Takaful IBB Berhad **Iran**: Iran Insurance Company, Alborz Insurance Company, Karafirin Insurance Company **Qatar:** Al Khaleej Insurance & Reinsurance Co. Qatar Islamic Insurance Company **Malaysia**: Syarikat Takaful Malaysia Bd, Takaful Ikhlas Sdn Bhd, ASEAN Retakaful International **Saudi Arabia:** The Company for Cooperative Insurance, Saudi Arabian Insurance Co., Allied Cooperative Insurance Group **UAE**: Islamic Arab Ins. Company-Salama, Abu Dhabi National Takaful Company **Sudan**: Sheikan Ins. & Reinsurance Co., Islamic Insurance Company **Bahrain**: Solidarity Insurance Company, Arabia ACE Insurance Co. **Kuwait:** Gulf Takaful Insurance Company, First Takaful Insurance Company **Bangladesh**: Farest Islami Life Insurance **Indonesia:** PT Asuransi Syar'a Mubarakah
Islamic Finance Industry Organizations	**International:** Islamic Financial Services Board (IFSB), Thomson Reuters, Deloitte, PriceWaterhouseCoopers **Turkey:** Participations Banks Association of Turkey (PBAT) **Pakistan:** Institute of Chartered Accountants of Pakistan **Malaysia:** Malaysia International Islamic Finance Centre

Conclusion

- In order for the Islamic Finance industry to grow and thrive, there are certain conditions that need to be developed.
- Each country should create and implement a national Islamic Finance Strategy to build and grow the Islamic finance industry.
- This will be beneficial by providing Islamic financial products and services to both their Muslim and non-Muslim population, will provide jobs to citizens that are interested in pursuing Islamic finance as a career, will build the economy by enabling the funding of small businesses, and providing needed financial assistance to the poor.
- Certain countries, such as Malaysia, Turkey, and Pakistan have developed national Islamic Finance strategies, but the majority of OIC member countries have not.

Conclusion

- The Islamic finance industry has tremendous potential in becoming an integral part of the global finance industry.
- Notable scholars, such as Robertson (1990; 1998), Vogel and Hayes (1998) have argued that there is a substantial need for an economy that is interest-free.
- Chapra (1985), Mills and Presley (1999) and Warburton (1999) have posed the argument that an equity-based economy tends to outperform a highly leveraged economy.
- Islamic finance prohibits charging interest and trading debt and engages in equity-based financing.
- This shows the potential impact that Islamic finance has on shaping an economy, since an equity-based economy performs better than a solely debt-based economy.

Conclusion

- The market has grown substantially since its inception in the 1950s with current total Islamic Finance assets being approximately USD 1 trillion.
- However, the industry has grown in limited regions, with most of its concentration in Malaysia and GCC countries.
- Increasing market share can be done through improvements on infrastructure, human capital, operations, regulatory systems, and financial institutions.
- A complete and advanced interbank, capital, and hedging infrastructure for the IFSI will also promote additional growth in market share.

Conclusion

- Islamic finance will be further strengthened by Shariah compliance, corporate governance and transparency effectiveness.
- Innovative business models that include new technologies and means of delivery will provide Islamic financial services more efficiently and cost effectively.
- This will enable greater financial inclusion from providing client in remote areas access to Islamic financial services.

Conclusion

- The main objective of Islamic finance is to show the true spirit of contributing to the economy and society and to prove its viability in building partnerships that further development, not creating financial instruments used as a means of exploitation.
- Communicating those inherent differences is important for increasing public interest in Islamic finance as well as ensuring the development of new and innovative products that are not slightly updated versions of existing conventional financial products.

Conclusion

- Investor interest in investing in assets that contribute to society and are managed in an ethical manner is increasing.
- This can be seen in the increase in market share of Islamic Finance on an international scale.
- The Word Bulletin (2009) has stated that, "The ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service."

Conclusion

- Islamic financial institutions not only value financial inclusion and providing services to the community, risk is shared with clients so that all participating parties benefit in an investments' success.
- The demand is present and further expansion of the Islamic finance industry will be able to provide both Muslims and secular investors with assets that adhere to religious, ethical, and regulatory standards.